

STRENGTHENING THE WTO SUBSIDIES REGIME

by

Zvenyslava Opeida

LL.M, Donetsk National University, 1998

LL.M, University of Illinois School of Law, 2001

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This dissertation was presented

by

Zvenyslava Opeida

It was defended on

August 30, 2017

and approved by

Vivian Curran, Professor, School of Law

James Cassing, Professor, Department of Economics

Friedl Weiss, Professor, University of Vienna Faculty of Law

Dissertation Advisor: Ronald A. Brand, Professor, School of Law

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Zvenyslava Opeida, S.J.D.

University of Pittsburgh, 2017

The World Trade Organization (WTO) has become one of the most important dispute resolution bodies in international law. It applies rules which both limit the use of subsidies that might distort international trade and control the unilateral responses to such subsidies by governments. The WTO jurisprudence, however, demonstrates that the effectiveness and predictability of the subsidy regime require a clearer definition of that regime's object and purpose. The Subsidies and Countervailing Measures Agreement (SCM Agreement), however, does not contain any express statement of the object and purpose of the WTO subsidy regime, which raises difficulties for both interpreting the current provisions and proposing changes to the Agreement in a coherent manner.

I propose that the object and purpose of the SCM Agreement should be identified as protecting competition in the market as a means of ensuring economic efficiency. Having defined the object and purpose of the WTO subsidy regime, I identify the parts of the SCM Agreement that are most inconsistent with the proposed objectives and propose changes to the SCM Agreement in order to bring it in line with the proposed object and purpose. First, to better serve the objective of protection of the process of competition, I propose changing the causality requirement for establishing injury to domestic industry. In particular, I recommend to require that injury to the domestic industry is caused by subsidization rather than subsidized imports. Second, to better serve the objective of promoting economic efficiency and increasing total

welfare, I propose to reinstate the category of non-actionable subsidies. This would enable WTO Members to grant subsidies that correct market distortions, such as environmental subsidies, research and development subsidies and regional aid subsidies. Finally, to ensure that measures used to counteract subsidies do not themselves create market distortions and reduce welfare, I propose to limit the unilateral use of countervailing duties by WTO Members by imposing mandatory public interest and lesser duty requirements.

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I. OVERVIEW

The World Trade Organization (WTO) has become one of the most important dispute resolution bodies in international law. It applies rules which both limit the use of subsidies that might distort international trade and control the unilateral responses to such subsidies by governments. The WTO jurisprudence, however, demonstrates that the effectiveness and predictability of the subsidy regime require a clearer definition of that regime's object and purpose.¹ The Subsidies and Countervailing Measures Agreement (SCM Agreement), however, does not contain any express statement of the object and purpose of the WTO subsidy regime, which raises difficulties for both interpreting the current provisions and proposing changes to the Agreement in a coherent manner.

Subsidies granted by a state to an industry within that state (or within a region in that state) can distort trade and thus are one of the non-tariff barriers addressed by the international trade regime administered by the WTO. With the substantial reduction of tariffs on a global basis accomplished in the early rounds of GATT (pre-WTO) negotiations, the need to address non-tariff barriers has become more important.² The resulting structure developed to address

¹ The terms of an international treaty must be interpreted "in the light of its object and purpose." Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331, art. 31(1) [hereinafter Vienna Convention]. This ensures that a treaty's text is interpreted to reflect the goals embodied in the document as a whole and that all articles are read together in a coherent and consistent manner.

² While the first six GATT trade negotiating rounds focused exclusively on negotiations for the reduction of tariffs, the Tokyo Round (1973-1979) was predominantly concerned with non-tariff measures and the Uruguay Round (1986-1994) continued detailed work on many non-tariff measures, including subsidies. *See* JOHN H. JACKSON, WILLIAM J. DAVEY & ALAN O. SYKES, JR., INTERNATIONAL ECONOMIC RELATIONS: CASES, MATERIALS AND TEXT

subsidies includes both rules for state-to-state negotiation and dispute resolution and rules for unilateral response within a state to subsidies granted by other states.³ The Doha Round negotiations include discussion of both of these tracks for responding to and administering subsidy disputes.⁴ Those negotiations on the subsidy regime have floundered, however, because of differences regarding the proper approach to disciplining the grant of subsidies by states and to existing trade remedies that may be applied in a state to respond to subsidies by other states.

The Uruguay Round SCM Agreement was undoubtedly an important step forward, and provided significant improvements in the regulation of subsidies.⁵ Nevertheless, the Doha Round negotiations make clear that subsidy discipline weaknesses remain which should be reduced or eliminated. 182 proposals for amendments to the Agreement have been submitted by WTO Members in the Doha Round negotiations on subsidies and countervailing measures.⁶

This study will emphasize the importance of multilateral rules on subsidies and propose improvements to and clarification of these rules. To make the SCM Agreement more workable, it is necessary to clarify the object and purpose of the WTO subsidy regulation and to modify the SCM Agreement in order bring it in line with the overall objectives of such regulation.

In addressing these issues, I will review the history of subsidies regulation and will analyze the current WTO rules on subsidies and countervailing duties. I will also use the differences in the EU and U.S. approaches to subsidies and countervailing duties in order to

ON THE NATIONAL AND INTERNATIONAL REGULATION OF TRANSNATIONAL ECONOMIC RELATIONS 248-49 (6th ed. 2013).

³ Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 275 (1999), 1867 U.N.T.S. 14 [hereinafter SCM Agreement].

⁴ John R. Magnus, *World Trade Organization Subsidy Discipline: Is this the "Retrenchment Round"?*, 38 J. WORLD TRADE 985, 1002-47 (2004).

⁵ SCM Agreement, *supra* note 3.

⁶ Magnus, *supra* note 4, at 990.

demonstrate the existing problems resulting from a lack of clear object and purpose and from the need to adjust existing rules. Finally, I will propose outcomes I believe should be adopted in order to make improvements to the existing regime for subsidies discipline.

A. HISTORICAL BACKGROUND

Subsidies have become an important instrument of trade policy. Governments have granted subsidies in various forms and for various reasons, including efforts to increase the competitiveness of national producers. Normally, subsidies which negatively affect only producers (consumers benefit from the lower price), are not considered as trade distorting as are other classic trade instruments, such as tariffs or quantitative restrictions which negatively affect both producers and consumers.⁷ At the same time, the effect of subsidies and the responses to them are controversial.⁸ Due to the complexity of the subject, there has been great difficulty in reaching a consensus on a common approach to the problem of regulation of subsidies at the international level.

Only two provisions of the GATT of 1947 contained provisions regarding the regulation of subsidies and hardly included any obligations concerning subsidies at all: Articles, VI and XVI. Article XVI merely provides that a contracting party to the GATT should notify other contracting parties of any subsidies that have an effect on trade and, if they cause serious damage

⁷ MITSUO MATSUSHITA, THOMAS J. SCHOENBAUM, PETROS C. MAVROIDIS, *THE WORLD TRADE ORGANIZATION: LAW, PRACTICE, AND POLICY* 332 (Oxford University Press 2006).

⁸ See, e.g., Alan O. Sykes, *The economics of the WTO rules on subsidies and countervailing measures*, John M. Olin Program in Law & Economics Working Papers, No. 186, University of Chicago 1, 1-36 (2003).

to interests of other contracting parties, should be prepared to discuss limiting such subsidies.⁹ Article VI deals with the imposition of countervailing duties, and most experts regard its rules as being neither clear nor comprehensive.¹⁰

In 1955, additional obligations on subsidies were included in the GATT, addressing the issue of export subsidies. Export subsidies for non-primary products are totally prohibited,¹¹ while contracting parties have an obligation to “seek to avoid” the use of subsidies on primary products.¹²

The Tokyo Round (1974-1979) resulted in the adoption of an Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the GATT (the “Subsidies Code”).¹³ The Subsidies Code was divided into two Tracks. Track I outlined the procedure that contracting parties must follow in order to adopt countervailing duties under national rules.¹⁴ It specifies that countries may impose countervailing duties only after having determined that the subsidized imports have caused injury to the domestic industry.¹⁵ Track II provided for an interpretation of the different provisions of GATT Article XVI on the multilateral level.¹⁶ The Subsidies Code did not clarify all of the obligations contained in the GATT. Moreover, only 24 contracting parties ratified the Code, with exceptions and reservations.¹⁷

⁹ General Agreement on Tariffs and Trade, 1947, 61 Stat. 173, T.I.A.S. No. 1700, 55 U.N.T.S. 187, art. XVI [hereinafter GATT].

¹⁰ See, e.g., GUSTAVO E. LUENGO HERNANDEZ DE MADRID, REGULATION OF SUBSIDIES AND STATE AIDS IN WTO AND EC LAW 125 (2007).

¹¹ GATT, *supra* note 9, art. XVI:4.

¹² *Id.*, art. XVI:3.

¹³ Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (MTN/NTM/W/236, 5 April 1979) [hereinafter Subsidies Code].

¹⁴ *Id.*, arts. 1-6.

¹⁵ *Id.*, arts. 2.1

¹⁶ *Id.*, arts. 7-19.

¹⁷ See, e.g., JOHN H. JACKSON, THE WORLD TRADING SYSTEM 290 (1997).

The Uruguay Round produced significant improvements in the regulation of subsidies with the SCM Agreement adding two mechanisms to limit the use of subsidies and countervailing duties.¹⁸ The first improvement was the traffic-light framework, placing subsidies into one of three categories. Subsidies in the red-light category are prohibited; subsidies in the yellow-light category are actionable; and subsidies in the green-light category are non-actionable.¹⁹ The second improvement came in limitations on the use of countervailing duties resulting from the imposition of required objective standards for an actionable subsidy: specificity and financial contribution.²⁰

There is no doubt that the SCM Agreement is a step forward toward providing additional clarity in the area of subsidies. It is also obvious, however, that there is room for improvement.

B. ORGANIZATION OF THE DISSERTATION

The general structure of this dissertation is as follows:

Table 1. Structure of the Dissertation

CHAPTER	CONTENTS
Chapter 1	<u>Basic overview of the dissertation</u> : historical background and organization of the dissertation
Chapter 2	<u>Economic Analysis of Subsidies</u> : brief introduction to the concept of subsidy in economic theory, effect of export and domestic subsidies on international trade, economic effect of countervailing duties; rationale for disciplining subsidies
Chapter 3	<u>Global Regulation of Subsidies in pre-WTO Era</u> : focus on the evolution of subsidies disciplines from the GATT to the WTO

¹⁸ SCM Agreement, *supra* note 3.

¹⁹ *Id.*, arts. 3-9.

²⁰ *Id.*, arts. 1-2.

CHAPTER	CONTENTS
Chapter 4	<u>Regulation of Subsidies in the WTO</u> : focus on the provisions of the Agreement on Subsidies and Countervailing Measures (including the definition of subsidy, classification of subsidies, multilateral dispute settlement and remedies, and the use of domestic countervail measures), as well as the subsidy-related provisions of the Agreement on Agriculture (including the commitments on export and domestic subsidies; and remedies)
Chapter 5	<u>EU Rules on Subsidies</u> : focus on the concept of “state aid” and comparison with the WTO definition of “subsidy;” EU external regime relating to subsidies
Chapter 6	<u>US Rules on Subsidies</u> : brief introduction to the historical background, the evolution of the rules on subsidies since before WTO; focus on the influence of WTO rules on the US regime, including the definition of subsidy and conditions for imposing countervailing duties
Chapter 7	<u>Comparison of the US and EU approaches to subsidies</u> , reasons for differences between the US and the EU
Chapter 8	<u>Identification of the object and purpose of the WTO subsidy regime, and proposed changes to the SCM Agreement in order to bring it in line with the proposed object and purpose</u>

1. Introduction to Subsidies

This dissertation contains eight chapters. Chapter 1 provides historical background on the regulation of subsidies in international trade and an overview of the structure of the dissertation. In Chapter 2 I provide an economic analysis of subsidies in order to understand the effect that subsidies granted by a state have on international trade. One of the fundamental issues of international subsidies regulation is how to distinguish between protectionist and non-protectionist subsidies.²¹ To create a regulatory framework that addresses the problem subsidies may cause to other states, without limiting the ability of a government to use subsidies for other legitimate policy goals, it is important to understand which subsidies have a trade-distorting

²¹ See, e.g., SIMON LESTER, BRYAN MERCURIO & ARWEL DAVIES, WORLD TRADE LAW: TEXT, MATERIALS AND COMMENTARY 422 (2012).

effect. I examine the effect of export subsidies and domestic subsidies in the market. In addressing the issue of subsidies, another important question is how a country should respond to foreign subsidies. In Chapter 2 I also focus on the effect of the adoption of countervailing duties, in order to determine in which case the use of countervailing duties serves to neutralize the effect of a subsidy. Once these questions are examined, I move on to the importance of regulating subsidies and the problem of how far-reaching disciplines on subsidies should be. Analysis of these issues facilitates the analysis and recommendations to be offered in Chapters 8 and 9.

2. GATT/WTO Regulation of Subsidies

In Chapter 3 I explore the evolution of the regulation of subsidies in international trade, in order to better understand the current obligations within the WTO system. The attitude of the world trading system has not always been the same throughout the last seventy years. It is thus important to understand what problems have arisen from such regulation and what kinds of solutions were supplied during each time period. Chapter 3 provides a thorough review of all the relevant stages in the evolution of the regulation of subsidies in international trade.

I begin this review of subsidies regulation with the first draft of the Havana Charter, which, although never adopted, constitutes the first multilateral attempt to regulate subsidies. I then proceed with the GATT 1947, which included the first rules on subsidies in international trade to be applied in practice. I then cover the reforms introduced in 1955. I move on to examine the Tokyo Round Subsidies Code of 1979, and the problems resulting from its application. Finally, I describe the negotiations on subsidies in the Uruguay Round that resulted in the SCM Agreement, which forms part of Annex 1A to the WTO Agreement and contains the primary current rules on the use of subsidies and countervailing duties. The SCM Agreement is usually

described as an uneasy compromise between different perspectives on subsidies, utilizing categories and concepts that may not have any obvious economic or policy rationale, but instead reflecting a difficult and, in some respects, incoherent political bargain.²² In Chapter 3 I analyze different concerns identified and positions adopted by negotiating countries. Numerous concerns could be summarized by the minutes of the meeting:

Several delegations considered that the international disciplines over the use of subsidies in world trade had faded and that there was little or no consensus over the meaning of vital provisions of the GATT and the Subsidies Code . . . It was also said that in certain instances, the GATT and the Agreement drew distinctions between permitted and prohibited subsidies that appeared to have little basis in sound economic policy . . . Several delegations pointed out that a number of problems existed also in the area of countervailing measures where loopholes in the existing rules permitted unilateral practices and interpretations, resulting in considerable arbitrariness, uncertainty and harassment of exporters.²³

I describe the different positions adopted by states when negotiating the regulation of subsidies, and how the parties reached agreement on such issues as the definition of “subsidy,” the classification of subsidies, the authorization process for the adoption of countervailing duties, and how to treat subsidies for primary products.

In Chapter 4 I provide an introduction to the SCM Agreement which resulted from the Uruguay Round. The main purpose of the SCM Agreement is to find the right balance between allowing states to grant subsidies for legitimate policy goals, on the one hand, and restricting their use when trade-distorting effects become too great, on the other.²⁴

I review the rules that identify which subsidies are subject to the SCM Agreement and examine the three constituent elements of the concept of ‘subsidy’: a *financial contribution*, a financial contribution *by a government or any public body*, and a financial contribution

²² PETROS C. MAVROIDIS, PATRICK A. MESSERLIN & JASPER M. WAUTERS, *THE LAW AND ECONOMICS OF CONTINGENT PROTECTION IN THE WTO* 298 (2008).

²³ NGSCM: Meeting of 16-17 March 1987, Note by the Secretariat, MTN.GNG/NG10/1, para. 5 (March 27, 1987).

²⁴ LESTER, MERCURIO & DAVIES, *supra* note 21, at 422.

conferring a benefit. I also discuss the concept of “specificity.” I then move on to classification of subsidies into three categories and will examine prohibited subsidies, actionable subsidies, and non-actionable subsidies. Special attention is paid to trade remedies established in the SCM Agreement at both multilateral and national levels. I discuss the differences in procedure and remedies available for prohibited and actionable subsidies at the multilateral level. I also review the rules (substantive and procedural requirements) regulating the unilateral imposition of countervailing duties against subsidized imports. In addition I examine the relationship of the SCM Agreement to provisions on subsidies in other WTO agreements, particularly the Agricultural Agreement. The analysis of the provisions of the SCM Agreement takes into account the interpretations made by Panels and the Appellate Body.

3. Comparative Analysis

Because the GATT and the SCM Agreement bind all WTO Members, they have had a profound effect on the domestic legislation of those Members. At the same time, as Professor Alan O. Sykes has demonstrated, different legal systems have responded very differently to the issues raised by subsidies, from the largely laissez-faire approach of the United States to the elaborate “state aid” rules of the European Union.²⁵ The United States and the EU represent the two largest economic trading blocks in the world, and have very different market philosophies and, consequently, very different ways of implementing the WTO rules.

In Chapter 5 I provide an overview of the EU law on subsidies. I first focus on the EU State Aid rules, which are vital to achieving an internal market. On the other hand, since the EU

²⁵ Alan O. Sykes, *The Questionable Case For Subsidies Regulation: A Comparative Perspective*, 2 J. LEGAL ANALYSIS 473, 473 (2010).

is a WTO Member,²⁶ its State Aid rules must conform to the WTO rules on subsidies. However, as the principles on which the WTO and the EU are based are different, the EU may allow granting subsidies in more cases than is permitted under the WTO. For example, there are cases where the European Commission has authorized State aids which are prohibited export subsidies under the WTO rules.²⁷ Therefore, it is important to identify possible conflicts between the EU and WTO systems. In Chapter 5 I examine the four elements of a State Aid: an aid in any form whatsoever; which is granted by a Member State or through State resources; which distorts or threatens to distort competition, by favoring certain firms or the production of certain goods; and which affects trade between EU Member States.²⁸ I then proceed to compare the EU and WTO systems, in order to show the differences between the WTO and the EU systems when regulating subsidies, and to explain the reasons for such differences.

Secondly, I provide an overview of the EU anti-subsidy legislation which was amended significantly as a result of the SCM Agreement. I examine the three basic substantive requirements for imposing countervailing duties with respect to subsidized imports under Regulation 597/2009: the existence of a “subsidy” that is “countervailable;” the existence of “injury;” and the existence of a Union interest’ calling for intervention.²⁹ Special attention is paid to the third element where it must be determined that a “Union interest called for intervention.” European Union institutions are given discretion as to the methods for analyzing

²⁶ World Trade Organization, *Understanding the WTO: Members and Observers*, http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm.

²⁷ LUENGO, *supra* note 10, at 12.

²⁸ *Id.* at 98.

²⁹ Council Regulation 597/2009 of 11 June 2009 on protection against subsidized imports from countries not members of the European Community, 2009 O.J. L 188/93. This Regulation replaced Council Regulation 2026/97 of 6 October 2007 on protection against subsidized imports from countries not members of the European Community, 1997 O.J. L 288/1.

the various interests for the purpose of imposing countervailing duties. According to Art. 21 (1) of the Regulation:

[A] determination as to whether the community interest calls for intervention shall be based on an appreciation of all the various interests taken as a whole, including the interests of the domestic industry and users and consumers, and a determination pursuant to this Article shall only be made where all parties have been given the opportunity to make their views known pursuant to para. 2.³⁰

The Union interest requirement is analyzed while taking into account the relationship between the EU and the EU Members States as the interests of the Union is not necessarily the same as the interests of each Member State. A polarization is possible when, for example, producers are concentrated in one country and users are concentrated in other countries.³¹

Finally, in Chapter 5 I examine the procedural requirements for imposing countervailing duties.

In Chapter 6 I give a general overview of the U.S. rules on subsidies. After providing a brief historical background, I move on to examine the influence of GATT/WTO rules on the U.S. regime, on the one hand, and the impact of the US concepts and ideas on multilateral negotiations, on the other hand. Firstly, I provide an overview of the U.S. countervailing duty law after the Tokyo Round, particularly the Trade Agreements Act of 1979. The concepts of domestic subsidies, specificity (the idea of benefit to the recipient as opposed to that of a charge on the public account), and material injury to a domestic industry will be discussed in greater detail. I also discuss the impact of prior U.S. countervailing duty laws relating to such important subsidy elements as benefit, financial contribution and specificity on the WTO rules.

³⁰ *Id.*, art. 21.1.

³¹ CLIVE STANBROOK & PHILIP BENTLEY, *DUMPING AND SUBSIDIES: THE LAW AND PROCEDURES GOVERNING THE IMPOSITION OF ANTI-DUMPING AND COUNTERVAILING DUTIES IN THE EUROPEAN COMMUNITY* 143 (1996).

I also analyze the implementation of the WTO rules after the Uruguay Round, embodied in amendments to the Tariff Act of 1930. This analysis of provisions of U.S. countervailing law takes into account the interpretations provided by statutory rules, interpretative statements, and administrative regulations. Special attention is given to the definition of subsidy (benefit, financial contribution, and specificity test) and conditions for imposing countervailing duties (injury, domestic industry of the like product, causal link).

In Chapter 7 I compare the U.S. and EU approaches to subsidies and discuss the reasons for existing differences.

4. Analysis and Conclusions

In Chapter 8 I discuss the need to identify the object and purpose of the SCM Agreement. Any changes to the current WTO subsidy regime must be based on a clear understanding of the ultimate purpose of that regime. Likewise, understanding the object and purpose of the SCM Agreement is necessary for interpreting the current provisions of the Agreement in a coherent and consistent manner.

The SCM Agreement, however, does not contain any express statement of its object and purpose. The WTO jurisprudence offers a very general and vague definition of the purpose of the WTO subsidy discipline. In *Brazil – Aircraft*, the Panel stated that “[t]he object and purpose of the SCM Agreement is to impose multilateral disciplines on subsidies which distort international trade.”³² In *US – Carbon Steel*, the Appellate Body concluded that “[t]aken as a whole, the main

³² Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/RW, adopted 4 August 2000, para. 7.26.

object and purpose of the SCM Agreement is to increase and improve GATT disciplines relating to the use of both subsidies and countervailing measures.”³³

It could be concluded, therefore, that the main purpose of the WTO subsidy regime is (1) to prevent WTO Members from granting subsidies that distort international trade, and (2) to control the unilateral responses to such subsidies by imposing CVDs, ensuring that they are justified and proportionate – thus, their distorting effect on international trade is limited. Although it is obvious that the WTO subsidies rules are meant to ensure that WTO Members do not grant subsidies and impose CVDs in such a way that might harm another country, the question remains what kind of harm these rules are supposed to prevent. Different interpretations of the word “harm” could result in different understandings of the ultimate purpose of the WTO subsidy regime.

An analysis of the text of the SCM Agreement leads to the conclusion that the current WTO subsidies regime considers subsidies primarily as obstacles to international trade, and thus has as its goal the protection of market access, relevant tariff commitments and trade opportunities of WTO Members. I argue that this approach suffers from two significant problems. First, subsidies may also distort competition in other WTO Members by allowing inefficient firms to survive artificially to the detriment of more efficient competitors. Second, subsidies may affect the total welfare of the importing country, i.e. the sum of consumer welfare and producer welfare. Economic theory shows that state intervention may, in fact, improve the functioning of markets when market mechanisms left alone fail to achieve the best outcome for the economy. Under such circumstances, subsidies may increase welfare by offsetting the

³³ Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/DS213/AB/R, adopted 19 December 2002, para. 73.

consequences of market failures.³⁴ It is important, therefore, to ensure that WTO Members are free to grant subsidies that produce this kind of positive effect. I propose that the object and purpose of the SCM Agreement should be identified as protecting competition in the market as a means of ensuring economic efficiency.

Having defined the object and purpose of the WTO subsidy regime, I identify the parts of the SCM Agreement that are most inconsistent with the proposed objectives and propose changes to the SCM Agreement in order to bring it in line with the proposed object and purpose. First, to better serve the objective of protection of the process of competition, I propose changing the causality requirement for establishing injury to domestic industry. In particular, I recommend to require that injury to the domestic industry is caused by *subsidization* rather than subsidized imports. Second, to better serve the objective of promoting economic efficiency and increasing total welfare, I propose to reinstate the category of non-actionable subsidies. This would enable WTO Members to grant subsidies that correct market distortions, such as environmental subsidies, research and development subsidies and regional aid subsidies. Finally, to ensure that measures used to counteract subsidies do not themselves create market distortions and reduce welfare, I propose to limit the unilateral use of countervailing duties by WTO Members by imposing mandatory public interest and lesser duty requirements.

³⁴ PAUL R. KRUGMAN, MAURICE OBSTFELD & MARC J. MELITZ, *INTERNATIONAL ECONOMICS: THEORY AND POLICY* 226-27 (9th ed. 2012); JOSEPH E. STIGLITZ, *ECONOMICS OF THE PUBLIC SECTOR* 77 (3d ed. 2000); HANS W. FRIEDERISZICK, LARS-HENDRIK RÖLLER & VINCENT VEROUDEN, *European State Aid Control: An Economic Framework*, in *HANDBOOK OF ANTITRUST ECONOMICS* 625, 632-34 (Paolo Buccirossi ed., 2007).

II. ECONOMIC ANALYSIS OF SUBSIDIES

A. THE DEFINITION OF SUBSIDY

Although the term “subsidy” is commonly used in economic literature, it lacks a universally agreed upon definition. A variety of government actions can be described as reallocations of resources to the private sector. The difficulty comes in distinguishing between government actions that are to be considered subsidies and other types of government assistance.

The word subsidy derives from the Latin word *subsidius*, meaning assistance, help, or support.¹ Thus, the word subsidy suggests the idea of some kind of a government support to the private sector. However, as there has been no general agreement regarding the recipients, forms, objectives, and effects of such government support, economic scholarship has produced numerous definitions for this term.

Professor Earl Rolph makes the important observation that a subsidy is a one-way income transfer for which a government gets nothing in return.² He also limits the forms of subsidies to cash payments and the provision of goods and services “which directly benefit particular

¹ OXFORD LATIN DICTIONARY 1849 (Oxford University Press 1976).

² EARL R. ROLPH, THE THEORY OF FISCAL ECONOMICS 66-67 (Berkeley: University of California Press 1956).

persons.”³ At the same time, Rolph expands the notion of a subsidy to include assistance to both producers and consumers (including unemployment, veteran, old-age benefits, etc.).⁴

Robert Hubbell points out that “special tax concessions which reduce expenses for particular kinds of enterprises may have results similar to direct payments.”⁵ Thus, according to Hubbell, subsidies may take the form of cash payments, the provision of goods and services at less than their market price, and “lower taxes which are exceptions to general tax rates.”⁶ He also confines the term “subsidy” to benefits that support commercial activities. By doing so, he excludes unemployment, veteran, and other payments not contingent upon recipient performance.⁷

Professor Carl Kaysen proposes a broader understanding of a “subsidy”:

In general analytical terms a subsidy to an enterprise can be defined as an increase in the demand for its output, or a decrease in the costs which it must bear to produce its output, which are not the result of market forces or “natural” changes in consumer tastes, techniques of production, or availabilities of natural resources; but rather result from the deliberate action of the subsidy giver (government). The reader can supply the appropriate changes which would be needed to make the definition applicable to a subsidy to a household, either as a consumer or as supplier of factors.⁸

This broad interpretation suggests that a subsidy is a regulatory rather than a financial device. Calamai and De Moor, too, view a subsidy as “*any measure that keeps prices for consumers below the market level or keeps prices for producers above the market level, or that*

³ *Id.* at 22, 66-67.

⁴ *Id.* at 66-67 (in his view, “a person obtains a subsidy does so because he conforms to the requirements set down in the subsidy legislation, such as having been a member of the Armed Forces, producing certain commodities for sale, or being unemployed”).

⁵ Robert L. Hubbell, *Concealed Subsidies in the Federal Budget*, X:3 NAT’L TAX J. 214, 215 (1957).

⁶ *Id.* at 215.

⁷ *Id.* at 214-15.

⁸ Carl Kaysen, *On Defining a Subsidy*, in vol. IV PUBLIC POLICY, YEARBOOK OF THE HARVARD GRADUATE SCHOOL OF PUBLIC ADMINISTRATION 5 (C.J. Friedrich & J.K. Galbraith eds., 1953).

reduces costs for consumers and producers by giving direct or indirect support.”⁹ Likewise, Schrank and Keithly define a subsidy as “*any government program that potentially permits the firm to increase its profits, beyond what they would have been in the absence of the government program.*”¹⁰ Schwartz and Clements follow Kaysen in identifying subsidies, arguing that it is necessary “to capture both explicit and implicit subsidy elements that are contained in different forms of government intervention.”¹¹ They add a classification system for subsidies based on seven categories: (1) cash subsidies (direct government payments to producers or consumers); (2) credit subsidies (government guarantees, interest subsidies to enterprises, etc.); (3) tax subsidies (reduction of specific tax liabilities); (4) equity subsidies (government equity participations); (5) in-kind subsidies (government provision of goods and services at below-market prices); (6) procurement subsidies (government purchases of goods and services at above-market prices); and (7) regulatory subsidies (implicit payments through government regulatory actions that alter market prices or access).¹²

These are fairly broad categories of government actions; however, the definition proposed by Kaysen indicates two requirements for a subsidy. First, only government measures that affect prices or costs of production should be regarded as a subsidy. Second, this particular effect must be the result of deliberate governmental action.¹³ The second requirement (intent) has not been widely accepted in the economic literature. Many scholars do not focus on government

⁹ ANDRÉ DE MOOR & PETER CALAMAI, *SUBSIDIZING UNSUSTAINABLE DEVELOPMENT – UNDERMINING THE EARTH WITH PUBLIC FUNDS 1* (Geneva: Earth Council 1997) (emphasis added).

¹⁰ W.E. Schrank & W.R. Keithly, Jr., *The Concept of Subsidies*, XIV MAR. RESOUR. ECON. 151, 156 (1999) (emphasis added).

¹¹ Gerd Schwartz & Benedict Clements, *Government Subsidies*, 13(2) J. ECON. SURV. 119, 120 (1999).

¹² *Id.* at 120-21.

¹³ Kaysen, *supra* note 8, at 9 (arguing that “[a] subsidy can conveniently be defined in this terminology as intended subsidy effect, which legislature (or other policy promulgating authority) foresaw and desired when it authorized the particular Government activity giving rise to the subsidy effect in question”).

intent as an indicator of a subsidy at all. Some find government motivation as the final test of what constitutes a “subsidy” problematic because “intent is always ambiguous.”¹⁴

The first requirement, however, is very important. Indeed, despite the fact that virtually any sort of government assistance to the private sector could be folded into a general definition of subsidies, it is the effect rather than the form of a transfer that is important. A subsidy arises only if a government program benefits private actors, compared to what a private actor would receive under normal market conditions without government intervention. As Professor Alan Sykes explains, to economists a natural benchmark for identifying subsidization is a hypothetical market equilibrium without the presence of government. When a government enters the picture through taxes or other programs, it alters equilibrium prices and output. Thus, activities for which net returns are enhanced may be viewed as “subsidized.”¹⁵

In sum, economists’ definitions of subsidies, despite considerable diversity – which stems from the fact that different scholars emphasize different elements of subsidies – have tended to increase in scope and to become extremely broad. By contrast, in a legal context, the definitions of a subsidy have tended to be more narrow, though they too vary widely from country to country, and even throughout different areas of the law within the same country.¹⁶ These

¹⁴ Warren C. Robinson, *What is a Government Subsidy?*, XX:1 NAT’L TAX J. 86, 89 (1967); William E. Schrank, *Subsidies for Fisheries: A Review of Concepts*, in *FAO PAPERS PRESENTED AT THE EXPERT CONSULTATION ON ECONOMIC INCENTIVES AND RESPONSIBLE FISHERIES 11-40* (Rome 2000) (also arguing that subsidies must be judged in terms of their impacts, rather than upon the intent).

¹⁵ Alan O. Sykes, *Subsidies and Countervailing Measures*, in *THE WORLD TRADE ORGANIZATION: LEGAL, ECONOMIC AND POLITICAL ANALYSIS*, vol. II, 83, 85 (Patrick F.J. Macrory, Arthur E. Appleton & Michael G. Plummer eds., 2005).

¹⁶ For example, the U.S. Department of Commerce used the following subsidy definition to account for certain government cash payments: “Subsidies are monetary payments provided by Government to private resident business, including farms. Subsidies are excluded from Government purchases of goods and services because they are not payment for any output, and they appear nowhere else in gross national product” (Office of Business Economics, Department of Commerce, June 1971). Whereas the Trade Agreements Act describes a subsidy (for the purpose of imposing countervailing duties) as any financial contribution, any form of price or income support as defined in the GATT (19 U.S.C. § 1677(5) B). The Act clarifies the term “subsidy” further by referring to the Illustrative List of Export Subsidies in Annex I of the WTO Agreement on Subsidies and Countervailing Measures,

differences in economic and legal definitions of a subsidy are hardly surprising. Economists need a definition in order to ascertain the nature of a subsidy, to further analyze the economic effects of subsidies in the market, and to identify which subsidies have negative effects and which may correct market failures or pursue other legitimate objectives of social policy that the market would not achieve otherwise. On the other hand, legal definitions of a subsidy are more context-specific; the same country may adopt a variety of definitions for different purposes. Indeed, any legal definition is not a fact but an artificial construct of a given legal system with a given practical purpose.¹⁷ As Professor Luka Rubini puts it, “the legal system, with its material provisions, procedural rules and remedies, and ultimately its objectives, does influence the actual definition of subsidy in *that* ‘legal system.’”¹⁸

B. ECONOMIC EFFECTS OF SUBSIDIES

Disciplining subsidies in an international context is a difficult and delicate issue that requires an understanding of the economic effects that subsidies granted by a country have on international trade. Before examining how subsidies can affect international trade, we must first gain a better understanding of the theories that justify international trade and lay down the foundations for the world trading system.

which provides twelve examples of subsidies that are countervailable, the list is non-exhaustive (19 U.S.C. § 1677(5) A).

¹⁷ See, e.g., H.L.A. Hart, *Definition and Theory in Jurisprudence*, 70 Q. REV. 37-60 (1954).

¹⁸ LUCA RUBINI, *THE DEFINITION OF SUBSIDY AND STATE AID: WTO AND EC LAW IN COMPARATIVE PERSPECTIVE* 17 (Oxford University Press 2009).

1. Analysis of International Trade

Economic liberalism has been the dominant theoretical perspective on international trade since the nineteenth century. This school of thought was first articulated by Adam Smith in his classic book, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), and was further advanced by David Ricardo who, in his book, *The Principles of Political Economy and Taxation* (1817), developed the theory of “comparative advantage.” The classical Smith-Ricardo model suggests that each country should specialize in the production of goods in which it has an advantage relative to other countries (absolute advantage), or which are more profitable to produce than other products, even if all the products could be produced more cheaply in other countries (comparative advantage). Liberal economic theorists maintain that in a free trade environment the country that produces certain goods more efficiently than other goods will allocate its resources to the production of the goods it produces more efficiently. It will buy other products it needs from countries with a comparative advantage in the production of those other products. Accordingly, each country will direct its resources to activities that yield the greatest return; the efficient allocation of factors of production will thus result in an increase in national and world welfare. Under this view, the global economy and each nation will be better off when free trade permits consumers to buy the cheapest products and producers to invest resources in the most productive way. Therefore, it is argued that governments should refrain from interfering with private entrepreneurs and free markets in international trade.¹⁹

The classical theories of absolute and comparative advantage were further developed by neoclassical economists who criticized classical theory for only focusing on one factor of

¹⁹ See R.A. JOHNS, INTERNATIONAL TRADE THEORIES AND THE EVOLVING INTERNATIONAL ECONOMY 149-62 (1985); RAZEEN SALLY, CLASSICAL LIBERALISM AND INTERNATIONAL ECONOMIC ORDER: STUDIES IN THEORY AND INTELLECTUAL HISTORY 13-65 (1998); BRUCE E. MOON, DILEMMAS OF INTERNATIONAL TRADE 51-57 (2000).

production (labor), which precludes the analysis of other issues. The foundations for the neoclassical model were laid by Eli Hecksher and Bertill Ohlin. Ohlin argued that:

All prices . . . are ultimately, in each region, at any given moment, determined by the demand for goods and the possibilities of producing them. Behind the former lie two circumstances to be considered as known data in the problem of pricing: (1) the wants and desires of consumers, and (2) the conditions of ownership of the factors of production, which affect individual incomes and thus demand. The supply of goods, on the other hand, depends ultimately on (3) the supply of productive factors, and (4) the physical conditions of production.²⁰

This observation brings us to the factor abundance theory, or the neoclassical theory of international trade, which provides valuable economic explanations for the most important forces playing a role in production and consumption decisions.²¹ Yet all of these theories lead to essentially the same conclusion: opening trade across borders increases national and world welfare. Consequently, the theory of comparative advantage still remains the most powerful argument in favor of free trade.

Opponents of the “invisible hand” – the notion that markets and the pursuit of self-interest will lead to economic efficiency – have their own arguments, the most common of which are the following:

(1) Government Intervention May be Necessary to Address Domestic Distortion: Free trade theory rests on the assumption that domestic economies function properly. Many economists have made a case against free trade based on the counterargument that sometimes domestic economies do not function properly (in poor nations market imperfections are in fact very common). Therefore, the argument goes, in the case of a domestic distortion the first-best

²⁰ W.R. ALLEN, *INTERNATIONAL TRADE THEORY: HUME TO OHLIN* 173 (New York 1965).

²¹ See P.A. Samuelson, *International Trade and the Equalization of Factor Prices*, 58 *ECON. J.* 163-84 (1948); W. Stolper & P. Samuelson, *Protection and Real Wages*, 9 *REV. ECON. STUD.* 58-73 (1941); T.M. Rybczynski, *Factor Endowments and Relative Commodity Prices*, 22 *ECONOMICA* 336-41 (1955); B. OHLIN, *INTERREGIONAL AND INTERNATIONAL TRADE* (Cambridge 1933).

optimal results of free trade are no longer available. Instead, government intervention (second-best option) may increase welfare by offsetting the consequences of market failures.²²

Advocates of free trade have two points in response to the market failure arguments. First, domestic market failure requires domestic policy changes, not international trade policies. Professors Paul Krugman, Maurice Obstfeld, and Marc Melitz observe that it is always preferable to deal with market failures “as directly as possible, because indirect policy responses lead to unintended distortions of incentives elsewhere in the economy.”²³ Generally, trade intervention, by introducing two distortions rather than one, may succeed in solving one problem but only at the same time that it causes another.²⁴ Second, the market failure argument may be valid only if the distortions are correctly identified. However, because market failures are usually hard to diagnose correctly, it is difficult to be sure about the appropriate policy response.²⁵

(2) Not all Benefits of Free Trade are Evenly Distributed: Comparative advantage theory suggests that free trade will increase the wealth of every nation. However, this does not mean that every person will be better off; some individuals and groups gain from free trade while others lose. Therefore, there is a need to introduce appropriate distributional mechanisms, where the total gains could be redistributed so that the losers are fully compensated for their losses. Governments can redistribute resources through the tax system, social programs, and the like.

²² PAUL R. KRUGMAN, MAURICE OBSTFELD & MARC J. MELITZ, *INTERNATIONAL ECONOMICS: THEORY AND POLICY* 226-27 (9th ed. 2012).

²³ *Id.* at 228 (arguing that “a tariff might raise welfare, despite the production and consumption distortion it causes, because it leads to additional production that yields social benefits. If the same production increase were achieved via a production subsidy rather than a tariff, however, the price to consumers would not increase and the consumption loss would be avoided. In other words, by targeting directly the particular activity we want to encourage, a production subsidy would avoid some of the side costs associated with a tariff.”).

²⁴ Alan V. Deardorff & Robert M. Stern, *Current Issues in US Trade Policies: An Overview*, in *U.S. TRADE POLICIES IN A CHANGING WORLD ECONOMY* 15, 38-40 (Robert M. Stern ed., 1987).

²⁵ KRUGMAN, OBSTFELD & MELITZ, *supra* note 22, at 228-29.

Generally, all of these strategies should address the distributional problem directly so that they do not create other distortions.²⁶

Although such redistribution can, theoretically, compensate the losers, it does not often take place in practice. Governments redistribute costs and benefits from one sector of the economy to another, from one region to another, between consumers and producers, between the rich and the poor, and these sorts of decisions are inevitably politicized. As a result, as Professor Bruce Moon puts it, “whichever trade policy the government chooses, it will harm some group.”²⁷ In fact, there is evidence that there are many losers in both developing and developed countries.²⁸ Today, according to Professor Joseph Stiglitz, the concern is that globalization might be creating “rich countries with poor people.”²⁹

(3) Infant Industries May Require Protection: Unlike the distribution argument, which suggests the protection of losers, the infant industry argument supports protection that increases the wealth of the state. The core of this argument is that a state has a *potential* comparative advantage in some product or production method. Thus, an industry that has the potential to become competitive needs government protection against international competition until it becomes mature and stable. Many economists believe that this kind of protectionism is the only way to minimize income gaps and substantial inequity between developed and developing countries. The economic literature has developed certain additional conditions that must be met in order to justify protection: (1) protection should be granted in cases where the industry does

²⁶ ANDREW T. GUZMAN, JOOST H. B. PAUWELYN, *INTERNATIONAL TRADE LAW* 22 (2009).

²⁷ MOON, *supra* note 19, at 22.

²⁸ The World Commission on the Social Dimensions of Globalization, established by the International Labor Organization, surveyed seventy three countries around the world and found that in all regions (except U.S., EU and South Asia) unemployment rates actually increased between 1990 and 2002; the Commission also found that 59% of the world’s people were living in countries with growing inequality, with only 5% in countries with declining inequality. See JOSEPH E. STIGLITZ, *MAKING GLOBALIZATION WORK* 8 (New York 2006).

²⁹ *Id.* at 9.

have the potential to become competitive; (2) protection must be temporary; once the industry is stable enough to compete internationally, all protective measures should be withdrawn; (3) protection must generate higher cumulative benefits than costs; and (4) policy makers must choose the optimal policy instruments for protection (it is argued that protection provided by subsidies is preferable to that provided by tariffs or quotas, as the latter additionally distort consumption).³⁰

However, these relatively straightforward recommendations are hard to apply in practice. The principal concern is whether a government will make wise decisions about which industries to support, due to political pressure, incompetence, corruption, or lack of information.³¹ Another difficulty is that both the benefits and the costs of protection change over time. Finally, choosing the optimal instrument for protection (tariffs, quotas, or subsidies) can also be complicated by practical considerations.³²

(4) Government Policy May Attempt to Shift Access Profits in an Oligopolistic International Markets towards the Home Market Firms (Strategic Trade Theory): Strategic trade policy may be defined as trade policy that conditions or alters a strategic relationship between firms. Where “strategic relations” are mutually recognized strategic interdependence between firms, meaning that profits of one firm are directly affected by strategic choices of other firms. This concept implies that strategic trade policy requires the presence of oligopoly, and may not arise under

³⁰ See John Stuart Mill, *The Principles of Political Economy*, in III COLLECTED WORK OF JOHN STUART MILL 918-19 (University of Toronto Press 1848); C.F. BASTABLE, *THE COMMERCE OF NATIONS* 140-43 (10th ed. 1921); W.M. CORDEN, *TRADE POLICY AND ECONOMIC WELFARE* ch. 8 (2d ed. 1997); M.C. Kemp, *The Mill-Bastable Infant Industry Dogma*, 68 J. POLIT. ECON. 65-67 (1960); A. Deardorff, *Why do Governments Prefer Nontariff Barriers*, in 26 CARNEGIE-ROCHESTER CONFERENCE SERIES ON PUBLIC POLICY 191-216 (1987); M. Melitz, *When and How Should Infant Industries be Protected*, 66 J. INT. ECON. 177-96 (2005).

³¹ GUZMAN & PAUWELYN, *supra* note 26, at 24.

³² Melitz, *supra* note 30, at 193-94 (suggesting that quotas induce higher welfare level than tariffs and that, in some specific cases, the quota may even be preferred to a subsidy).

perfect competition or monopoly.³³ Under such circumstances, the argument goes, a government, by supporting its firms in international competition, can raise national welfare at the expense of firms in another country.³⁴ A government can use a variety of instruments to shift profits from foreign to domestic firms, including export subsidies and subsidies for research and development (R&D).

Although, in practice, interventionist policies in countries like the United States, France, Japan, and South Korea have had an important effect in allowing industries in those countries to develop strong international presence,³⁵ many economists are skeptical about government intervention in trade. The key concern is the ability of a government to formulate interventions that do more good than harm. Furthermore, a country that introduces a strategic trade policy may provoke retaliation. As a result, a trade war between two interventionist governments may leave both countries worse off than if a *laissez-faire* approach were adopted by both.³⁶

In sum, comparative advantage theory provides a strong argument for how free trade can increase national welfare. However, as Professors Paul Krugman, Maurice Obstfeld, and Marc Melitz point out, “economic theory does *not* provide a dogmatic defense of free trade.”³⁷ There is an ongoing debate on many important issues in trade (including the role of subsidies) and about the appropriate balance to be found between economic benefits and a variety of other interests (including ethical principles and social values). In the international context, too, the world trading system is based on the theory of comparative advantages. Yet, as Professor Bruce

³³ J. Brandner, *Strategic Trade Policy*, in NBER WORKING PAPER SERIES 1 (Cambridge 1995).

³⁴ Paul R. Krugman, *Is Free Trade Passé?*, 1:2 J. ECON. PERSPECT. 131, 141 (1987).

³⁵ For example, US high technology production and export are to a large extent due to substantial R&D subsidies to many industries through heavily subsidized university research sectors, subsidies to defense and space exploration sectors, as well as direct export subsidies provided by the Export-Import Bank of the United States to high technology industries, including aircraft production. See Brandner, *supra* note 33, at 64-65.

³⁶ Krugman, *supra* note 34, at 141-42.

³⁷ KRUGMAN, OBSTFELD & MELITZ, *supra* note 22, at 229.

Moon puts it, “the *ultimate goals* of GATT/WTO are classically liberal . . . but the *means* used to accomplish them reveals an underlying philosophy that contains both liberal and mercantilist assumptions.”³⁸

2. Effects of Subsidies on International Trade

The substantial reduction of barriers to trade is the key instrument of the WTO to achieve its overall objectives. At the time when the GATT of 1947 was drafted, tariffs and quotas were considered to be the primary obstacles to international trade. Consequently, the GATT sets out a general prohibition on quantitative restrictions.³⁹ Tariffs are not prohibited; however, as a result of the eight GATT Rounds tariff duties were substantially reduced.⁴⁰ This removal of tariffs and quantitative restrictions is only valuable if “the parties do not turn around and impose new non-tariff barriers.”⁴¹ In fact, the reduction of trade barriers at the border has led to a rise in non-tariff barriers. Cameron’s studies have found that the openness of the economy is a major factor in the expansion of the public economy.⁴² Likewise, examining evidence from members of the OECD, Blais argues that, as the rates of tariffs have decreased in the industrialized world, governments have chosen to increase disbursement of production subsidies. Overall, the study finds that, all else being equal, a reduction of 3 percentage points in tariffs leads to an increase of 1 percentage

³⁸ MOON, *supra* note 19, at 92 (emphasis added).

³⁹ General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194, art. XI [hereinafter GATT].

⁴⁰ *Id.*, art. II. In the late 1940s, before the creation of the GATT, the average duty on industrial products imposed by developed countries was about 40 percent *ad valorem*. After the tariff negotiations, this average has been reduced to about 3.9 percent *ad valorem*.

⁴¹ R.E. Hudec, *Regulation of Domestic Subsidies Under MTN Subsidies Code*, in INTERFACE THREE: LEGAL TREATMENT OF DOMESTIC SUBSIDIES 4 (D. Wallace, F.J. Loftus & V.Z. Krikorian eds., 1984).

⁴² D.R. Cameron, *The Expansion of the Public Economy*, 72 AM. POLIT. SCI. REV. 1243-61 (1978).

point in public subsidies.⁴³ This has led the WTO to focus on non-tariff trade policies and domestic policies with an impact on trade.⁴⁴

Subsidies are a form of non-tariff barrier. The effects of subsidies are different from those of tariffs. First, in contrast to tariffs and quotas, which result in higher prices, subsidies lead to lower prices, thereby favoring the consumer. Second, whereas tariffs involve imposing duties on imports, and thereby raise revenue for the government, subsidies in many instances include economic transfers from the government to firms. Consequently, governments are interested in granting subsidies only if they can offset the loss with revenue in some other way. Professor Nikolaos Zahariadis observes that subsidies are distributed taking into account economic and revenue trade-offs in ways that are not considered in setting tariffs.⁴⁵ Finally, subsidies are less visible and transparent than tariffs and other non-tariff barriers. As subsidies involve only governments and domestic producers, they are more difficult for outsiders to detect. In fact, we still do not have clear and accurate information about the extent of subsidization around the world.⁴⁶ Such a lack of transparency makes it difficult to assess the extent to which subsidies actually affect international trade.

From an economic perspective, the main purpose of subsidies is to reallocate resources and thereby alter economic activity and behavior in order to achieve an outcome that is “more

⁴³ André Blais, *The Political Economy of Public Subsidies*, 19:2 COMP. POLIT. STUD. 201, 210 (1986) (It should be noted though that subsidies are only a partial substitute for tariffs; government merely attempt to mitigate the negative effects of trade liberalization on specific industries and not to offset them entirely.).

⁴⁴ While the first six GATT trade negotiating rounds focused exclusively on negotiations for the reduction of tariffs, the Tokyo Round (1973-1979) was predominantly concerned with non-tariff measures and the Uruguay Round (1986-1994) continued detailed work on many non-tariff measures, including subsidies. See JOHN H. JACKSON, WILLIAM J. DAVEY & ALAN O. SYKES, JR., *INTERNATIONAL ECONOMIC RELATIONS: CASES, MATERIALS AND TEXT ON THE NATIONAL AND INTERNATIONAL REGULATION OF TRANSNATIONAL ECONOMIC RELATIONS* 248-49 (6th ed. 2013).

⁴⁵ NIKOLAOS ZAHARIADIS, *STATE SUBSIDIES AND THE GLOBAL ECONOMY* 6 (New York 2008).

⁴⁶ *Id.* at 92 (for example, the U.S. Federal government has consistently refused to publicize subsidy figures on the rationale that they are disbursed by states over which it does not have jurisdiction).

desirable” from what would occur otherwise.⁴⁷ Government subsidies often are justified by arguing that they offset various domestic market failures, protect infant industries, change the distribution of income, increase employment, or meet other social objectives. Indeed, economic theory shows that, under certain circumstances, market mechanisms left alone fail to achieve the best outcome for the economy. Government intervention could, therefore, be useful to correct such failures.⁴⁸ Moreover, some economists suggest that subsidies should be a preferred form of government involvement in trade matters, taking the place of tariffs, quotas, and other nontariff barriers.⁴⁹ In practice, however, the use of subsidies is not based on purely economic grounds. In many cases, subsidies are a result of complicated interactions between societal demands for subsidies and the institutional ability of politicians to supply them.

On the demand side, groups affected by global trade (such as industry groups and labor unions) compete with one another to access politicians in support of subsidies in order to compensate their losses. They form lobby groups and confront policymakers with contributions that affect the latter’s chances for reelection. Governments never have enough resources to address all the issues before them; thus, the willingness of policymakers to listen to affected groups is dependent upon the ability of those groups to put pressure on politicians. Cox observes that when subsidies are given in order to alleviate damage caused by trade, “the amount of the policy concession (subsidy) is more a function of the influence of the pressure groups than the

⁴⁷ Gerd Schwartz & Benedict Clements, *Government Subsidies*, 13:2 J. ECON. SURV. 119, 126 (1999).

⁴⁸ See *supra* note 22 and accompanying text.

⁴⁹ Jagdish N. Bhagwati & V.K. Ramaswami, *Domestic Distortions, Tariffs and the Theory of Optimum Subsidy*, 71(1) J. POLIT. ECON. 44, 44-50 (1963); Harry G. Johnson, *Optimal Trade Intervention in the Presence of Domestic Distortions*, in *TRADE, GROWTH AND THE BALANCE OF PAYMENT* 3, 3-34 (Richard E. Caves, Harry G. Johnson & Peter B. Kenen eds., 1965) (arguing that according to the targeting principle, under which the optimal intervention targets the affected margin directly, production subsidies are almost always a preferred policy instrument to tariffs. This is because a production subsidy distorts only one margin (producer decisions), whereas a tariff distorts two margins (producer and consumer decisions)).

amount of harm that might be incurred.”⁵⁰ Therefore, governments are more likely to respond to demands from more politically powerful groups. The political power of groups, in turn, depends upon their size and ability to organize. Larger groups have more members and, therefore, a greater likelihood to contribute more and to deliver more votes.⁵¹ For example, Kindleberger has found that the larger numbers of farmers was partly the reason why France and Germany imposed tariffs in the 1880s but the UK did not.⁵² Additionally, producers and labor groups must have the ability to organize in order to put effective political pressure on the government, to create “coalitions which operate, albeit not exclusively, outside electoral politics.”⁵³ Professor Nikolaos Zahariadis argues that demands for subsidies, and by consequence the level of subsidies, are likely to be more successful in more corporatist systems⁵⁴ where institutions provide forums for the articulation of demands and the making of compensatory deals.⁵⁵ Professor Peter Katzenstein also observes that in small European countries, which are rule-takers rather than rule-makers, unions and industries have developed more coordinated ways to cope with the pressures of the global economy.⁵⁶

⁵⁰ A. Cox, *Easing Subsidy Reform for Producers, Consumers, and Communities*, in OECD, SUBSIDIES REFORM AND SUSTAINABLE DEVELOPMENT: POLITICAL ECONOMY ASPECTS 63 (Paris 2007).

⁵¹ ZAHARIADIS, *supra* note 45, at 80; David R. Cameron, *Distributional Coalitions and other Sources of Economic Stagnation: On Olson’s Rise and Decline of Nations*, vol. 42, Issue 04 IO 561, 572 (1988).

⁵² C.P. Kindleberger, *Group Behavior and International Trade*, 59 J. POLIT. ECON. 30, 30-46 (1951).

⁵³ P.A. Hall, *The Political Economy of Europe in an Era of Interdependence*, in CONTINUITY AND CHANGE IN CONTEMPORARY CAPITALISM 135, 150 (H. Kitschelt, P. Lange, G. Marks & J.D. Stephens eds., 1999).

⁵⁴ Democratic corporatism is generally described as “the voluntary, cooperative regulation of conflicts over economic and social issues through highly structured and interpenetrating political relationships between business, trade unions, and the state, augmented by political parties.” See PETER J. KATZENSTEIN, *SMALL STATES IN WORLD MARKETS* 32 (Cornell University Press 1985).

⁵⁵ ZAHARIADIS, *supra* note 45, at 85.

⁵⁶ KATZENSTEIN, *supra* note 54, at 191-204.

On the supply side, policymakers choose to grant subsidies based on an objective function that takes into account both their own chances for reelection and the voters' welfare.⁵⁷ Thus, on the one hand, politicians have to listen to constituents who are important for their reelection; on the other hand, however, policymakers have preferences of their own and may choose not to adhere to societal demands. For example, because of rising U.S. hegemony, policymakers have been able to overcome industry objections and impose their own preferences on trade policy.⁵⁸ Blais's studies have found that the political composition of the government may also influence the supply of governmental intervention, and public subsidies are likely to be more substantial in those countries where the government is controlled by a left-wing party.⁵⁹ Furthermore, formal political institutions have an effect on the distribution of subsidies as they regulate access and control the process. The likelihood of subsidies increases in systems where power is more diffused among parties and branches of government because, under these conditions, compromises will include satisfying a higher number of groups than would otherwise be the case.⁶⁰ Accordingly, subsidies are expected to be higher in countries with multiparty coalition governments, proportional representation systems, bicameral legislatures, federal systems, and the like. At the same time, the ability to demand subsidies is likely to be weaker in countries with more independent central banks that are not elected bodies; thus, lobbying contributions will have a limited impact on central bankers.⁶¹

⁵⁷ See, e.g., Gene M. Grossman & Elhanan Helpman, *Protection for Sale*, 84 AM. ECON. REV. 833, 833-50 (1994).

⁵⁸ D.A. LAKE, *POWER, PROTECTION AND FREE TRADE: INTERNATIONAL SOURCES OF U.S. COMMERCIAL STRATEGY: 1887-1939* (Cornell University Press 1988).

⁵⁹ Blais, *supra* note 43, at 205.

⁶⁰ ZAHARIADIS, *supra* note 45, at 89-94.

⁶¹ W.R. CLARK, *CAPITALISM, NOT GLOBALISM: CAPITAL MOBILITY, CENTRAL BANK INDEPENDENCE, AND THE POLITICAL CONTROL OF THE ECONOMY* 14-16 (University of Michigan Press 2003).

In general, the ultimate problem with studying subsidies is that, in many cases, they are more a political than an economic issue, and as such they are less suitable to economic analysis. The relationship between politics and economics explains why subsidies that are granted are not always economically justifiable; and yet, it also explains the resistance to their removal in the domestic and international context.

According to classical free trade theory, subsidies are thought to lower the producers' costs of production, which may lead recipients to reduce prices and expand output. Thus, if they are imposed on a competitive market, they may distort comparative advantage and produce a less efficient global division of labor, which will result in lower economic welfare.⁶² As was mentioned above, economists do not offer general objections to the use of subsidies. In analyzing the distinction between desirable and undesirable subsidies, Professor Alan Sykes identifies three groups of subsidies that are not necessarily harmful. First, some subsidies have no impact on the output of recipients and, therefore, do not distort resource allocation. Second, even where a subsidy confers a benefit on the recipient, governments can use them to remedy "market failures." Third, even when obvious market failures are absent, governments may still grant subsidies to the private sector in order to achieve a socially desirable effect.⁶³

In the international context, it is thus important to define potentially troublesome subsidies. If a subsidy does lead a recipient to reduce price and expand output, this may attract customers away from unsubsidized firms. Consequently, subsidies can be used to protect domestic firms from foreign competitors. Professor John Jackson describes three possible effects

⁶² RAMBOD BEHBOODI, INDUSTRIAL SUBSIDIES AND FRICTION IN WORLD TRADE: TRADE POLICY OR TRADE POLITICS? 11 (1994).

⁶³ Sykes, *supra* note 15, at 88-89.

of such subsidies.⁶⁴ First, subsidies of country A can enhance export potential of products into importing country B, in which case country B may respond with countervailing duties. Second, subsidies from country A can enhance the exportation of its products to country C, where they compete with similar products that are exported from country B. In this case, country B does not have a resource to respond other than that which is provided by an international forum like the WTO. Third, if country A subsidizes products that are sold in its home market, it is harder for countries B and C to export similar goods to country A. Under this scenario, the effects of a subsidy are similar to that of a tariff. Once again, countries B and C can only deal with this through international mechanisms. In general, subsidies to exporting firms may divert business away from more efficient competitors and even trigger subsidy wars; and subsidies to import-competing firms provide an alternative to traditional border instruments for purposes of trade protection and they may thereby undermine market access commitments.

In analyzing the effects of subsidies on international trade, economists make a clear distinction between export and domestic production subsidies. Thus, it is helpful to consider each of these categories separately.

a. Effects of Export Subsidies Export subsidies are government incentive programs that favor export sales over domestic sales. A government can provide an export subsidy either as a specific amount per unit exported or as a percent of the value of the exported goods. The objective of this support is to enable domestic producer to “win” sales in other countries by undercutting the prices charged by foreign producers. When a government grants an export subsidy to a domestic producer, the producer will export the subsidized products up to the point where the domestic

⁶⁴ JOHN H. JACKSON, *THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS* 280-81 (2d ed. 1997).

price for the exported goods exceeds the sum of the international price plus the amount of the subsidy. As soon as the domestic price is greater than the sum of the international price plus the subsidy, the producer will again sell the products in the domestic market.⁶⁵

Export subsidies have an overall negative net welfare impact on the subsidizing country. In general, they result in: consumer loss (the withdrawal of supply from the domestic market causes domestic prices to rise); government and taxpayer loss (a subsidy raises costs to the government equal to the total value of the subsidy); and producers gain (since they receive a higher price in the domestic market and in the country where the products are exported by adding the subsidy). Additionally, although economic theory suggests that, under certain circumstances, government intervention can offset the consequences of market failures,⁶⁶ it is difficult to imagine a market failure that is best addressed with an export subsidy.

A country that receives subsidized goods may benefit from subsidies given to foreign exporters because its consumers can purchase products at a more competitive price which may, in turn, improve the conditions of trade in the country (the domestic producers hurt by lower prices can economize on their losses by shifting productive resources to activities with higher returns). As a result, some economists suggest that, instead of imposing countervailing duties, governments affected by foreign subsidies should be sending a “thank you” note to the subsidizing government. As Professor Donald Boudreaux put it, if the Chinese government taxes the Chinese people in order to artificially reduce the prices that Europeans and Americans pay for Chinese exports, why should Europeans and Americans complain?⁶⁷ However, it should also be taken into account that, although consumers in the importing country may enjoy lower prices

⁶⁵ GUSTAVO E. LUENGO HERNÁNDEZ DE MADRID, *REGULATION OF SUBSIDIES AND STATE AIDS IN WTO AND EC LAW: CONFLICTS IN INTERNATIONAL TRADE LAW* 22 (2007).

⁶⁶ See *supra* notes 22-23 and accompanying text.

⁶⁷ Donald J. Boudreaux, *Do Subsidies Justify Retaliatory Protectionism?*, 31(3) *ECONOMIC AFFAIRS* 4, 4 (2011).

in the short-run, this situation can change in the medium – or long-run. As Gustavo Luengo rightly points out, if the prices of the subsidized products were very low, competitors in the market to which the products are exported would not be able to remain in the market. This may result in a monopoly situation in that market and in a subsequent increase in prices that harms consumers.⁶⁸ Thus, export subsidies can have a negative effect on both the country that grants the subsidies and the country that receives the subsidized products.

From a global perspective, export subsidies are also generally undesirable. First, they can upset expectations of competing exporters pursuant to negotiated trade agreements by diminishing their market access opportunities. Second, even if they do not frustrate the market access expectations, they are a source of economic distortion. By inducing the expansion of higher cost exporters at the expense of lower cost exporters, they lead to the inefficient allocation of resources and factors of production because exported goods are no longer produced at the lowest possible cost. Moreover, collecting funds to subsidize exports entails taxing other sectors and activities, which creates further economic distortions.⁶⁹ In sum, an export subsidy generally leads to costs that exceed its benefits.

b. The Effects of Domestic Subsidies Domestic production subsidies are granted for the production of goods manufactured domestically, irrespective of whether the final product is exported. This type of subsidy is usually rationalized for domestic reasons and is linked to the economic and social policies of the country. Although these measures can distort competition in the market, they can also correct market failures or promote social values that the market would

⁶⁸ LUENGO, *supra* note 65, at 23-24.

⁶⁹ Sykes, *supra* note 15, at 91.

not achieve otherwise. Consequently, economic analysis has a much more nuanced approach to domestic production subsidies.

A domestic production subsidy has two effects on the domestic market: reducing costs for the producer and/or reducing the price of the product for the consumer. Unlike export subsidies, domestic production subsidies avoid the increase in price to consumers and thus the associated distortions. However, under perfect competition, they may lead to an inefficient allocation of resources: the firms receiving subsidies are likely to maintain or increase their market share, whereas other more efficient firms may become excluded from that market. Additionally, the taxes used to finance the subsidy will cause additional economic distortions. On the other hand, the subsidy may be appropriate if it is used for repairing market imperfections or pursuing socially valuable objectives. Moreover, some economists suggest that domestic subsidies are the best instrument governments can use to address domestic distortions.⁷⁰

From an international perspective, domestic subsidies may have two economic effects. One effect of a subsidy may be the substitution of domestic products for imported goods in the subsidizing country. Foreign competitors that do not receive subsidies from their governments may not be able to afford to sell the goods they export to a subsidizing country at prices that are lower than their cost of production. As a result, higher-priced imports will no longer be competitive, thereby impeding foreign competitors' access to the subsidizing country's market.⁷¹ Thus, subsidies can be used as a form of protectionism,⁷² and they may thereby undermine the

⁷⁰ Bhagwati & Ramaswami, *supra* note 49, at 44-50; Johnson, *supra* note 49, at 3-34.

⁷¹ Food and Agriculture Organization of the United Nations, *The Effects of Subsidies and Market Restrictions on Agriculture and Fisheries Production and Market Access*, 27th Regional Conference for Latin America and the Caribbean (2002), <http://www.fao.org/docrep/meeting/004/y6068e.htm>.

⁷² Samuelson and Nordhaus define protectionism as 'any policy adopted by a nation to protect domestic industries against competition from imports.' PAUL A SAMUELSON & WILLIAM D. NORDHAUS, *ECONOMICS* 980 (13th ed. 1989).

market access commitments of importing nations. Second, artificially lowered costs of production allow firms that receive subsidies to market their goods in non-subsidizing countries at prices below those of local competitors. Local producers would, therefore, not be able to be competitive, even though they may be much more efficient in production. Additionally, the benefits to other exporters of market access commitments may also be threatened. In either case, the lower costs of subsidized products cause a misallocation of output between foreign and domestic markets, whereby resources are diverted to less efficient producers.⁷³ This results in a less efficient global division of labor, which leads to lower global economic welfare.

It should be emphasized, however, that these conclusions are based on the assumption that the free market produces a better allocation of resources, meaning that resources are allocated in accordance with the desires of the consumers who generate market demand.⁷⁴ In practice, allocative and distributive decisions are made by a multitude of actors not only for economic, but also for political, social, or moral reasons.⁷⁵ Thus, subsidies do not always create greater distortions in the international economy. As Professor Rambod Behboodi put it, “distortion of an otherwise distorted market may in fact lead to efficiencies.”⁷⁶ Indeed, in some cases they offset the effects of other distortions. In others, the economic effect of a subsidy, as one deviation from free market principles, may be hard to evaluate when surrounded by other deviations. Thus, for both domestic and international markets, the economic effects of domestic production subsidies are generally viewed as less distortional and harmful than subsidies for exports.

⁷³ John J. Barceló III, *Subsidies, Countervailing Duties and Antidumping after the Tokyo Round*, 13 CORNELL INT’L L.J. 257, 282-83 (1980).

⁷⁴ Hudec, *supra* note 41, at 31.

⁷⁵ BEHBOODI, *supra* note 62, at 26.

⁷⁶ *Id.* at 31.

C. THE ECONOMIC EFFECTS OF COUNTERVAILING DUTIES

Countervailing duties (CVDs) are additional customs duties imposed by an importing country in order to offset the effect of subsidies granted by an exporting country to its exporter. The objective of a CVD is to bring the imported price to its true market price and, thus, provide a level playing field between domestic producers of a product and foreign producers of the same product who can afford to sell it at a lower price because of the subsidy they receive from their government.

The economic effects of CVDs are similar to tariffs as they artificially increase the price of subsidized products in the market. However, unlike tariffs, which are imposed on products imported from any country, CVDs are only imposed on products coming from the country that granted the subsidy.⁷⁷ Therefore, although consumers have to pay more for subsidized imported products, the purpose of the CVD is to allow domestic like products and like products imported from other countries to continue competing in that market.⁷⁸

Scholarship on subsidies indicates two possible goals that support countervailability: deterrence and neutralization. The first rests on the assumption that subsidies interfere with the efficient allocation of productive resources and the purpose of CVD laws is, therefore, to preclude this inefficiency by discouraging subsidy practices and to, in turn, enhance global welfare. Under a deterrence analysis, CVDs seek “to nullify the foreign program of subsidization prospectively by inducing foreign firms not to participate in it.”⁷⁹ This rationale, however, is not

⁷⁷ Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 231 (1999), 1869 U.N.T.S. 14, art. 19 [hereinafter SCM Agreement].

⁷⁸ LUENGO, *supra* note 65, at 28.

⁷⁹ Charles J. Goetz, Lloyd Granet & Warren F. Schwartz, *The Meaning of “Subsidy” and “Injury” in Countervailing Duty Law*, 6 INT’L REV. L. & ECON. 17, 20 (1986).

conceptually sound. Because of the requirement of “injury to domestic industry” as a precondition for CVDs, only a limited number of countries can impose them in response to a subsidy practice. In practice, they have been used infrequently and by only a few nations (the United States has been the only major trading nation to use CVDs extensively).⁸⁰ Thus, according to Professor Sykes, using CVDs sporadically and in an uncoordinated fashion may simply divert subsidized goods to markets that do not employ CVDs rather than discourage subsidies as such.⁸¹ Furthermore, existing national CVD laws do not distinguish between efficient and inefficient subsidies and, thus, it is questionable whether they serve the purpose of increasing global welfare by discouraging market-distorting subsidy practices. Even if an international consensus regarding market-distorting subsidy practices could be reached in the future, unilateral and uncoordinated imposition of CVDs by some countries and not others is likely to have “little systematic deterrent effect.”⁸² Additionally, producers that receive subsidies benefit from them until the country importing the subsidized product decides to impose CVDs. Thus, even if the subsidizing country knows that such protective measures can be adopted, this does not necessarily deter the granting of the subsidy.⁸³ Finally, the deterrence rationale is inconsistent with the current WTO agreements, which prohibit only certain categories of subsidies.⁸⁴ As Professor Diamond has written, adopting this logic is inconsistent with “any

⁸⁰ Sykes, *supra* note 15, at 104.

⁸¹ *Id.*

⁸² Alan O. Sykes, *Second-Best Countervailing Duty Policy: A Critique of the Entitlement Approach*, 21(4) LAW & POL'Y INT'L BUS. 699, 699 (1990).

⁸³ LUENGO, *supra* note 65, at 28.

⁸⁴ SCM Agreement, *supra* note 77, art. 5 (stating that only export subsidies and subsidies contingent upon the use of domestic over imported goods are prohibited).

national position which is hostile to all subsidies or which unilaterally attempts to deter their use.”⁸⁵

Under the alternative neutralization approach, it is not the purpose of CVD law *per se* to evaluate or affect foreign subsidies, instead the use of countervailing duties has the objective of neutralizing *the effects* that the subsidy causes in the country importing subsidized goods. Professor Goetz, Mr. Granet, and Professor Schwartz suggest an “entitlement model” of CVD policy, which has been further developed by Professor Diamond:

We assume that American firms are entitled to that domestic market outcome which would have resulted from a ‘fair’, competitive process, by which is meant one which has not been ‘manipulated’ by foreign government subsidization. The idea then is to restore the competition in the American market to its ‘but for’ state by neutralizing the effect of the subsidy.⁸⁶

Unlike a deterrence-based CVD law, which is based on the benefit a subsidy confers on an exporting firm and sets duty rates sufficiently high to offset that benefit, the entitlement approach focuses on the effect of a subsidy on the cost of the recipient firm’s exports and sets duty rates at the level that offsets any reduction in the marginal costs of exports to the importing country, since that reduction represents the only aspect of a subsidy that can adversely affect the importing country’s producers.⁸⁷

The neutralization approach also seems to be more consistent with current WTO agreements than are other interpretations. The Subsidies and Countervailing Measures Agreement requires that countervailing measures be imposed only following a determination that

⁸⁵ Richard Diamond, *Economic Foundations of Countervailing Duty Law*, 29 VA. J. INT’L L. 767, 780 (1989).

⁸⁶ Goetz, Granet & Schwartz, *supra* note 79, at 18-19.

⁸⁷ See Richard Diamond, *A Search for Economic and Financial Principles in the Administration of United States Countervailing Duty Law*, 21(4) LAW & POL’Y INT’L BUS. 507, 534-38 (1990); Goetz, Granet & Schwartz, *supra* note 79, at 530-37.

the subsidies materially injure producers in the particular export market.⁸⁸ Therefore, as Professor Cass points out, “if remedies are available only where they have certain effects, it is more consistent to interpret the remedial structure as intended to offset those effects than to preclude entirely the underlying practices.”⁸⁹

On the other hand, however, the neutralization theory fails to explain why domestic producers should be entitled to CVDs offsetting injury imposed on them even in situations where foreign subsidization is globally and national-welfare improving.

Some scholars have questioned whether existing national CVD laws are justifiable at all.⁹⁰ In particular, Professor Sykes has expressed deep skepticism of U.S. CVD law and suggested that abolishing it might best serve the national economic interests. He argues that the central features of existing law, such as the specificity test, and the injury test, have no convincing efficiency rationale. Professor Sykes maintains that, despite the fact that competition from abroad can disadvantage domestic producers, it is still desirable for “its ability to promote efficient resource allocation” as it encourages each country “to specialize in the production of goods and services that it can supply relatively more efficiently than other nations.”⁹¹ Although competition with subsidized imports may result in lost profits and economic hardship for workers and their families, these difficulties are no different from hardships that can result from competition with unsubsidized imports or from competition with domestic producers. Therefore, the argument goes, “individuals dislocated by import competition, ‘subsidized’ or not, arguably

⁸⁸ SCM Agreement, *supra* note 77, art. 5(a).

⁸⁹ Ronald A. Cass, *Trade Subsidy Law: Can a Foolish Inconsistency be Good Enough for Government Work?*, 21(4) LAW & POL’Y INT’L BUS. 609, 618 (1990).

⁹⁰ Alan O. Sykes, *Countervailing Duty Law: An Economic Perspective*, 89 COLUM. L. REV. 199-263 (1989); Michael J. Trebilcock, *Is the Game Worth the Candle? Comments on a Search for Economic and Financial Principles in the Administration of US Countervailing Duty Law*, 21 LAW & POL’Y INT’L BUS. 723-37 (1990).

⁹¹ *Id.* at 209.

should enjoy no greater entitlement to government assistance than the victims of other competition.”⁹² Professor Sykes argues that the best way to address this problem is through retraining programs, public employment agencies, and the like, as such programs can reduce the hardships of economic dislocation at a lower cost to the economy than protectionist measures. These programs create fewer short run allocative inefficiencies than CVDs; moreover, they encourage the movement of resources to higher valued uses in the long run.⁹³

From an international perspective, too, Professor Sykes maintains that the existing U.S. CVD laws cannot be justified as part of a larger international system to enforce multilateral constraints on welfare-reducing subsidies. The unilateral imposition of CVDs by a single country will deter subsidization by other governments “only haphazardly.”⁹⁴ In Professor Sykes’s words:

the two systematic benefits to countries that participate in an international agreement to restrict subsidy practices – the constraints on the ability of each government to engage in wasteful subsidization expenditures itself and the elimination of subsidized competition in each country’s export markets – arise only if *other countries* are willing to use countervailing duties systematically against prohibited subsidy practices.⁹⁵

The United States has been the only major trading nation to use CVDs extensively, while other countries impose them only infrequently.⁹⁶ Therefore, unless the duties are imposed multilaterally, they are unlikely to be a useful tool of enforcement.

⁹² *Id.* at 211.

⁹³ *Id.* at 212.

⁹⁴ *Id.* at 260.

⁹⁵ *Id.*

⁹⁶ According to WTO statistics, at the end of 1995 the United States imposed 71 countervailing duties, almost two-thirds of the 111 measures then in place for WTO members. From 1995-2007, 117 new measures were notified. Of that total, 47 were imposed by the United States, 23 by the EU, 11 by Canada, and 36 by a group of 11 other countries. From 2008 to mid-2012, 51 measures were imposed – 27 by the US, 8 by Canada, 6 by the EU and 4 by China. *See* JACKSON, DAVEY & SYKES, *supra* note 44, at 1026.

D. THE RATIONALE FOR DISCIPLINING SUBSIDIES

It is hardly surprising that subsidies are one of the most controversial issues in international trade regulation. There is an inevitable tension between the regulation of subsidies at the international level and the sovereignty of states. On the one hand, governments are free to adopt policies, including the use of subsidies, that they deem to be necessary to achieve their goals, and the reluctance of some states to abandon their sovereignty on certain matters makes it difficult to discipline subsidies at the international level. On the other hand, however, subsidies imply distortions and, thus, reductions in the gains of national as well as international economies. Therefore, while governments “have a collective interest in co-operating to limit the adverse effects on trade, they also have a legitimate interest in seeking to influence economic activity within their jurisdiction.”⁹⁷

There is also a growing concern with the use of subsidies as an alternative form of protection. One of the lessons of the Great Depression is that protectionist policies can quickly and destructively spread from nation to nation. Thus, in the absence of internationally accepted rules on subsidies, governments may be “caught up in a wasteful spiral of escalating emulation.”⁹⁸ As U.S. Congressman David R. Obey put it:

As much as I detest the idea of export subsidies, I guess we have no choice but to participate in the stupidity. Given the general economic collapse, we have to grab at whatever life preservers are around when the ship is going down.⁹⁹

⁹⁷ Terry Collins-Williams, *A Negotiator's Perspective on Enhancing Subsidies' Discipline*, in *WHAT SHAPES THE LAW? REFLECTIONS ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES* 57, 57 (Luca Rubini & Jennifer Hawkins eds., 2016).

⁹⁸ GARY CLYDE HUFBAUER, JOANNA SHELTON-ERB, *SUBSIDIES IN INTERNATIONAL TRADE* 8 (MIT Press 1984).

⁹⁹ Murray A., *Special Report: Export Subsidies*, 357 CONG. Q., Feb. 19, 1983.

The regulation of subsidies at the international level contributes to maximizing the benefits derived from the increasing interdependency of states. At the same time, economists are cautious about over-disciplining subsidies. In particular, Professors Bagwell and Staiger maintain that subsidy disciplines tend to deter tariff concessions, rather than protect them.¹⁰⁰ In their view, the reduction of “policy space” following stricter subsidy disciplines makes countries more reluctant to make tariff commitments in the first place.¹⁰¹ Indeed, the international regulation of subsidies leads to more liberal states, since regulation reduces the level of intervention in their economies. However, a significant strengthening of multilateral discipline on subsidies may ultimately undermine the ability of tariff negotiations to serve as the mechanism for expanding market access.

Disciplining subsidies is a delicate exercise. Unlike tariffs, whose strong negative effects on trade clearly outweigh other policy considerations, subsidies can be used for a variety of important social and economic purposes. Therefore, in creating rules for subsidies, one cannot simply call for their reduction, as has been the approach to tariffs. Instead, there is a need to create a more nuanced regulatory framework that addresses the problems subsidies may cause without limiting the ability of governments to use subsidies for important goals. Thus, creating international rules on subsidies requires:

- (1) defining the principles and objectives that the regulation of subsidies should promote;
- (2) defining the concept of “subsidy” applied in the context of international regulation in order to limit the regulatory effect to “bad” subsidies;

¹⁰⁰ K. Bagwell & R.W. Staiger, *Will International Rules on Subsidies Disrupt the World Trading System?*, 96 AM. ECON. REV. 877, 877-95 (2006).

¹⁰¹ *Id.* at 891 (noting that “an SCM challenge of the home subsidy is worth less to the foreign government if the home government has not bound its tariff, because the home government is then free to adjust its tariff in response to the loss of its subsidy. But this raises the possibility that the home government might be able to avoid an SCM challenge by refusing to bind its tariff in . . . negotiations.”).

(3) defining “good” and “bad” subsidies by distinguishing between subsidies with which governments can accomplish legitimate policy objectives from subsidies that create a distortion in the markets and cause an inefficient allocation of resources; and

(4) defining an adequate response to “bad” subsidies.

III. GLOBAL REGULATION OF SUBSIDIES IN THE PRE-WTO ERA

For most of history, governments were free to grant subsidies in any form and for any reason. The earliest attempts to control such conduct involved clauses in bilateral trade treaties in which states pledged not to grant various kinds of subsidies.¹ The first treaty to contain such a pledge was signed between France and the German Zollverein (the German Customs Union) in 1862.²

Such treaties were “wholly ineffective in suppressing the practice against which they were directed” though,³ which led to the enactment by many countries of countervailing duty (CVD) laws. The first CVD laws were adopted by the United States in 1890⁴ (a law which applied only to certain grades of sugar) and Belgium in 1892.⁵ The latter was the first general CVD law that authorized a government to impose on any imports which had received an export subsidy an additional duty equal to the amount of the subsidy. In a 1927 study for the League of Nations, Trendelenburg reported that, despite the relatively widespread existence of CVD laws,

¹ Professor Jacob Viner identified twenty-nine treaties containing such pledges, mainly between European countries. See JACOB VINER, *DUMPING: A PROBLEM IN INTERNATIONAL TRADE* 166 (University of Chicago Press 1923).

² British and Foreign State Papers (1864-1865), vol. LV 298, 301 (London 1870), <http://babel.hathitrust.org/cgi/pt?id=hvd.hj12n9;view=1up;seq=7> (in this treaty, however, the pledge was unilateral, being given only by France).

³ VINER, *supra* note 1, at 168 (noting that “France, Germany, and Austria, countries which frequently pledged themselves not grant export bounties, were during the life of the treaties containing these pledges the outstanding examples of countries granting export bounties. None of the treaties contained any provision for the enforcement by penalty duties or otherwise of the pledge against bounties.”).

⁴ Tariff Act of 1890, Ch. 1244, § 26 Stat. 567, § 237.

⁵ VINER, *supra* note 1, at 169 (quoting MIHAIL N. COSOIU, *DIE BELGISCHE HANDELSPOLITIK DER LETZTEN 40 JAHRE* 29 (Stuttgart 1914)).

they were rarely used in practice, if at all.⁶ It was only in the 1940s that countries made the first attempt to establish obligations in the field of subsidies in a multilateral framework. In general, the questions for international law were to what extent countries should be allowed to grant, or should be restrained from granting, subsidies, and, on the other hand, to what extent should countries be allowed to take measures to counteract such subsidies.

A. SUBSIDIES AND THE HAVANA CHARTER

1. General Introduction

The initiatives towards the founding international organization for trade began during World War II and were taken principally by the United States, in cooperation with its allies, particularly Great Britain.⁷ The Bretton Woods conference of 1944, which established the International Monetary Fund and the International Bank for Reconstruction and Development, also recognized the need for a comparable international institution for trade to complement them.⁸ In 1945, multilateral trade negotiations started within the framework of the UN Economic and Social

⁶ Ernst Trendelenburg, *Memorandum on the Legislation of Different States for the Prevention of Dumping, with Special Reference to Exchange Dumping*, Geneva: League of Nations, 1927, at 7.

⁷ JOHN H. JACKSON, *WORLD TRADE AND THE LAW OF GATT: LEGAL ANALYSIS OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE* 36-38 (1969) (Professor Jackson observes that these initiatives “stemmed from two strands of American economic policy.” The first strand was the 1934 Reciprocal Trade Agreements Act that enabled the U.S. President to negotiate mutual reductions of tariffs. By 1945, the United States had entered into 32 bilateral agreements reducing tariffs. Weaknesses of the bilateral approach became apparent, however, and a multilateral approach was needed. The second strand of American policy was “the development of ideas during World War II that recognized the need for international economic institutions to prevent the type of “beggar-my-neighbor” policies . . . which, in the minds of many leaders, were responsible to a great degree for World War II itself.”).

⁸ UNITED NATIONS MONETARY AND FINANCIAL CONFERENCE (Bretton Woods, N.H., July 1-22, 1944), *PROCEEDINGS AND DOCUMENTS* 941 (U.S. Dep’t of State Pub. No. 2866, 1948) (The conference recognized that “complete attainment of . . . the purposes and objectives . . . cannot be achieved through the instrumentality of the fund alone”, the conference therefore recommended that governments seek to reach agreement to “reduce obstacles to international trade and in other ways promote mutually advantageous international commercial relations.”).

Council, which adopted a resolution in favor of forming an International Trade Organization (ITO) in 1946.⁹ During this time the United States prepared a Suggested Charter for an International Trade Organization of the United Nations,¹⁰ which was partly the result of the U.S. and British discussions.¹¹ This Suggested Charter formed the basis for negotiations leading finally to the ITO Charter.¹²

Negotiations over the ITO and the international trading system were held in three separate forums. One part of the negotiations focused on drafting the Charter for the ITO institution itself; the second part concentrated on an agreement to reduce tariffs; and the third part focused on drafting the general provisions relating to the tariff obligations. The two latter parts were eventually separated out of the more complete Charter, and came into being as the General Agreement on Tariffs and Trade (GATT).¹³ The idea was that the GATT would be a specific trade agreement within the broader institutional context of the ITO Charter and that the ITO would provide the organizational support for the GATT.¹⁴ After several rounds of

⁹ 1 U.N. ECOSOC Res. 13, U.N. Doc. E/22 (1946).

¹⁰ U.S. Suggested Charter, Dep't of State Pub. No. 2598 (1946).

¹¹ RICHARD N. GARDNER, *STERLING-DOLLAR DIPLOMACY* 145-61, 269-71 (1956) (The Suggested Charter was largely based on the Proposals for Consideration by an International Conference on Trade and Employment drafted by the British and U.S. negotiators in the fall of 1945. In Professor Gardner's word, "[w]ithout agreement between these two countries, progress on the Charter would be impossible.").

¹² JACKSON, *supra* note 7, at 41.

¹³ General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT 1947].

¹⁴ JACKSON, *supra* note 7, at 43; *see also* William Diebold, *Reflections on the International Trade Organization*, 14 N. ILL. U. L. REV. 335, 336 (1993-1994) (stating that "the best way of fitting together GATT and the ITO is to think of the GATT agreement as the chapter of the ITO Charter dealing with traditional trade restrictions.").

negotiations,¹⁵ fifty-three countries participating in the Havana Conference completed work on the ITO Charter.¹⁶ The Havana Charter was signed on March 24, 1948.¹⁷

The Havana Charter never entered into force. In the U.S. election of 1948, the Republicans won control of the U.S. Congress and it soon became clear that Congress would not ratify the agreement. In 1950, President Truman eventually decided that he would no longer seek congressional approval for the ITO. Since ITO membership by the United States, the world's leading economy and trading nation at the time, was crucial, the remaining countries abandoned the effort, and the ITO was never formed.¹⁸

Although never adopted, the Charter was the most comprehensive economic agreement for the times. It dealt with a large number of segments of international trade not usually covered in previous trade negotiations, such as foreign investment,¹⁹ labor standards,²⁰ employment,²¹ and economic development.²² For the first time in an international agreement, the Charter recognized the dependence of free trade upon the maintenance of stability and the importance of

¹⁵ Four conferences were held to draft the GATT and the ITO Charter: London (1946), New York (1947), Geneva (1947) and Havana (1947-1948).

¹⁶ Those countries were Afghanistan, Australia, Austria, Belgium, Bolivia, Brazil, the Union of Burma, Canada, Ceylon, Chile, China, Colombia, Costa Rica, Cuba, Czechoslovakia, Denmark, the Dominican Republic, Ecuador, Egypt, El Salvador, France, Greece, Guatemala, Haiti, India, Indonesia, Iran, Iraq, Ireland, Italy, Lebanon, Liberia, Luxembourg, Mexico, the Netherlands, New Zealand, Nicaragua, Norway, Pakistan, Panama, Peru, Philippine, Portugal, Southern Rhodesia, Sweden, Switzerland, Syria, Transjordan, the Union of South Africa, the United Kingdom, the United States, Uruguay, and Venezuela.

¹⁷ Final Act of the UN Conference on Trade and Employment (U.N. Doc. ICITO/1/4, April 1948) [hereinafter Havana Charter].

¹⁸ William Diebold also argued that one of the factors leading to the demise of the ITO was that “the ITO promised mainly longrun gains; any shortrun gains in opening the American market and liberating trade in the rest of the world to help European recovery would have to come largely through GATT and the Marshall Plan.” See Diebold, *supra* note 14, at 341.

¹⁹ Havana Charter, *supra* note 17, art. 12.

²⁰ *Id.*, art. 7.

²¹ *Id.*, arts. 2, 3.

²² *Id.*, Ch. III.

maintaining stability through measures that do not restrain trade.²³ Furthermore, it was recognized that trade liberalization cannot be achieved only by means of traditional trade negotiations; there was the need for establishing international rules that related to the domestic policies of diverse countries. In the words of William Diebold, “it was necessary to break new ground in international economic relations and also to permit international agreements to influence domestic economic measures to an unprecedented degree.”²⁴ Unlike many previous agreements, the Charter did not “confine itself to resolutions and recommendations, but set[] forth a series of series of specific commitments with binding force on governments.”²⁵ In sum, the Charter contained significant commitments that were more extensive than those assumed in any previous international economic agreement.²⁶

2. Regulation of Subsidies in the Havana Charter

Although the ITO Charter never came into force, its provisions on subsidies constitute the first multilateral attempt to regulate this area. More importantly, the ITO Charter greatly influenced the GATT since most of the provisions introduced in Article XVI of the GATT originated from

²³ Clair Wilcox, *The Promise of the World Trade Charter*, 27(3) FOREIGN AFFAIRS 486, 491 (1949).

²⁴ Diebold, *supra* note 14, at 336.

²⁵ Wilcox, *supra* note 23, at 487.

²⁶ Professor Robert Hudec, nevertheless, expressed the view that

[governments were unable to accept any serious change in existing policy, or even close supervision . . . Judging by their conduct, the governments were of the view that the Charter had almost no chance of prevailing over any important domestic interest which was then receiving more protection than a desired rule would have allowed. On the other hand, these governments did accept quite detailed legal obligations where those obligations did not require any major changes in existing law or practice.]

See ROBERT E. HUDEC, *THE GATT LEGAL SYSTEM AND WORLD TRADE DIPLOMACY* 21 (2d ed. 1990).

this Charter.²⁷ Thus, it is helpful to explore in more details the provisions of the Charter dealing with subsidies.

In general, the ITO Charter reflects a balanced approach to any kind of government assistance, stating that such assistance is “justified” if it is granted “to promote the establishment, development or reconstruction of particular industries or braches of agriculture”²⁸ in the Member states. Yet, at the same time, “an unwise use of such measures would impose undue burdens on their own economies and unwarranted restriction on international trade, and might increase unnecessarily the difficulties of adjustment for the economies of other countries.”²⁹

Chapter IV of the Charter (Commercial policy) contains four articles dealing with subsidies (Section C).³⁰ The Charter provides a fairly broad understanding of a subsidy, as “any form of income or price support, which operates directly or indirectly to maintain or increase exports of any product from, or to reduce, or prevent an increase in, imports of any product into, its territory.”³¹ Domestic subsidies are not prohibited. Article 25, however, imposes a general obligation on the Members to notify the ITO of any subsidies and their possible effect.³² The obligation to discuss with other Members the possibility of limiting the subsidization is only established for cases where a subsidy caused or threatened to cause serious prejudice to the interests of other Members.³³

Export subsidies, on the other hand, are prohibited when they result in the sale of a product for export at a price lower than the comparable price charged for the like product to

²⁷ See *infra* Section B.

²⁸ Havana Charter, *supra* note 17, art. 13.1.

²⁹ *Id.*

³⁰ *Id.*, arts. 25-28.

³¹ *Id.*, art. 25.

³² *Id.*

³³ *Id.*

buyers in the domestic market.³⁴ There are three exceptions to the general rule for export subsidies. First, the use of export subsidies is allowed in order to offset a subsidy granted by a country that is not a Member of the ITO.³⁵ Second, a system for the stabilization of the domestic price of a primary commodity,³⁶ which results at times in the sale of the commodity for export at a price lower than the comparable prices charged for the like commodity to buyers in the domestic market, are not considered export subsidies.³⁷ Finally, Article 28 prohibits any ITO Member from granting any form of subsidy, which operates directly or indirectly to maintain or increase the export of any primary commodity from its territory in such a way as to have the effect of maintaining or acquiring for that Member more than an equitable share of world trade in that commodity.³⁸ Therefore, as for export subsidies for primary products, it seems that they are not prohibited as long as they are not employed for the purpose of sustaining or increasing share of the world's trade. As Professor Clair Wilcox, vice-chairman of the U.S. Delegation to the Havana Conference, observed in 1949, "the wording adopted at Havana is so broad that it will probably permit any country to subsidize the exportation of primary commodities."³⁹

³⁴ *Id.*, art. 26.1. (Members had to comply with this obligation after the Charter would have been in force two years, a period which may be extended, upon request, by the ITO (art. 26.3)).

³⁵ *Id.*, art. 26.4. (In order to neutralize the injury that a subsidy of one Member caused in another Member's territory, it is only allowed to impose countervailing duties (art. 34.4)).

³⁶ Primary commodity is "any product of farm, forest or fishery or any mineral, in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade." *Id.*, art. 56.

³⁷ *Id.*, art. 27.1 (In order to fall under this exception to the general prohibition of export subsidies, such price stabilization system has to (1) be designed as to result in the sale of the commodity for export at a price higher than the comparable price charged for the like commodity to buyers in the domestic market, and (2) operate in such a way that they neither stimulate exports unduly nor cause serious prejudice to the interests of other members.)

³⁸ *Id.*, art. 28.1.

³⁹ CLAIR WILCOX, A CHARTER FOR WORLD TRADE 127-28 (New York 1949).

B. SUBSIDIES IN THE GATT OF 1947

In the absence of the ITO, the GATT filled this void and assumed the role that had been assigned to the ITO.⁴⁰ However, since this agreement originally had been designed to record the results of tariff negotiations, the GATT did not include either the Charter's organizational provisions or most of its substantive chapters. Basically, only the chapter on "Commercial Policy" was transferred to the GATT, and even there some provisions were altered.

The substantial reduction of tariffs is, together with the elimination of discrimination, the key instrument of the GATT for achieving its overall objectives. In fact, the GATT was very successful in reducing tariffs on trade in goods, in particular on industrial goods.⁴¹ Nevertheless, with respect to the reduction of non-tariff barriers, it was notably less successful. In particular, there has been great difficulty in obtaining a consensus on any common approach to regulating subsidies. According to Professor Jackson, the difficulty in reaching such a consensus reflected a view that subsidies were a preferable means of protection, as compared with tariffs or quotas: subsidies can promote and expand international trade because they lower the price of a product, which will encourage consumption.⁴² Thus, initially the provisions on subsidies in the GATT

⁴⁰ Contracting parties agreed upon the provisional application of the GATT by signing a Protocol of Provisional Application.

⁴¹ In the late 1940s, before the creation of the GATT, the average duty on industrial products imposed by developed countries was about 40 percent *ad valorem*. After the tariff negotiations, this average has been reduced to about 3.9 percent *ad valorem*.

⁴² JACKSON, *supra* note 7, at 367-69 (stating that it was the U.S. view at the preparatory meetings in London (1946), though it proposed to distinguish domestic subsidies that should be allowed, but requiring notification and consultation, from export subsidies that should be prohibited. However, a group of less-developed and primary product-exporting countries opposed this view arguing that "both production and export subsidies could effectively result in oversupply on the world market and unfairly restrict some countries' exports"; in particular, the Australian delegation argued that "export and production subsidies should be treated in the same manner, both being prohibited when there were harmful effects, both being allowed where no harmful effect occurred," Brazil went even further suggesting that all subsidies should be prohibited.).

were extremely limited, further efforts to increase the obligations on subsidies led to amendments of the GATT in 1955.

1. Regulation of Subsidies in the GATT

Article XVI of the GATT, which sets out the basic rules to discipline subsidies, is based on a much shortened version of the Havana Charter's provisions on subsidies. The Charter contained two sets of rules regarding subsidies: general obligations to notify subsidies and to discuss the possibility of their limiting (Article 25 of the Charter) and the prohibition of export subsidies (Articles 26-28 of the Charter). Only the former survived in the original version of GATT. Article XVI of the GATT initially consisted of one paragraph, containing simply a requirement that any contracting party that maintains a subsidy must *notify* the GATT Contracting Parties "of the extent and nature of the subsidization, of the estimated effect of the subsidization . . . and of the circumstances making the subsidization necessary,"⁴³ and be prepared to *discuss* the possibility of limiting the subsidization with affected contracting parties.⁴⁴ Such limited provisions could be explained by the fact that the GATT provisions should have been "temporary" until the adoption of the Havana Charter. Professor Jackson also points out that the important reason why the export subsidy prohibition was not carried into the GATT was the U.S.

⁴³ In practice, the Contracting Parties have made periodic requests for complete notifications of all subsidies currently in effect. This is done in the form of a questionnaire that is sent out by the Secretariat. The first request for notifications came in March of 1950. However, governments were reluctant to notify their subsidies since they were afraid that such notification would encourage other countries to adopt countervailing measures. See Jackson, *supra* note 7, at 388-89.

⁴⁴ GATT 1947, *supra* note 13, art. XVI:1.

position that the executive authority of the U.S. government did not permit an undertaking with regard to export subsidies.⁴⁵

The precise scope of GATT Article XVI is also not entirely clear because there is no general definition of the term “subsidy” in the GATT.⁴⁶ Just as the Havana Charter did, Article XVI contains two characteristics of the concept of “subsidy.” First, it suggests the broad use of the word “subsidy” that includes “any form of income or price support.” Second, such a measure must have the effect of directly or indirectly increasing exports of any product from the Contracting Party’s territory or reducing imports of any product into its territory.⁴⁷ Although it seems that the language of the Article suggests that it only applies to subsidies that increase exports or reduce imports, a GATT panel concluded that it is not sufficient “to consider increased exports or reduced imports only in a historical sense.”⁴⁸ The panel report further noted that the phrase “increased exports” was intended “to include the concept of maintaining exports at a level higher than would otherwise exist in the absence of the subsidy.”⁴⁹ Thus, in assessing whether exports were increased or imports were reduced, the criterion is what would happen *in the absence* of a subsidy.

Article VI of the GATT authorizes Contracting Parties to countervail against domestic and export subsidies. At the same time, the GATT imposes two important limitations on this unilateral defense mechanism. First, countervailing measures may only be imposed when a

⁴⁵ JACKSON, *supra* note 7, at 370.

⁴⁶ Nevertheless, a GATT panel later concluded that “the lack of a precise definition had not, in practice, interfered with the operation of Article XVI.” *See* GATT, 10th Supp. BISD 201, para. 23, at 208 (1962); as Collins-Williams and Salembier quipped “[i]t was possible for the best minds of the day to proceed on a basis that might be described as ‘I know one when I see one.’” *See* Terry Collins-Williams & Gerry Salembier, *International Disciplines on Subsidies: The GATT, the WTO and the Future Agenda*, 30 J. WORLD TRADE 5, 6 (1996).

⁴⁷ GATT 1947, *supra* note 13, art. XVI.

⁴⁸ GATT, 9th Supp. BISD 188, 191 (1961).

⁴⁹ *Id.* at 191, *quoted from* GATT, 2 BISD 44 (1952).

subsidy causes or threatens to cause material injury to the domestic industry.⁵⁰ Second, the maximum amount of such CVD could not exceed the amount of “estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product.”⁵¹ The former requirement was intended to reduce the possibility that CVDs would be imposed at will on any product as a protectionist tool. However, the United States, the only country that actively used these measures, was exempted from using the injury test,⁵² which obviously reduced the effectiveness of Article VI. Article VI does not contain a definition of a subsidy. In the view of Professor Barceló, “GATT’s failure to link countervailing duties to the direct regulation of subsidies in Article XVI compounds the unboundedness of the Article VI language.”⁵³ In fact, a country may impose countervailing measures even if the subsidy involved does not violate Article XVI.⁵⁴

In sum, the GATT initially allowed Contracting Parties to offset the effect of subsidies only unilaterally by imposing CVDs (applying their own definition of a subsidy) and did not impose any direct restraints on the subsidizing government’s practices (countries were only obliged to notify their subsidies and to discuss, upon request, the possibility of limiting the subsidy).⁵⁵ In the words of Collins-Williams and Salembier, at this stage, the problem of

⁵⁰ GATT 1947, *supra* note 13, art. VI:6.

⁵¹ *Id.*, art. VI:3.

⁵² ROBERT O’BRIEN, SUBSIDY REGULATION AND STATE TRANSFORMATION IN NORTH AMERICA, THE GATT AND THE EU 107 (1997) (noting that “[t]hey successfully argued that since their law predated the GATT and did not contain an injury measure, the GATT provisions were not applicable”). *See also* Protocol of the Provisional Application of the 1947 GATT (Part II of the GATT applied only “to the fullest extent not inconsistent with existing legislation.”) (UNTS 308, BISD IV/77, TIAS 1700).

⁵³ John J. Barceló III, *A History of GATT Unfair Trade Remedy Law: Confusion of Purposes*, 517 CORNELL LAW FACULTY PUBLICATIONS 311, 324 (1991).

⁵⁴ Contracting Parties to the General Agreement on Tariffs and Trade, *Antidumping and Countervailing Duties, Report of the Group of Experts* 20-21 (1961).

⁵⁵ There is no record of any country ever having limited a subsidizing practice as a result of consultation under Art. XVI.

subsidies “was given a simple solution: countervailing duties up to the amount of the subsidization.”⁵⁶

2. The Reforms of 1955

As it was evident that Article XVI in its original version was insufficient, in 1955 the Contracting Parties decided to increase the obligations on subsidies and amended Article XVI by adding Section B, which consists of paragraphs 2, 3, 4, and 5. They also added Interpretive Notes to Article XVI, in Annex I of the GATT. Most of the modifications originated from the Havana Charter’s provisions on *export* subsidies.⁵⁷

Section B distinguishes export subsidies on non-primary products that are totally prohibited from export subsidies on primary products that, in many cases, are permitted. This asymmetry in the treatment of subsidies on primary and non-primary products reflected the interests of the United States and Europe, where agriculture traditionally had been heavily protected.⁵⁸ Likewise, developing countries were unwilling to limit their ability to grant subsidies for primary products, especially when tariffs for manufactured products had been substantially removed, while tariffs for agricultural products (which were the main products exported by these countries) experienced only an insignificant reduction.⁵⁹

⁵⁶ Collins-Williams & Salembier, *supra* note 46, at 6.

⁵⁷ Havana Charter, *supra* note 17, arts. 26, 27 and 28.

⁵⁸ O’BRIEN, *supra* note 52, at 106-07.

⁵⁹ GUSTAVO E. LUENGO HERNÁNDEZ DE MADRID, REGULATION OF SUBSIDIES AND STATE AIDS IN WTO AND EC LAW: CONFLICTS IN INTERNATIONAL TRADE LAW 48 (2007).

a. Non-Primary Products Under GATT Article XVI:4, which basically echoes the provisions of Article 26 of the Havana Charter, all export subsidies for non-primary products, which result in “the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market,”⁶⁰ should have been abolished by 1 January 1958.⁶¹ The second sentence of this paragraph contained a “standstill” provision: an obligation not to introduce new or to extend existing subsidies until 31 December 1957⁶²; since it was anticipated that by that time GATT members would have reached the agreement on the prohibition of all export subsidies on non-primary products.⁶³

The agreement was not reached by 1958. In 1960, under French leadership the Contracting Parties were finally able to agree on the text of a Declaration Giving Effect to the Provisions of Article XVI, Paragraph 4⁶⁴ that also elaborated a non-exhaustive list of measures considered to be export subsidies.⁶⁵ The Declaration, and the prohibition, were to become effective on the date on which the more developed European countries, the United States, and Canada all accepted the Declaration. As Kenneth Dam pointed out, developed countries were

⁶⁰ GATT panel later concluded that “from an economic point of view, there was a presumption that an export subsidy would lead to any or a combination of the following consequences in the export sector: (a) lowering of prices, (b) increase of sales effort, and (c) increase of profits per unit.” See Panel Report, *Tax Legislation – Income Tax Practices Maintained By France*, L/4423, adopted December 7-8, 1981, BISD 23S/114; Panel Report, *Tax Legislation – Income Tax Practices Maintained By Belgium*, L/4424, adopted December 7-8, 1981, BISD 23S/127; Panel Report, *Tax Legislation – Income Tax Practices Maintained By The Netherlands*, L/4425, adopted December 7-8, 1981, BISD 23S/137.

⁶¹ GATT 1947, *supra* note 13, art. XVI:4.

⁶² *Id.*

⁶³ Interpretative Note, Ad art. XVI, para. 4.

⁶⁴ Declaration Giving Effect to the Provisions of Article XV:4 of the GATT, 1960 (Agreement No. 69 in App. C); GATT, 9th Supp. BISD 32 (1961).

⁶⁵ This list was the precursor to the illustrative List of Export Subsidies, contained in Annex to the WTO SCM Agreement.

prepared to agree to prohibit export subsidies, but only in a concerted move.⁶⁶ Ultimately, only 17 countries accepted the Declaration,⁶⁷ which came into force for them on 14 November 1962. Accordingly, the first sentence of Article XVI:4 (obligation to abolish all subsidies on non-primary products) was only in force for the seventeen contracting parties; the standstill clause contained in the second sentence of Article XVI:4 (obligation not to introduce new subsidies), which had been extended by a series of declarations beginning in 1957, expired on 31 December 1967.

b. Primary Products Article XVI:3 of the GATT generally follows the language of Article 28 of the Havana Charter. While not prohibiting export subsidies on primary goods, it sets out a trade effects test in an attempt to limit the use of such subsidies. Contracting Parties should “seek to avoid” the use of subsidies on the export of primary products; if, however, they use “any form of subsidy,” they are not to apply such subsidies so as to get “more than an equitable share of world export trade in that product.”⁶⁸ The language of this Article, where the first part of the provision refers to “export subsidies,” while the second part relates to “any form of subsidy” that has the effect of increasing exports of a primary product, seems to suggest that it covers not only export subsidies but also any domestic subsidies that lead to this effect.⁶⁹

This Article has been a subject of substantial criticism, mainly from the primary goods-exporting countries, not only because there is no economic logic in the different treatment of

⁶⁶ KENNETH W. DAM, *THE GATT: LAW AND INTERNATIONAL ECONOMIC ORGANIZATION* 145 (1970) (stating that “this was one of the first times that . . . the Contracting Parties formally recognized that developing countries should be treated differently from developed countries.”).

⁶⁷ Those countries are Austria (with reservations), Belgium, Canada, Denmark, France, Federal Republic of Germany, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Southern Rhodesia, Sweden, Switzerland, the United Kingdom (with reservations), and the United States (with reservations).

⁶⁸ GATT 1947, *supra* note 13, art. XVI:3.

⁶⁹ JACKSON, *supra* note 7, at 393.

subsidies on primary and non-primary goods, but because the concept of “equitable share” refers to share in “world” export trade of a particular product and not to trade in that product in an individual market.⁷⁰ In particular, Australia argued that:

by referring to equitable” shares of world trade” and not “individual markets” the Article sought to solve the problem of primary product for the wrong end, since the danger of export subsidies was greatest in individual markets. It was possible to argue that notwithstanding damage being done by subsidization in individual markets a country’s total share of world exports was not being increased.⁷¹

This provision clearly generates problems of interpretations. The phrase “more than an equitable share of world export trade” has been described by Professor Jackson as “the most difficult interpretive problem of paragraph 3.”⁷² Professor Colin Phegan, too, points to the problem of the shift “from prohibition of export subsidies as such, defined in relatively simple and concrete terms, to prohibition of export subsidies having a certain trade effect, measured only by a criterion which is exceptionally flexible and uncertain.”⁷³ In particular, he questions whether any increase in a country’s share of world export trade is “equitable.” He also fears that it would be difficult to establish a causal connection between the subsidy and the increase in the share of world export trade in practice.⁷⁴ For example, in the *EEC-Refunds on Exports of Sugar* case, where Brazil and Australia argued that refunds on sugar exports applied by the European Community were inconsistent with Article XVI:3, the Panel could not reach a definite conclusion that the increased share had resulted in the EC “having more than equitable share of

⁷⁰ The French delegation, supported by Australia, Uruguay, the Dominican Republic, Canada, and Italy argued that the words “world markets” should be construed as meaning “individual markets.” However, the United States delegation refused to accept the “individual market” concept and the wording remained as it is. See JACKSON, *supra* note 7, at 394-95.

⁷¹ GATT Doc. SR. 9/41, at 3 (1955).

⁷² JACKSON, *supra* note 7, at 393.

⁷³ Colin Phegan, *GATT Article XVI.3: Export Subsidies and “Equitable Shares,”* 16 J. WORLD TRADE L. 251, 255 (1982).

⁷⁴ *Id.* at 255-61.

world trade in that production.”⁷⁵ Although the Panels concluded that the EC enjoyed a significant increase in share of world trade while Australia and Brazil suffered a decline, these may have been explained by factors other than the effect of EC refunds on export.⁷⁶

In sum, after the reforms of 1955 Article XVI of GATT established the subsidy discipline initially foreseen in the Havana Charter: (1) *general* obligations to notify subsidies and to discuss, upon request, the possibility of their limiting; (2) the prohibition of *export* subsidies for *non-primary* products, provided that the subsidy results in a lower price in the export market than in the domestic market (only in force for certain, mostly developed countries); and (3) subsidies for *primary* products are permitted except where the subsidy results in the subsidizing country having more than an equitable share of world export trade. Dominic Coppens observes that these amendments introduced three types of bifurcation that were already present during the GATT/ITO negotiations.⁷⁷ First, given that export subsidies are more distortional and harmful than domestic subsidies, countries disciplined export subsidies first, and only at a later stage (and to a lesser extent) disciplined domestic subsidies. Second, because of the negotiating power of subsidizing developed countries, disciplines on agricultural subsidies are less severe than those on industrial subsidies. Finally, the disciplines were first concluded among developed countries and only later were gradually extended to developing countries. Coppens notes that “all three

⁷⁵ *EEC-Refunds on Exports of Sugar: Australia’s Complaint*, Panel’s report adopted on 6 November 1979 (L/4833), at 319(f).

⁷⁶ *Id.* (Australia and Brazil were parties to the International Sugar Convention, which imposed an obligation to limit export of sugar to their minimum levels. The EC did not join the Convention and, therefore, were under no such constraints.).

⁷⁷ DOMINIC COPPENS, *WTO DISCIPLINES ON SUBSIDIES AND COUNTERVAILING MEASURES: BALANCING POLICY SPACE AND LEGAL CONSTRAINTS* 26-27 (Cambridge University Press 2014).

types of asymmetries would gradually contract over the next decades, although they are still present today.”⁷⁸

C. TOKYO ROUND SUBSIDIES CODE OF 1979

Unlike the first six GATT negotiating rounds, which were focused almost exclusively on reducing tariffs,⁷⁹ the purpose of the Tokyo Round (1973-1979) expanded to non-tariff measures and systemic issues.⁸⁰ The Tokyo Round Subsidies Code, which entered into force in 1980, was a significant outcome of the negotiations.⁸¹ In essence, the Subsidies Code constituted an uneasy compromise between the United States and the EC.

The United States sought to strengthen international rules on the use of subsidies during the Tokyo Round.⁸² While the United States was, in general, opposed to subsidization, most of

⁷⁸ *Id.* at 27.

⁷⁹ Geneva (1947), Annecy (1949), Torquay (1951), Geneva (1956), Dillon (1960-1961), and Kennedy Round (1964-1967).

⁸⁰ The Tokyo Round negotiations were officially opened in 1973 (BISD, 20th Supp. 1973). They developed the Agreements on Technical Barriers to Trade, Government Procurement, Interpretation and Application of Articles VI, XVI and XXIII (Subsidies), Arrangement Regarding Bovine Meat, International Dairy Arrangement, Implementation of Article VII (Custom Valuation), Import Licensing Procedures, Trade in Civil Aircraft, and Implementation of Article VI (Anti-Dumping Duties), as well as Understandings on Differential and More Favorable Treatment of Developing Countries, Declaration on Trade Measures Taken for Balance-of-Payment Purposes, Safeguard Action for Development Purposes, and Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance.

⁸¹ Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (MTN/NTM/W/236, 5 April 1979) [hereinafter Subsidies Code].

⁸² The report of the Senate Finance Committee on the 1974 Act set the goal:

In the long run, United States interests will be best served by an international agreement to eliminate subsidies which distort world trade patterns and discriminate against United States sales both at home and abroad. Central to the forthcoming multilateral negotiations should be the establishment of acceptable international rules governing the use of subsidies.

S. REP. NO. 1298, 93d Cong., 2d Sess. 183 (1974), *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 7186, 7318.

its trading partners viewed subsidy programs as important tools of national policy.⁸³ At the beginning of the Tokyo Round the U.S. position was that the issue of limiting subsidies in all their aspects (export, domestic and agriculture) was more important than the issue of adopting countervailing measures against them. In their view, if countries eliminated offensive subsidy practices, there would be no need for CVDs at all.⁸⁴

In contrast, the EC, as well as developing countries, were unconcerned about subsidization. They instead insisted on disciplining the extensive use of CVDs by the United States. Under U.S. law, CVDs could be imposed merely upon determination of a subsidy, without assessing the injury to the domestic industry caused by the subsidized imports.⁸⁵ Thus, the EC wanted the United States to commit itself to an injury standard in accordance with GATT Article VI, and to include a test for material injury caused by a subsidy as a prerequisite to adopting CVDs.

Eventually, the United States and the EC achieved what Professor Andreas Lowenfeld described as two compromises.⁸⁶ First, in return for a prohibition on export subsidies, the United States agreed to apply the injury test. Second, in exchange for a more permissive attitude on domestic subsidies, the determination relevant to imposition of CVDs was left, as before, to the authorities of the importing country. As soon as the United States and the EC reached the

⁸³ Richard R. Rivers & John D. Greenwald, *The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences*, 11 LAW & POL'Y INT'L BUS. 1447, 1452-53 (1979) (noting that "[i]n key European countries such as France, Great Britain and Italy, government aid to industry, in various forms, had become routine. In the agricultural sector, the Europeans had gone so far as to institutionalize export subsidies A number of developing countries, in particular, had planned their development around export-led growth. In order to encourage export sales, they had developed various . . . forms of government incentives.").

⁸⁴ O'BRIEN, *supra* note 52, at 110-11.

⁸⁵ The U.S. countervailing duty law (1897) dated from before GATT 1947 and was therefore grandfathered from Article VI of the GATT.

⁸⁶ ANDREAS F. LOWENFELD, *INTERNATIONAL ECONOMIC LAW* 209-10 (Oxford University Press 2002).

agreement, other states such as Canada and Japan were included in negotiations. Later negotiations brought in the developing countries.

The United States ratified the Code on a conditional most-favored-nation basis, affording the injury test only to the Subsidies Code signatories.⁸⁷ This resulted in a series of bilateral negotiations between the United States and a number of countries, mostly developing ones, wherein the United States agreed to provisionally apply the Code and the injury test to those countries in exchange for their accession to the Code and commitment to reduce certain subsidy practices. Consequently, about a dozen developing countries (including Brazil and India) were “encouraged” to join the Code.⁸⁸ Ultimately, the Subsidies Code only applied to the twenty-four countries that signed and ratified it.

1. Track I – Countervailing Duties

Reflecting the compromise between the United States and the EC, the Subsidies Code is divided into two Tracks: Track I deals with the adoption of CVDs and Track II focuses on obligations on subsidies. Under Article 2 of the Subsidies Code, CVDs could be imposed only pursuant to an investigation by authorities of importing country, which should determine: (1) the existence of a subsidy; (2) material injury to the domestic industry; and (3) a causal link between the subsidized imports and the injury.⁸⁹

⁸⁷ SCM/M/3, 27 June 1980, at 3-9; SCM/W/116, 5 September 1986; MTN.GNG/NG10/W/4, 28 April 1987, at 87-93. U.S. legislation therefore specified that only selected countries could benefit from the injury test provision. These selected countries (known as “covered by the Agreement”) included signatories of the Subsidies Code, but only on the following conditions: the President of the United States had to determine that these signatories “accorded adequate benefits, including substantially equal competitive opportunities for the commerce of the United States.” (19 U.S.C. § 2503(b)).

⁸⁸ Andrew L. Stoler, *The Evolution of Subsidies Disciplines in GATT and the WTO*, 44 J. WORLD TRADE 797, 802 (2012); R.E. IN THE GATT LEGAL SYSTEM 83-89 (1987).

⁸⁹ Subsidies Code, *supra* note 81, art. 2.1.

Although the Code elaborated significantly on the provisions of GATT Article VI, it did not contain a definition of subsidy. The lack of such a definition gave countries certain flexibility when establishing the existence of a subsidy for adopting CVDs. As Professor Barceló pointed out, as there is nothing in the Code that specifically links the Track II subsidy definition language to Track I, an importing country can apply its own unilateral definition of a subsidy.⁹⁰ The absence of an explicit link between Track I and Track II also raises questions whether countervailing duties may be levied against both export and domestic subsidies without distinction, and whether they may be imposed against subsidies that are consistent with the GATT. The position of the EC was that Track II definitions should be read into Track I, and domestic subsidies should be countervailed only if they represent disguised export subsidies.⁹¹ The U.S. investigative authorities, on the other hand, took the position that they are authorized to impose CVDs even against subsidies that are expressly permitted by the Code as long as they cause material injury to the U.S. domestic industry.⁹²

According to Article 6.1 of the Subsidies Code, a determination of injury should involve an examination of both (a) the volume of subsidized imports and their effect on prices in the domestic market for like products, and (b) the consequent impact of these imports on domestic producer of such products.⁹³ As for the causal link, negotiators rejected the initial proposal to borrow the language from the Antidumping Code (1967), according to which dumped imports must be “demonstrably the principal cause” of material injury to a domestic industry,⁹⁴ on the

⁹⁰ Barceló, *supra* note 53, at 327.

⁹¹ *Id.* at 329 and n.53.

⁹² David Simon, *Can GATT Export Subsidy Standards Be Ignored by the United States in Imposing Countervailing Duties?*, 5 NW. J. INT'L L. & BUS. 183, 197-204 (1983).

⁹³ Subsidies Code, *supra* note 81, art. 6.1.

⁹⁴ Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, June 30, 1967, 19 U.S.T. 4348, T.I.A.S. No. 6431, art. 3(a).

ground that this standard is difficult to meet.⁹⁵ Eventually, the parties agreed to a Canadian formula: “[i]t must be demonstrated that the subsidized imports are through the effects of the subsidy, causing injury within the meaning of this Agreement.”⁹⁶ Although the Subsidies Code does not require that the subsidized imports are the principal cause of the injury, Article 6.4 also contains a non-attribution requirement. According to this requirement, investigating authorities must examine any known factors other than the subsidized imports that are injuring the domestic industry at the same time and they must not attribute the injury caused by these other factors to the subsidized imports.⁹⁷

Under the Code, CVDs may not be in excess of the amount of the subsidy.⁹⁸ It is, however, desirable that the level of CVDs be less than the total amount of the subsidy if such lesser duty would be adequate to remove the injury to the domestic industry.⁹⁹ Nevertheless, the United States rejected this suggestion. Its statute provided that “there shall be imposed . . . a countervailing duty . . . equal to the amount of subsidy.”¹⁰⁰ The EC, on the other hand, provided that “[t]he amount of countervailing duties shall not exceed . . . the amount of the subsidy . . . established; it should be less if such lesser duty would be adequate to remove the injury.”¹⁰¹

⁹⁵ Rivers & Greenwald, *supra* note 83, at 1484.

⁹⁶ Subsidies Code, *supra* note 81, art. 6.4

⁹⁷ *Id.*

⁹⁸ *Id.*, art. 4.2.

⁹⁹ *Id.*, art. 4.1.

¹⁰⁰ Trade Agreement Act of 1979, § 701(a), 19 U.S.C. § 1671(a)

¹⁰¹ Council Regulation (EEC) No. 2176/84 of 23 July 1984, 27 OJ L 201/1, art. 13(3) (1984).

2. Track II – Obligations on Subsidies

Track II of the Subsidies Code provides for an interpretation of the provisions of GATT Article XVI. In general, signatories agreed that subsidies are widely used by governments to promote social and economic policy objectives,¹⁰² but, on the demand of the U.S., they also acknowledged that they could adversely affect other signatories.¹⁰³

a. Export Subsidies The most significant improvements in the area of export subsidies were those dealing with non-primary products. Subsidies still were not defined; however, an Annex provided a comprehensive list of illustrations of what is meant by export subsidies on non-primary products.¹⁰⁴ This illustrative list, built on the 1960 Declaration,¹⁰⁵ is the beginning of what would later be the red category of prohibited subsidies.

The GATT prohibits subsidies granted on non-primary products, provided that the export subsidy results in dual pricing: a lower price in the export market than in the domestic market.¹⁰⁶ This emphasis on price discrimination was subject to criticism because it made little economic sense and was difficult to prove. Trade distortions could result from export subsidies without price effect being evident.¹⁰⁷ The Code does not repeat the price comparison criterion.¹⁰⁸ It

¹⁰² Subsidies Code, *supra* note 81, art. 8.1.

¹⁰³ *Id.*

¹⁰⁴ Subsidies Code, *supra* note 81, art. 9.2 and Annex “Illustrative list of Export Subsidies.”

¹⁰⁵ Declaration Giving Effect to the Provisions of Article XV:4 of the GATT, *supra* note 64.

¹⁰⁶ GATT 1947, *supra* note 13, art. XVI:4.

¹⁰⁷ John J. Barceló III, *Subsidies and Countervailing Duties – Analysis and a Proposal* 9 LAW & POL’Y INT’L BUS., 779, 784 (1977) (for example, “if . . . the subsidy proceeds were channeled to greater advertising efforts, improvements in services, or more extensive product guarantees”).

¹⁰⁸ Subsidies Code, *supra* note 81, art. 9.1 (“Signatories shall not grant export subsidies on products other than certain primary products”).

therefore prohibits all the subsidies set out in the illustrative list *without regard to the price impact of those subsidies*.¹⁰⁹

The improvements for primary product subsidies were more cosmetic. The scope of the Article 10 of the Code is limited to “certain primary products,” and excludes minerals, leaving only products of farm, forest, or fishery.¹¹⁰ In general, this article reiterated the existing disciplines found in GATT Article XVI:3, but elaborated on certain concepts, such as “an equitable share of world trade,” which, as noted earlier, created some problems in interpretation. Initially, the United States tried to tighten the rule of Article XVI:3 by proposing that “an inequitable share of the world market” should be found to exist whenever a country increased its share of any national market of a certain product. However, this approach did not find the support of the EC.¹¹¹ Eventually, the parties agree to focus on two factors: displacement of nonsubsidized exports by subsidized exports¹¹² and price undercutting.¹¹³ Although this clarification did not solve all the problems of interpretation, the displacement and price undercutting concepts were substantial improvements over the “equitable share” concept, which was “felt with ease but proven with difficulty.”¹¹⁴

¹⁰⁹ Rivers & Greenwald, *supra* note 83, at 1475-76; JOHN H. JACKSON, *THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS* 288-289 (2d ed. 1997); COPPENS, *supra* note 77, at 28.

¹¹⁰ Subsidies Code, *supra* note 81 n.29.

¹¹¹ Rivers & Greenwald, *supra* note 83, at 1477 (stating that “[i]t would have effectively frozen international market shares, even in markets where neither the United States nor other exporters had a major interest.”).

¹¹² Subsidies Code, *supra* note 81, art. 10.2 (“For purpose of Article XVI:3 of the General Agreement and paragraph 1 above: (a) ‘more than an equitable share of world export trade’ shall include any case in which the effect of an export subsidy granted by a signatory is to displace the exports of another signatories bearing in mind the development on world markets”).

¹¹³ *Id.*, art. 10.3 (“Signatories further agree not to grant export subsidies on exports of certain primary products to a particular market in a manner which results in prices materially below those of other suppliers to the same market.”)

¹¹⁴ Rivers & Greenwald, *supra* note 83, at 1478.

b. Domestic Subsidies The main novelty of the Code was the introduction of rules regarding domestic subsidies. This was probably the most sensitive issue raised in the Tokyo Round negotiations. The EC and many developing countries viewed any attempt at stringent international regulation of domestic subsidies as intolerable interference in internal policy matters. The United States, on the other hand, insisted on developing rules governing their use.¹¹⁵

The compromise character of disciplines for domestic subsidies becomes clear in Article 11. On the one hand, signatories recognize that domestic subsidies “are widely used as important instruments for the promotion of economic and social policy objectives and do not intend to restrict the right of signatories to use such subsidies to achieve these and other important policy objectives.”¹¹⁶ On the other hand, however, signatories recognize that domestic subsidies may (1) cause or threaten to cause injury to a domestic industry of another signatory or (2) serious prejudice to the interests of another signatory or (3) nullify or impair benefits accruing to another signatory under the General Agreement.¹¹⁷ Therefore, parties shall “seek to avoid” causing such effects through the use of subsidies.¹¹⁸ Despite the weak “seek to avoid” language, the Code, for the first time under the GATT, provided the right to take action against domestic subsidies causing serious prejudice to the interests of another party.¹¹⁹

¹¹⁵ *Id.* at 1470-71.

¹¹⁶ Subsidies Code, *supra* note 81, art. 11.1

¹¹⁷ *Id.*, art. 11.2.

¹¹⁸ *Id.*

¹¹⁹ Rivers & Greenwald, *supra* note 83, at 1474 (noting that “[t]he effect of this provision was to provide a remedy without a corresponding obligation not to cause serious prejudice.”).

Professor Jackson describes Article 11 as “the first general multilateral treaty discipline on government use of domestic subsidies which have an impact on international trade.”¹²⁰ Its deliberate ambiguity, however, reflected the lack of agreement among the negotiating countries and, therefore, provided “a temporary, but ultimately unsatisfactory solution to the subsidy issue.”¹²¹

c. Dispute Settlement Mechanism under Track II Given that countervailing duties may only be applied to subsidies that cause injury to the domestic industry, and cannot address subsidies that have adverse effects on the interests of other signatories, the Code introduced special multilateral dispute settlement proceedings. Articles 12 and 13 embody the compromise between the EC and Japan on one side, who insisted on a less-adjudicative solution and maximum political flexibility, and the United States, Canada and developing countries, who advocated for a more adjudicative model.¹²²

According to Article 12, *consultations* may be requested with any signatory believed to be granting or maintaining an export subsidy or a domestic subsidy that causes any of the effects provided by Article 11.2.¹²³ If such consultations fail to resolve the dispute, the dispute may be referred to the Committee on Subsidies and Countervailing Measures (a permanent body composed of representatives from each of the signatories to the Code¹²⁴) for *conciliations*.¹²⁵ The Committee, through its good offices, should encourage the signatories involved to develop “a

¹²⁰ JACKSON, *supra* note 109, at 289.

¹²¹ O’BRIEN, *supra* note 52, at 114.

¹²² Rivers & Greenwald, *supra* note 83, at 1488.

¹²³ Subsidies Code, *supra* note 81, art. 12.

¹²⁴ *Id.*, art. 16.

¹²⁵ *Id.*, art. 13.1 & 13.2

mutually accepted solution.”¹²⁶ If the matter remains unresolved, the dispute may be referred to a dispute settlement *panel* for adjudication.¹²⁷ The panel should submit a report to the Committee, which – like the GATT Council in cases brought under Article XXIII – shall “make such recommendations to the parties as may be appropriate to resolve the issue.”¹²⁸ If the recommendations are not followed, the Committee may authorize “appropriate countermeasures.”¹²⁹ Thus, while the Code sets up a formal complaint procedure, at the same time it strongly encourages a negotiated settlement through consultations and conciliations.

d. Developing Countries Developing countries demanded “special and differential treatment” in the area of subsidies. At the early stages of negotiations, they took a quite extreme position: a prohibition against countervailing duties to offset subsidies on developing countries’ exports, and no discipline whatsoever regarding the use of subsidies by developing countries.¹³⁰ The resolution was one of compromise. There is no special treatment with regard to countervailing duties in the Code. Likewise, the rules on the use of export subsidies on primary products apply equally to exports from developed and developing countries.

The only significant special treatment granted to developing countries was with regard to export subsidies on non-primary products. The provisions of Article 9 of the Code, which prohibit such subsidies, do not apply to developing countries.¹³¹ At the same time, developing countries agree that “export subsidies on their industrial products shall not be used in a manner

¹²⁶ *Id.*, art. 17.1

¹²⁷ *Id.*, art.17.3

¹²⁸ *Id.*, art. 13.4

¹²⁹ *Id.*

¹³⁰ Rivers & Greenwald, *supra* note 83, at 1480.

¹³¹ Subsidies Code, *supra* note 81, art. 14.2.

which causes serious prejudice to the trade or production of another signatory.”¹³² Additionally, they agree to “endeavour to enter into” commitments “to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with [their] competitive and development needs.”¹³³ In the words of Richard Rivers and John Greenwald, the U.S. negotiators of the Subsidies Code, it was “the heart of the deal” with the developing countries on export subsidies on non-primary products.¹³⁴

In sum, the Subsidies Code represents a significant step forward in disciplining subsidies. As Professor Lowenfeld noted, the Code “introduced more law into the question of subsidies than had existed before.”¹³⁵ The most important changes are: (1) more elaborated substantive and procedural rules on imposing CVDs; most importantly, the imposition of CVDs is made subject to a material injury test, which was lacking in U.S. CVD law; (2) the prohibition of export subsidies for non-primary products without regard to the price impact of those subsidies; (3) the introduction of rules regarding domestic subsidies that provide a right to take action against domestic subsidies causing serious prejudice to the interests of another party; and (4) the introduction of special multilateral dispute settlement proceedings. Yet, at the same time, the Code “made extremely limited progress in addressing the basic issues of disagreement”¹³⁶ which led to further negotiations in the Uruguay Round.

¹³² *Id.*, art. 14.3.

¹³³ *Id.*, art. 14.5.

¹³⁴ Rivers & Greenwald, *supra* note 83, at 1482.

¹³⁵ LOWENFELD, *supra* note 86, at 217.

¹³⁶ O'BRIEN, *supra* note 52, at 114; *see also* Gary Hufbauer, *What Shapes Subsidy Disciplines in the GATT and WTO? in WHAT SHAPES THE LAW? REFLECTION ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES* 42 (Luca Rubini & Jennifer Hawkins eds., 2016) (stating that “the Tokyo Round took a modest forward step towards disciplining subsidies. GATT members were generally more concerned about ensuring a free hand for their own . . . subsidies than on limiting the subsidies of other members.”).

D. THE NEGOTIATIONS ON SUBSIDIES IN THE URUGUAY ROUND

1. General Introduction

The Uruguay Round (1986-1994) is widely viewed as the most complex and ambitious negotiations undertaken by GATT. One of the biggest achievements of the Uruguay Round is the creation of the World Trade Organization (WTO), which, unlike the GATT, is an international organization with full legal personality and legal capacity.¹³⁷ The WTO was formally established and became operational on 1 January 1995.¹³⁸

Negotiations in the traditional area of trade in goods resulted in adopting a number of multilateral agreements (including the Agreement on Subsidies and Countervailing Measures, and the Agreement on Agriculture that contains specific rules on domestic support and export subsidies in the agricultural sector) which provide for rules that are more detailed than the rules contained in the GATT. Moreover, for the first time, trade in services and intellectual property rights were included in the GATT/WTO system through the General Agreement on Trade in Services¹³⁹ and the Agreement on Trade Related Aspects of Intellectual Property Rights.¹⁴⁰ In fact, such an extension of the institutional structure to services and intellectual property was a

¹³⁷ Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 4 (1999), 1867 U.N.T.S. 154, 33 I.L.M. 1144, art. VIII:1 (1994) [hereinafter WTO Agreement] (“The WTO shall have legal personality, and shall be accorded by each of its Members such capacity as may be necessary for the exercise of its functions.”). The WTO is entitled to “privileges and immunities” (art. VIII:2), it has its institutional structure (art. IV), distinctive functions (art. III) and explicit authority to develop relations with other intergovernmental organizations (art.V).

¹³⁸ *Id.*, art. I.

¹³⁹ GATS: General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 284 (1999), 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994) [hereinafter GATS].

¹⁴⁰ TRIPS: Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 320 (1999), 1869 U.N.T.S. 299, 33 I.L.M. 1197 (1994) [hereinafter TRIPS Agreement].

result of the Grand Bargain by which the United States, the EC and other developed countries gained better market access for services and improved intellectual property protection in exchange for more open agricultural markets and an end to global textile and apparel quotas.¹⁴¹

The result of the Uruguay Round was the package of multilateral trade agreements annexed to a single document, the Marrakesh Agreement Establishing the World Trade Organization.¹⁴² Through this “ingenious device,”¹⁴³ all agreements annexed to the WTO Agreement, unlike the previous Tokyo Round Codes, become equally binding on all Members as a single body of law.¹⁴⁴

Another important negotiating success of the Uruguay Round is the reform of dispute settlement procedures.¹⁴⁵ The current WTO dispute system with its compulsory jurisdiction, strict time-frames, the possibility of appellate review and detailed mechanism to ensure compliance is unique among international dispute settlement system.¹⁴⁶ One of the most important innovations is the quasi-automatic adoption of panel reports. Under the previous GATT dispute settlement procedure, the adoption of a panel report required consensus.¹⁴⁷ Thus,

¹⁴¹ RAJ BHALA, *MODERN GATT LAW: A TREATISE ON THE GENERAL AGREEMENT ON TARIFFS AND TRADE* 262 (2005).

¹⁴² WTO Agreement, *supra* note 137, art. II.

¹⁴³ MITSUO MATSUSHITA, THOMAS J. SCHOENBAUM, PERTOS C. MAVRODIS & MICHAEL HAHN, *THE WORLD TRADE ORGANIZATION: LAW, PRACTICE, AND POLICY* 10 (3d ed. 2015).

¹⁴⁴ WTO Agreement, *supra* note 137, art. II:2 (“[t]he agreements and associated legal instruments included in Annexes 1, 2 and 3 . . . are integral parts of this Agreements, binding on all Members”); art. XVI:4 (“[e]ach member shall ensure the conformity of its laws, regulation and administrative procedures with its obligation as provided in the annexed Agreements.”).

¹⁴⁵ Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, *THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS* 354 (1999), 1869 U.N.T.S. 401, 33 I.L.M. 1226 (1994) [hereinafter DSU].

¹⁴⁶ PETER VAN DEN BOSSCHE, *THE LAW AND POLICY OF THE WORLD TRADE ORGANIZATION: TEXT, CASES AND MATERIALS* 94 (Cambridge University Press 2005).

¹⁴⁷ In the early years of GATT, disputes were resolved by working parties, set up pursuant to Article XXIII:2 of the GATT. These working parties included representative of all interested Contracting Parties, including the parties to the dispute, and made their decisions on the basis of consensus. As of 1952, disputes were heard by “panels” composed of three or five independent experts. The reports of the panel had to be adopted by the GATT Council,

the losing party could delay or block this decision. Furthermore, the fact that the losing party could prevent the adoption of a panel report meant that panels were often tempted to arrive at a conclusion that would be acceptable to all parties, regardless of whether that conclusion was legally sound.¹⁴⁸ The Uruguay Round fundamentally changed this procedure: the report is adopted unless the Dispute Settlement Body decides by consensus *not to adopt* the report which eliminates the possibility of blockage.¹⁴⁹ This is a move away from a system of negotiation, a system that encouraged delay by favoring unanimity of acceptance which was preferred by the EC to one of adjudication, supported by the United States.¹⁵⁰

2. Negotiations on Subsidies

The Tokyo Subsidies Code made limited progress in addressing the basic issues of disagreement.¹⁵¹ The economic recession of the 1980s increased the pressure on governments to support national producers, especially in the steel industry¹⁵² and agriculture. Thus, as a result of

consisting of all Contracting Parties, by consensus. Since the Kennedy and Tokyo Rounds, the dispute settlement procedures have been codified and supplemented by a number of understandings. In particular, under Paragraph 6(i) of the Annex to the Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance: “[t]he report of the Working Party represents the views of all its members and therefore records different views if necessary. Since the tendency is to strive for consensus, there is generally some measure of negotiation and compromise in the formulation of the Working Party’s report.” (Nov. 28, 1979, GATT B.I.S.D. (26th Supp.) at 217 (1980)). See BOSSCHE, *supra* note 146, at 176-80; Ernst-Ulrich Petersmann, *International Trade Law and the GATT/WTO Dispute Settlement System 1948-1996: An Introduction*, in INTERNATIONAL TRADE LAW AND THE GATT/WTO DISPUTE SETTLEMENT SYSTEM 5, 33-36 (Ernst-Ulrich Petersmann ed., 1997).

¹⁴⁸ BOSSCHE, *supra* note 146, at 180.

¹⁴⁹ DSU, *supra* note 145, arts. 16.4, 17.14.

¹⁵⁰ MATSUSHITA, SCHOENBAUM, MAVRODIS & HAHN, *supra* note 143, at 86.

¹⁵¹ See *supra* notes 82-85 and accompanying text.

¹⁵² In the 1970s and early 1980s the US and the EC steel industry suffered a significant decline. The EC opted for a modernization policy through subsidies to make its steel industry more competitive. Between 1980 and 1985, the EC reported over \$35 billion in government subsidies to steel manufactures. The United States, in contrast, responded with a wave of countervailing duty investigations. For example, in 1982, of the 131 countervailing duty investigations brought by the developed countries, 124 were initiated by the United States, most on steel products.

the Tokyo negotiations round, the United States did not achieve limiting subsidies by their trading partners, while other countries witnessed an increase in the use of countervailing duties by the United States. Moreover, the disputes between Contracting Parties regarding subsidies remained unresolved due to the lack of adoption of the reports by the losing party and the lack of agreement between the contracting parties on the interpretation or application of the Subsidies Code.¹⁵³

At the beginning of the Uruguay Round, the positions adopted by the contracting parties were similar to those adopted during the Tokyo Round negotiations. The United States advocated for stronger and more effective subsidy discipline, while most of the other negotiating participants, including the EC, insisted on further disciplining the use of countervailing duties and defining a “subsidy” which, in their view, would limit the use of countervailing duties by the United States.¹⁵⁴ Yet, at the same time, a compromise was facilitated by a growing shared understanding among most governments of the burden which subsidies placed on their national budgets and taxpayers and the risk that any subsidy introduced to give a competitive advantage would be matched by other countries’ subsidization.¹⁵⁵ Therefore, negotiating countries expected that an agreement would provide, as John Croome put it, “a mutual disarmament treaty for subsidies” which would serve the interests of all.¹⁵⁶

(THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY (1986-1992), at 822-25 (Terence P. Stewart, Esq. ed., vol. I 1993).

¹⁵³ Before the completion of the Uruguay Round negotiations, the Committee on Subsidies and Countervailing Measures was unable to adopt any GATT panel report.

¹⁵⁴ THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY (1986-1992), *supra* note 152, at 844-45.

¹⁵⁵ JOHN CROOME, RESHAPING THE WORLD TRADING SYSTEM: A HISTORY OF THE URUGUAY ROUND 60 (2d ed. 1999).

¹⁵⁶ *Id.*

Negotiations resulted in the Subsidies and Countervailing Measures Agreement (SCM Agreement) which, unlike the previous Tokyo Subsidies Code, binds all WTO members.¹⁵⁷ It restates certain provisions of the Code but departs from the sharp distinction between export and domestic subsidies. Instead, it defines a “subsidy”¹⁵⁸ and divides subsidies into three categories (prohibited, actionable, and non-actionable).¹⁵⁹ The key to reaching agreement on subsidies in general was the decision to write agriculture out of the SCM Agreement. The negotiations on subsidies for agriculture products took place separately, and resulted in the Agreement on Agriculture, which provides for special rules on agricultural subsidies.

a. Defining Subsidy The SCM Agreement contains, for the first time in any multilateral trade agreement, a definition of the concept of subsidy.¹⁶⁰ As the Panel stated in *US-FSC*: “the inclusion of this detailed and comprehensive definition of the term ‘subsidy’ is generally considered to represent one of the most important achievements of the Uruguay Round in the area of subsidy discipline.”¹⁶¹ Indeed, this definition is a key to the entire Agreement, as it defines which measures are subject to the WTO subsidy discipline, including unilateral countervailing duties.

The main obstacle to reaching an agreement on the definition of a subsidy was the fundamental difference in approach to the issue between the United States and the EC. The United States proposed to define a subsidy as “any government action or combination of

¹⁵⁷ WTO Agreement, *supra* note 137, art. II:2.

¹⁵⁸ Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, 1999, 1867 U.N.T.S. 14, art. 1.1 [hereinafter the SCM Agreement].

¹⁵⁹ *Id.*, Parts II, III & IV.

¹⁶⁰ *Id.*, art. 1.1.

¹⁶¹ Panel Report, *United States – Tax Treatment for ‘Foreign Sales Corporations,’* WT/DS108/R, adopted 20 March 2000, para. 7.80

government actions which confers a benefit on the recipient firm(s).”¹⁶² Under this view, a subsidy exists only if a beneficiary of the government action has obtained an advantage which it could not obtain in the market place.¹⁶³ What matters, therefore, is not the form of government action, but its effect (a benefit to the recipient). The United States suggested that the amount of the countervailing duties should be sufficient to counteract the benefit granted by a subsidy.¹⁶⁴ It should also be emphasized that the United States did not press for a general definition of subsidy; the proposed definition referred specifically to actionable subsidy, i.e. subsidies that are not prohibited but actionable.

In contrast, the EC proposed to define a subsidy as “a financial charge . . . incurred by a government or administrative authority on behalf of a beneficiary.”¹⁶⁵ The EC understood a subsidy as a financial contribution that only involves a cost or charge on public accounts,¹⁶⁶ focusing, therefore, on the form of government action. In the view of the EC, for a subsidy to exist there needed to be a charge on the public account, from which a benefit flowed to an industry.¹⁶⁷

¹⁶² *Elements of the Framework for Negotiations, Submission by the United States*, GATT Doc. No. MTN.GNG/NG10/W/29, at 2 (Nov. 22, 1989) [hereinafter 1989 Framework Proposal from the United States].

¹⁶³ *Uruguay Round. Negotiating Group on Subsidies and Countervailing Duties. Meeting of 19-20 October 1989*, GATT Doc. No. MTN/GNG/NG10/14, at 5 (Nov. 15, 1989).

¹⁶⁴ *Id.* (“ . . . the proper method of the calculation of the amount of a subsidy was the ‘benefit to the recipient’ approach . . . the injurious subsidization had to be looked at from the perspective of the industry in the importing country, i.e. the amount of benefits the competitor was receiving.”).

¹⁶⁵ *Communication from the EEC*, GATT Doc. No. MTN.GNG/NG10/W/7, at 3 (June 11, 1987).

¹⁶⁶ As it was established by the decisions of the European Court of Justice, the criterion of “charge on public account” includes (1) all government actions involving a financial burden which is reflected in the public budget as an expense or a potential expense (*e.g.*, payments, loans, provisions of services, etc.); (2) the foregoing of revenues that would have been collected by the government “but for” its actions (*e.g.*, tax exemptions, conversions of debt, etc.). *See* Case 187/85 *Fediol*, ECR [1988] 4155, at para. 9 and 11; C-72 and 73/91, *Sloman Neptun*, ECR [1993] I-903, at para. 21; C-379/98, *PreussenElektra AG v. Schleswag AG*, [2001] ECR I-2099, at para. 62.

¹⁶⁷ *Meeting of 19-20 October 1989*, *supra* note 163, at 5 (the EC argued that “benefit to the recipient” approach, supported by the United States, “could lead to abnormal results where the subsidy found would be much higher than that actually paid. It could also result in finding a subsidy where there was none.”).

Eventually, the negotiating parties agreed to a general definition of a subsidy by joining both criteria. Under Article 1.1 of the SCM Agreement, for a measure to constitute a subsidy it must represent a financial contribution or income support by a government which confers a benefit.¹⁶⁸ Therefore, both elements must be cumulatively present for a subsidy to exist. As the Panel stated in *US-Export Restraints*, “the definition ultimately agreed in the negotiations definitively rejected the approach espoused by the United States of defining subsidies as benefits resulting from any government action, by introducing the requirement that the government action in question constitute a ‘financial contribution’ as set forth in an exhaustive list.”¹⁶⁹

b. The “Traffic Light Approach” Apart from the prohibition of export subsidies on non-primary goods by developed countries, the GATT and Tokyo Round Subsidies Code rules had concentrated on trade effects of subsidies in specific cases. For the Uruguay Round negotiators it was thus critical to reach agreement regarding what kinds of subsidies always, or never, distorted trade. This would only leave a middle category of potentially harmful subsidies for examination and would reduce the scope of application of CVDs.¹⁷⁰ The solution to this problem was found in the suggested distinction between prohibited, actionable, and non-actionable subsidies.

Prohibited (“red light”) subsidies were a controversial issue because some countries insisted upon expansion of this category while others preferred a narrow definition of prohibited subsidies. The Tokyo Round Subsidies Code had already introduced a prohibition on export subsidies on non-primary products; however, it was less successful with export subsidies for primary products. The United States, Australia, and Canada suggested the elimination of the

¹⁶⁸ SCM Agreement, *supra* note 158, art. 1.1.

¹⁶⁹ Panel Report, *US – Measures Treating Exports Restraints as Subsidies*, WT/DS194/R, adopted 23 August 2001, para. 8.69.

¹⁷⁰ CROOME, *supra* note 155, at 61-61.

distinction between primary and non-primary products and to extend the prohibition of export subsidies on primary products.¹⁷¹ The EC, on the other hand, insisted upon leaving this issue to the negotiating group on agriculture.¹⁷²

There was also disagreement as to whether certain domestic subsidies should be prohibited. The EC, India, and Korea maintained that the prohibition should not extend to any category of domestic subsidies.¹⁷³ Other participants, including the United States, Canada, and Japan, opposed this view.¹⁷⁴ For example, the United States proposed to include in the prohibited category subsidies contingent upon production performance, grants to cover operating losses, and direct forgiveness of debt, among others.¹⁷⁵

The final agreement took a middle course. The SCM Agreement prohibits two types of subsidies: (1) export subsidies, i.e. subsidies which are contingent upon export performance, including the export subsidies specified in the “Illustrative List” (however, this provision does not apply to agricultural subsidies which are governed exclusively by the Agreement of Agriculture), and (2) subsidies contingent upon the use of domestic over imported goods¹⁷⁶ (therefore, the Agreement does not directly prohibit any domestic subsidies).

¹⁷¹ 1989 Framework Proposal by the United States, *supra* note 162, at 3; *Elements of the Framework for Negotiations, Submissions by Australia*, GATT Doc. No. MTN.GNG/NG10/W/32, at 2 (Nov. 30, 1989) [hereinafter 1989 Framework Proposal by Australia]; *Elements of the Framework for Negotiations, Submissions by Canada*, GATT Doc. No. MTN.GNG/NG10/W/25, at 2 (June 28, 1989) [hereinafter 1989 Framework Proposal by Canada].

¹⁷² *Elements of the Framework for Negotiations, Submissions by the European Community*, GATT Doc. No. MTN.GNG/NG10/W/31, at 2-3 (Nov. 27, 1989) [hereinafter 1989 Framework Proposal by the EC].

¹⁷³ 1989 Framework Proposal by the EC, *supra* note 172, at 3; *Elements of the Framework for Negotiations, Submissions by India*, GATT Doc. No. MTN.GNG/NG10/W/33, at 1 (Nov. 30, 1989) [hereinafter 1989 Framework Proposal by India]; *Elements of the Framework for Negotiations, Communication from the Republic of Korea*, GATT Doc. No. MTN.GNG/NG10/W/34, at 1 (Jan. 18, 1990) [hereinafter 1990 Framework Proposal by Korea].

¹⁷⁴ 1989 Framework Proposal by the United States, *supra* note 162, at 3; 1989 Framework Proposal by Canada, *supra* note 171, at 2-3; *Elements of the Framework for Negotiations, Submissions by Japan*, GATT Doc. No. MTN.GNG/NG10/W/27, at 1 (Oct. 6, 1989) [hereinafter 1989 Framework Proposal by Japan].

¹⁷⁵ *Elements of the Framework for Negotiations, Submissions by the United States*, GATT Doc. No. MTN.GNG/NG10/W/39 (Sept. 27, 1990), at 2-3 [hereinafter 1990 Framework Proposal by the United States].

¹⁷⁶ SCM Agreement, *supra* note 158, art. 3.1.

Non-actionable (“green light”) subsidies are exempt from countervailing actions, and WTO members have a “green light” to employ them.¹⁷⁷ The creation of this category marked a major departure from previous multilateral negotiations on subsidies.¹⁷⁸ The EC proposed this idea in June 1987, and by February 1988 the concept had been developed in a paper by Switzerland.¹⁷⁹ This subject was one of the most contentious of the subsidies group negotiations, with a variety of proposals from participants to include certain types of subsidies in the non-actionable category, including generally available public support measures (Australia, Canada, the EC, India, Japan, the Nordics, and Switzerland),¹⁸⁰ environmental schemes based on the “polluter pays” principle (Switzerland and the Nordics),¹⁸¹ governmental aid for research and development (the EC, Canada, Switzerland, Japan and the Nordic countries),¹⁸² and regional development assistance (the EC, Canada, Switzerland, India, the Nordic countries and Japan).¹⁸³ The United States was the strongest advocate of keeping the category of non-actionable subsidies

¹⁷⁷ *Id.*, art. 8.

¹⁷⁸ Collin-Williams & Salembier, *supra* note 46, at 10-11 (stating that this “was a major priority for several participants in negotiations, notably the European Community and Canada . . . Driven by unhappy and politically charged experiences with U.S. countervailing duty laws . . . these countries pressed for . . . non-actionable status for certain . . . subsidies”).

¹⁷⁹ CROOME, *supra* note 155, at 62.

¹⁸⁰ 1989 Framework Proposal by Australia, *supra* note 171, at 7; 1989 Framework Proposal by Canada, *supra* note 171, at 8; 1989 Framework Proposal by the EC, *supra* note 172, at 8; 1989 Framework Proposal by India, *supra* note 173, at 2-3; 1989 Framework Proposal by Japan, *supra* note 174, at 3; *Elements of the Framework for Negotiations, Submission by the Nordic Countries*, GATT Doc. No. MTN.GNG/NG10/W/30 (Nov. 27, 1989) [hereinafter 1989 Framework Proposal by the Nordic Countries], at 3; *Elements of the Framework for Negotiations, Communication from Switzerland*, GATT Doc. No. MTN.GNG/NG10/W/26, at 8 (Sept. 13, 1989) [hereinafter 1989 Communication from Switzerland].

¹⁸¹ 1989 Communication from Switzerland, *supra* note 180, at 7; 1989 Framework Proposal by the Nordic Countries, *supra* note 180, at 16.

¹⁸² 1989 Framework Proposal by the EC, *supra* note 172, at 9; 1989 Framework Proposal by Canada, *supra* note 171, at 9; 1989 Communication from Switzerland, *supra* note 180, at 7; 1989 Framework Proposal by Japan, *supra* note 174, at 4; 1989 Framework Proposal by the Nordic Countries, *supra* note 180, at 3, 16.

¹⁸³ 1989 Framework Proposal by the EC, *supra* note 172, at 8-9; 1989 Framework Proposal by Canada, *supra* note 171, at 9; 1989 Communication from Switzerland, *supra* note 180, at 7; 1989 Framework Proposal by India, *supra* note 173, at 2-3; 1989 Framework Proposal by the Nordic Countries, *supra* note 180, at 3; 1989 Framework Proposal by Japan, *supra* note 174, at 4.

to a minimum, since this category made it easier to disguise subsidies that were prohibited.¹⁸⁴ There was, however, a general consensus among all participants that governmental provision of basic human services, e.g. education, health services, etc., should not be actionable.¹⁸⁵

In the end, the SCM agreement established the following categories of non-actionable subsidies: (1) non-specific; (2) assistance for research activities; (3) assistance to disadvantaged regions; and (4) assistance to promote adaptation of existing facilities to new environmental requirements.¹⁸⁶ “Green light” subsidies, however, were included in the SCM Agreement on a provisional basis, subject to review.¹⁸⁷

Actionable (“yellow light”) subsidies are subsidies that are not prohibited but countervailable or otherwise actionable. An actionable subsidy is determined by its trade effects (i.e., injury, nullification or impairment, or serious prejudice).¹⁸⁸ The Tokyo Subsidies Code already had stated that one of the adverse effects that may be caused by the use of subsidies is “serious prejudice” to the interests of GATT signatories.¹⁸⁹ However, problems with the interpretation of “serious prejudice” made the Track II provisions difficult to work with in practice.¹⁹⁰ In the Uruguay Round, a number of participants pointed out this problem and suggested that the term should be reviewed in order to give it greater clarity. In particular, Canada stated that “present rules do not adequately address trade distortions that may occur as a

¹⁸⁴ 1989 Framework Proposal by the United States, *supra* note 162, at 6.

¹⁸⁵ THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY (1986-1992), *supra* note 152, at 903.

¹⁸⁶ SCM Agreement, *supra* note 158, art. 8.

¹⁸⁷ *Id.*, art. 31 (The validity of Article 8 (non-actionable subsidies) should have been expressly renewed at the end of 1999. The renewal never took place.).

¹⁸⁸ *Id.*, art. 5, 6.

¹⁸⁹ Subsidies Code, *supra* note 81, art. 8.

¹⁹⁰ THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY (1986-1992), *supra* note 152, at 893.

result of subsidies that displace imports in the home market of the subsidizing country or in third country markets.”¹⁹¹

The final agreement addresses “serious prejudice” in two ways. First, it establishes a category of “dark amber” subsidies, i.e. four categories of subsidies presumed to cause serious prejudice, with the burden shifted to the respondent state to show that no adverse effects were caused by the challenged measure.¹⁹² However, the provision establishing a presumption of serious prejudice was enacted to serve on a provisional basis, for 5 years; at the end of that time it will be reviewed to determine whether to extend its application.¹⁹³ Second, the SCM Agreement provides that serious prejudice *may be found* where subsidized imports cause adverse effects in the subsidizing country’s market or third country markets, and lists four instances where serious prejudice may arise.¹⁹⁴ If a complaining Member can show that a subsidy has any of these effects, then serious prejudice may be found to exist.¹⁹⁵

c. Countervailing Duties A number of measures to tighten the adoption of CVDs were undertaken to meet the interests of countries concerned about the U.S. practice. Because the GATT and the Subsidies Code lacked a subsidy definition, all kinds of government intervention which distort trade could potentially be countervailable and every country could apply its own unilateral definition of subsidy. In particular, the United States’ approach was to define as

¹⁹¹ 1989 Framework Proposal by Canada, *supra* note 171, at 2.

¹⁹² SCM Agreement, art. 6.1. (“Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of: (a) the total ad valorem subsidization of a product exceeding 5 per cent; (b) subsidies to cover operating losses sustained by an industry; (c) subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems; (d) direct forgiveness of debt, i.e. forgiveness of government-held debt, and grants to cover debt repayment).”)

¹⁹³ *Id.*, art. 31.

¹⁹⁴ *Id.*, art. 6.3(a)-(d).

¹⁹⁵ *Id.*

countervailable subsidies *benefits* arising from government action, regardless of the nature of that action.¹⁹⁶ The EC and essentially all other countries opposed this view.¹⁹⁷ Canada, for example, stated that “while virtually any government action could be construed as having possible effects on production and trade, there need to be some outside limits on the scope of government activity that can be considered to be a subsidy and *subject to countervail*.”¹⁹⁸

The resulting two-part definition of subsidy, consisting of “financial contribution” and “benefit,” “was intended specifically to prevent the countervailing of *benefits* from any sort of (formal, enforceable) government measures, by restricting to a finite list the *kinds* of government measures that would, if they conferred benefits, constitute subsidies.”¹⁹⁹ In order to reduce the number of CVDs imposed by a WTO Member, an investigation must be initiated by the domestic industry²⁰⁰ rather than just a few troubled firms. Where the amount of a subsidy is “*de minimis*” (less than 1 percent), the authorities must terminate the investigation immediately.²⁰¹ A sunset provision was also included to encourage the elimination of CVDs once the injurious effects of the subsidy are no longer pertinent.²⁰²

To sum up, the SCM Agreement significantly improved existing rules on a number of key aspects: (1) a precise definition of a subsidy; (2) distinction between prohibited, actionable, and non-actionable subsidies; and (3) tightening the rules on imposing CVDs. Furthermore, creating the WTO resulted in establishing a new multilateral dispute settlement mechanism,

¹⁹⁶ See *infra* notes 162-64 and accompanying text.

¹⁹⁷ CROOME, *supra* note 155, at 172.

¹⁹⁸ *Negotiating Group on Subsidies and Countervailing Measures, Statement Made by the Delegation of Canada at the Meeting Held on 28-29 June 1988*, MTN.GNG/NG10/W/22, 7 July 1988, at 2 (emphasis added).

¹⁹⁹ *US-Export Restraint*, *supra* note 169, para. 8.73.

²⁰⁰ SCM Agreement, *supra* note 158, art. 11.2

²⁰¹ *Id.*, art. 11.9.

²⁰² *Id.*, art. 21.2.

which considerably improved the tools at the disposal of states to obtain redress against harmful subsidies. In the following Chapter, a detailed analysis of the current WTO rules on subsidies is undertaken.

IV. REGULATION OF SUBSIDIES IN THE WTO

The WTO rules on subsidies are set out in Articles VI and XVI of the GATT 1994 and in the Agreement on Subsidies and Countervailing Measures (SCM Agreement). The SCM Agreement is one of the agreements included in Annex 1A of the Agreement establishing the WTO, which includes multilateral commitments concerning trade in goods. With respect to the relationship between the GATT and the SCM Agreement, the Interpretative Note to Annex 1A¹ states that in the event of conflict between a provision of the GATT and a provision of another agreement in Annex 1A the provision of the other agreement shall prevail *to the extent of the conflict*.²

The Agreement on Agriculture (AoA) provides for special rules on agricultural subsidies. In case of conflict between the provisions of the SCM Agreement and the AoA, the latter prevails over the former.³ Subsidies granted to services are subject to the provisions of the General Agreement on the Trade in Services and, therefore, are not covered by the SCM Agreement.

¹ Annex 1A, Multilateral agreements on trade in goods, “General interpretative note to Annex 1A.”

² As the Panel explained in *EC-Bananas*:

[i]n light of the wording, the context, the object and the purpose of this Note, we consider that it is designed to deal with (i) clashes between obligations contained in GATT 1994 and obligations contained in agreements listed in Annex 1A, where those obligations are mutually exclusive in the sense that a Member cannot comply with both obligations at the same time, and (ii) the situation where a rule in one agreement prohibits what a rule in another agreement explicitly permits.

See Panel Report, *EC – Regime on the Importation, Sale and Distribution of Bananas*, WT/DS27/R/USA, adopted 25 September 1997, para. 7.155.

³ Agreement on Agriculture, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 33 (1999), 1867 U.N.T.S. 410, art. 21 [hereinafter AoA].

A. THE AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES

The goal of the SCM Agreement is not entirely clear because of the lack of a preamble which usually provides some indication of the object and purpose of an agreement. The WTO jurisprudence, although vague, provides some guidance, indicating that “[t]he object and purpose of the SCM Agreement is to impose multilateral disciplines on subsidies which distort international trade.”⁴ Professor Luca Rubini identifies two main objectives of the Agreement: (1) to discourage subsidies that may harm competing foreign producers in two ways, either by breaching their market access expectations or by affecting their competitive position, and (2) to control the unilateral reaction to those subsidies that injure domestic industries, ensuring that it is justified and proportionate and hence its possible damage is limited.⁵ In discussing the objectives of the Agreement, some scholars have argued that its purpose is not “to further global efficiency.”⁶ Although the Agreement initially recognized the legitimacy of certain subsidies, which suggested a more complex and balanced approach that went beyond producers’ interests,

⁴ Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/RW, adopted 4 August 2000, para. 7.26; *see also* Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999, para. 9.119 (stating that the object and purpose of the SCM Agreement is “the establishment of multilateral disciplines on the premise that some forms of government intervention distort international trade [or] have the potential to distort [international trade]”); Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted 17 February 2004, para. 64 (the object and purpose of the Agreement is “to strengthen and improve GATT disciplines relating to the use of both subsidies and countervailing measures, while, recognizing at the same time, the right of Members to impose such measures under certain conditions”).

⁵ LUKA RUBINI, *THE DEFINITION OF SUBSIDY AND STATE AID: WTO AND EC LAW IN COMPARATIVE PERSPECTIVE* 57 (Oxford University Press 2009).

⁶ Gene M. Grossman & Petros C. Mavroidis, *Here Today, Gone Tomorrow? Privatization and the Injury Caused by Non-Recurring Subsidies*, in *THE WTO CASE LAW OF 2001*, at 170, 180-86 (Henrik Horn & Petros C. Mavroidis eds., 2003) (arguing that “an interpretation of the SCM Agreement that associates harm with a loss in aggregate economic welfare cannot be sustained in the light of the manner in which the Agreement was structured”; in particular, the Agreement “does not confine the use of countervailing duties to situations in which an importing country has established the presumption of a welfare loss . . . Rather, countervailing measures are permitted *only* when there has been . . . injury to a *domestic industry* in an importing country”) (emphasis in original).

since the expiry of non-actionable subsidies in 1999, the SCM Agreement is about discouraging subsidies that may harm *producers*' interests.⁷

1. Definition of Subsidy

The SCM Agreement contains, for the first time in the GATT/WTO, a detailed and comprehensive definition of “subsidy,” by which it limits the scope of its coverage to government assistance that meets certain criteria. For a measure to constitute a subsidy, it must: (1) represent a financial contribution or an income/price support by a government; which (2) confers a benefit;⁸ (3) to a specific recipient.⁹ All three elements must be cumulatively present for a subsidy to exist.

a. Financial Contribution Article 1.1 (a)(1) addresses the “financial contribution” criterion, describing three forms of such a contribution: (1) direct (e.g., grants, loans) or potential direct (e.g., loan guarantees) transfers of funds; (2) government revenue, otherwise due, that is foregone or not collected; and (3) the provision by a government of goods or services other than general infrastructure, or the purchase by a government of goods.¹⁰ This list is exhaustive.¹¹ At

⁷ See RUBINI, *supra* note 5, at 56-59; Grossman & Mavroidis, *supra* note 6, at 180-86; Gary N. Horlick, *How Subsidies Rules Have Been Shaped*, in WHAT SHAPES THE LAW? REFLECTIONS ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES 65, 66 (Luca Rubini & Jennifer Hawkins eds., 2016) (“the current SCM Agreement focuses mainly on harm to competitors, rather than harm to competition or – much more important – harm to global public goods . . . even in the absence of harm to competitors.”).

⁸ Agreement on Subsidies and Countervailing Measures, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 231 (1999), 1869 U.N.T.S. 14, art. 1 [hereinafter SCM Agreement].

⁹ *Id.*, art. 2.

¹⁰ *Id.*, art. 1.1(a)(1).

¹¹ Panel Report, *United States – Measures Treating Exports Restraints as Subsidies*, WT/DS194/R, adopted 1 August 2001, para. 8.69.

the same time, as the Appellate Body in *Canada – Renewable Energy* concluded, the listed forms of financial contribution are “not mutually exclusive.” Thus, a transaction may fall under more than one type of financial contribution.¹²

It is important to emphasize that the “financial contribution” is *separate from* the “benefit,” and that these two criteria *together* determine whether a subsidy exists.¹³ In *US – Export Restraints*, the Panel explained that the determination of a financial contribution must concentrate on the examination of the *nature* of the action by the government and not its effects.¹⁴ The negotiating history and current WTO jurisprudence support the conclusion that the function of the financial contribution requirement is to ensure that not all government actions that confer benefits can be countervailable. As Professor Rubini sums it up, all forms of financial contribution involve a clear transfer of economic resources in the form of a transfer of something of value – either money, goods or services – from the government; however, as a consequence of the function of limitation of the financial contribution, not *all* transfers of economic resources constitute a financial contribution under the SCM Agreement.¹⁵

The direct/potential transfer of funds is a classic example of subsidy. This type of financial contribution involves financing provided by the government to the recipient. As the

¹² Appellate Body Report, *Canada – Certain Measures Affecting the Renewable Energy Generation Sector/Canada – Measures Relating to the Feed-in Tariff Program*, WT/DS412, 426/AB/R, adopted 24 May 2013, paras. 5.120-5.121.

¹³ Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, adopted 2 August 1999, para. 157 (emphasis in original).

¹⁴ *US – Export Restraints*, *supra* note 11, paras. 8.15-8.76 (noting that otherwise “the door would be reopened to the countervailing the *benefits* regardless of the nature of the government action that gave rise to them. This would effectively render the ‘financial contribution’ requirement meaningless.”).

¹⁵ RUBINI, *supra* note 5, at 111. WTO jurisprudence substantially confirms the limiting role of the financial contribution element. In *US – DRAMS*, the Appellate Body explained that “not all government measures capable of conferring benefits would necessarily fall within Article 1.1(a)” as, otherwise, there would be no need for the financial contribution “because all government measures conferring benefits, *per se*, would be subsidies.” See Appellate Body, *United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea*, WT/DS296/AB/R, adopted 20 July 2005, para. 114 building on its findings in *US – Softwood Lumber IV*, para. 52.

Appellate Body explained in *Japan – DRAMS (Korea)*, the term “funds” includes not only money, but also financial resources and other financial claims more generally.¹⁶ The inclusion of loans as a specific example of direct transfer of funds in Article 1.1(a)(1)(i) suggests that the provision of funds captures not only a donation but also cases where the recipient assumes obligations to the government in exchange for the funds provided.¹⁷

The second form of financial contribution is when a government does not collect, or forgoes, revenue which is otherwise due (e.g., fiscal incentives such as tax credits). The term “otherwise due” implies a comparison between the challenged measure and a “defined, normative benchmark.”¹⁸ In *US – FSC*, the Appellate Body explained:

As Members, in principle, have the sovereign authority to determine their own rules of taxation, the comparison under Article 1.1(a)(1)(ii) of the SCM Agreement must necessarily be between the rules of taxation contained in the contested measure and other rules of taxation of *the Member in question*.¹⁹

Initially, the Panel in *US – FSC* applied a “but for” test, in which the benchmark was found by identifying the tax treatment in the absence of the government measure. The Appellate Body, however, expressed concerns about the application of such an approach and its limitation in identifying a general rule and exception relationship, emphasizing that in doing so “a panel

¹⁶ Appellate Body Report, *Japan – Countervailing Duties on Dynamic Random Access Memories from Korea*, WT/DS336/AB/R, adopted, 17 December 2007, para. 250 (stating that “the fact that the words ‘grants, loans, and equity infusion’ are preceded by the abbreviation ‘e.g.’, indicates that they are cited as examples of transactions falling within the scope of Article 1.1(a)(1)(i).” These examples, which are illustrative, do not exhaust the class of conduct captured by subparagraph (i).”).

¹⁷ Appellate Body Report, *United States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS353/AB/R, adopted 12 March 2012, paras. 616-17 n.1294 (explaining that “[t]he fact that there is an element of reciprocity in some of the transactions listed as examples in subparagraph (i) does not mean that what is provided to the government by the recipient in return for the funds must be equivalent to the value of the funds. That issue becomes relevant in the subsequent assessment of benefit under Article 1.1(b) of the SCM Agreement”).

¹⁸ Appellate Body Report, *United States – Tax Treatment for ‘Foreign Sales Corporations,’* WT/DS108/AB/R, adopted 20 March 2000, para. 89.

¹⁹ *Id.* (emphasis added).

may artificially create a rule and an exception where no such distinction exists.”²⁰ Instead, the identification of circumstances in which government revenue that is otherwise due is forgone requires “a comparison between the tax treatment that applies to the alleged subsidy recipients and the tax treatment of *comparable income of comparably situated taxpayers*.”²¹

The third form of financial contribution is the provision of goods and services or purchase of goods other than general infrastructure. The WTO adjudicating bodies have adopted a very broad interpretation of the word “goods.” For example, in *US – Softwood Lumber III* the question before the Panel was whether the Canadian stumpage program, a scheme whereby Canadian harvesters of timber would rent land at less than market value, constituted the provision of goods in the sense of the SCM Agreement. Canada argued that “stumpage” is a right to harvest standing timber while the term “goods” used in the Agreement refers to products which are capable of being imported and traded across borders.²² The panel disagreed, however, and concluded that:

Although “goods” in Article 1.1(a)(1)(ii) SCM Agreement certainly includes tradable products, there is no reason to limit its meaning to only such products In particular, this provision states that when the government provides “goods or services,” this constitutes a financial contribution. The “goods” in question are not imported or exported, simply provided by the government . . . Goods in this context are distinguished from services, and in our view the two cover the full spectrum of in-kind transfers the government may undertake by providing resources to an enterprise.²³

²⁰ Appellate Body Report, *US – Large Civil Aircrafts*, *supra* note 17, para. 815; *see also* *US – FSC*, *supra* note 18, para. 91 (stating that “there may be situations where the measure at issue might be described as an ‘exception’ to a ‘general’ rule of taxation. In such situations, it may be possible to apply a ‘but for’ test We do not, however, consider that Article 1.1(a)(1)(ii) always *requires* panels to identify, with respect to any particular income, the ‘general’ rule of taxation prevailing in a Member. Given the variety and complexity of domestic tax system, it will usually be very difficult to isolate a ‘general’ rule of taxation and ‘exceptions’ to that ‘general’ rule.”) (emphasis in original).

²¹ Appellate Body Report, *US – Large Civil Aircrafts*, *supra* note 17, para. 812 (emphasis added).

²² Panel Report, *United States – Preliminary Determinations with Respect to Certain Softwood Lumber from Canada*, WT/DS236/R, adopted 1 November 2002, paras. 4.116-4.120.

²³ *Id.*, para. 7.28.

The only exception among all possible goods and services that could be provided by the government and explicitly defined as not constituting a financial contribution is general infrastructure.²⁴ In the panel’s view, the term “general infrastructure” refers to “infrastructure that is not provided to or for the advantage of only a single entity or limited group of entities, but rather is available to all or nearly all entities.”²⁵ In determining whether the infrastructure is “general infrastructure,” the relevant factors are not only the existence of *de jure* or *de facto* limitations on access or use it, but also the circumstances under which the infrastructure was created, as well as the nature and type of the infrastructure.²⁶

b. Attributing the Financial Contribution to a Government Art. 1.1 of the SCM Agreement distinguishes between direct and indirect financial contributions.

For a financial contribution to be a subsidy, it must be made by “a government or any public body,”²⁷ including regional and local authorities. Since the concept of a “public body” is not further defined, it raises the question of the correct interpretation of the term. In addressing the issue whether state-owned enterprises are considered public bodies, the Appellate Body adopted a narrower interpretation of “public body.” It explained that Art. 1.1 joins “government” in a narrow sense and “public body” under the collective term “government,” which suggests

²⁴ SCM Agreement, *supra* note 8, art. 1.1(a)(1)(iii).

²⁵ Panel Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/R, adopted 1 June 2011, para. 7.1036 [hereinafter Panel Report, *EC – Large Civil Aircraft*].

²⁶ *Id.*, para. 7.1037-7.1044 (stating that “we do not consider that there is any form or type of infrastructure which is inherently ‘general’ *per se*. For instance, in our view, such things as railroads or electrical distribution systems do not necessarily constitute ‘general infrastructure.’ Rather, the determination whether the provision of the good or service in question is ‘general infrastructure’ or not must be made on a case-by-case basis, taking into account the existence or absence of *de jure* or *de facto* limitations on access or use, and any other factors that tend to demonstrate that the infrastructure was or was not provided to or for the use of only a single entity or a limited group of entities”).

²⁷ SCM Agreement, *supra* note 8, art. 1.1(a)(1).

“certain commonalities in the meaning of the term ‘government’ in the narrow sense and the term ‘public body’ and a nexus between these two concepts.”²⁸

The Appellate Body identifies these core commonalities between government and public body as “the performance of governmental functions, or the fact of being vested with, and exercising, the authority to perform such functions.”²⁹ It is also acknowledged that the existence of mere formal links between an entity and government is unlikely to suffice to establish the necessary possession of governmental authority. Likewise, the absence of an express statutory delegation of authority does not necessarily preclude a determination that a particular entity is a public body.³⁰ Accordingly, different types of evidence may be relevant in establishing the public body requirement – and ownership can be a contributing factor, but not the decisive one.

An indirect financial contribution occurs when the government makes payments to a funding mechanism or when it entrusts or directs a private body to make payments.³¹ The purpose of this provision is to ensure that governments do not evade their obligations under the SCM Agreement by using a private body as a “proxy” to make the contribution.³²

The Appellate Body has clarified that “entrustment” occurs where a government “gives responsibility to a private body,” and “direction” refers to situations where the government “exercises its authority over a private body.”³³ Although the Appellate Body adopted a fairly

²⁸ Appellate Body Report, *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R, adopted 25 March 2011, para. 288.

²⁹ *Id.*, para. 290.

³⁰ *Id.*, para. 318 (stating that “[w]hat matters is *whether* an entity is vested with authority to exercise governmental functions, rather than *how* that is achieved”) (emphasis in original).

³¹ SCM Agreement, *supra* note 8, art. 1.1(a)(1)(iv).

³² Appellate Body, *US – DRAMS*, *supra* note 15, paras. 108, 115, 116.

³³ *Id.*, para. 116 (there, the Appellate Body disagreed with the Panel conclusion that “entrusts” contains the notion of “delegation”, while “directs” contains the notion of “command.” “Delegation” usually involves a formal action, while “entrusts” connotes giving responsibility to someone. Likewise, while governments can exercise authority by

broad interpretation of “entrustment or direction,” it identified two important limitations. First, the private body must have been entrusted or directed to carry out one of the forms of financial contribution covered by subparagraphs (i)-(iii).³⁴ Second, entrustment and direction suggest a more active role than mere acts of encouragement. In the Appellate Body’s view, in most cases it would involve “some form of threat or inducement.”³⁵ Furthermore, entrustment and direction do not cover the situation in which the government intervenes in the market in some way, which may or may not have a particular result simply based on the given factual circumstances and the exercise of free choice by the actors in that market. Thus, government “entrustment” or “direction” cannot be inadvertent or a mere by-product of governmental regulation.³⁶

c. Benefit to the Recipient A financial contribution by a government is a subsidy within the meaning of the SCM Agreement only if the financial contribution confers a “benefit.” Article 1 does not stipulate that the financial contribution must confer a benefit *on a recipient*. The Appellate Body, however, clarified that a benefit:

does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a “benefit” can be said to arise only if a person, natural or legal, or a group of persons, has in fact received something. The term “benefit,” therefore, implies that there must be a recipient.³⁷

command, they are likely to have other, more subtle, means at their disposal. Thus, both Panel’s interpretations were found too narrow (para. 110)).

³⁴ *Id.*, para. 112 (stating that “[a] situation where the government entrusts or directs a private body to carry out a function that is outside the scope of paragraphs (i) through (iii) would consequently fall outside the scope of paragraph (iv)”).

³⁵ *Id.*, paras. 114, 116.

³⁶ *Id.*, para. 114.

³⁷ Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, para. 154.

Consequently, whereas the requirement to show that a financial contribution has been made is a question that must be addressed from the perspective of the government (the donor), whether a benefit has been conferred must be assessed from the perspective of the recipient.³⁸

In assessing whether a recipient has received a benefit, WTO adjudicating bodies apply the private investor test. As the Appellate Body explained in *Canada – Aircraft*:

the word “benefit” . . . implies some kind of comparison. This must be so, for there can be no “benefit” to the recipient unless the “financial contribution” makes the recipient “better off” than it would otherwise have been, absent that contribution. In our view, the *marketplace provides an appropriate basis for comparison in determining whether a “benefit” has been “conferred”*, because the trade-distorting potential of a “financial contribution” can be identified by determining *whether the recipient has received a “financial contribution” on terms more favorable than those available to the recipient in the market.*³⁹

In other words, for a benefit to be demonstrated it must be shown that a recipient obtained an advantage, which it could not have obtained in the marketplace. The term “benefit,” therefore, refers to benefit *to the recipient*, and uses *the market* or private investors as a benchmark for determining the existence and amount of benefit. For example, in the case of a government loan, no benefit is conferred unless there is a difference between the amount that the firm receiving the loans pays on the government loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market.⁴⁰

It is important to note that the recipient of the benefit might be different from the recipient of the financial contribution. At least two types of cases are possible here: products

³⁸ Panel Report, *European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea*, WT/DS299/R, adopted 3 August 2005, paras. 7.212, 7.175.

³⁹ Appellate Body Report, *Canada – Aircraft*, *supra* note 37, para. 157 (emphasis added).

⁴⁰ SCM Agreement, *supra* note 8, art. 14. WTO adjudicating bodies have relied on Article 14 as the relevant context for the interpretation of “benefit” under Article 1.1(b) even though this provision serves in the context of CVDs investigation to determine the amount of subsidy in terms of the benefit to the recipient. See Appellate Body Report, *Canada – Aircraft*, *supra* note 37, para. 155; Appellate Body Report, *Canada – Renewable Energy/Feed-in Tariff Program*, *supra* note 12, paras. 5.163.

produced in previously subsidized state-owned enterprises and final products that are produced from subsidized inputs.

In *US – Countervailing Measures on Certain EC Products*, the panel and Appellate Body addressed whether a benefit derived from a non-recurring financial contribution continues to exist following a transfer of ownership of a state-owned enterprise to a new private owner at arm’s length and for fair market value. The U.S. argued that the fact that the private owner pays full market price for the enterprise indicates only that the private owner is not receiving a *new* subsidy. It does not indicate, however, that from the perspective of the legal person producing the subject merchandise, the effect of the subsidy has been eliminated.⁴¹ Both the Panel and the Appellate Body disagreed with this position:

... the value of the “benefit” under the SCM Agreement is to be assessed using the marketplace as the basis for comparison. It follows, therefore, that once a fair market price is paid for the equipment, its *market value* is redeemed, regardless of the utility the firm may derive from the equipment. Accordingly, it is the market value of the equipment that is the focal point of analysis, and not the equipment’s utility value to the privatized firm.⁴²

Yet, at the same time, the Appellate Body reversed the Panel’s conclusion that there was an irrebuttable presumption to the effect that every time a fair market value has been paid the benefit disappears. Instead, it concluded that the presumption is rebuttable even in the case of payment of the market value, and that the facts of the case will reveal whether a benefit continues to exist after privatization.⁴³

⁴¹ Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted 9 December 2002, para. 99 (stating that a change in ownership “does not remove the new equipment, extract knowledge from the workers, or increase the previously lowered debt load”).

⁴² *Id.*, para. 102 (emphasis in original).

⁴³ *Id.*, paras. 120-127 (Arguing that the Panel “overlooks the ability of governments to obtain certain results from markets by shaping the circumstances and conditions in which markets operate. Privatizations involve complex and long-term investments in which the seller – namely the government – is not necessarily always a passive price taker and, consequently, the ‘fair market price’ of a state-owned enterprise is not necessarily always unrelated to

In *US – Softwood Lumber IV*, the WTO adjudicative bodies faced a related question. Canada had granted a subsidy, through a stumpage program, to timber harvesters, who then sold trees (*standing timber*) to the *log* producers. The logs were further processed into *primary lumber* by sawmills (some of which were independent and others owned by timber harvesters); part of lumber was then further processed by independent manufactures into *remanufactured lumber*. The U.S. had imposed countervailing duties on primary and remanufactured lumber based on a determination of subsidization of the lumber producers through the stumpage programs. The key question for the Panel and Appellate Body was whether the lumber producer benefited from cheap trees that were provided by the government to the harvester and log producers. Put differently, did the benefit pass through to the lumber producers?

The Appellate Body acknowledged that:

Where a subsidy is conferred on input products, and countervailing duty is imposed on processed products, the initial recipient of the subsidy and the producer of the eventually countervailed product, may not be the same. In such a case, there is a direct recipient of the benefit – the producer of the input product. When the input is subsequently processed, the producer of the processed product is an indirect recipient of the benefit – provided it can be established that the benefit flowing from the input subsidy is passed through, at least in part, to the processed product.⁴⁴

The investigating authority must undertake a pass-through analysis when: (1) a subsidy is provided in respect of a product (not subject to investigation) that is an input into the processed, imported product that is the subject of the countervail investigation; and (2) the producer of the

government action. In privatizations, governments have the ability, by designing economic and other policies, to influence the circumstances and the conditions of the sale so as to obtain a certain market valuation of the enterprise.”).

⁴⁴ Appellate Body Report, *US – Softwood Lumber IV*, *supra* note 4, para. 144.

input product and the producer of the imported product subject to the countervail investigation are *unrelated*.⁴⁵

d. Specificity Article 1.2 of the SCM Agreement provides that subsidies are subject to the rules on prohibited and actionable subsidies, as well as the rules on countervailing duties, only if they are “specific.”⁴⁶ Accordingly, subsidies that are not “specific” cannot be challenged or countervailed.

The rationale for this requirement is, in the words of Professor Petros Mavroidis, that only specific subsidies can lead to inefficient resource allocation, and, eventually, to trade distortions; if a subsidy is generally available, then all productive units in a country can benefit from it, and there will be no diversion of resources to certain enterprises which would not otherwise have attracted such resources.⁴⁷ Another reason for the exclusion from countervailability of generally available subsidies seems to be the acknowledgment of the role that subsidies play in promoting legitimate policy goals.⁴⁸

⁴⁵ In *US – Softwood Lumber IV*, the Appellate Body concluded that in the situations when timber harvesters sell *logs* (which are not subject to the investigation) to *independent* sawmills for further processing into *primary lumber* (subject to the investigation), a pass-through analysis is required; while in the situations when timber harvesters that *own* sawmills process the *logs* they harvest into *primary lumber* (subject to the investigation) and sell this lumber to *unrelated* remanufacturers for further processing into *remanufactured lumber* (also subject to the investigation), no pass-through analysis was required. *Id.*, paras. 145-64.

⁴⁶ SCM Agreement, *supra* note 8, art. 1.2.

⁴⁷ PETROS C. MAVROIDIS, *TRADE IN GOODS: THE GATT AND THE OTHER WTO AGREEMENTS REGULATING TRADE IN GOODS* 549 (Oxford University Press 2012); *see also* MARC BENITAH, *THE LAW OF SUBSIDIES UNDER THE GATT/WTO SYSTEM* 258 (2001) (“[A] specific subsidy gives the industry having selectively received such a subsidy a wrong signal as to its real production costs. This leads this industry to artificially overproduce the subsidized goods relative to what it would have produced in a situation with undistorted production costs. At the same moment, more socially valued goods are under-produced due to the lack of productive resources. This type of ‘distortion’ would not have taken place had the subsidy been generally available to all industries.”); Warren E. Schwartz & Eugene W. Harper, Jr., *The Regulation of Subsidies Affecting International Trade*, 70 MICH. L. REV. 831, 840 (1972) (“... resources will be employed in the producing of the subsidized goods rather than other goods of greater real value.”).

⁴⁸ SIMON LESTER, BRYAN MERCURIO & ARWELL DAVIES, *WORLD TRADE LAW: TEXT, MATERIALS AND COMMENTARY* 429 (2012).

According to Article 2, a subsidy is specific when it has been provided explicitly to an enterprise, an industry or a group of enterprises or industries.⁴⁹ The SCM Agreement distinguishes between four types of specificity: (1) enterprise specificity; (2) industry specificity; (3) regional specificity; and (4) prohibited subsidies, which are considered specific *per se*.⁵⁰

A subsidy is *de jure* specific if “the granting authority, or the legislation pursuant to which the granting authority operates, *explicitly limits* access to a subsidy to certain enterprises.”⁵¹ The Appellate Body explained that a limitation is “explicit” if it is “express, unambiguous, or clear from the content of the relevant instrument, and not merely ‘implied’ or ‘suggested.’”⁵² It further clarified that a subsidy will be specific if access is limited to the financial contribution, to the benefit or to both.⁵³

If the criteria and conditions governing eligibility for, and the amount of, a subsidy are objective, the subsidy is not specific, provided that eligibility is automatic and the criteria and conditions are strictly applied.⁵⁴ According to footnote 2 to the SCM Agreement, these criteria and conditions are considered “objective” if they are neutral, do not favor certain enterprises over others, and are economic in nature and horizontal in application.⁵⁵

Even if on its face a subsidy is not specific, it still can be specific *de facto*. In assessing whether a subsidy is *de facto* specific the factors to be considered are: (1) the use of a subsidy program by a limited number of certain enterprises; (2) the predominant use by certain

⁴⁹ SCM Agreement, *supra* note 8, art. 2.

⁵⁰ *Id.*

⁵¹ SCM Agreement, *supra* note 8, art. 2.1(a) (emphasis added).

⁵² Appellate Body Report, *US – Anti-Dumping and Countervailing Duties (China)*, *supra* note 28, para. 372.

⁵³ *Id.*, para. 378.

⁵⁴ SCM Agreement, *supra* note 8, art. 2.1(b) (“The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.”).

⁵⁵ SCM Agreement, *supra* note 8 n.2.

enterprises; (3) the granting of disproportionately large amounts of subsidy to certain enterprises; and (4) the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.⁵⁶ In *US – Softwood Lumber IV*, the Panel clarified that there is no need to show intent (deliberate action by the government) in order to satisfy the *de facto* requirement. What matters is that at least one of the four above mentioned criteria has been met.⁵⁷

2. Classification of Subsidies

As noted earlier, the WTO rules on subsidies only apply to measures that are subsidies within the meaning of Article 1.1, and which are also specific, as defined in Article 2. However, granting a subsidy covered under Articles 1 and 2 does not necessarily constitute an inconsistency with the SCM Agreement. The Agreement groups subsidies in three categories (prohibited, actionable and non-actionable subsidies), each imposing different discipline.

a. Prohibited Subsidies Article 3 of the SCM Agreement prohibits: (1) export subsidies; and (2) import substitution subsidies.⁵⁸ Thus, WTO Members may not grant or maintain these types of subsidies.

Export subsidies are “subsidies contingent, in law or in fact . . . upon export performance, including those illustrated in Annex I.”⁵⁹ The language of the article suggests that there are two

⁵⁶ SCM Agreement, *supra* note 8, art. 2.1(c).

⁵⁷ Panel Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/R, adopted 17 February 2004, para. 7.116 (stating that Article 2 is concerned with the distortion that is created by a subsidy which “either in law or in fact is not broadly available” and does not, therefore, require an investigation into the intent of the subsidizing country).

⁵⁸ SCM Agreement, *supra* note 8, art. 3.

categories of export subsidies: subsidies listed in Annex I (Illustrative List of Export Subsidies) and other subsidies that are contingent upon export performance.⁶⁰

The Illustrative List in Annex I includes eleven types of export subsidies and it is basically the same as the list included in the previous Subsidies Code.⁶¹ A subsidy that falls within the scope of the Illustrative List is *deemed* to be a prohibited subsidy: there is no additional requirement to demonstrate that it is contingent upon export performance under Article 3.1(a).⁶² Additionally, because of the language of Article 3.1(a), which reads that “the following subsidies, within the meaning of Article 1, shall be prohibited, it would appear that there is the need to demonstrate the subsidy elements. However, as the Panel concluded in *Korea – Commercial Vessels*, given the *per se* nature of the items set forth in the Illustrative List, no further separate analysis under Article 1 is necessary.⁶³ Therefore, merely establishing that a measure falls under any type of subsidy included in the Illustrative List is sufficient for a finding that it constitutes a prohibited export subsidy.

Article 3.1(a) also prohibits subsidies contingent, in law or in fact, upon export performance. In contrast to subsidies covered by the Illustrative List, this type of export subsidy

⁵⁹ *Id.*, art. 3.1(a).

⁶⁰ As the Appellate Body explained: “[t]he use of the word ‘including’ in Article 3 . . . clearly indicates that there are measures other than those listed in the Illustrative List that could be covered by Article 3.” See *Brazil – Aircraft*, *supra* note 13, para. 34.

⁶¹ Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (MTN/NTM/W/236, April 5, 1979), Annex “Illustrative list of Export Subsidies” [hereinafter Subsidies Code].

⁶² Panel Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/AB/RW, adopted 4 August 2000, para. 6.31 (stating that “[t]his is confirmed from the words ‘subsidies contingent’ . . . upon export performance, *including* those illustrated in Annex I” (emphasis in original), which in their ordinary meaning tell us that measures identified in the Annex are *ipso facto* ‘subsidies contingent upon export performance’”).

⁶³ Panel Report, *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, adopted 11 April 2005, para. 7.204 n.126 (noting that “[t]his perhaps reflects the historical context of the *Illustrative List*, in the sense that it was first drafted before the definition of “subsidy” set forth in the *SCM Agreement* was introduced”).

is present only if both elements are demonstrated: a *subsidy* that is *contingent on exportation*.⁶⁴ First, it should be established that the measure in question is a “subsidy” within the meaning of Article 1 (a financial contribution by a government conferring a benefit). Second, it is necessary to demonstrate that it is contingent *de jure* or *de facto* upon export performance under Article 3.1(a). *De jure* export contingency is demonstrated on the basis of the words of the relevant legislation, regulation, or legal instrument.⁶⁵ *De facto* export contingency is interpreted in footnote 4 of the SCM Agreement:

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.⁶⁶

In *EC – Large Civil Aircraft*, the Appellate Body further clarified that whereas “actual exportation” refers to exportation that has occurred at the time a subsidy is granted, “anticipated exportation” means exportation that is expected by the granting authority (not by the recipient) to occur in the future.⁶⁷ The legal standard for *de facto* export contingency requires that there exist a relationship of conditionality between the granting of the subsidy and anticipated exportation. Such conditionality can be established by recourse to the following test: “is the granting of the subsidy geared to induce the promotion of future export performance by the recipient?”⁶⁸ As the Appellate Body explained, this standard is only met when the subsidy is granted “so as to provide an incentive to the recipient to export in a way that is not simply reflective of the

⁶⁴ DOMINIC COPPENS, *WTO DISCIPLINES ON SUBSIDIES AND COUNTERVAILING MEASURES: BALANCING POLICY SPACE AND LEGAL CONSTRAINTS* 119 (Cambridge University Press 2014).

⁶⁵ Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 167.

⁶⁶ SCM Agreement, *supra* note 8 n.4 (emphasis added).

⁶⁷ Appellate Body Report, *European Communities and Certain member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/AB/R, adopted 1 June 2011, para. 1043.

⁶⁸ *Id.*, para. 1044.

conditions of supply and demand in the domestic and export markets undistorted by the granting of the subsidy.”⁶⁹ In other words, the mere fact that the subsidy increases the recipient’s export sales is not sufficient for establishing an export subsidy. The standard is only met if the subsidy is designed to increase the firm’s ratio of export sales to domestic sales.⁷⁰

Import substitution subsidies are subsidies contingent upon the use of domestic over imported goods.⁷¹ This is the only form of domestic subsidy that is prohibited.

Similarly to export subsidies, the WTO adjudicating bodies apply a two-part analysis for import substitution subsidies. First, it must be established that the measure in question is a “subsidy” within the meaning of Article 1. Second, this subsidy must be “contingent . . . upon the use of domestic over imported goods.”⁷² The legal standard of contingency is considered similar to that under the export contingency standard.⁷³ The one key difference between the two provisions is that Article 3.1(a) explicitly refers to subsidies both “in law” and “in fact,” whereas

⁶⁹ *Id.*, para. 1045.

⁷⁰ The Appellate Body gives the following example:

Assume that a subsidy is designed to allow a recipient to increase its future production by five units. Assume further that the existing ratio of the recipient’s export sales to domestic sales, at the time the subsidy is granted, is 2:3. The granting of the subsidy will *not* be tied to anticipated exportation if, all other things being equal, the anticipated ratio of export sales to domestic sales is not greater than the existing ratio. In other words, if, under the measure granting the subsidy, the recipient would not be expected to export more than two of the additional five units to be produced, then this is indicative of the absence of a tie. By contrast, the granting of the subsidy would be tied to anticipated exportation if, all other things equal, the recipient is expected to export at least three of the five additional units to be produced. In other words, the subsidy is designed in such a way that it is expected to skew the recipient’s future sales in favour of export sales, even though the recipient may also be expected to increase its domestic sales.

Id., para. 1048.

⁷¹ SCM Agreement, *supra* note 8, art. 3.1(b).

⁷² *Id.*

⁷³ Appellate Body Report, *Canada – Certain measures Affecting the Automotive Industry*, WT/DS139, 142/AB/R, 31 May 2000, para. 123 (stating that “this legal standard applies not only to ‘contingency’ under Article 3.1(a), but also to ‘contingency’ under Article 3.1(b) of the SCM Agreement.”).

Article 3.1(b) does not. Nevertheless, the Appellate Body has explained that Article 3.1(b) covers both *de jure* and *de facto* contingency.⁷⁴

b. Actionable Subsidies Any specific subsidy within the meaning of Articles 1 and 2 is subject to challenge in the event it causes adverse effects to the interests of another Member.⁷⁵ Article 5 distinguishes between three types of “adverse effect”: (1) injury to the domestic industry of another Member (Article 5(a)); (2) nullification or impairment of benefits accruing directly or indirectly to other Members under the GATT 1994 (Article 5(b)); and (3) serious prejudice, including a threat thereof, to the interests of another Member (Article 5(c)).

Subsidies causing injury to the domestic industry are subject to challenge when three conditions are fulfilled: (1) there are *subsidized imports*, i.e. imports of products from producers who benefited from specific subsidies within the meaning of Articles 1 and 2; (2) there is *injury* to the domestic industry of the like products; and (3) there is a *causal link* between the subsidized imports and the injury to the domestic industry.

Injury must be caused to the domestic industry producing the “like product.” The concept of “like product” is defined in footnote 46 to the SCM Agreement as:

a product which is *identical*, i.e. alike in all respects to the product under consideration, or in the absence of such a product, another products which, although not alike in all respects, has characteristics *closely resembling* those of the product under consideration.⁷⁶

⁷⁴ *Id.*, paras. 135-43. (the Appellate Body noted that Article III:4 of the GATT also addresses measures that favour the use of domestic over imported products but covers both *de jure* and *de facto* inconsistency. Thus, in the Appellate Body’s view, “it would be most surprising if a similar provision in the *SCM Agreement* applied only to situations involving *de jure* inconsistency.” Furthermore, a finding that Article 3.1(b) extends only to contingency “in law” would “make circumvention of obligations by Members too easy.”)

⁷⁵ SCM Agreement, *supra* note 8, art. 5.

⁷⁶ *Id.* n.46 (emphasis added).

When compared to the definition of “like product” in non-discrimination provisions (Articles I and III of the GATT), the definition in the SCM Agreement seems narrower. Professor Won-Mog Choi identifies two reasons for that. First, since Articles I and III are basic anti-discrimination provisions at the heart of the GATT, the term should be construed broadly so as to strike down discriminatory measures wherever possible. In the case of anti-subsidy measures, on the other hand, the term should be interpreted most narrowly, since this provision establishes exceptions to general GATT rules. Second, by drawing too broad a category of “like product,” it can be more difficult for complainants to meet the standing criteria and to prove injury.⁷⁷ Although it is generally accepted that the concept of “like product” has different meaning in the different provisions, the elements to consider in establishing “likeness” are basically the same: physical characteristics, end uses, consumer habits and preferences, substitutability, and tariff classification.⁷⁸

Article 16.1 of the SCM Agreement defines “domestic industry” as:

the domestic producers as a whole of the like products or . . . those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products.⁷⁹

In cases where producers are related to the exporters or importers, or are themselves importers of the subsidized product, such producers may be excluded.⁸⁰ As these producers likely benefit

⁷⁷ WON-MOG CHOI, ‘LIKE PRODUCTS’ IN INTERNATIONAL TRADE LAW: TOWARDS A CONSISTENT GATT/WTO JURISPRUDENCE 91, 128 (Oxford University Press 2003).

⁷⁸ See, e.g., Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54, 55, 59, 64/R, adopted 23 July 1998, para. 14.173 (stating that “we do not see that the SCM Agreement precludes us from looking at criteria other than physical characteristics, where relevant to the like product analysis. The term ‘characteristics closely resembling’ in its ordinary meaning includes but not limited to physical characteristics, and we see nothing in the context or object and purpose of the SCM Agreement that would dictate a different conclusion.”).

⁷⁹ SCM Agreement, *supra* note 8, art. 16.1.

⁸⁰ *Id.*

from the subsidized imports as a result of such relationship, they do not share the same interest with the rest of the domestic industry and unlikely are injured.⁸¹

The concept of “injury” to domestic industry covers: (1) material injury; (2) a threat of material injury to a domestic industry; and (3) material retardation of the establishment of a domestic industry.⁸² The “material injury” standard in the SCM Agreement is lower than the “serious injury” standard for safeguard measures because anti-subsidy measures counteract unfair trade actions.⁸³

Finally, a causal link between the subsidized imports and the injury to the domestic industry must be established. Article 15.5 also contains a “non-attribution” requirement. According to this requirement, investigating authorities *must* examine any known factors other than the subsidized imports that are injuring the domestic industry at the same time and they must not attribute the injury caused by these other factors to the subsidized imports.⁸⁴

Subsidies also have adverse effects on the interests of other Members when the subsidized imports cause the nullification or impairment of benefits accruing directly or indirectly to other Members under the GATT. According to footnote 12 to the SCM Agreement, the term “nullification and impairment” is used in the same sense as it is used in Article XXIII:1(b) of the GATT (non-violation complaints).⁸⁵ In several cases, panels have acknowledged that nullification and impairment arises when the effect of a tariff concession is

⁸¹ COPPENS, *supra* note 64, at 234.

⁸² SCM Agreement, *supra* note 8 n.45.

⁸³ See Panel Report, *EC – Large Civil Aircraft*, *supra* note 25, para. 7.2083; Appellate Body Report, *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*, WT/DS177, 178/AB/R, adopted 16 May 2001, para. 124.

⁸⁴ SCM Agreement, *supra* note 8, art. 15.5 (“Factors which may be relevant in this respect include, inter alia, the volumes and prices of nonsubsidized imports of the product in question, contraction in demand or changes in patterns of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry.”).

⁸⁵ *Id.* n.12.

systematically offset or counteracted by a subsidy program.⁸⁶ The high standard of “systematic offsetting/counteracting” is set to preserve the exceptional nature of the non-violation remedy.⁸⁷

Finally, subsidies have adverse effects on the interest of other Members when they cause serious prejudice to the interests of another WTO Member. Currently,⁸⁸ according to Article 6.3 “serious prejudice” or “threat of serious prejudice” *may* arise where a subsidy has one or more of the following effects: (1) the subsidy displaces or impedes the imports of a like product of another Member into the market of the subsidizing Member; (2) the subsidy displaces or impedes the exports of a like product of another Member from a third country market; (3) the subsidy results in a significant price undercutting by the subsidized product in comparison to the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market; or (4) the subsidy leads to increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity in comparison to the average share it had during the previous period of three years.⁸⁹

⁸⁶ See, e.g., GATT Panel Report, *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, adopted 25 January 1990, BISD 37S/86, paras. 147-48; Panel Report, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS 217, 234/R, adopted 16 September 2002, para. 7.127.

⁸⁷ The Panel explained that “[a]ny subsidy to domestic producers is likely to have some adverse effect on the competitive relationship between domestic and imported products. However, the fact that there will be some impact should not be sufficient to uphold a claim of non-violation nullification or impairment. Otherwise, any specific domestic subsidy programme which is related to a product on which there is a tariff concession could constitute the non-violation nullification or impairment of benefits. This would hardly make non-violation nullification or impairment an “exceptional” or “unusual” remedy, as the Appellate Body has said it should be.” See *US – Offset Act* n.341.

⁸⁸ “Dark amber” category set out in Article 6.1, i.e. four categories of subsidies presumed to cause serious prejudice, with the burden shifted to the respondent state to show that no adverse effects were caused by the challenged measure, expired at the end of 1999 because there was no consensus among members in favor of continuing its existence. As Hoda and Ahuja explained, the drafters of the WTO Agreement conceived of the stricter discipline in Article 6.1 and the concession on non-actionability under Article 8 as a package and thus their future was bound together, as a result both expired after a period of five years. See Anwarul Hoda & Rajeev Ahuja, *Agreement on Subsidies and Countervailing Measures: Need for Clarification and Improvement*, 39 J. WORLD TRADE 1009, 1061 (2005).

⁸⁹ SCM Agreement, *supra* note 8, art. 6.3.

If a complaining Member can show that a subsidy within the meaning of Articles 1 and 2 has any of these effects, then “serious prejudice” may be found to exist.

In *Korea – Commercial Vessels*, Korea argued that a finding of serious prejudice requires additional elements, such as injury to domestic industry and/or the importance of that industry to the overall interests of complaining party. However, the Panel disagreed, stating that serious prejudice is an entirely different concept from injury. Rather than having to do with the condition of a particular domestic industry within the territory of a Member (the subject matter of injury analysis), in the Panel’s view serious prejudice has to do in the first instance with negative effects on a Member’s *trade interests* in respect of a product caused by another Member’s subsidization.⁹⁰

Although the complainant has to demonstrate that the challenged subsidies are causing adverse effects, Article 6.3 only requires present adverse effects during the reference period, and not present subsidization. In *EC – Large Civil Aircraft*, the Appellate Body concluded that the requirement that the effects of subsidies be felt in the reference period does not mean that the subsidies, and in particular the benefit conferred, must also be present during that period. By its terms, Article 6 imposes an obligation on Members not to cause adverse effects to the interests of other Members through the use of any subsidy as defined in Article 1. Thus, this obligation continues to exist in respect of subsidies that have come to an end by the time of the reference period.⁹¹

c. Non-actionable Subsidies These are subsidies that are allowed and therefore may not be countervailed. The provisions of Article 8 on non-actionable subsidies are no longer in force,

⁹⁰ Panel Report, *Korea – Commercial Vessels*, *supra* note 63, paras. 7.576-7.580 (emphasis in original).

⁹¹ Appellate Body Report, *EC – Large Civil Aircraft*, *supra* note 66, para. 712.

having lapsed five years after the SCM Agreement's entry into force, because there was no consensus in favor of continuing the application of Article 8. As from 1 January 2000, the categories of research and development, regional and environmental subsidies have been actionable, provided that they are specific.

Article 8 identifies two groups of non-actionable subsidies: (1) subsidies that are not specific within the meaning of Article 2; and (2) certain types of specific subsidies, such as certain narrowly defined research and development subsidies, regional, and environmental subsidies.⁹²

WTO Members must notify the SCM Committee of such subsidies before their adoption in order to benefit from non-actionable subsidy status.⁹³ Thus, if a subsidy is not notified, it may be actionable and countervailable. However, such subsidies are still non-actionable if they are found during a countervailing or multilateral proceeding to conform to the standards set forth in Article 8.2.⁹⁴ In fact, no single formal notification was made over the entire period that Article 8 was in place.⁹⁵

3. Counteracting Subsidies

The SCM Agreement provides WTO members with two possibilities for counteracting subsidies: (1) *multilateral*, when a WTO Member confronted with prohibited or actionable subsidies imposed by other Members may use the WTO dispute settlement system to force the Member acting in violation of the SCM's subsidies regime to return to WTO-compatible behavior, and

⁹² SCM Agreement, *supra* note 8, arts. 8.1, 8.2.

⁹³ *Id.*, art. 8.3.

⁹⁴ *Id.* n.35.

⁹⁵ G/SCM/W/546/Rev. 2, April 26, 2006, para. 17.

(2) *unilateral*, when a WTO Member may take unilateral actions by imposing countervailing duties (CVDs) to offset the effect of the prohibited or actionable subsidy in its domestic market. While the multilateral approach requires a WTO Member to bring the case before the WTO adjudicating bodies,⁹⁶ the unilateral approach is normally initiated by the domestic industry injured by the subsidized imports.⁹⁷ In the latter case, nevertheless, the final decision whether or not to impose CVDs is made by the importing WTO Member. Article 19.2 of the Agreement makes it clear that the imposition of CVDs even in cases where all requirements for such imposition have been fulfilled is a *right* and not an *obligation* of a WTO Member.⁹⁸

Although the Agreement allows pursuing multilateral and unilateral approaches at the same time, with regard to the effects of a particular subsidy a WTO Member has to choose only one of the two forms of relief.⁹⁹ Yet the Agreement does not prohibit a WTO Member from pursuing the unilateral approach to offset the negative effects in its domestic market, alongside the multilateral approach to address the negative effects of the same subsidy in its export markets.¹⁰⁰ In some situations, however, only one option is available.

In general, three scenarios are possible. First, subsidies of country A enhance export potential of products into importing country B, causing harm to the domestic producers in country B. In this situation, both options are available for country B. The unilateral avenue has obvious advantages since it is a more direct route to take than challenging subsidies at the WTO.

⁹⁶ SCM Agreement, *supra* note 8, arts. 4.4, 7.4.

⁹⁷ *Id.*, arts. 11.1, 11.6 (it can be also initiated “by the authorities of their own accord.”).

⁹⁸ *Id.*, art. 19.2 (“[t]he decision whether or not to impose a countervailing duty in cases where all requirements for the imposition have been fulfilled . . . to be made by the authorities of the importing Member.”).

⁹⁹ *Id.* n.35 (“The provisions of Part II or III may be invoked in parallel with the provisions of Part V; however, with regard to the effects of a particular subsidy in the domestic markets of the importing Member, only one form of relief (either a countervailing duty . . . or a countermeasure under Articles 4 or 7) shall be available”).

¹⁰⁰ M. MATSUSHITA, T.J. SCHOENBAUM, P.C. MAVROIDIS & M. HAHN, *THE WORLD TRADE ORGANIZATION: LAW, PRACTICE, AND POLICY* 304 (3d ed. 2015) (arguing that in this case “neither the letter nor the spirit of footnote 35 exclude the simultaneous but not overlapping use of both CVDs and of the multilateral track.”).

The investigation is initiated and controlled by the national authorities that autonomously determine the existence of a subsidy, the amount of subsidization and injury.¹⁰¹ Even though CVDs may be later challenged in the WTO, as Professor Davey points out, since WTO dispute settlement takes several years to produce a result, the fact that a CVD may at some time in the future be found WTO-inconsistent, does not preclude its effectiveness in alleviating harm caused to domestic industry in the meantime.¹⁰² Likewise, while CVDs are imposed by national authorities of the country that receives the subsidized imports, the only remedy available under the multilateral track is removal of the adverse effect or withdrawal of the subsidy by a subsidizing Member,¹⁰³ which may raise the problem of non-compliance. On the other hand, it is important to note here that the adoption of CVDs only neutralizes the effects of the subsidy in the market of the Member that receives the subsidized imports, but it does not extinguish the subsidy. Professor Mavroidis points out that the imposition of CVDs may protect the domestic industry at home, but may be at the expense of the domestic industry's export performance, as the subsidized products move to other markets.¹⁰⁴ Moreover, prohibited subsidies can only be challenged unilaterally when they cause injury to the domestic industry of the importing country, while a multilateral option does not require this condition.¹⁰⁵

The second possible scenario is when subsidies from country A enhance the exportation of its products to country C, where they compete with similar products that are exported from country B. And finally, if country A subsidizes products that are sold in its home market, it is

¹⁰¹ SCM Agreement, *supra* note 8, art. 11.2.

¹⁰² William J. Davey, *Subsidy Control in the GATT/WTO: Surveillance and Litigation*, in *WHAT SHAPES THE LAW? REFLECTIONS ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES* 61, 63 (Luca Rubini & Jennifer Hawkins eds., 2016).

¹⁰³ SCM Agreement, *supra* note 8, arts. 4.7, 7.8.

¹⁰⁴ MAVROIDIS, *supra* note 47, at 603.

¹⁰⁵ SCM Agreement, *supra* note 8, arts. 3, 11.2.

harder for countries B and C to export similar goods to country A. In both of these situations, country B cannot respond with CVDs; its only option is to follow the multilateral approach and bring the case before the WTO adjudicating bodies.

a. The Multilateral Option In addition to general rules of the Dispute Settlement Understanding (DSU), the SCM Agreement contains special procedural rules that apply to actions brought at the WTO regarding prohibited (Article 4) and actionable (Article 7) subsidies.

Regarding prohibited subsidies, the time-limits for actions under the SCM Agreement are half as long as those for proceedings under the DSU. Consultations may be requested with any WTO Member believed to be granting or maintaining a prohibited subsidy. If consultations fail within 30 days, the complaining member may then refer the matter to the Dispute Settlement Body (DSB).¹⁰⁶ Given the compulsory nature of WTO jurisdiction, a responding member has no choice but to accept the jurisdiction of the WTO dispute system.¹⁰⁷ The Panel must issue its report in a period of 90 days after it is established.¹⁰⁸ Where a Panel report is appealed, the Appellate Body must issue its decision within 30 days (with the possibility of extending this term up to 30 more days) from the date when the party to the dispute notifies its intention to appeal. The Appellate Body report should be adopted by the DSB within 20 days following its issuance to the Members unless the DSB decides by consensus not to adopt the report. The adopted Appellate Body report is accepted unconditionally by the parties to the dispute.¹⁰⁹

¹⁰⁶ SCM Agreement, *supra* note 8, art. 4.4.

¹⁰⁷ Dispute Settlement Rules: Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 354 (1999), 1869 U.N.T.S. 401, 33 I.L.M. 1226 (1994), art. 6.1 (“If the complaining party so requests, a panel shall be established at the latest at the DSB meeting following that at which the request first appears as an item on the DSB’s agenda.”) [hereinafter DSU].

¹⁰⁸ SCM Agreement, *supra* note 8, art. 4.6

¹⁰⁹ *Id.*, art. 4.9.

If a subsidy is found by a WTO adjudicating body to be prohibited, the subsidizing Member must “withdraw the subsidy without delay.”¹¹⁰ The Panel must specify the time period within which the subsidy must be withdrawn.¹¹¹ As the Appellate Body explained in *Brazil – Aircraft*, withdrawal of the prohibited subsidy involves removal of the subsidy.¹¹² In the case of recurring subsidies, it seems clear that if payments continue to be made, the subsidy has not been withdrawn.¹¹³ The question remaining is what constitutes “withdrawal” in the case of non-recurring subsidies that have been granted in the past. In *Australia – Automotive Leather II*, the U.S. proposed repayment only of the ongoing benefit conferred by the subsidy since the adoption of the panel report,¹¹⁴ which would be in line with the general principle that WTO law only provides for prospective remedies. The Panel, however, went further and concluded that repayment *in full* of the subsidy, and not just the prospective portion of the subsidy as allocated over time, was the only way to “withdraw” such subsidies.¹¹⁵ This ruling was heavily criticized by WTO Members and scholars because of its retroactive character, and to date this approach has not been adopted by other Panels.

If a recommendation to withdraw the subsidy is not followed within the time period set by the Panel, the DSB must, upon the request of the original complainant, authorize “appropriate

¹¹⁰ *Id.*, art. 4.7.

¹¹¹ *Id.*

¹¹² Appellate Body Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/AB/RW, adopted 4 August 2000, para. 45.

¹¹³ *Id.*, (stating that “[i]n our view, to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to ‘withdraw’ prohibited export subsidies, in the sense of ‘removing’ or ‘taking away.’”).

¹¹⁴ Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States*, WT/DS126/RW, adopted 11 February 2000, paras. 6.16, 6.21.

¹¹⁵ *Id.*, 6.39.

countermeasures.”¹¹⁶ Footnote 9 to the SCM Agreement explains that “appropriate” means not disproportional. Based on the notion that the case of prohibited subsidies is the only instance where the WTO Agreement not only explicitly outlaws a practice, but also modifies the substantive content of a Panel’s or Appellate Body’s recommendation, WTO adjudicating bodies have consistently held that the punishment of prohibited subsidies through countermeasures can be harder than the punishment of any other breach of the WTO Agreement.¹¹⁷

Like remedies for prohibited subsidies, the remedies for actionable subsidies also differ from the remedies provided for in the DSU. However, the time-frames are longer, compared with the remedies for prohibited subsidies. If consultations do not result in a mutually agreed solution within 60 days, any Member party to such consultations may refer the matter to the DSB for the establishment of a Panel.¹¹⁸ The Panel must issue its report within 120 days after it is established¹¹⁹ and the Appellate Body must issue its decision within 60 days, with the possibility of extending the term up to 30 more days.¹²⁰

If a panel concludes that a subsidy causes adverse effects to the interests of another Member (be it injury, nullification or impairment, or serious prejudice), the subsidizing Member “shall take appropriate steps to remove the adverse effect or . . . withdraw the subsidy.”¹²¹ In other words, the subsidizing country is not required to withdraw the subsidy as long as it

¹¹⁶ SCM Agreement, *supra* note 8, art. 4.10, 4.11 (The defending party could refer the matter to arbitration if it does not agree that the proposed level is appropriate).

¹¹⁷ PETROS C. MAVROIDIS, PATRICK A. MESSERLIN & JASPER M. WAUTERS, *THE LAW AND ECONOMICS OF CONTINGENT PROTECTION IN THE WTO* 425-26 (2008) (noting that “whereas Art. 19 DSU requests Panel, assuming that they found that a violation occurred, to recommend that the WTO Member concerned bring its measures into compliance, without specifying how, Art. 4.7 SCM requests from Panels, in case they found that a prohibited subsidy was granted to recommend that ‘the subsidizing member withdraw the subsidy without delay.’”).

¹¹⁸ SCM Agreement, *supra* note 8, art. 7.4.

¹¹⁹ *Id.*, art. 7.5.

¹²⁰ *Id.*, art. 7.7.

¹²¹ *Id.*, art. 7.8.

removes its adverse effects, which should be done within 6 months from the date when the DSB adopts the Panel or Appellate Body report.¹²² Instead of withdrawing the subsidy or removing its adverse effects, the subsidizing Member can also agree with the complaining member on compensation.¹²³ It is worth emphasizing that in this specific context, compensation is a permanent alternative for bringing the measure into consistency with WTO law, which is not the case under general WTO dispute settlement rules where compensation is a temporary remedy only available in the event when a final remedy, i.e. the withdrawal of the WTO-inconsistent measure, has not been implemented.¹²⁴

In case of non-compliance, the injured WTO Member can take countermeasures that must be “commensurate with the degree and nature of the adverse effect” of the subsidies granted.¹²⁵ By contrast with certain cases dealing with countermeasures for prohibited subsidies, where arbitrators decided that the amount of the countermeasures should be based on the amount of the subsidy and not its trade effect,¹²⁶ here it seems that the level of countermeasures has to correspond to the adverse effects endured by the complaining member.¹²⁷

¹²² *Id.*, art. 7.9.

¹²³ *Id.*

¹²⁴ DSU, *supra* note 107, art. 22.1 (“Compensation and the suspension of concessions . . . are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions . . . is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreement.”).

¹²⁵ SCM Agreement, *supra* note 8, art. 7.9.

¹²⁶ Decision by the Arbitrators, *Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS46/ARB, August 28, 2000, para. 3.60; Decision by the Arbitrators, *United States – Tax Treatment for “Foreign Corporations” – Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS108/ARB, August 30, 2002, paras. 5.41, 5.49, 6.33, 6.35; Decision by the Arbitrator, *Canada – Export Credits and Loan Guarantees for Regional Aircraft – Recourse to Arbitration by Canada under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, circulated February 17, 2003.

¹²⁷ There has been no jurisprudence so far in the context of Article 7.9 of the SCM Agreement, therefore we can only speculate as to the precise scope of the term “commensurate with the degree and nature of the adverse effect.”

b. The Unilateral Option If a WTO Member can demonstrate that subsidized imports are causing injury to the domestic industry, it is allowed to take unilateral action against such a subsidy. A WTO Member does not need the WTO's approval before it can impose CVDs. However, the SCM Agreement disciplines this unilateral option by providing that CVDs may only be imposed pursuant to an investigation in accordance with the procedural and substantive obligations stipulated in Part V of the Agreement.

An investigation can be initiated either by, or on behalf of, the domestic industry allegedly injured by the subsidized imports, or by the authorities of their own accord.¹²⁸ The application by the domestic industry must contain sufficient evidence of the existence of (1) a subsidy, (2) injury to the domestic industry; and (3) a causal link between the subsidized imports and the alleged injury.¹²⁹ When the investigating authority decides to initiate an investigation, it is required to notify exporters of the subsidized products and the exporting Member.¹³⁰ Article 12 provides for certain "due process" rights on the gathering of evidence. In particular, interested Members and all interested parties in an investigation must be given notice of the information which the authorities require and ample opportunity to present in writing all evidence which they consider relevant.¹³¹ They must also have the right to present information orally.¹³²

Procedural requirements for CVD investigations are largely the same as those for anti-dumping investigations set out in the Anti-dumping Agreement. Yet, at the same time, Mavroidis, Messerlin and Wauters point out that the important difference is the obvious involvement of the subsidizing government. This makes CVD actions much more sensitive

¹²⁸ SCM Agreement, *supra* note 8, arts. 11.1, 11.6.

¹²⁹ *Id.*, art. 11.2.

¹³⁰ *Id.*, art. 22.

¹³¹ *Id.*, art. 12.1.

¹³² *Id.*, art. 12.2.

politically and partly explains why this instrument is used less frequently than anti-dumping actions.¹³³ Likewise, according to Dominic Coppens, it explains why “due process” requirements in CVD procedures with regard to foreign governments are more extensive.¹³⁴ In particular, once the complaint has been accepted, Members whose products may be subject to investigation must be invited for consultations with the aim of clarifying the situation and arriving at a mutually agreed solution.¹³⁵

If a final determination is made that a subsidy has caused injury, a Member is allowed to impose definitive CVDs unless the subsidy is withdrawn.¹³⁶ A CVD must never exceed the amount of the subsidy.¹³⁷ The SCM Agreement also contains a lesser duty provision, providing that it is desirable that the duty be less than the total amount of the subsidy if such lesser duty would be adequate to remove the injury to the domestic industry.¹³⁸ CVDs may not be imposed retroactively, i.e. they may only be applied to products imported after the decision to impose CVDs enters into force.¹³⁹ Article 21.1 states that CVDs shall remain in place “as long as and to the extent necessary to counteract subsidization which is causing injury.”¹⁴⁰ Nevertheless, the SCM Agreement provides for a “sunset” clause under which all CVDs must be withdrawn five

¹³³ MAVROIDIS, MESSERLIN & WAUTERS, *supra* note 117, at 375.

¹³⁴ COPPENS, *supra* note 64, at 222.

¹³⁵ SCM Agreement, *supra* note 8, art. 13.

¹³⁶ *Id.*, art. 19.1. (There is *no obligation* to impose countervailing duties. According to Art. 19.2 “[t]he decision whether or not to impose a countervailing duty in cases where all requirements for the imposition have been fulfilled . . . to be made by the authorities of the importing Member.”).

¹³⁷ *Id.*, art. 19.4.

¹³⁸ *Id.*, art. 19.2.

¹³⁹ *Id.*, art. 20.1 (There are two exceptions to this general principle, see Articles 20.2 and 20.6).

¹⁴⁰ *Id.*, art. 21.1.

years after their imposition, unless the WTO Member concerned has concluded that the expiry of the duty would likely lead to continuation or recurrence of subsidization and injury.¹⁴¹

B. THE AGREEMENT ON AGRICULTURE

The Agreement on Agriculture (AoA) provides for special rules on agricultural subsidies. The AoA provides the basic rules for agriculture products and the subsidy commitment schedules of the WTO Members, similar to the tariff schedules for goods, which are annexed to the Agreement. Where a commitment has been made in the schedule for a particular product, the Member agrees not to provide more than the confirmed amount of subsidies. Where no commitment has been made, no subsidies are permitted for that product.

As Lester, Mercurio, and Davies point out, the approach of the AoA in addressing subsidies is different from that of the SCM Agreement. While the SCM Agreement explicitly focuses on the trade-distorting effects of subsidies, the AoA, aside from its distinction between export and domestic subsidies, does not focus on their effect.¹⁴² Likewise, the legal framework for agricultural products established by the AoA differs from that of the GATT era. The notion of “equitable share of world trade” has been replaced by a set of commitments to reduce domestic support to agricultural products and the use of export subsidies.

The AoA establishes two sets of obligations. The first set is found in the provisions on market access, which provide that WTO Members may protect their domestic agriculture producers only through tariffs. Article 4.2 of the AoA requires WTO Members first to convert

¹⁴¹ *Id.*, art. 21.3.

¹⁴² LESTER, MERCURIO & DAVIES, *supra* note 48, at 457.

protective measures to tariffs, and then to progressively liberalize the resulting protection through the reduction of tariffs, as happens in non-agricultural sectors.¹⁴³

The second set of AoA obligations contains two categories of provisions, one dealing with general disciplines and individual commitments on *export* subsidies and one dealing with disciplines and commitments on *domestic* subsidies.

1. Export Subsidies

According to Article 8 of the AoA, each WTO Member “undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member’s Schedule.”¹⁴⁴ Thus, unlike the SCM Agreement, the AoA does not prohibit export subsidies *per se*. Moreover, it distinguishes between the listed types of export subsidies (Article 9) and non-listed export subsidies that are subject to the anti-circumvention requirement (Article 10).

Article 9.1 provides for six types of agricultural export subsidies. As in the case with the Illustrative List under the SCM Agreement, a subsidy that falls within the scope of Article 9.1 is *deemed* to be an export subsidy. There is no need for a separate demonstration of an “export subsidy” within the meaning of Article 1.¹⁴⁵

Under Article 3.3 of the AoA, a WTO Member:

shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products *specified* in Section II of Part IV of its Schedule *in excess* of the budgetary outlay and quantity commitment levels

¹⁴³ AoA, *supra* note 3, art. 4.2.

¹⁴⁴ *Id.*, art. 8.

¹⁴⁵ Appellate Body Report, *European Communities – Export Subsidies on Sugar*, WT/DS265,266,283/AB/R, adopted 19 May 2005, para. 269.

specified therein and shall *not provide* such subsidies in respect of any agricultural product *not specified* in that Section of its Schedule.¹⁴⁶

This provision clearly distinguishes between export subsidies that are subject to reduction commitments and those which are not. With regard to scheduled agricultural products, the listed types of export subsidies are only prohibited to the extent they are in excess of the reduction commitment level of the Member in question. With regard to unscheduled agricultural products, export subsidies subsidy are prohibited as such.

Article 10.1 of the AoA stipulates that export subsidies not listed in Article 9.1 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments.¹⁴⁷ Thus, it must first be established that the measure in question is an “export subsidy,” which is defined by the AoA as a subsidy “contingent upon export performance.”¹⁴⁸

Current case law supports the view that circumvention is present, and not merely assumed, when export subsidies not listed in Article 9.1 are granted to scheduled products above their reduction commitment levels.¹⁴⁹ At the same time, export subsidies not listed in Article 9.1

¹⁴⁶ AoA, *supra* note 3, art. 3.3 (emphasis added).

¹⁴⁷ *Id.*, art. 10.1.

¹⁴⁸ *Id.*, art. 1(e); *see also* Appellate Body Report, *US – FSC*, *supra* note 18, para. 141 (stating that “[a]lthough there are differences between the export subsidy disciplines established under two Agreement, those differences do not, in our view, affect the common substantive requirement relating to export contingency. Therefore, we think it appropriate to apply the interpretation of export contingency that we have adopted under the SCM Agreement to the interpretation of export contingency under the Agreement on Agriculture.”).

¹⁴⁹ *See, e.g.*, Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Second Recourse to Article 21.5 of the DSU by New Zealand and the United States*, WT/DS103,113/AB/RW2, adopted 17 January 2003, para. 70 (noting that “[p]ursuant to Article 3 of the Agreement on Agriculture, a Member is entitled to grant export subsidies within the limits of the reduction commitment specified in its Schedule”).

and not subject to reduction commitments are flatly prohibited since members are not allowed to grant “any subsidy whatsoever to exports of unscheduled products.”¹⁵⁰

Export subsidies must, to the extent they are inconsistent with the AoA, be withdrawn without delay pursuant to Article 4.7 of the SCM Agreement.

2. Domestic Subsidies

While not prohibiting WTO Members from granting domestic subsidies on agricultural products, the AoA establishes annual limits for each Member (Total Aggregate Measurement of Support, Total AMS) in the specific Schedules of Commitments. According to Article 3.2, no WTO Member can provide support to a domestic producer in excess of the commitment levels specified in Section I of Part IV of its Schedule.¹⁵¹ However, if a measure is exempt from being included in the Total AMS, that measure is not considered “domestic support” in the meaning of the AoA and it is therefore allowed. Thus, as Gustavo Luengo put it, the AoA does not define domestic support but rather establishes rules for determining whether or not a government measure falls within the calculation of the Totals AMS.¹⁵²

Domestic support measures are categorized in three different boxes, depending on their trade-distortive effect: amber box, blue box, and green box.

Green box subsidies are exempt from reduction commitments and, therefore, are permitted. This category of subsidies “shall meet the fundamental requirement that they have no,

¹⁵⁰ Panel Report, *United States – Subsidies on Upland Cotton – Recourse to Article 21.5 of the DSU by Brazil*, WT/DS267/RW, adopted 20 June 2008 n.782.

¹⁵¹ AoA, *supra* note 3, art. 3.2.

¹⁵² GUSTAVO E. LUENGO HERNÁNDEZ DE MADRID, REGULATION OF SUBSIDIES AND STATE AIDS IN WTO AND EC LAW 210 (2007).

or at most minimal, trade-distorting effects or effects on production.”¹⁵³ To meet this requirement, a measure should fulfill certain criteria. First, support must be provided through a publicly funded government program (including government revenue forgone) not involving transfers from consumers.¹⁵⁴ Second, the support must not have the effect of providing price support to producers.¹⁵⁵ Finally, the support program must meet the policy-specific criteria and fit into the list of programs listed in the AoA.¹⁵⁶

Amber box subsidies are regarded as the most harmful for trade and beyond a certain *de minimis* level¹⁵⁷ are subject to reduction commitments. All domestic support that is not exempted is considered subject to reduction commitments.¹⁵⁸ AMS means annual level of support in monetary terms in the form of non-exempted product-specific and non-product-specific support.¹⁵⁹ A specific AMS is established for each basic agricultural product receiving market price support, non-exempt direct payments, or any other subsidy not exempt from the reduction commitment.¹⁶⁰ Support which is non-product specific is totaled into one non-product specific AMS.¹⁶¹ The sum of all these AMS’s is the Total AMS, which is one single figure representing the full amount of domestic subsidies subject to reduction commitments. Thus, if the WTO Member is subject to reduction commitments, the domestic support it provides for agricultural

¹⁵³ AoA, *supra* note 3, Annex 2, para. 1.

¹⁵⁴ *Id.*, Annex 2, para. 1(a).

¹⁵⁵ *Id.*, Annex 2, para. 1(b).

¹⁵⁶ *Id.*, Annex 2, paras. 2-13 (the list covers general services, food security industry, domestic food aid, direct payment to producers, decoupled income support, etc.).

¹⁵⁷ *Id.*, Article 6.4 establishes a *de minimis* threshold 5 percent (10 percent for developing Members) above the total value of production of an agricultural product for the year.

¹⁵⁸ *Id.*, art. 6.1.

¹⁵⁹ *Id.*, art. 1(a).

¹⁶⁰ *Id.*, Annex 3, para. 1.

¹⁶¹ *Id.*

products should not exceed the levels established in its commitments. On the other hand, if the Member is not subject to reduction commitments, it must not provide support to agricultural producers in excess of the *de minimis* level.¹⁶²

Blue box subsidies are those that may be deemed trade-distorting, but are contingent upon limitations in production. They are excluded from reduction commitments if (1) they are based on fixed area and yields, or (2) they are made on 85 percent or less of the base level production, or (3) livestock payments are made on a fixed number of head.¹⁶³

Domestic agricultural subsidies are actionable (if they cause adverse effects) and countervailable (if they cause injury to domestic industry) under the SCM Agreement.

In sum, the regulation of subsidies in GATT/WTO underwent a series of changes over the years and resulted in more precise and stricter disciplines regarding the use of subsidies and countervailing measures. Likewise, since the establishment of the WTO in 1995, the rules relating to subsidies have been further shaped by the WTO adjudicating bodies. Dominic Coppens observes that during the almost fifty years of the GATT, subsidy disciplines were developed by contracting parties (with virtually no influence of the largely inefficient GATT dispute settlement system); while, over the last twenty years, shaping of subsidy disciplines has been the result of judicial decisions.¹⁶⁴

Yet, at the same time, as the previous Chapter has established, the current regime on subsidies in essence reflects a compromise between the opposing views of the United States and

¹⁶² *Id.*, art. 7.

¹⁶³ *Id.*, art. 6.5(a).

¹⁶⁴ Dominic Coppens, *Twenty Years of (Re)-Shaping WTO Subsidy Law by the Appellate Body and Panels*, in *WHAT SHAPES THE LAW? REFLECTIONS ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES* 69, 70 (Luca Rubini & Jennifer Hawkins eds., 2016); *see also* Horlick, *supra* note 7, at 67 (noting that “we can expect continued rewriting of the SCM Agreement by an Appellate Body which clearly thinks it understands subsidies better than did the negotiators.”).

the EU. These views, in turn, reflect their domestic practice. Despite the importance of international efforts in regulating subsidies, the resulting discipline comes from the bottom, i.e. from domestic forces. The latter will also have a major impact on the prospects for future developments of WTO rules in this area.¹⁶⁵ In this respect, thus, it is important to examine and compare U.S. and EU disciplines on subsidies, as well as to identify the reasons for existing differences. Chapter V and Chapter VI will address, respectively, the rules on subsidies in the EU and in the United States, while Chapter VII will compare the American and European approaches to subsidy.

¹⁶⁵ Although the future dynamics of negotiations will likely to be determined more by the relationship between developed and developing countries, rather than by the relationship among the main developed economies.

V. EU RULES ON SUBSIDIES

The European Union (EU), which legally replaced the European Community (EC) in 2009 as a result of the Treaty of Lisbon, is a complex supranational organization comprised of twenty-eight Member States. The EU is based on two treaties – the Treaty on European Union (TEU)¹ and the Treaty on the Functioning of the European Union (TFEU)² – which constitute a primary law of the EU. The secondary legislation of the EU includes regulations, which are binding upon all the Member States and are directly applicable within all such states; directives, which are binding as to the end to be achieved while leaving some choice as to form and method open to the Member States; decisions, which are binding on those to whom they are addressed; and recommendations and opinions, which have no binding force.³

The EU has been a WTO member since 1 January 1995. All the Member States of the EU are also WTO members in their own right. Thus, the provisions of the WTO agreements are legally binding upon both the EU and its Member States. However, the EU does not extend the

¹ Consolidated Version of the Treaty on European Union, 26 October 2012, Official Journal of the European Union (C 326/15) [hereinafter TEU].

² Consolidated Version of the Treaty on the Functioning of the European Union, 26 October 2012, Official Journal of the European Union (C 326/47) [hereinafter TFEU].

³ *Id.*, art. 288.

direct effect doctrine to the WTO agreements.⁴ Consequently, the provisions of these agreements may only be invoked in EU law if EU law expressly refers to or incorporates such provisions.

A. INTRODUCTION

With respect to subsidies, EU law contains two sets of rules: (1) on the use of subsidies (State aid); and (2) on the use of countervailing duties in response to subsidized imported goods.

In the EU, Member States are required to obtain authorization from the Commission before they implement State aid.⁵ The purpose of State aid control is to prevent companies from gaining an unfair competitive advantage through government support. The rules provide for the prevention of misallocation of resources since subsidies can lead to inefficiencies and a waste of public money to the detriment of the EU's welfare. State aid control, thus, is meant to lead to the best allocation of resources and to serve the goal of economic integration and Europe-wide welfare.⁶

EU State rules are part of the EU competition rules. It needs to be pointed out, however, that they relate to two kinds of competition: competition between undertakings in the relevant

⁴ The EC Council stated that “by its nature the Agreement establishing the World Trade Organization, including the Annexes thereto, is not susceptible to being directly invoked in Community or Member State courts” (94/800/EC: Council Decision (of 22 December 1994) concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay Round multilateral negotiations, 1994 OJ L 336/1, 11th recital in the preamble).

⁵ TFEU, *supra* note 2, art. 108.

⁶ Massimo Merola, *The Forces Shaping State Aid Control in the EU*, in *WHAT SHAPES THE LAW? REFLECTIONS ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES* 101, 102 (Luca Rubini & Jennifer Hawkins eds., 2016); *see also Ninth Report on State Aids in the European Union*, COM (2001) 403 final, at para. 2 (18 July 2001) (stating that “State aid can frustrate free competition by preventing the most efficient allocation of resources and posing a threat to the unity of the internal market” and that “sound State aid control and the judicious use of state resources lead . . . to the reduction in the disparities between prosperous regions and regions where there is either a concentration of crisis-ridden sectors or indeed no jobs at all.”).

market (like antitrust) and competition between Member States in the internal market. Member States have different resources to grant aid. As a result, the undertakings may have greater or fewer possibilities to receive aid depending on the Member State in which they are located.⁷ State aid control, therefore, was introduced to avoid distortions of competition between companies and also to avoid subsidies races between Member States trying to attract companies to their territories.⁸

Countervailing duties are imposed by the EU in order to counteract the injurious effects of subsidized imports from non-EU countries on the EU market and to restore fair competition.⁹ The EU is based on a Custom Union where customs duties are prohibited between Member States and a common tariff is adopted in respect of third countries.¹⁰ Likewise, the creation of the Common Market resulted in granting the EU exclusive competence in Common commercial policy,¹¹ which covers trade protection measures.¹² Thus, the competence of the EU in imposing countervailing duties is exclusive, Member States are not allowed to take anti-subsidy actions against goods imported from other Member States or third countries.

⁷ Former Commissioner Neelie Kroes stated that “some Member States have deeper pockets than others” and noticed that “one Member State spent 20 billion Euro of State aid in 2005, compared to 64 billion for the entire EU 27” (see Neelie Kroes, *The Law and Economics of State aid control – A Commission Perspective*, SPEECH/07/60, speech delivered in Berlin on 8 October 2007 at Joint EStALI/ESMT Conference on “The Law and Economics of European State Aid Control,” at 4.).

⁸ Jose Luis Buendia Sierra, *EU State Aid Control: Competition Between Undertakings or Between Member States?*, in *WHAT SHAPES THE LAW? REFLECTIONS ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES* 121, 122 (Luca Rubini & Jennifer Hawkins eds., 2016).

⁹ Council Regulation 597/2009 of 11 June 2009 on protection against subsidized imports from countries not members of the European Community OJ L188/93.

¹⁰ TFEU, *supra* note 2, art. 28.

¹¹ *Id.*, art. 3.1(e).

¹² *Id.*, art. 207.1.

B. RULES ON THE USE OF STATE AID

The State aid policy of the EU cannot be properly understood without appreciating the broader objectives of EU policy and especially EU competition policy, which includes the rules on state aid.

Competition law has played a pivotal role in the process of European integration and has been profoundly influenced by ordoliberalism economic theory,¹³ developed by German economists and legal scholars from the 1930's to the 1950's. Professor Razeen Sally describes ordoliberalism as a holistic conception of political economy that goes some way beyond the mere economics of the market.¹⁴ It does not regard the market exclusively as a utilitarian efficiency device or an end in itself. To the contrary, the ordoliberals viewed "individual economic questions as constituent parts of a greater whole."¹⁵ They criticized *laissez-faire* economics for ignoring the interaction of different policy areas that form part of an overarching economic order, arguing that this kind of thinking overlooks repercussions of particular policies on each other and, by extension, on the order as a whole.¹⁶ In particular, Professor Walter Eucken, one of the founders of ordoliberalism, criticized *laissez-faire* theory for not constructing the rules of the

¹³ Ordoliberalism takes its name from "order" in Latin. The *Ordo* concept originates in ancient philosophy, where it found expression in the word *kosmos*, which signified both "universe" and "order." It then recurs through Saint Augustine to the scholasticism of the Middle Ages. It reappears in the thoughts of the seventeenth and eighteenth centuries, making the distinction between a given *ordre naturel* and a consciously instituted *ordre positif*. (See RAZEEN SALLY, CLASSICAL LIBERALISM AND INTERNATIONAL ECONOMIC ORDER: STUDIES IN THEORY AND INTELLECTUAL HISTORY 108 (1998), quoting WALTER EUCKEN, DIE GRUNDLAGEN DER NATIONALÖKONOMIE 239 (1989 [1941].))

¹⁴ *Id.* at 106.

¹⁵ Walter Eucken, Franz Böhm & Hans Grossmann-Doerth, *The Ordo Manifesto of 1936*, in GERMANY'S SOCIAL MARKET ECONOMY: ORIGINS AND EVOLUTION 23-24 (Allan T. Peacock & Hans Willgerodt eds., 1989). (Stating that "[t]he treatment of all practical political-legal and political economic questions must be keyed to the idea of the economic constitution . . . The economic constitution must be understood as a general political decision as to how the economic life of the nation is to be structured.")

¹⁶ SALLY, *supra* note 13, at 108.

game to govern the economic process, thus leaving the generation of order to uncontrolled and spontaneous development. This, in his view, resulted in the emergence and rise of monopolies and oligopolies that progressively distorted both the market and the legal orders of societies.¹⁷

In general, the ordoliberalists accepted the basic classical liberal points – that competition is necessary for economic well-being and that individuals should be as free as possible from state interference. However, in their view, it was not sufficient to protect the individual from the power of government, because both political and economic power were threats to individual freedoms. In particular, Professor Wilhelm Röpke advocated an economy composed to the extent possible of small and medium-sized firms and thus a society with a minimum of “big businesses.”¹⁸ Second, classical liberals argue that the competitive process will protect itself better than governmental intervention can, and the best way to protect competition is to leave it alone. The ordoliberalists, on the other hand, insist on a strong state capable of resisting the influence of private power groups and argue that the effectiveness of the economy depends on its relationship to the political and legal systems.¹⁹ Thus, the argument goes, the basis for successful economic policy is the establishment of a strong legal and institutional framework, the main task of which is to create conditions under which the market functions properly and creates optimum economic outcomes.²⁰

¹⁷ *Id.* at 109 (quoting WALTER EUCKEN, GRUNDSÄTZE DER WIRTSCHAFTSPOLITIK 29, 41-43, 49-50, 52-55 (1990 [1952])) (stating that without any mechanism to hinder and check monopolies *laissez-faire* contributed to the replacement of “competition through achievements” (*Leistungswettbewerb*), which rewarded and punished entrepreneurs through the selection process of the market, by “competition to prevent competition” (*Behinderungswettbewerb*), which entailed the use of predatory measures, such as boycotts, price discrimination and cartels, to drive out and close the gates to competition).

¹⁸ WILHELM RÖPKE, INTERNATIONAL ECONOMIC DISINTEGRATION 67-69 (1942).

¹⁹ DAVID J. GERBER, LAW AND COMPETITION IN TWENTIETH CENTURY EUROPE: PROTECTING PROMETHEUS 245-50 (Oxford 1998); SALLY, *supra* note 5, at 105-21.

²⁰ As Professor Eucken put it, ordoliberalism “seeks to construct the *forms* of the economy or to influence the *conditions* under which they come about. But it leaves within these forms the plans and actions of households and

Finally, social goals are an important part of ordoliberal thought. Classical liberals argue that the market, if left to itself, will promote economic growth and thus enhance social welfare. The ordoliberals – although agreeing that the economy is the primary means for integrating society around democratic and humane principles – view economic power as a major obstacle to social justice, because it creates the perception that the market is unfair and thus prevents it from operating as an instrument of social integration.²¹

Ordoliberalism was the basis for the post-war “social market economy” created in Germany. Likewise, it became a model for the building of the European single market and eventually the EU.²²

Ordoliberal influence was particularly important in the area of EU competition law. For ordoliberals, competition law is central to the economic constitution of society because it constrains both economic power by punishing anticompetitive conducts and political power by limiting discretionary public intervention in the economy.

The purpose of introducing EU competition law was to complement the internal market rules by preventing businesses from partitioning the internal market and by encouraging

enterprises completely free.” (emphasis in original) (SALLY, *supra* note 13, at 111 (quoting WALTER EUCKEN, GRUNDSÄTZE DER WIRTSCHAFTSPOLITIK 242 (1990 [1952])).

²¹ GERBER, *supra* note 19, at 241 (quoting WALTER EUCKEN, GRUNDSÄTZE DER WIRTSCHAFTSPOLITIK 185-93 (1990 [1952])); FRANZ BÖHM, DIE ORDNUNG DER WIRTSCHAFT ALS GESCHICHTLICHE AUFGABE UND RECHTSSCHÖPFERISCHE ELEISTUNG 185 (Stuttgart 1937) (arguing that a liberal program could not work if it did not satisfy a certain type of “social need.”).

²² *Id.* at 263-65 (“Ordoliberal ideas suffused the process of European unification at its earliest stages and its highest levels. The leading German representatives in the founding of the EC generally were closely associated with Ordoliberalism.”). For example, Walter Hallstein was one of the founders of the EC and the first president of the European Commission, Hans von der Groeben was one of the two principal drafters of the “Spaak Report,” on which the EC Treaty was based, and the first Commissioner for competition policy, and Müller-Armack, the creator of social market economy ideas, was responsible as an official of the German government for influencing the development of EC economic policy during its formative years.

competition across borders.²³ Professors Craig and de Búrca identify three objectives of EU competition law: first, to enhance efficiency, in the sense of maximizing consumer welfare and achieving the optimal allocation of resources; second, to protect consumers and small firms from large aggregations of economic power; and third, to facilitate the creation of a single European market.²⁴ The State aid policy, as an integral part of EU competition policy, is therefore tied to these objectives and is applied taking into account the broad context and overall goals pursued by the EU.

1. The Evolution of State Aid Law and Policy

State aid rules date back to the establishment of the EC in 1957 (originally Articles 92-94 of EC Treaty, now Articles 107-109 of TFEU). While the language of these provisions has never been modified, the actual implementation of the rules has change a lot over time.

Article 92(1) of the EC Treaty (now Article 107 of TFEU) establishes the general principle that any state aid which distorts competition and affects trade between Member States is incompatible with the common market.²⁵ Further, Article 93 of the EC Treaty (now Article 108 of TFEU) gives the European Commission the authority to examine the compatibility of State aids with the common market. It requires Member States to notify their aid to the Commission and obtain Commission authorization before the implementation of such aid.²⁶

²³ DAMIAN CHALMERS, CHRISTOS HADJEMMANUIL, GIORGIO MONTI & ADAM TOMKINS, *EUROPEAN UNION LAW: TEXT AND MATERIALS* 928 (2006); G. Marengo, *The Birth of Modern Competition Law in Europe*, in *EUROPEAN INTEGRATION AND INTERNATIONAL COORDINATION: STUDIES IN TRANSNATIONAL ECONOMIC LAW IN HONOUR OF C.-D. EHLERMANN* 297, 298 (A. von Bogandy, P. Mavroidis & Y. Mény eds., 2002).

²⁴ PAUL CRAIG & GRÁINNE DE BÚRCA, *EU LAW: TEXT, CASES, AND MATERIALS* 936-37 (3d ed. 2002).

²⁵ TFEU, *supra* note 2, art. 107(1).

²⁶ *Id.*, art. 108.

Finally, Article 94 of the EC Treaty (now Article 109 of TFEU) empowers the Council to make any appropriate Regulations for the application of Articles 92 and 93.²⁷

Although the logic of the EC Treaty is to ensure undistorted competition regardless of whether the distortion is caused by the behavior of businesses or by the state, originally State aid law did not receive the same attention as antitrust or merger control and was at the margin of competition policy. Until the mid-1980s, a period referred to by some authors as the “dark ages,”²⁸ the EC was unable to contain national protectionism during the economic crisis of the 1970s and early 1980, leading to subsidy wars in particular in the field of textiles and steel.²⁹ There was a lack of discipline among Member States in terms of notification of aid before implementing it. The Commission also had to withdraw a proposed Regulation – thus applying *soft law* to regulate State aid instead of using Regulations and limiting its own power in this area.³⁰

In 1986, the Single European Act (SEA) amended the EC Treaty to require the progressive establishment of an internal, barrier-free market by 31 December 1992.³¹ The basic assumption behind the creation of the European single market was that Europeans would gain economic benefits from a more competitive market. Competition law, therefore, was given an

²⁷ *Id.*, art. 109.

²⁸ Thibaut Kleiner, *The State Aid Reform*, in *THE EC STATE AID REGIME: DISTORTIVE EFFECTS OF STATE AID ON COMPETITION AND TRADE* 827, 828 (Michael Sánchez Rydelski ed., 2006).

²⁹ Thibaut Kleiner, *Modernization of State Aid Policy*, in *RESEARCH HANDBOOK ON EUROPEAN STATE AID LAW* 1, 6 (Erika Szyszczak ed., 2012); *see also* Merola, *supra* note 6, at 103 (stating that because of the financial crisis “European government started to deliberately use public subsidies to promote national undertakings and raise employment level. Additionally, the fact that Japanese and American companies started locating their plants in Europe led some Member States to offer subsidies in order to attract them in their country.”).

³⁰ Kleiner, *supra* note 29, at 6.

³¹ Single European Act, 1987 OJ L 169/1, at art. 8a (amending Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11) [hereinafter SEA].

important role in ensuring that these economic benefits would be achieved.³² As a result, the Commission started to enforce State aid law more effectively, in particular regarding repayment of unlawful aid.³³ Professor Massimo Merola emphasized that the Commission's new policy ordering the recovery of unlawfully granted aid was the first key turning points in the reshaping of the EU State control system because without this instrument – not included in the Treaty – Member States would have had nothing to fear in implementing illegal aid.³⁴

The most significant developments occurred during the 1990s. *Hard law* was adopted by the Council to regulate the Commission's State aid procedure³⁵ and to enable the Commission to adopt group exemption regulations in the field of horizontal aid.³⁶ With the adoption of hard law the Commission started to have an increasing influence on Member States' national aid policies. In parallel, during this period the European Court of Justice (ECJ) adopted landmark decisions on some key concepts in State aid law.³⁷

In sum, this phase of the evolution of State aid policy is marked by tightening the rules on granting State aid and securing their enforcement. At the same time, as Thibaut Kleiner points

³² As Hans von der Groeben, the first Commissioner for competition policy, observed: “without rules on competition and an active competition policy, even the customs union would cease to exist.” Although restricting anti-competitive behavior on the part of private actors was central, it was not sufficient to create a level playing field because, as customs barriers were removed and competition intensified, some Member States “would not be able to resist temptation to grant application for aid.” (VON DER GROEBEN, *THE EUROPEAN COMMUNITY. THE FORMATIVE YEARS 60, 63-54* (Office for Official Publications of the European Communities 1987)).

³³ In 1982, the first decision ordering a recovery was issued (Decision No. 1982/312/EC of 19 May 1982, OJ 1982 L 138/18). This became possible due to the European Court of Justice support, which ruled that the Commission could ask for repayment of illegally granted aid (Case 70/72, *Commission v. Germany*, [1973] ECR 813, at para. 13.).

³⁴ Merola, *supra* note 6, at 104.

³⁵ Council Regulation No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 83/1, 27.03. 1999 [hereinafter Procedure Regulation].

³⁶ Council Regulation (EC) No 994/98 of 7 May 1998 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal aid, OJ L 142, 14.5.1998.

³⁷ *See, e.g.*, Case C-379/98, *PreussenElektra AG v. Schleswag*, [2002] ECR I-2099; Case C-399/94, *Syndicat Français de l'Express International (SFEI) and Others v. La Poste*, [1996] ECR I-3547; Case C-305/89 *Italy v. Commission (Alfa Romeo)*, [1991] ECR I-1603; Case C-75/97, *Belgium v. Commission (Maribel)*, [1999] ECR I-3671.

out, this period was influenced by the derogatory model, where State aid control was primarily associated with the preservation of the single market.³⁸ In his view, this approach leads to a vision of State aid “as a legal process of formal typology, categorizing some State actions as aid and designating formal areas of derogation to the general prohibition of State aid.”³⁹

In 2005, Commissioner Neelie Kroes introduced the State aid reform program through the State Aid Action Plan (SAAP).⁴⁰ SAAP was meant to reshape certain aspects of State aid law and policy in order to better fulfil long term economic goals in EU industrial policy and economic growth. The SAAP’s subtitle, “less and better targeted aid,” reflects the idea of the Lisbon Strategy to create stronger growth and more jobs.⁴¹ Reforms promoted a new role for State aid, “not as a legal control mechanism restraining Member States’ from intervention in the economy, but rather as a policy supporting common goals of the Union.”⁴² In other words, the main objective was not just to reduce aid but rather to divert aid to reasonable objectives of common interest and, thus, to promote better-targeted aid and better public spending. By introducing the SAAP the Commission acknowledged that there are two possible ways of increasing society’s welfare through State aid. First, State aid, when it targets market failures, can improve *efficiency*. Second, when the market functions properly but produces undesirable

³⁸ Kleiner, *supra* note 29, at 2-3.

³⁹ *Id.* (stating that in result “a strict legal tradition has developed in which State aid is deemed illegal, unless certain (largely form-based) criteria are met.”).

⁴⁰ State Aid Action Plan – Less and Better Targeted State Aid: A Roadmap for State Aid Reform 2005-2009, COM (2005) 107 final [hereinafter SAAP].

⁴¹ Communication to the Spring European Council – working together for growth and jobs – a new start for the Lisbon Strategy, Communication from President Barroso in agreement with Vice-President Verheugen COM 24 final, Brussels 2.2.2005.

⁴² Kleiner, *supra* note 29, at 12.

results (such as social or regional inequality), government intervention through State aid can be used to achieve *equity* objectives.⁴³

The cornerstone of SAAP's reforms was the introduction of a refined economic analysis. Before SAAP, EC State aid rules tended to be rather form-based and did not leave much room for assessing the impact of the measure on competition and trade.⁴⁴ A newly developed "balancing test" now assesses the compatibility of a State aid measure in three steps: (1) whether there is a market failure or another objective of common interest (e.g. social or regional cohesion); (2) whether the aid measure is targeted, i.e. does the proposed aid address the market failure or other objective; and (3) are whether the distortions of competition and effect on trade are sufficiently limited, so that the overall balance is positive.⁴⁵ Thus, the test looks at the positive and negative effects of aid and compares them in order to determine whether, on balance, the aid should be authorized. In this way, the new test not only distinguishes between "good" and "bad" aid, but also delivers a tool that might serve to justify "good" aid in terms of efficiency and equity, as compared to total welfare.

In 2012, the Commission launched the State Aid Modernization (SAM).⁴⁶ The objectives pursued by SAM to a large extent overlap the ones pursued by SAAP.⁴⁷ At the same time, the

⁴³ SAAP, *supra* note 40, at I.1.10.

⁴⁴ Hans W. Friederiszick, Lars-Henkrik Röller & Vincent Verouden, *EC State Aid Control: An Economic Perspective*, in THE EC STATE AID REGIME: DISTORTIVE EFFECTS OF STATE AID ON COMPETITION AND TRADE 145, 152 (Michael Sánchez Rydelski ed., 2006).

⁴⁵ *Id.* at 165.

⁴⁶ Communication from the Commission, *EU State Aid Modernization*, COM/2012/0209 final, 08/05/2012 [hereinafter SAM].

⁴⁷ Among the main objectives of SAM are to foster growth in a competitive internal market and to streamline the rules and provide for faster decisions (*id.* at 2.1, 2.3).

new reform appears to be “more pragmatic.”⁴⁸ According to the Commission, “[t]he drive towards more efficient spending should not translate into micro control of all public expenditure but rather into *prioritization and stronger scrutiny of the aid with a significant impact on the single market.*”⁴⁹ It is achieved by an extension of the categories of State aid that are exempt from *ex ante* notification to the Commission.⁵⁰ This would allow the Commission to focus more efficiently on aid which has a significant impact on the single market.

In general, the latest developments resulted, in Professor Merola’s words, in “a move from a purely form-based approach towards an effects-based and efficiency-based approach.”⁵¹ Similarly, according to Thibaut Kleiner, they demonstrate a move from a derogatory model to a competition model. While a derogatory model views State aid as belonging more to the single market body of regulation, and the prohibition of State aid as necessary for the preservation of the single market, a competition model views State aid control as one way to promote the good functioning of markets.⁵²

⁴⁸ Buendia, *supra* note 8, at 127; Claire Micheau, *Evolution of State Aid Rules: Conceptions, Challenges, and Outcomes*, in STATE AID LAW OF THE EUROPEAN UNION 18, 34 (Herwig C.H. Hofmann & Claire Micheau eds., 2016).

⁴⁹ SAM, *supra* note 46, at 19 (emphasis added).

⁵⁰ Commission Regulation (EU) No 1224/2013 of 29 November 2013 amending Regulation (EC) No. 800/2008, OJ L 320, 30/11/2013 (According to evidence collected for the 2014 State aid scoreboard, over 80% of compatible aid measure are now going through the General Block Exemption Regulation, and can therefore be implemented by Member States immediately, without having to seek prior approval by the Commission. See http://ec.europa.eu/competition/state_aid/scoreboard/index_en.html).

⁵¹ Merola, *supra* note 6, at 107.

⁵² Kleiner, *supra* note 29, at 3-4. See also Buendia, *supra* note 8, at 215-27 (arguing that originally the main purpose of State aid policy was rather “to put limits on *the competition between Member States* and to prevent subsidy war between them.” Since 2000, however, the emphasis started to change more to “*the competition between undertakings* as the core mission of State aid control.”) (emphasis added).

2. The Concept of State Aid

The basic objective of State aid policy is laid down in Article 107(1) of the TFEU, which provides that:

Save as otherwise in this Treaty, 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 Member States, be incompatible with the common market.⁵³

The provision does not provide a definition of State aid. Instead, it contains cumulative conditions which a measure must satisfy in order to be classified as State aid: (1) it must be granted by the state or through state resources; (2) it must confer an advantage to the recipient; (3) it must favor certain undertakings and thus be selective; and (4) it must distort competition and affect trade between Member States.

If these criteria are met, a measure is considered to be State aid, must be notified to the Commission, and will normally be considered incompatible with the common market unless it falls under exceptions provided in Article 107(2) and (3).

a. Aid Granted by a Member State or through State Resources The wording of Article 107(1), which refers to “any aid” “in any form *whatsoever*,” suggests a very broad interpretation of the term “State aid.” This view was supported by the ECJ which held that the concept of aid is wider than that of a subsidy,

because it embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without, therefore,

⁵³ TFEU, *supra* note 2, art. 107(1).

being subsidies in the strict meaning of the word, are similar in character and have the same effect.⁵⁴

Under Article 107(1), State aid must be granted “by a Member State or through state resources” in order to be prohibited. Although the language of the provision seems to suggest that State aid may be granted alternatively by a Member State *or* through state resources, the ECJ had interpreted this provision to mean that *both* State attribution and State resources are required in order for a measure to fall under the scope of Article 107.⁵⁵

The notion of “State” includes the central government and its ministries or departments, regional and local governments or councils and municipalities.⁵⁶ Likewise, certain measures taken by public undertakings and private bodies can fall within Article 107(1).⁵⁷ Aid, however, should not be presumed solely because the undertaking is under the influence or control of the State. Given that public undertakings often have a degree of autonomy in relation to decision-making, whether or not an undertaking is to be considered acting under the influence of the State is to be determined by all the circumstances of the case and the context in which a given measure is taken.⁵⁸

In its landmark decision, *PreussenElektra*, the ECJ determined that “only advantages granted directly or indirectly through State resources are to be considered as aid” within the

⁵⁴ Case 30/59, *De Gezamenlijke Steenkolenmijnen in Limburg v. High Authority of the European Coal and Steel Community*, [1961] ECR 1, para. 27.

⁵⁵ Case 78/76, *Steinike & Weinlig v. Federal Republic of Germany*, [1977] ECR 595, para. 21.

⁵⁶ PHEDON NICOLAIDES, MIHALIS KEKELEKIS & MARIA KLEIS, *STATE AID POLICY IN THE EUROPEAN COMMUNITY: PRINCIPLES AND PRACTICE* 11 (2d ed. 2008).

⁵⁷ In *Steinike & Weinlig*, the ECJ stated that the prohibition under Article 107(1) “covers all aid granted by a member state or through state resources without its being necessary to make a distinction whether the aid is granted directly by the state or by public or private bodies established or appointed by it to administer aid.” (*supra* note 55, para. 21).

⁵⁸ Case C-482/99, *France v. Commission*, [2002] ECR I-nyr, para. 55.

meaning of Article 107(1).⁵⁹ In other words, aid must entail some form of financial burden on public funds. In his Opinion, Advocate General Jacobs, too, favored this narrow interpretation of “State resources” over a more extensive one, arguing that it “provides more legal certainty”:

the more extensive interpretation would oblige the Member States, affected undertakings, the Commission, national courts and ultimately the Community Courts to decide in respects of all legislation regulating the relationship between enterprises whether it does confer selective advantages on certain undertakings . . . Since such an assessment is a difficult exercise with an uncertain outcome, it seems preferable that *legislation regulating the relationship between private actors is as a matter of principle excluded from the scope of the State aid rules*.⁶⁰

Consequently, regulatory or administrative measures are not considered to be State aid within the meaning of Article 107(1), even if they confer a commercial advantage to certain undertakings.

b. Advantage Granted to the Recipient The recipients of State aid are “undertakings.” This term is not defined anywhere in the Treaty. It refers broadly to any natural or legal person, regardless of legal status and means by which it is financed, who carries out economic activities of certain regularity and duration and which could be done for remuneration.⁶¹

⁵⁹ Case C-379/98, *PreussenElektra AG v. Schleswag*, [2002] ECR I-2099, para. 58 (There, the ECJ concluded that the German law requiring private electricity supply undertakings to purchase electricity produced in their area of supply from renewable energy sources at minimum prices higher than the real economic value of that type of electricity did not constitute State aid because the transfer of resources took place *between private undertakings* and, thus, *there was no impact on the public budget*).

⁶⁰ Opinion in *PreussenElektra*, *id.*, para. 157 (emphasis added).

⁶¹ NICOLAIDES, KEKELEKIS & KLEIS, *supra* note 56, at 17. In a recent case, it was confirmed that:

[i]t is settled case law that, first, in the field of [i] competition law the concepts of undertaking covers any entity engaged in an economic activity, regardless of the legal status and the way in which it is financed and, secondly, any activity consisting in offering goods or services on a given market is an economic activity. It follows from this that where or not an activity is economic in nature does not depend on the private or public status of the entity engaged in it or the profitability of that activity.

Case C-288/11 P, *Mitteldeutsche Flughafen and Flughafen Leipzig-Halle GmbH v. Commission*, EU:C:2012:821, para. 50.

To be able to ascertain whether the provision of public funds constitutes State aid which confers an advantage to certain undertakings, the Commission and the ECJ have developed the “private investor” test. The test examines the terms and conditions under which public authorities make funding available to undertakings and asks whether a hypothetical private investor would have made the funds available, and, if so, whether that investor would have done so on the same terms. If the terms and conditions would not have been acceptable to the hypothetical private investor, then the measure is considered to be State aid.⁶² The hypothetical market investor is, in principle, only guided by prospects of profitability and optimization of the return on the invested capital.⁶³ Thus, other kinds of considerations, such as social or cultural considerations, should only be taken into account when assessing the compatibility of the aid.⁶⁴

c. Selectivity The selectivity criteria serve to distinguish general measures introduced by Member States from those that constitute State aid. Article 107(1) refers to the aid favoring “a certain undertaking or the production of certain goods,” i.e. only aids that are selective or specific fall within the notion of “State aid.”

In order to determine what “certain” means in “favouring certain undertakings or the production of certain goods,” the ECJ has made it clear that neither a high number of benefiting undertakings nor the diversity and importance of industrial sectors warrants the conclusion that a

⁶² Paris Anestis & Stephen Mavroghenis, *The Market Investor Test*, in *THE EC STATE AID REGIME: DISTORTIVE EFFECTS OF STATE AID ON COMPETITION AND TRADE* 109, 112 (Michael Sánchez Rydelski ed., 2006).

⁶³ In 2014, the Court of Justice of the European Union (previously the ECJ) confirmed that it is established case law that when contributions of capital by a public investor disregard any prospect of profitability, even in the long term, such contributions must be regarded as aid (Joined cases C-533/12 P and C-536/12 P, *SNCM and France v. Corsica Ferries France*, EU:C:2014:2142, para. 39).

⁶⁴ See Case C-305/89 *Italy v. Commission (Alfa Romeo)*, [1991] ECR I-1603, paras. 19, 20; joined Cases T-233/99 *Westdeutsche Landersbank Girozentrale and Land Nordrhein – Westfalen v. Commission (West LB)*, [2003] ECR II-435, paras. 250, 251, 255, 258.

scheme constitutes a general measure rather than a State aid.⁶⁵ For example, a Spanish program to assist in the purchase of commercial vehicles by natural persons, small and medium enterprises, regional public bodies, and bodies providing local public services, was found to be selective because it excluded large enterprises.⁶⁶ Similarly, in *Adria-Wien*, the ECJ concluded that the energy tax rebate for undertakings engaged primarily in the manufacture of goods was selective because the end result was that undertakings manufacturing goods were supplied with energy on preferential terms compared to undertakings supplying services.⁶⁷

Notwithstanding the appearance of being generally available, the measure at issue may in fact be limited to certain enterprises and, thus, constitute State aid. In *Commission v. Italy*, in assessing whether a measure by which Italy reduced social welfare contributions by 4 per cent for male workers and 10 per cent for female workers was selective, the ECJ observed that such a measure favored *de facto* industries with a large number of female workers, in particular, the textile, clothing, footwear and leather industries. Accordingly, the Court concluded that such a measure constituted State aid.⁶⁸

Thus, the notion of selectivity is a very broad one. As Advocate General Roemer sums it up, the requirement of selectivity applies to any measure which does not apply generally to all undertakings in a Member State.⁶⁹

⁶⁵ Case C-75/97, *Belgium v. Commission (Maribel)*, [1999] ECR I-3671, paras. 32-34.

⁶⁶ Case C-351/98, *Spain v. Commission*, [2002] ECR I-8031, para.43.

⁶⁷ Case C-143/99, *Adria-Wien Pipeline GMBH* [2001] ECR I-8365, para. 48.

⁶⁸ Case 203/82, *Commission v. Italy*, [1983] ECR 2525, para. 4.

⁶⁹ Case 6 & 11/69, *Commission v. France*, [1969] ECR 523, *per* Advocate General Roemer, at 552.

On the other hand, when aid is granted in accordance with objective, neutral and automatic criteria, there is no specificity. In the *CETM* case, the Court of First Instance (CFI) explained:

The fact that the aid is not aimed at one or more specific recipients defined in advance, but that it is subject to a series of objective criteria pursuant to which it may be granted, within the framework of a predetermined overall budget association, to an indefinite number of beneficiaries who are not initially individually identified, cannot suffice to call into question the selective nature of the measure, and, accordingly, its classification as state aid.⁷⁰

For example, investment in infrastructure which benefits undertakings generally, rather than one or more specific undertaking, is regarded as a general measure which is not selective and thus does not constitute State aid.⁷¹

d. Effect on Trade and Distortion of Competition The definition of State aid under Article 107(1) provides for two different final elements: the measure must “distort or threaten to distort competition,” and it must “affect trade between Member States.”⁷² Although formally separate, these elements usually have been assessed together.⁷³

As aid must “distort or threaten to distort” competition, it is not necessary to establish that the aid actually disturbs the conditions of competition. It suffices to show that the measure threatens to distort competition.⁷⁴ The main approach for the assessment of the distortion of

⁷⁰ Case T-55/99, *Confederación Española de Transporte de mercancías (CETM) v. Commission*, [2000] ECR II-3207, para. 40.

⁷¹ See Commission Decision 91/390, *Saint Gobain (Eurofloat)*, OJ 1991 L315/11, Case C-225/91, *Matra SA v. Commission*, [1993] ECR I-3203, para. 29.

⁷² TFEU, *supra* note 2, art. 107(1).

⁷³ Case T-288/97, *Regione Autonoma Friuli Venezia Giulia v. Commission*, [2001] ECR II-1169, paras. 49-50.

⁷⁴ *Id.*

competition (and the effect on trade) was set in the *Philip Morris* case.⁷⁵ The ECJ there required the strengthening of “the position of [the recipient] undertaking compared with other undertakings competing in intra-Community trade” to prove a distortion of competition and an effect on trade.⁷⁶

While the Commission is required to provide a statement of reasons for its determination of distortion of competition,⁷⁷ in principle no type of market analysis is necessary. For example, in the *Wam* case,⁷⁸ the General Court concluded that the Commission was not required to define the relevant market and analyze its structure, as well as the competitive relationships that arise. Furthermore, the court explained that aid that is intended to release an undertaking from costs which it would normally have to bear in its day-to-day management or normal activities, in principle, distorts the conditions of competition.⁷⁹ Therefore, the standard of proof for the “distortion of competition” element is relatively low and no detailed evidence is required.

As mentioned above, the “effect on trade between Member States” is traditionally analyzed together with the concept of “distortion of competition.” Moreover, in *Philip Morris*, the ECJ concluded that once the position of an undertaking active in Community trade is “strengthened,” an effect on trade should almost invariably be assumed.⁸⁰

⁷⁵ Case 730/79, *Philip Morris v. Commission*, [1980] ECR 2671.

⁷⁶ *Id.*, para. 11.

⁷⁷ Case 296/82, *Netherlands and Leeuwarder Papiervarenfabriek BV*, [1985] ECR 809, para. 24.

⁷⁸ Case T-257/10, *Italy v. Commission*, ECLI:EU:T:2012:504, para. 100.

⁷⁹ *Id.*, para. 78-79.

⁸⁰ Case 730/79, *Philip Morris*, *supra* note 75, para. 11. In a more recent case, the General Court confirmed that it is settled case law that since these two conditions [affecting inter-state trade and distorting competition] are linked, the Commission is not required to analyze them separately provided that the Commission’s reasoning clearly shows how these conditions have been fulfilled (Case T-257/10, *Italy v. Commission*, *supra* note 60, para. 100).

If a measure benefits only products which are not subject to any competition, or which are not the subject of inter-State trade, or where trade is affected only at the national level, the measure does not fall within the scope of Article 107(1). For example, the Commission has concluded that aid for research and development granted to Airbus did not affect trade between Member States and, therefore, did not constitute State aid under Article 107(1), because Airbus is the only producer of civil aircraft in the EU, and there is potentially no market for more EU producers.⁸¹ Similarly, subsidies granted to hairdressers would not be considered to be State aid within the meaning of Article 107(1) because individuals do not normally buy hairdressing services from other Member States.⁸²

Nevertheless, even if aid is granted to an undertaking which sells its products exclusively within the domestic market, it still may have an effect on trade between Member States. This could be the case where undertakings established in other Member States have less chance of exporting their products to the markets in the Member State granting the aid,⁸³ or where there is no intra-Community trade at the time when the aid is granted but it is already foreseeable that exports will shortly be directed to other Member States.⁸⁴

There is no threshold below which it may be concluded that aid does not distort competition or affect trade between Member States. As the ECJ explained in *Spain v. Commission*:

As regards the Spanish government's first argument that the overall amount of aid in question is small and that it is divided among a large number of farmers, each of whom received a negligible sum in national or Community terms, it is settled

⁸¹ Commission Decision N 369/98, 1998 OJ (C52) 10.

⁸² XXVIth Report on Competition Policy, 1996, at 230.

⁸³ Case 102/87, *France v. Commission*, [1988] ECR 4067, para. 19; Cases C-278/92-280/92, *Spain v. Commission*, [1994] ECR I-4103, para. 40.

⁸⁴ Cases T-447-449/93, *AITEC v. Commission*, [1995] ECR II-1971, paras. 139-140.

case-law of the Court *that the relatively small amount of aid or the relatively small size of undertaking which receives it does not as such exclude the possibility that intra-Community trade may be affected* . . . Other factors may be decisive when assessing the effect of aid on trade, such as whether the aid is cumulative and whether the undertakings that receive it are operating in a sector that is particularly exposed to competition.⁸⁵

In sum, “distort competition” and “effect on trade” elements are both relatively easy to establish. As Vittorio Di Bucci observes, whenever the other requirements of the definition are fulfilled, a distortion of competition affecting intra-EC trade will almost invariably follow.⁸⁶

3. Compatibility with the Common Market

Article 107(1) does not contain a direct prohibition against aid but only a declaration of incompatibility with the common market. Although the ECJ originally interpreted this provision as an implied prohibition, it emphasized that the prohibition is neither absolute nor unconditional.⁸⁷ In certain cases, State aid is compatible with the common market and, therefore, permissible. First, Article 107(2) lays down that certain categories of aid are automatically compatible with the common market. Second, the Commission has discretion under Article 107(3) to consider the compatibility of certain categories of aid with the common market on the basis of a number of objectives. Finally, according to Article 107(3)(e) the Council may decide

⁸⁵ Case C-113/00, *Spain v. Commission*, [2002] ECR I-7601, para. 30 (emphasis added).

⁸⁶ Vittorio Di Bucci, Comments on the Paper “*Selectivity, Economic Advantage, Distortion of Competition and Effect on Trade*,” in *ECONOMIC ANALYSIS OF STATE AID RULES – CONTRIBUTIONS AND LIMITS* 156, 159 (J. Derenne & M. Merola eds., 2007). See also Friederiszick, Röller & Verouden, *supra* note 44, at 149 (stating that “it appears that distortions of competition and effects on trade are almost assumed to be present when the measure is selective.”).

⁸⁷ Case 78/76, *Steinike v. Weinlig*, *supra* note 55, para. 8; Case C-301/87, *Commission v. France*, [1990] ECR I-307, para. 15; Case C-399/94, *Syndicat Français de l’Express International (SFEI) and Others v. La Poste*, [1996] ECR I-3547, para. 36.

that other categories of aid may be compatible with the common market if such a decision is justified by exceptional circumstances.

a. State Aid *per se* Compatible with the Common Market Article 107(2) defines three categories of State aid that are automatically compatible with the common market: (a) aid having a social character, granted to individual consumers; (b) aid designed to make good the damage caused by natural disasters or exceptional occurrences; and (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany.⁸⁸

Although these categories of State aid must be notified to the Commission prior to being put into effect, once it is established that a type of aid falls under the scope of one of these provisions, the Commission cannot withhold its authorization and should regard it as compatible with the common market.⁸⁹

Aid of a social character should be granted directly to individual consumers rather than undertakings. Thus, for example, the provision of cheap bread for consumers with low incomes falls under the scope of Article 107(2)(a), whereas aid granted directly to the mill in the form of subsidized wheat does not.⁹⁰ This aid must also be granted “without discrimination related to the origin of the products concerned.”⁹¹

Aid to offset the damages caused by natural disasters or exceptional occurrences are compatible with the common market if there is a direct link between a natural disaster or

⁸⁸ TFEU, *supra* note 2, art. 107(2).

⁸⁹ Case 730/79, *Philip Morris*, *supra* note 75, para. 17.

⁹⁰ Case 52/76, *Benedetti v. Munari*, [1977] ECR 163, *per* Advocate General Reischl, at 190.

⁹¹ TFEU, *supra* note 2, art. 107(2)(a). This also applies to discrimination in favor of providers of services (Commission Decision 2001/247/EC, *Ferries Golfo de Vizcaya*, OJ 2001 L89/28).

exceptional occurrence and the economic disadvantage which calls for the aid in question.⁹² “Natural disasters” include floods, droughts, tornadoes, forest fires, earthquakes, plagues, and the like.⁹³ To fall in the scope of Article 107(2)(b) the natural disaster must be out of the ordinary, substantial and unpredictable. Thus, for example, rainfall below normal rates that has a negative effect on agricultural production is not to be considered a natural disaster.⁹⁴ “Exceptional occurrences” are war, serious civil disturbance, nuclear explosions, and other cases of *force majeure*.⁹⁵ In all of these cases, the aid granted should not exceed the damage to be repaired.⁹⁶

Aid in relation to the division of Germany was authorized before German re-unification, when the objective of the aid was to offset the effects of the physical division of the country (transport, communications, etc.), not the overall effects of the communist economic system in East Germany.⁹⁷ As of 1990, the Commission has considered item (c) no longer to justify aid granted to regions of East Germany.⁹⁸

b. State Aid which may be Compatible with the Common Market Article 107(3) lists five categories that “*may be considered to be compatible with the common market.*”⁹⁹ The first four categories of aid are subject to control by the Commission, whereas under Article 107(3)(e) the Council has the power to exempt other categories of aid. It must do so acting by a qualified

⁹² Case C-301/96, *Germany v. Commission*, [2003] ECR I-9919, para. 66.

⁹³ *VIIIth Report on Competition Policy* (1978), para. 164.

⁹⁴ *Id.*

⁹⁵ CONOR QUIGLEY & ANTONY COLLINS, *EC STATE AID LAW AND POLICY* 78 (2003).

⁹⁶ *XXIInd Report on Competition Policy* (1992), para. 497.

⁹⁷ NICOLAIDES, MIHALIS & KLEIS, *supra* note 56, at 45-46.

⁹⁸ *XXth Report on Competition Policy* (1990), para. 178; *Commission Decision 94/1068, concerning aid granted to the Volkswagen Group for investments in the new German Länder*, OJ L 385 [1994], at 1.

⁹⁹ TFEU, *supra* note 2, art. 107(3) (emphasis added).

majority on a proposal from the Commission.¹⁰⁰ The four categories of aid subject to Commission approval are: (1) aid to certain severely depressed regions;¹⁰¹ (2) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;¹⁰² (3) sectoral and regional aid which does not adversely affect trading conditions to an extent contrary to the common interest;¹⁰³ and (4) aid to promote culture and heritage conservation.¹⁰⁴

The Commission has a wide discretion as to whether such aid should be authorized. In 1980, the Commission established a general approach for exercising its discretionary power with regard to Article 107(3), which has become known as the “*compensatory justification principle*.” In particular, the Commission explained that for aid to benefit from exemption under Article 107(3) it must contain a “compensatory justification which takes the form of a contribution by the beneficiary of aid over and above the effects of normal play of market forces to the achievement of Community objectives.”¹⁰⁵ In other words, whereas it is *necessary* for the aid to be consistent with an objective in Article 107(3), consistency alone is *not sufficient* to merit exception. The Member State Government must demonstrate that the aid is *indispensable* to the achievement of the Article 107(3) objective.¹⁰⁶ In *Philip Morris*, the Dutch government granted aid to assist cigarette manufacturer Philip Morris expand its facility in the economically depressed region of Bergen-op-Zoom. Both the government and Philip Morris argued that the aid

¹⁰⁰ *Id.*, art. 107(3)(e).

¹⁰¹ *Id.*, art. 107(3)(a).

¹⁰² *Id.*, art. 107(3)(b).

¹⁰³ *Id.*, art. 107(3)(c).

¹⁰⁴ *Id.*, art. 107(3)(d).

¹⁰⁵ *Xth Report on Competition Policy* (1980), para. 213.

¹⁰⁶ Thomas J. Doleys, *Managing the Dilemma of Discretion: The European Commission and the Development of EU State Aid Policy*, 13(1) J. IND. COMPET. TRADE 23, 31 (2013) (emphasis in original).

merited exemption under Article 107(3)(a) because it would help “promote the economic development” in the area, where the standard of living was “abnormally low.” The Commission agreed that the region was economically depressed, but at the same time it noted that Philip Morris, a healthy and profitable company, was capable of undertaking the investment on its own and did not require government assistance. According to the Commission, such aid was not indispensable to reaching the objectives of Article 107(3) and, therefore, lacked a compensatory justification.¹⁰⁷

Subsequently, the Commission indicated that it would take into account the following factors when exercising its discretion with regard to Article 107(3): (1) the aid should promote development which is in the interest of the Community as a whole; (2) the aid must be necessary for the achievement of this result, and the objective must not be obtainable otherwise in its absence; (3) the duration, intensity and scope of the aid must be proportional to the importance of the intended result.¹⁰⁸

Over the years, the Commission also adopted a number of regulations and so-called *soft-law* provisions, such as guidelines and communications. In particular, through General Block Exemption Regulations the Commission can declare certain categories of aid (for small and medium-sized enterprises, research and innovation, region development and the like) compatible with the common market and not subject to the notification requirement.¹⁰⁹ The purpose of block exemption regulations is to release the Commission from the time-consuming assessment of

¹⁰⁷ Decision 79/743/EEC, OJ L 217, 25.8.1979 (The ECJ confirmed the Commission decision and endorsed the Commission’s right to apply the compensatory justification principle (Case 730/79, *Philip Morris*, *supra* note 75, paras. 22-27)).

¹⁰⁸ XIIth *Report on Competition Policy* (1982), para. 160.

¹⁰⁹ Commission Regulation (EU) No. 1224/2013 of 29 November 2013 amending Regulation (EC) No. 800/2008, OJ L 320, 30/11/2013.

rather small aid schemes and *ad-hoc* cases and to enable it to concentrate on the important cases in terms of potential effects on competition.¹¹⁰

Although the general principle behind the Commission's compatibility assessment is to balance the positive impact of the aid measure (pursuing an objective of common interest) with its potential negative effects (distortions of trade and competition), in practice decisions tend to be "rather form-based and [do] not leave much room for assessing the impact of the measure on competition and trade."¹¹¹ Consequently, as Professors Friederiszick, Röller and Dr. Verouden point out, this increases the risk of disallowing aids which do not meet the conditions but which would very likely be benign from the common EU point of view, while allowing aids which formally meet the conditions but which are likely to be ineffective or to distort competition.¹¹²

In 2005, the Commission introduced its State Aid Action Plan (SAAP) which is intended to strike a better balance between the costs and benefits of State aid through an increased reliance on economic analysis.¹¹³ Under SAAP, the Commission's assessment of the compatibility of aid should be more firmly grounded on the wider economic impact of the aid measure, its potential to remedy market failures, and its impact on competition and relevant market – as opposed to its impact on rivals' costs.¹¹⁴ The SAAP indicates that there are two ways in which State aid may

¹¹⁰ Renate Repplinger-Hach & Volker Zuleger, *Non-Notifiable State Aid – the Block Exemption Regulation*, in *THE EC STATE AID REGIME: DISTORTIVE EFFECTS OF STATE AID ON COMPETITION AND TRADE* 671, 672-73 (Michael Sánchez Rydelski ed., 2006).

¹¹¹ Friederiszick, Röller & Verouden, *supra* note 44, at 152.

¹¹² *Id.* at 152-53 (noting that "[t]he combination of a rather broad approach taken when considering whether a measure constitute State aid or not and a form-based State aid approval system meant that EC State aid control bore the risk of being overly broad (to look at too many measures) and at the same time to be too imprecise, in the sense of not discrimination well enough between 'good' aid measures and 'bad' aid measures.").

¹¹³ SAAP, *supra* note 40.

¹¹⁴ LEIGH HANCHER, TOM OTTERVANGER & PIET JAN SLOT, *EU STATE AID* 148 (2012); Professor Coppi also notes

[w]hat is novel, is that . . . the discussion of the distortion of competition does not major on maintaining a 'level playing field' among undertaking, but rather on the potential negative effects in terms of *producers' incentives* that the aid may have. This absence of focus on the 'unfairness'

increase welfare: by improving *efficiency* when the market fails to deliver an optimal economic outcome; and by improving *equity*, when the market produces social or regional inequality.¹¹⁵ Therefore, the centerpiece of the refined economic approach in the State aid reform package is the “balancing test,” which assesses the compatibility of a State aid measure in response to three questions: (1) is the State aid aimed at a well-defined objective of common interest (e.g. social or regional cohesion); (2) is the State aid well designed to deliver the objective of common interest, *i.e.*, does the proposed measure address the market failure or other objective; and (3) are the distortions of competition and effect on trade sufficiently limited, so that the overall balance is positive?¹¹⁶ In other words, a particular State aid measure should be declared compatible whenever its benefits (in terms of economic efficiency or equity) outweigh the distortions of competition that the measure is likely to cause.

Before the SAAP, the only application of economic analysis was in the area of the “private investor test,” which is used to identify whether the transfer of state resources constitutes aid.¹¹⁷ The balancing test, therefore, is an important development, as it advances a much needed economic approach to the compatibility criteria under Article 107(3), and thus

of selective aid is atypical of State aid discourse, where considerations about ‘fairness’ have often been the main element of the analysis of the distortions of competition. The new focus on incentives is consistent with the refined economic approach where aid is judged on the basis of efficiency considerations, rather than fairness.

Lorenzo Coppi, *The Role of Economics in State Aid Analysis and the Balancing Test*, in RESEARCH HANDBOOK ON EUROPEAN STATE AID LAW 64, 80 (Erika Szyszczak ed., 2012) (emphasis in original).

¹¹⁵ SAAP, *supra* note 40.

¹¹⁶ Staff discussion paper, *Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 [107(3)]*, 15 May 2009 (*Common Principles* paper).

¹¹⁷ See *supra* notes 62-64 and accompanying text.

provides the opportunity for reducing the level of political interference in State aid control and furthering the role of economic and legal analysis.¹¹⁸

4. Procedure and Remedies

Supervisory control by the Commission is considered essential to the effective enforcement of the EU rules on State aid. Article 108 of the TFEU sets out the procedure for the examination of State aid measures by the Commission. In order to make the process more transparent and predictable, Council Regulation 659/1999 (hereinafter “Procedural Regulation”) lays down detailed rules for the application of Article 108.¹¹⁹ These rules have been further refined and clarified by Commission Regulation 794/2004 (hereinafter “Implementing Regulation”), which provides interpretative rules and a set of notification forms.¹²⁰ Finally, EU case law has developed a consistent practice for the application of Article 108.

a. Commission’s Supervisory Control According to Article 108 of the TFEU, Member States are required to notify each State aid to the Commission and obtain Commission authorization before they implement the measure.¹²¹ Member States are thus under an obligation not to implement a State aid before the Commission has stated its position by declaring either that the

¹¹⁸ It needs to be pointed out that the new economic approach is only applied to the issue of State aid compatibility under Article 107(3). It is not carried out in order to identify whether a measure constitutes State aid in the meaning of Article 107(1), in particular it is not applied for establishing “distortion of competition” and “effect on trade” elements.

¹¹⁹ Council Regulation (EC) 659/1999 of 22 March 1999 laying down detailed rules for the application of [ex] Article 93 of the EC Treaty [Article 108 of the TFEU], OJ 1999 L 83 (amended by Council Regulation (EU) No. 734/2013 of 22 July 2013 amending Regulation (EC) No 659/1999, OJ L 204).

¹²⁰ Commission Regulation (EC) 794/2004 of 21 April 2004 implementing Council Regulation (EC) laying down detailed rules for the application of [ex] Article 93 of the EC Treaty [Article 108 of the TFEU], OJ 2004 L 140.

¹²¹ TFEU, *supra* note 2, art. 108.

measure does not constitute State aid under Article 106 or that it is compatible with the internal market under Article 107. In contrast to other competition procedures, where the parties concerned are directly involved and have procedural rights of their own, State aid procedure involves only the Member State and the Commission. Third parties, such as a beneficiary or a competitor of a beneficiary, do not have a formal role to play other than being an “informant.”¹²²

The procedures for controlling State aid vary depending on whether or not the measure has been previously notified to the Commission. The notification requirement is applicable to “*new aid*” measures.¹²³ Article 1(c) of the Procedural Regulation defines “new aid” as any aid that is not “existing aid,”¹²⁴ but including alterations to existing aid.¹²⁵ According to Article 2.1 of the Procedural Regulation, any plans to grant new aid must be notified to the Commission “in sufficient time” by the Member State concerned.¹²⁶ Once the notification is received, the Commission must conduct a preliminary examination of the State aid.¹²⁷ The preliminary procedure is intended to enable the Commission to form a *prima facie* opinion on the partial or

¹²² Michael Schütte, *Procedural Aspects of EU State Aid Law and Practice*, in RESEARCH HANDBOOK ON EUROPEAN STATE AID LAW 336, 337-38 (Erika Szyszczak ed., 2012).

¹²³ It should be noted that not all State aids must be notified. First, Block Exemption Regulations declare certain categories of horizontal aid compatible with the common market and not subject to the notification requirement. Second, aids that are classified as *de minis* under the Regulation No 69/2001 do not constitute State aid in the meaning of Article 106(1) and, therefore, do not need to be notified.

¹²⁴ “Existing aid” is (1) aid that existed prior to the entry into force of the EC Treaty in each Member State; (2) aid schemes or individual aid that has been authorized by the Commission or the Council or the Council; (3) aids notified to the Commission for which a decision has not been made concerning its compatibility with the common market in a period of two months; (4) aid that is considered illegal for not being notified, but was granted more than ten years ago; and (5) aid that, at the time it was granted, did not constitute State aid in accordance with Article 106.1, but subsequently became State aid due to the evolution of the common market and has not in the meantime been altered by the Member State. (Procedural Regulation, *supra* note 119, art. 1(b).)

¹²⁵ *Id.*, art. 1(c).

¹²⁶ *Id.*, art. 2.1.

¹²⁷ *Id.*, art. 4.1.

complete compatibility of the aid in question.¹²⁸ As a result of its preliminary examination, the Commission can conclude that (1) the measure does not constitute State aid in the meaning of Article 106(1) of the TFEU;¹²⁹ (2) “no doubts are raised” as to the compatibility of the measure with the common market;¹³⁰ or (3) there are “doubts” as to the compatibility of the measure with the common market.¹³¹ The decision must be taken within two months.¹³² In cases where the Commission has serious doubts as to the compatibility of the measure, it must open the formal investigation procedure.¹³³ The Member State concerned is informed of the initiation of proceedings by letter, whereas the other Member States and interested third parties are informed by a notice published in the Official Journal.¹³⁴ The Commission must conclude the formal procedure within 18 months from the opening of the procedure.¹³⁵ This time limit may be extended by common agreement between the Commission and the Member State concerned.¹³⁶ As a result of the formal procedure, the Commission may determine: (1) that the measure does not constitute State aid;¹³⁷ (2) that the measure is compatible with the common market (positive

¹²⁸ Case C-204/97, *Portugal v. Commission*, [2001] ECR I-3175, para. 32; Case C-198/91, *Cook v. Commission*, [1993] ECR I-2487, para. 22; Case C-225/91, *Matra v. Commission*, [1993] ECR I-3203, para.16.

¹²⁹ Procedural Regulation, *supra* note 119, art. 4.2 (In practice, however, this kind of Decision is often avoided because such an assessment is subject to full legal review by the European Courts. In situations like these, Member States are usually encouraged to withdraw the notification, thus relieving the Commission from having to take a “no aid” Decision. *See* Schütte, *supra* note 122, at 340-41.).

¹³⁰ *Id.*, art. 4.3.

¹³¹ *Id.*, art. 4.4.

¹³² *Id.*, art. 4.5.

¹³³ *Id.*, art. 4.5; TFEU, *supra* note 2, art. 108(2).

¹³⁴ *Id.*, art. 26.2.

¹³⁵ *Id.*, art. 7.6.

¹³⁶ Case C-49/05P, *Ferriere Nord SpA v. Commission*, [2008] ECR I-68, paras. 48-50.

¹³⁷ Procedural Regulation, *supra* note 119, art. 7.2.

decision);¹³⁸ (3) that the measure may be considered compatible with the common market if it is subject to certain conditions (conditional decision);¹³⁹ or (4) the measure is incompatible with the common market (negative decision).¹⁴⁰

Article 108(3) of the TFEU specifically prohibits the granting of any State aid before the Commission has had the opportunity to assess its compatibility with the common market.¹⁴¹ Thus, a measure that does constitute a State aid, and that has been implemented without prior notification, is considered to be *an unlawful* or *illegal aid*. On the other hand, the mere fact that aid is unlawful does not mean that it is also incompatible with the common market.¹⁴² The procedure for unlawful aid is similar to that for new aid. It consists of two phases, a preliminary examination and, in case there are doubts regarding the nature of the measure or its compatibility, a formal investigation procedure. The Commission may issue an injunction requiring the Member State to suspend any unlawful measure until the Commission has taken a decision on the compatibility of the measure with the common market (suspension injunction).¹⁴³ Likewise, the Commission may adopt a decision requiring the Member State to provisionally recover any unlawful aid until the final decision is taken (recovery injunction).¹⁴⁴ The provisional recovery is exceptional, and the Commission does not use it in practice.¹⁴⁵ In the

¹³⁸ *Id.*, art. 7.3.

¹³⁹ *Id.*, art. 7.4.

¹⁴⁰ *Id.*, art. 7.5.

¹⁴¹ TFEU, *supra* note 2, art. 108(3).

¹⁴² Case C-173/73, *Italy v. Commission*, [1974] ECR 709, para. 13.

¹⁴³ Procedural Regulation, *supra* note 119, art. 11.1.

¹⁴⁴ *Id.*, art. 11.2 (A provisional recovery injunction may be ordered only “if the following criteria are fulfilled: according to an established practice there are not doubts about the aid character of the measure concerned; and there is urgency to act; and there is serious risk of substantial and irreparable damage to a competitor.”).

¹⁴⁵ Schütte, *supra* note 122, at 346-47.

case of non-notified aid, the Commission always assesses the compatibility of unlawful State aid with the common market in accordance with the rules applicable *at the time when the aid was granted*.¹⁴⁶ If, at the end of the investigation procedure, the Commission reaches the conclusion that the unlawful aid is not compatible with the common market it must order recovery of the unlawfully paid aid.¹⁴⁷

Misuse of aid involves action by a beneficiary rather than by a Member State and arises where aid is used by the beneficiary in contravention of a decision of the Commission declaring a measure to be compatible with the common market.¹⁴⁸ The procedure is the same as that for unlawful aid, but the Commission should always open the formal investigation procedure, given that misuse of aid can only arise in the context of existing aid.¹⁴⁹ Where the Commission finds that the misuse of aid is incompatible with the common market, it requires the Member State to recover the aid that has been misused.¹⁵⁰

b. Recovery of Aid If, in the course of a State aid investigation, the Commission reaches the conclusion that the grant of certain aid is incompatible with the common market, the Commission must decide that the Member State concerned “shall take the necessary measures to recover the aid from the beneficiary,” unless this would be contrary to a general principle of Community law.¹⁵¹ Thus, the Commission has no discretion to wave the recovery of the

¹⁴⁶ *Commission Notice on the Determination of the Applicable Rules for the Assessment of Unlawful State Aid*, OJ 2002 C 119/22.

¹⁴⁷ Procedural Regulation, *supra* note 119, art. 14.1.

¹⁴⁸ *Id.*, art. 1(g).

¹⁴⁹ *Id.*, art. 16.

¹⁵⁰ *Id.*

¹⁵¹ *Id.*, art. 14.1.

unlawful aid. The language of the article also makes it clear that a recovery decision must be addressed to the Member State which granted the unlawful aid rather than to the beneficiary.

According to Article 14.3, recovery “shall be effected without delay and in accordance with the procedures under the national law of the Member State concerned, provided that they allow the immediate and effective execution of the Commission’s decision.”¹⁵² Thus, after the Commission decides that the Member State must recover unlawful aid, the Member State recovers this aid from the beneficiary pursuant to the applicable national procedures.

The ECJ has explained that the main purpose of the recovery of unlawful aid is “to eliminate the distortion of competition caused by the competitive advantage afforded by the unlawful aid.”¹⁵³ The recovery “seeks to re-establish the previous situation.”¹⁵⁴ At the same time, the Commission is not obliged to determine the precise amount of aid to be recovered. It suffices that the Commission determines in a clear manner what measures are State aids and when they were adopted. In these cases, the national courts determine the amount to be repaid.¹⁵⁵ Recovery of the aid must also include interest on the aid, from the time the aid was first granted until the moment the aid is fully recovered.¹⁵⁶ Recovery of interest is necessary to ensure that the competitive advantage resulting from the grant of the unlawful aid is completely eliminated. It prevents the beneficiary from benefiting after reimbursement of the principal aid amount *de facto* from an interest-free loan.¹⁵⁷

¹⁵² *Id.*, art. 14.3.

¹⁵³ Case C-277/00, *Germany v. Commission (SMI)*, [2004] ECR I-3925, para. 76.

¹⁵⁴ *Id.*, para. 74.

¹⁵⁵ Case 102/87, *France v. Commission*, [1988] ECR I-4067, para. 33; Case C-480/98, *Spain v. Commission*, [2000] ECR I-8717, paras. 25-26.

¹⁵⁶ Procedural Regulation, *supra* note 119, art. 14.2.

¹⁵⁷ Thomas Köster, *Recovery of Unlawful State Aid*, in *THE EC STATE AID REGIME: DISTORTIVE EFFECTS OF STATE AID ON COMPETITION AND TRADE* 653, 657 (Michael Sánchez Rydelski ed., 2006).

Recovery does not necessarily have to be in the form of a cash payment. A Member State is free to choose the means of fulfilling the recovery order, provided that the measures chosen do not adversely affect the scope and effectiveness of EU law.¹⁵⁸

5. Comparison of the WTO and EU Rules on Subsidies and State Aid

The WTO and the EU have different general objectives, which affect the rules on subsidies and state aids in each organization. The WTO is a “trade” organization which merely aims to gradually eliminate trade barriers among its members.¹⁵⁹ The EU, on the other hand, has a much further reaching object and purpose. It pursues quite extensive economic policies (creation of internal market, competition, infrastructure, transport, etc.) as well as other policy areas (human rights, health, consumer protection, environment, culture, immigration, etc.).¹⁶⁰ Moreover, the EU is a regional organization comprised of countries with a substantial degree of commonality of values and objectives while the WTO is a universal international organization which currently counts 164 members.

These differences have implications at the institutional level. The institutional framework and enforcement regime in the EU are far more complex, sophisticated and effective than those

¹⁵⁸ Case C-369/07, *Commission v. Hellenic Republic*, [2009] ECR I-5703, para. 2 (stating that “in principle, so long as it is provided for under the national legal system as a mechanism for extinguishing debts, a set-off operation can constitute an appropriate means by which State aid may be recovered.”).

¹⁵⁹ According to the Preamble of the WTO Agreement, the ultimate objectives of the WTO are rather broad and include the increase of standards of living, the attainment of full employment; the growth of real income, and the expansion of production of, and trade in, goods and services. At the same time, the principal means to achieve these objectives are limited to the *reduction of trade barriers* and the *elimination of discriminatory treatment in international trade*. (See Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 4 (1999), 1867 U.N.T.S. 154, 33 I.L.M. 1144 (1994) [hereinafter WTO Agreement]).

¹⁶⁰ TEU, *supra* note 1, art. 3; *see also, e.g.*, Deidre M. Curtin & Ige F. Dekker, *The European Union from Maastricht to Lisbon: Institutional and Legal Unity out of the Shadows*, in THE EVOLUTION OF EU LAW 155, 185 (Paul Craig & Gráinne De Búrca eds., 2d ed. 2011) (stating that “the Union has become a general political international organization with important functions in almost every field of public life.”).

in the WTO system. The WTO is a classical international organization where all decisions are made by Member States.¹⁶¹ In the EU, on the other hand, the decision-making process involves more actors and therefore interests: the Council (composed of representatives of the Member States and representing their interests); the European Parliament (directly elected by the EU citizens and thus representing the people of the Member States), and the Commission (a politically independent institution that represents and uphold the interests of the EU as a whole).¹⁶² Moreover, EU law enjoys primacy over the domestic laws of Member States¹⁶³ and may have direct effect,¹⁶⁴ which is not the case with WTO law.

The rules on subsidy control in the WTO and EU are tied to these main objectives and are applied and enforced, taking into account the institutional structure and overall goals pursued by the WTO and EU. The WTO law on subsidies is aimed at ensuring free trade between WTO Members by providing a system that enables the Members to protect their domestic industries against injury caused by subsidized goods.¹⁶⁵ Consequently, the main objective of the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) is to discourage subsidies that might harm competing foreign *producers* rather than reduce aggregate economic welfare.¹⁶⁶ Even though initially the SCM Agreement recognized the legitimacy of certain subsidies, which suggested a more complex and balanced approach that went beyond producers' interests, since the expiry of the non-actionable subsidies in 1999 the WTO rules are about

¹⁶¹ WTO Agreement, *supra* note 159, art. IX:1.

¹⁶² TEU, *supra* note 1, art. 13.

¹⁶³ Case 6/64, Flaminio Costa v. E.N.E.L., [1964] ECR 585.

¹⁶⁴ Case 26/62, Van Bend en Loos v. Nederlandse Administratie der Balestingen, [1963] ECR 1.

¹⁶⁵ Pernille Wegener Jessen, *Rules on State Aid and Subsidies*, in *LIBERALIZING TRADE IN THE EU AND THE WTO: A LEGAL COMPARISON* 288, 291 (Sanford E. Gaines, Birgitte Egelund Olsen & Karsten Engsig Sørensen eds., 2014).

¹⁶⁶ PETROS C. MAVROIDIS, *TRADE IN GOODS: THE GATT AND THE OTHER WTO AGREEMENTS REGULATING TRADE IN GOODS* 523-26 (Oxford University Press 2012); LUCA RUBINI, *THE DEFINITION OF SUBSIDY AND STATE AID: WTO AND EC LAW IN COMPARATIVE PERSPECTIVE* 57 (Oxford University Press 2010).

discouraging subsidies that may harm *producers'* interests. As Professor Rubini puts it, the balance is now tipped too far towards *subsidy aversion*.¹⁶⁷

By contrast, EU State aid law is part of EU competition policy. While it also is aimed at preventing trade barriers and preserving the common market, it goes much further, focusing on the protection of the competitive process in the market. Protection of competition does not only mean protecting competitors but ensuring that markets work efficiently as well. Economic efficiency is analyzed by assessing the effect of a State aid measure on total welfare, i.e. the sum of consumer welfare and producer welfare.¹⁶⁸ Consequently, the EU State aid policy is aimed at improving the efficient functioning of markets by correcting market failures, as long as the benefits of intervention outweigh the costs. Moreover, the EU acknowledges that government intervention through State aid can be used to achieve equity objectives in order to compensate for the consequences of competitive markets, which may create disparities between individuals and between regions. As a result, the EU is more likely to allow certain subsidies within its legal framework than is the WTO.

In addition to the differences regarding the objectives of the rules, there is an essential difference regarding the scope of the rules. The GATT and the SCM Agreement only regulate the subsidization of goods,¹⁶⁹ whereas the TFEU regulates state aid to both goods and services. Thus, the following comparison of WTO and EU law on subsidies will be limited to the subsidization of goods.

¹⁶⁷ RUBINI, *supra* note 166, at 56-59 (emphasis in original).

¹⁶⁸ Friederiszick, Röller & Verouden, *supra* note 44, at 154.

¹⁶⁹ GATS does not impose binding obligations regarding subsidies for *services*. Its provisions merely includes the possibility of reaching an agreement in this matter and seeking consultations in the event that a subsidy to services negatively affects the interests of another Member (*see* GATS: General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, [THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS] 284 (1999), 1869 U.N.T.S. 183, 33 I.L.M. 1167, art. XV (1994) [hereinafter GATS]).

a. Definitions of “Subsidy” and “State Aid” Most elements of the definitions of “subsidy” and “State Aid” (granted by a government/Member State, advantage/benefit granted to a recipient, specificity/selectivity¹⁷⁰) are considered to be not fundamentally different.¹⁷¹ The main difference between the two definitions notable arises with regard to the nature of the resources granted.

In addition to being provided by the State, Article 107(1) of the TFEU requires that a prohibited State aid measure be granted out of “state resources.”¹⁷² In *PreussenElektra*, the ECJ made it clear that “only advantages granted directly or indirectly through State resources are to be considered as aid” within the meaning of Article 107(1).¹⁷³ There, the ECJ held that legislation forcing private regional electricity suppliers to purchase electricity produced from renewable energy producers in their area of supply at fixed minimum prices did not constitute State aid because it did not “involve any direct or indirect transfer of State resources to undertakings which produce that type of electricity.”¹⁷⁴ Thus, State aid will only exist where the measure involves a “charge on the public account.”

By contrast, no such requirement exists under WTO law. The first element of the definition of a subsidy in Article 1.1 of the SCM Agreement consists of an alternative between a

¹⁷⁰ One important difference between WTO and EU law, however, is that of regional selectivity. Subsidies granted for a region are not specific according to Article 2.2 of the SCM Agreement, providing that that are available to all enterprises in the region, whereas the same measure is selective according to Article 107(1) of the TFEU.

¹⁷¹ See, e.g., GUSTAVO E. LUENGO HERNÁNDEZ DE MADRID, REGULATION OF SUBSIDIES AND STATE AIDS IN WTO AND EC LAW: CONFLICTS IN INTERNATIONAL TRADE LAW 440-43, 450-55 (2007); Claus-Dieter Ehlermann & Martin Goyette, *The Interface Between EU State Aid Control and the WTO Disciplines on Subsidies*, 4 EUROPEAN STATE AID LAW QUARTERLY 695, 700-94 (2006); Jessen, *supra* note 140, at 298, 302-03.

¹⁷² TFEU, *supra* note 2, art. 107(1) (stating that “any aid granted by a Member State or through state resources . . . be incompatible with the common market.”).

¹⁷³ Case C-379/98, *PreussenElektra*, *supra* note 59, para. 58.

¹⁷⁴ *Id.*, para. 59.

“financial contribution by a government” or “any form of income or price support”.¹⁷⁵ The latter involves no burden on government funds. The “financial contribution” may involve a charge on the public account in certain cases (for example, transfer of public resources, foregoing of government revenue or the provision of goods or services by the government) but not in all of them. The question whether subsidies within the meaning of Article 1 of the SCM Agreement necessarily involve a charge on the public account was answered in *Canada-Civilian Aircraft*.¹⁷⁶ The context of the debate, however, was not the interpretation of the “financial contribution” element but the definition of the “benefit” under Article 1.1(a)(2).¹⁷⁷ In particular, Canada was arguing that a “cost to government” must be demonstrated in order to establish a benefit.¹⁷⁸ The Panel, however, rejected the argument and concluded that:

If “benefit” were to include the notion of net cost to government, it could exclude from the definition of “subsidy” situations explicitly identified in Article 1.1(a)(1) itself as constituting government financial contributions even though no cost to the government might be involved. Specifically, Article 1.1(a)(1)(iv) identifies as a “financial contribution” the situation where a government directs a private body to make “financial contribution” within the meaning of Article 1.1(a)(1)(i)-(iii). In such a situation, the net cost could be incurred entirely by the private body rather than the government. Canada’s interpretation of “benefit” (i.e., to include net cost to government) would render Article 1.1(a)(1)(iv) meaningless, since a form of “financial contribution” explicitly included in Article 1.1(a) would automatically (i.e., because it would never meet the net cost to government test) be excluded by Article 1.1(b).¹⁷⁹

¹⁷⁵ Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 231 (1999), 1869 U.N.T.S. 14, art. 1.1 [hereinafter SCM Agreement].

¹⁷⁶ Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/RW, adopted 21 July 2000.

¹⁷⁷ *Id.* at paras. 95-99.

¹⁷⁸ *Id.* (The EU, as a third party, argued that the discussion on the cost to government should focus on the first element of the definition (financial contribution) and not on the second element (benefit) of subsidy).

¹⁷⁹ Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, adopted 14 April 1999, para 9.115.

Therefore, because of the absence of the requirement of a “charge on the public account,” the notion of a subsidy in WTO law is broader than the notion of State aid in EU law. Some scholars and experts have expressed the view that government measures such as those in *PreussenElektra* – which in view of the ECJ’s finding are not State aid within the meaning of Article 107(1) of the TFEU – would most likely to be considered subsidies within the meaning of Article 1.1 of the SCM Agreement.¹⁸⁰

b. Prohibited and Permitted Measures in the WTO and the EU The most significant difference between the two systems is what happens once a measure is established to be a subsidy or a State aid. As Gustavo Luengo observes, the dividing line between measures that are prohibited and measures that are permitted is drawn differently in the WTO and the EU.¹⁸¹

WTO law expressly prohibits export subsidies and import substitution subsidies.¹⁸² If a subsidy is found by a WTO adjudicating body to be prohibited, the subsidizing Member has an obligation to immediately withdraw it.¹⁸³ Prohibited subsidies are considered specific *per se*,¹⁸⁴ therefore, the “specificity” element does not have to be established. Moreover, measures that fall under the scope of the Illustrative List of Export Subsidies are deemed to be prohibited subsidies, there is no need to establish all elements of a subsidy (i.e. (1) financial contribution by a

¹⁸⁰ Marco M. Slotboom, *Subsidies in WTO Law and in EC Law: Broad and Narrow Definition*, 36 J. WORLD TRADE 517, 539-40 (2002); LUENGO, *supra* note 145, at 448; Jessen, *supra* note 140, at 301-02.

¹⁸¹ LUENGO, *supra* note 171, at 456.

¹⁸² SCM Agreement, *supra* note 175, art. 3.

¹⁸³ *Id.*, art. 4.7.

¹⁸⁴ *Id.*, art. 2.

government, which (2) confers a benefit to (3) a specific recipient) pursuant to Articles 1 and 2 of the SCM Agreement.¹⁸⁵

In the EU, *all* government measures that fall within the meaning of Article 107(1) of the TFEU (i.e. measures which are granted by the state or through state resources; confer an advantage to the recipient; are selective; distort competition, and affect trade between Member States) are considered to be State aids which are incompatible with the common market.¹⁸⁶ This prohibition is not absolute though; a State aid measure still may be authorized by the Commission as compatible with the common market and, therefore, permissible under Articles 107(2) and 107(3).

Export subsidies and import substitution subsidies¹⁸⁷ are not prohibited *per se* under EU law. They may be authorized by the Commission in light of any of the objectives contained in Article 107(3) of the TFEU. Even though the Commission has recognized that export subsidies are “clearly at odds with the objective of an internal market,”¹⁸⁸ it nevertheless has pointed out that it could authorize “soft aid in favor of SMEs related to the development of export markets, such as aid for consultancy and marketing research, provided that the aid is a one-off operation and limited to the penetration of new markets.”¹⁸⁹

Thus, while WTO law expressly prohibits certain types of government measures without demonstration of the specificity element (and in certain cases without even establishing the

¹⁸⁵ Panel Report, *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, adopted 11 April 2005, para. 7.204, n.126.

¹⁸⁶ TFEU, *supra* note 2, art. 107(1).

¹⁸⁷ It needs to be pointed out that a government measure favoring domestic products over EU products would violate the provisions on free movement of goods and services (Articles 34 and 56 of the TFEU); the rules on State aid would not justify authorization of such a measure. However, in the event that the measure in question discriminates between EU products and products from a non-EU country, it may be permitted under EU State aid rules.

¹⁸⁸ *XXVth Report on Competition Policy* (1995), para. 208.

¹⁸⁹ *Id.*

subsidy elements), EU law does not contain such a prohibition. At the same time, although all State aids are declared to be incompatible with the common market, they still may be justified in many cases.

With regard to permitted (green) subsidies, since the expiry of the non-actionable subsidies in 1999, WTO law recognizes no exceptions to its discipline on the basis of the objectives of a measure. By contrast, in the EU includes in the green category aids of a social character and aids to offset the damages caused by natural disasters or exceptional circumstances to be *per se* compatible with the common market.¹⁹⁰ In terms of State aid that may be declared compatible with the common market, the Commission adopted a set of Guidelines and Regulations to establish the criteria that aids under Article 107(3) of the TFEU must comply with in order to be authorized. This body of *soft law* justifies the use of sectoral (agricultural, broadcasting services, coal, electricity, fishing, steel, transport, energy, etc.) and horizontal (environment protection, research and innovation, regional development, employment and training, promoting small and medium enterprises, rescuing and restructuring companies in crisis) aids.

Finally, the approach to actionable (yellow) subsidies (which are all subsidies that do not fall within category of “red” subsidies in the WTO and all State aids that do not fall within category of “green” subsidies in the EU) is also different. In the WTO, if a subsidy causes “adverse effects to the interests of other Members”, the subsidizing Member has to withdraw the subsidy or remove its adverse effects.¹⁹¹ Thus, as Luengo observes, if a subsidy causes harmful effects to the interests of another Member, other types of (positive) effects on other Members,

¹⁹⁰ TFEU, *supra* note 2, art. 107(2).

¹⁹¹ SCM Agreement, *supra* note 175, arts. 5, 7.8.

either social or economic, will not be taken into account.¹⁹² The EU, by contrast, does not consider the effect that a State aid might have on another Member. Instead, it evaluates the impact of the aid on the EU interest as a whole.¹⁹³ Consequently, if the aid increases EU's welfare, the Commission may authorize it even though it might negatively affect the interest of a particular Member. Second, whereas the WTO analysis focuses exclusively on harm to *producers* in another Member, the EU evaluates whether State aid is used to improve the efficiency of the market or to achieve other social objectives (social or regional cohesion, employment, cultural diversity, etc.). Therefore, the EU takes into account more objectives and interest when permitting or prohibiting State aids than those taking into account by the WTO.

In sum, given that the concept of State aid under EU law is narrower than the concept of subsidy under WTO law and that EU provides more possibilities for justifying State aid while the WTO does not provide any, the EU allows for a greater intervention of Member States in their economies than the WTO does.

c. Control and Remedies The enforcement regimes of the WTO and the EU are very different, largely as a result of the different institutional organization. The WTO system is “complaint-driven,”¹⁹⁴ the subsidy must always be challenged by another WTO Member before remedies follow.¹⁹⁵ By contrast, the EU provides for *ex ante* assessment of State aid: EU Member States are required to notify their aid to the Commission and obtain its authorization before they

¹⁹² LUENGO, *supra* note 171, at 472.

¹⁹³ TFEU, *supra* note 2, art. 107(3).

¹⁹⁴ Ben Slocock, *EC and WTO Control Systems – Some Reflections*, 2 EUROPEAN STATE AID LAW QUARTERLY 249, 255 (2007).

¹⁹⁵ SCM Agreement, *supra* note 175, arts. 4, 7.

implement it.¹⁹⁶ Moreover, EU Members cannot adopt unilateral measures against another EU Member, while WTO Members affected by subsidized imports causing material injury to their domestic industry may impose countervailing duties unilaterally.¹⁹⁷

Under WTO law, the Member that granted a prohibited subsidy has to withdraw it,¹⁹⁸ which means that the Member must stop granting a subsidy *after* it was declared prohibited by a WTO adjudicating body. With regard to actionable subsidies, if a Panel concludes that a subsidy causes adverse effects to the interests of another Member, the subsidizing Member can choose between withdrawing the subsidy and removing its adverse effect.¹⁹⁹ Under EU law, on the other hand, a Member State cannot continue to keep the subsidy that was declared to be incompatible with the common market by means of compensation.²⁰⁰ Second, WTO rules only offer a prospective remedy, i.e. they do not affect subsidies that have been granted in the past. In Professor Hudec's words, the only remedy for violation of WTO rules is "a forward-looking order to directing the defendant to comply in the future."²⁰¹ Under EU law, by contrast, if the Member State has not notified State aid that is incompatible with the common market (unlawful aid) or grants the aid that has been notified and authorized but in a manner contrary to the Decision of the Commission (misused aid), the offending Member has to recover the aid.²⁰² The recovery must also include interest on the aid, from the time the aid was first granted until the

¹⁹⁶ TFEU, *supra* note 2, art. 108.

¹⁹⁷ SCM Agreement, *supra* note 175, Part V.

¹⁹⁸ *Id.*, art. 4.7.

¹⁹⁹ *Id.*, art. 7.8.

²⁰⁰ TFEU, *supra* note 2, art. 108.

²⁰¹ Robert E. Hudec, *Broadening the Scope of Remedies in WTO Dispute Settlement*, in *IMPROVING WTO DISPUTE SETTLEMENT PROCEDURES: ISSUES AND LESSONS FROM THE PRACTICE OF OTHER INTERNATIONAL COURTS AND TRIBUNALS* 369, 382 (Friedl Weiss ed., 2000).

²⁰² Procedural Regulation, *supra* note 119, art. 14.1.

moment the aid is fully recovered.²⁰³ The retrospective character of remedies in the EU is aimed at the reestablishing the previous situation on the market.

In case of non-compliance, the injured WTO Member can adopt retaliatory measures,²⁰⁴ which usually take the form of increase in the custom duties. As a result, the offending WTO Member may choose to maintain the subsidy, while the injured party imposing these measures may also be negatively affected by them.²⁰⁵ By contrast, under EU law the ECJ can impose penalties if a Member State has not complied with its judgment²⁰⁶ and it does so “in a remarkably aggressive way.”²⁰⁷ Moreover, competitors and other third parties affected by unlawful or misused aids, can also claim damages from national authorities in national courts for failure to implement the Commission recovery Decision.²⁰⁸

In sum, the EU allows more government interventions, authorizing the State aids that may fall into categories of prohibited or actionable subsidies under WTO law. Such a difference is a reflection of the fact that the EU and the WTO pursue different objectives. While the WTO merely aims to gradually eliminate trade barriers among its members, the EU pursues not only economic integration among its members through the creation of a common market where products, services, capital and people move freely, but it also seeks social and political

²⁰³ *Id.*, art. 14.2.

²⁰⁴ SCM Agreement, *supra* note 175, arts. 4, 7.

²⁰⁵ PETER VAN DEN BOSSCHE, *THE LAW AND POLICY OF THE WORLD TRADE ORGANIZATION: TEXT, CASES AND MATERIALS* 223 (Cambridge University Press 2005) (stating that “[i]n particular for developing-country members, applying retaliation measures is often not a genuine option. In *EC-Bananas III*, Ecuador was authorized to apply retaliation measures for an amount of US\$201.6 million a year but found it impossible to make use of this possibility without causing severe damage to its own economy.”).

²⁰⁶ TFEU, *supra* note 2, art. 260(2) (stating that “[i]f the Court finds that the Member State concerned has not complied with its judgement it may impose a lump sum or penalty payment on it.”).

²⁰⁷ DAMIAN CHALMERS, CHRISTOS HADJIEMMANUIL, GIORGIO MONTI & ADAM TOMKINS, *EUROPEAN UNION LAW: TEXT AND MATERIALS* 365 (Cambridge University Press 2006).

²⁰⁸ Joined Cases C-6/90 and C-9/90, *Francovich and Bonifaci v. Italy*, [1991] ECR I-5537, paras. 31-35; Joined Cases C-24/93 and C-48/93, *Brasserie du Pêcheur/Factortame III*, [1996] ECR I-1029, paras. 74-80.

integration. As a result, the WTO focuses exclusively on protecting trade interests of an individual WTO Member, which means the interests of producers of that Member. The EU, on the other hand, concentrates on the Community interest, protecting the competitive process in the common market (taking into account interests of both producers and consumers), as well as other social objectives.

At the same time, the enforcement of the EU State aid rules is more advanced and effective than that in the WTO, basically as a result of their different institutional arrangements. In the EU, there is *ex ante* control: subsidies are submitted to the Commission, which either authorizes or prohibits them. Already granted State aid, which is declared incompatible with the common market, must be repaid. In the WTO, there is *ex post* control: another WTO Member has to challenge the measure before remedies follow. Those remedies do not include repayment.

C. EU COUNTERVAILING DUTY LAW

EU countervailing duty (CVD) law has been substantially amended as a result of the SMC Agreement²⁰⁹ and includes “almost verbatim”²¹⁰ provisions of that Agreement. Currently, CVD proceedings are governed by the Council Regulation 597/2009 (hereinafter Regulation).²¹¹

²⁰⁹ The first legislation empowering the EC to impose CVDs was Council Regulation No 459/68 of 5 April 1968 on protection against dumping or the granting of bounties or subsidies by countries which are not members of the European Economic Community (OJ 1968 L93/1). It covered both dumping and subsidy proceedings. Only after conclusion of the SCM Agreement the EU decided that it would be better to adopt two separate legal instruments for each type of proceedings. Council Regulation No 3284/94 of 22 December 1994 (OJ 1994 L394/22) was the first regulation that set out the legal framework for anti-subsidy proceedings only.

²¹⁰ KONSTANTINOS ADAMANTOPOULOS & MARÍA J PEREYRA-FRIEDRICHSEN, EU ANTI-SUBSIDY LAW AND PRACTICE 46 (2001).

²¹¹ Council Regulation 597/2009 of 11 June 2009 on protection against subsidized imports from countries not members of the European Community (OJ L188/93) [hereinafter Regulation].

1. Substantive Elements

In order to impose countervailing measures against subsidized imports, three basic elements need to be established during the course of investigation: (1) the imports concerned are benefiting from countervailable subsidies; (2) the subsidized imports cause or threaten to cause material injury to the Union industry producing the like product; and (3) the imposition of countervailing measures is in the interest of the EU.²¹²

a. Subsidy With regard to the definition of a subsidy, the Regulation closely follows the language of Article 1 of the SCM Agreement. In order to find the existence of a subsidy, two cumulative conditions must be met: (1) there must be a financial contribution by a government in the country of origin or export or there must be a form of income or price support within the meaning of Article XVI of the GATT 1994; and (2) there must be a benefit conferred thereby.²¹³

Prior to the Uruguay Round, the EU approach was consistent with their position regarding a State aid: a subsidy can only be found if government intervention involves a charge on the public account.²¹⁴ This restrictive interpretation is no longer applicable now that the SCM Agreement contains a much broader definition of a subsidy, without specifying that there must

²¹² *Id.*, art. 15.1.

²¹³ *Id.*, art. 3.

²¹⁴ Commission Decision 85/233/EEC, OJ L 108, 20.04.1985, para. 28 (stating that “any subsidy must involve a charge on the public account. To extend the concept of subsidies to include practices other than those involving such a charge would be excessive, and taken to its extreme could lead to any government intervention whatsoever in the economy being regarded as a subsidy, including tax measures or even regulatory action such as the introduction of price controls or pollution standards.”).

be a cost to the government.²¹⁵ Thus, the current practice is to examine the existence and amount of subsidy in terms of benefit to the recipient.²¹⁶

Article 4 of the Regulation provides that subsidies shall be subject to countervailing measures only if they are specific.²¹⁷ Like in the WTO, while export subsidies and domestic content subsidies are automatically considered as specific and therefore countervailable,²¹⁸ domestic subsidies must be specific in order to be countervailable. In general, the EU institutions tend to adopt a very broad interpretation of the notion of specificity. As a result, schemes which are available to a large portion of domestic industry were nevertheless found to be specific.²¹⁹

Article 5 of the Regulation follows the language of Article 14 of the SCM Agreement stating that the amount of countervailable subsidies shall be calculated in terms of the benefits conferred on the recipient which is found to exist during the investigating period.²²⁰ Yet, at same time, while the SCM Agreement does not contain specific rules on the exact calculation methods to be used for determining the amount of subsidy in terms of benefit to the recipient, more detailed rules concerning calculation methods to be used are set out in Articles 6 and 7 of the Regulation.²²¹ Those rules were further elaborated upon by the Commission in its Guidelines for the calculation of the amount of subsidy in countervailing duties investigations adopted in

²¹⁵ VAN BAEL & BELLIS, *ANTI-DUMPING AND OTHER TRADE PROTECTION LAWS OF THE EC* 537 (Kluwer Law International 2004).

²¹⁶ Council Regulation 1599/1999, OJ L 189, 22. 07.1999, para. 38 (there, the Commission rejected the argument of the Government of Korea that, with regard to the calculation of the subsidy amount in the case of loans, the cost-to-the-government approach rather than the benefit-to-the-recipient approach should have been used).

²¹⁷ Regulation, *supra* note 211, art. 4.1.

²¹⁸ *Id.*, art. 4.4.

²¹⁹ VAN BAEL & BELLIS, *supra* note 215, at 541.

²²⁰ Regulation, *supra* note 211, art. 5.

²²¹ *Id.*, arts. 6, 7.

1998.²²² One of the most important new elements in the Guidelines is the interest adjustment, which is not provided for neither in the Regulation nor in the SCM Agreement. The Guidelines distinguishes between the “face” value of a subsidy which is the amount at the time it is transferred to the recipient or foregone by the government and the value “found to exist” during the investigation period. Article 5 of the Regulation requires to establish the value found to exist during the investigating period. In order to do so, the Commission has to adjust the “face” value and does so by transforming that face value into the value prevailing during the investigation period though the application of the normal commercial interest rate.²²³

b. Injury The determination of injury to the Union industry in CVD proceedings is governed by Articles 8 and 9 of the Regulation. The factors to be considered in determining whether an industry is suffering injury are listed in Article 8.4 of the Regulation. This list almost exactly mirrors the list in Article 15.4 of the SCM Agreement. Although the WTO Appellate Body concluded that each of those factors must be addressed by the investigating authority,²²⁴ the ECJ nevertheless emphasized the discretion of the EU authorities and explained that they have to examine only the relevant factors having a bearing on the state of the Union industry.²²⁵

The list of factors to be considered in examining the impact of the subsidized import on the Union industry includes a factor not provided for in the SCM Agreement – “the fact that an industry is still in the process of recovering from the effects of past subsidization or

²²² *Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations*, 1998 OJ (C 394) 6.

²²³ *Id.* at 7.

²²⁴ Appellate Body Report, *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland*, WT/DS122/AB/R, adopted 12 March 2001, para. 125.

²²⁵ Case C-351/04, *Ikea Wholesale v. Commissioners of Customs & Excise*, [2007] ECR I-7723, paras. 61, 63.

dumping.”²²⁶ The rationale behind this language seems to be a concern that otherwise prices that have been depressed by past dumping or subsidization would be used for the calculation of the injury margin, thus leading to the imposition of a duty lower than that needed to remove injury.²²⁷

c. The Union Interest One of the main differences between EU and WTO CVD law is that the EU law requires an additional element to allow the imposition of countervailing measures, i.e. the existence of a “Union interest” calling for intervention. Article 31.1 of the Regulation provides that:

A determination as to whether the Community interest calls for intervention should be based on an appraisal of all the various interests taken as a whole, including the interests of the domestic industry and users and consumers. A determination pursuant to this Article shall be made only where all parties have been given the opportunity to make their views known pursuant to paragraph 2. In such an examination, the need to eliminate the trade-distorting effects of injurious subsidisation and to restore effective competition shall be given special consideration.²²⁸

The EU institutions must give consideration to the Union interest when imposing provisional measures,²²⁹ definitive duties,²³⁰ and when terminating proceedings following withdrawal of complaint.²³¹

When assessing the Union interest requirement, the EU institutions examine, where appropriate, the interest of the Union industry, users, importers, and consumers. Having established that material injury has been caused to the Union industry by subsidized imports, it is

²²⁶ Regulation, *supra* note 211, art. 8.4.

²²⁷ VAN BAEL & BELLIS, *supra* note 215, at 556.

²²⁸ Regulation, *supra* note 211, art. 31.1.

²²⁹ *Id.*, art. 12.1(d).

²³⁰ *Id.*, art. 15.1.

²³¹ *Id.*, art. 14.1.

necessary to assess whether it is in the interest of the Union industry to impose CVDs. The factors considered in the examination mostly overlap with those analyzed in the injury examination but with the focus on the future. Since even if subsidized imports have caused injury in the past, the imposition of duties may not always render the domestic industry viable.²³² Some factors considered in this context, such as safeguarding employment²³³ or protecting the environment,²³⁴ have no connection with injury.

End-users may also be badly affected by the imposition of CVDs because they may lead to a shortage of supply, increase in prices, etc. Nevertheless, the EU institutions have traditionally given more weight to the interest of complainant industry than to those of user industry.²³⁵ For example, in *Styrene-butadiene-styrene thermoplastic rubber (SBS)*, some users argued that the imposition of CVDs would negatively affect the price and availability of SBS.

The Commission disagreed, however, stating that:

the imposition of provisional countervailing measures, does not foreclose the Community to imports . . . [but] . . . will merely establish fair trading conditions. As to the availability of SBS, there are a number of producers operating in the Community; these producers have unused production capacity, and there are other sources of imports which, under fair trading conditions, will find the Community market more appealing again.²³⁶

Likewise, in most cases the Commission concludes that the interest of importers/distributors/traders are not at serious risk.²³⁷ In *Printers*, foreign producers argued that

²³² EDMOND MCGOVERN, EUROPEAN COMMUNITY ANTI-DUMPING AND TRADE DEFENCE LAW AND PRACTICE 44:1 (2008).

²³³ Council Regulation No 1799/2002 of 8 October 2002, OJ (L 274), at recital 114.

²³⁴ Commission Regulation No 1783/94 of 18 July 1994, OJ (L 189), at recital 43.

²³⁵ See VAN BAEL & BELLIS, *supra* note 215, at 298; see also ADAMANTOPOULOS & PEREYRA-FRIEDRICHSEN, *supra* note 210, at 141-42 (stating that “in order to outweigh the interest of the Community industry deriving from the imposition of measures, the interest of the end-users need to be substantial.”).

²³⁶ Commission Regulation No 1092/2000 of 24 May 2000, OJ (L 124/26), at recital 12.

²³⁷ VAN BAEL & BELLIS, *supra* note 215, at 300.

they employ a considerable amount of people in the distribution of their products on the Union market and that imposition of measures could jeopardize these job. The Commission replied stating that:

. . . on balance, the Community's interests lie more in maintaining employment in the manufacturing sector of the Community industry than in protecting a dealer and distributor business which depends to a great extent on imports.²³⁸

The imposition of countervailing measures generally does not benefit the consumer since the prices will increase and the choice of products available to the consumer may also be reduced. In *Laser Optical Reading System*, the Commission concluded that imposition of protective measures would “severely limit consumer choice” and that “this loss of choice as regard the current variety of models available could not be compensated in the foreseeable future by the Community industry.”²³⁹ In such circumstances the Commission considered that “the interests of consumers [were] by far outweighing the interest of the Community industry” and proceeding was terminated accordingly.²⁴⁰

Finally, when assessing the Union interest requirement, the impact of countervailing measures on competition within the EU is also a factor to consider. For example, in *Typewriter Ribbon Fabrics*, where there was only one Union producer and one Chinese producer/exporter of the product in question, the Commission concluded that it was not in the Union's interest that there would be only one supplier of this product and that, therefore, any protective measures should not lead to the withdrawal of Chinese imports from the Union market or eliminate

²³⁸ Commission Regulation No 1413/88 of 25 May 1988, OJ (L 130), at recital 12.

²³⁹ Commission Decision 1999/55/EC, OJ (L 18) 62, at recital 18.

²⁴⁰ *Id.*

competition between these imports and Union production. Consequently, a price undertaking was considered more appropriate.²⁴¹

2. Procedure and Remedies

a. Procedure CVD investigation can be initiated upon a written complaint by any natural or legal person, or any association not having legal personality, acting on behalf of the Community industry.²⁴² A complaint may be submitted to the Commission, or to a Member State, which shall forward it to the Commission.²⁴³ Typically, complaints are brought by European trade associations of the manufactures of the product in question, on behalf of one or more their members. They can also be filed by national producers' associations, a group of national producers, or even by individual producers, as long as they fulfil the major proportion criterion.²⁴⁴

A complaint must include sufficient evidence of the existence of (1) countervailable subsidies; (2) injury; and (3) a causal link between the allegedly subsidized imports and the alleged injury.²⁴⁵ When the Commission decides to initiate an investigation, it should notify the exporters, importers and representative associations of importers or exporters, as well as the country of origin and/or export and the complainants of the initiating of the proceedings.²⁴⁶

Because of the "Union interest" requirement, the Regulation provides certain procedural rights

²⁴¹ Commission Regulation No 1937/90 of 4 July 1990, OJ (L 174), at recital 19.

²⁴² Regulation, *supra* note 211, art. 10.1.

²⁴³ *Id.*

²⁴⁴ THEMISTOKLIS K. GIANNAKOPOULOS, SAFEGUARDING COMPANIES' RIGHTS IN COMPETITION AND ANTI-DUMPING/ANTI-SUBSIDIES PROCEEDINGS 253 (Kluwer Law International 2004).

²⁴⁵ Regulation, *supra* note 211, art. 10.2.

²⁴⁶ *Id.*, art. 10.13.

and obligations not only for complainants and importers but also for representative users and consumer organizations, which are considered as interested parties.²⁴⁷ During the investigation, the right to a fair hearing includes two basic elements: the parties' right of access to information and the right to be heard.²⁴⁸ There is no formal hearing procedure; hearings are normally attended by the members of the Commission's staff in charge of the case. As they are not public and there is no official record, they are more like informal meetings.²⁴⁹

The provisions of the Regulation dealing with interim, newcomer and expiry reviews largely correspond to their equivalent in the SCM Agreement.²⁵⁰ The only significant difference between the EU and the WTO rules is a circumvention provision which the SCM Agreement does not contain. Allegations of circumvention arise when products subject to countervailing duties manage to enter the EU without the appropriate duties having been paid. Adamantopoulos and Pereyra-Friedrichsen identify three ways in which duties are typically avoided: (1) the product is subject to further or lesser processing in the country of origin: the tariff heading is therefore changed and it falls outside the product scope of the measures; (2) processing takes place in another country: the origin of the products is therefore changed and the measures are thus avoided; (3) parts of the product are imported and assembled within the EU: this avoids the payment of duties due upon importation of the finished assembled product.²⁵¹

Article 23.3 of the Regulation defines circumvention as:

a change in the pattern of trade between third countries and the Community or between individual companies in the country subject to measures and the

²⁴⁷ *Id.*, art. 11.

²⁴⁸ *Id.*

²⁴⁹ VAN BAEL & BELLIS, *supra* note 215, at 384.

²⁵⁰ Regulation, *supra* note 211, arts. 18-20; SCM Agreement, *supra* note 175, arts. 19.3, 21.

²⁵¹ ADAMANTOPOULOS & PEREYRA-FRIEDRICHSEN, *supra* note 210, at 220-21.

Community, which stems from a practice, process or work for which there is insufficient due cause or economic justification other than the imposition of the duty, and where there is evidence of injury or that the remedial effects of the duty are being undermined in terms of the prices and/or quantities of the like product and that the imported like product and/or parts thereof still benefit from the subsidy.²⁵²

Consequently, the circumvention measures can be invoked where: (1) countervailing measures have already been duly imposed; (2) there is a change in the pattern of trade between the Community and third countries;²⁵³ (3) the change in the pattern of trade must be the result of a practice, process or work for which there is insufficient cause or economic justification other than the circumvention of the duties; (4) there is evidence that the remedial effects of the duty being undermined in terms of prices and/or quantities of the like product; and (5) the imported like product and/or parts thereof still benefit from the subsidy.

As a result of the anti-circumvention investigation, either the existing duty is extended with retroactive effect as from the date of initiation of the investigation, or the investigation is terminated but the existing duty remains in force.²⁵⁴

b. Remedies Like in the WTO law, the EU law provides for two types of relief in CVD proceedings: (1) the imposition of CVDs (provisional and definitive duties); or (2) the acceptance of undertaking.

Provisional duties are imposed by the Commission no earlier than 60 days from the initiation of the proceedings but no later than nine months from the initiation of the

²⁵² Regulation, *supra* note 211, art. 23.3.

²⁵³ The Regulation does not define “change in the pattern of trade,” consequently the Commission has a considerable margin of discretion when determining whether this condition has been fulfilled. Typically, a change in pattern means an increase in imports from a third country not subject to the countervailing measures, increased imports of parts of the product subject to the measures or altering a product without economic justification (*see* VAN BAEL & BELLIS, *supra* note 215, at 485-87).

²⁵⁴ Regulation, *supra* note 211, art. 23.1.

proceedings.²⁵⁵ Nevertheless, the Commission is not obliged to impose provisional measures as the sole alternative to the termination of the proceedings. On the contrary, the Commission may decide not to propose their imposition but to continue with its investigation towards the definitive stage.²⁵⁶ In practice, provisional duties are not physically collected upon imposition, but are secured by way of customs guarantee at the point where the goods subject to such duties enter the EU.²⁵⁷ Provisional duties are imposed for a maximum period of four months, there is no possibility to extend this period.²⁵⁸

Initially, definitive duties were imposed by the Council acting on the proposal submitted by the Commission, as opposed to provisional duties imposed by the Commission.²⁵⁹ The proposal must have been adopted by the Council unless it decides by a simple majority (where each Member State has one vote) to reject the proposal.²⁶⁰ As a result, very often political considerations rather than the findings of the Commission influenced the decision of certain Member States.²⁶¹

In 2013, the Council and the European Parliament agreed on new rules that increase the Commission power in imposing definitive CVDs, which makes the process more technical and less political in nature. The purpose of the new rules is to bring EU CVD law in line with the

²⁵⁵ *Id.*, art. 12.1.

²⁵⁶ ADAMANTOPOULOS & PEREYRA-FRIEDRICHSEN, *supra* note 210, at 193-94.

²⁵⁷ Regulation, *supra* note 211, art. 12.2.

²⁵⁸ *Id.*, art. 12.6.

²⁵⁹ Unlike the Commission that consists of the appointed Commissioners whose “independence is beyond doubt” and who “shall neither seek nor take instructions from any government” (Art. 17.3 of the TEU), the Council consists of the Heads of State or Government of the Member States (Art. 15.2 of the TEU).

²⁶⁰ Regulation, *supra* note 211, art. 15.1.

²⁶¹ Georg Berrisch, *EU Anti-Dumping and Anti-Subsidy Policy: Interesting Times Ahead*, Law Business Research (December 2013), <http://whoswholegal.com/news/features/article/30988/eu-anti-dumping-anti-subsidy-policy-interesting-times-ahead>.

new “comitology procedures” introduced by the Treaty of Lisbon.²⁶² Regulation 182/2011 (New Comitology Regulation) lays down the new procedure for the adoption of implementing acts by the Commission, including the adoption of regulations imposing definitive CVDs (until 2014 the mechanisms for the adoption of CVD and anti-dumping duties were excluded from the scope of the general comitology rules). The most important change to the process is that definitive CVDs are adopted by the Commission, not the Council.²⁶³ Another change is that these measures are subject to standard comitology rule where only a qualified majority of Member States may block their adoption.²⁶⁴

Definitive CVDs may not exceed the total amount of countervailable subsidies established.²⁶⁵ EU law, like WTO law, contains a lesser duty provision. However, while the SCM Agreement provides that it is *desirable* that the duty be less than the total amount of the subsidy if such lesser duty would be adequate to remove the injury to the domestic industry,²⁶⁶ in the EU the Regulation *obliges* Member States to impose the duty that is not higher than the total amount of countervailable subsidies if it would be adequate to remove the injury.²⁶⁷ The EU institutions’ practice is to calculate an “injury margin” by comparing the export prices of the subsidized products with the production costs of the Community production of the like product

²⁶² Under the “comitology procedure,” committees of Member State experts control the Commission in execution of its powers. The procedure was criticized for the lack of transparency and the lack of legitimacy of experts. The changes in EU decision-making system introduced by the Treaty of Lisbon are aimed at giving more power to the EU legislator. Now the European parliament can delegate two types of powers to the European Commission: “delegated acts” (Art. 290 of TFEU) and “implementing acts” (Art. 291 of TFEU). The latter has been implemented by Regulation 182/2011.

²⁶³ Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission’s exercise of implementing powers (OJ L 55/13), art. 8.

²⁶⁴ TFEU, *supra* note 2, art. 238.

²⁶⁵ Regulation, *supra* note 211, art. 15.1.

²⁶⁶ SCM Agreement, *supra* note 175, art. 19.2.

²⁶⁷ Regulation, *supra* note 211, art. 15.1.

plus a reasonable profit margin. This “injury margin” puts a cap on the level of the countervailable duty.²⁶⁸ The “lesser duty” rule results in a lower level of duties overall, which arguably leads to fewer distortions to market competition.

CVDs remain in place as long as, and to the extent that, it is necessary to counteract the countervailable subsidies which are causing injury.²⁶⁹ In order to establish if the duties are still necessary, the Regulation provides for a system of reviews²⁷⁰ and refunds.²⁷¹ The normal duration of definitive CVDs is five years from its imposition or from the date of its most recent review.²⁷² If a review reveals that an expiry would lead to a continuation or recurrence of subsidization or injury, the CVDs will remain in force.²⁷³

A price undertaking is an alternative to imposing CVDs. A price undertaking is an agreement between the Commission and (1) the country of origin and/or export whereby the latter agrees to eliminate or limit the subsidy or take other measures concerning its effect; or (2) any exporter whereby the latter agrees to revise its prices or to cease exports to the area in question as long as such exports benefit from countervailable subsidies so that the injures effects of the subsidies is eliminated.²⁷⁴ For example, in *Women’s Shoes*, the Commission accepted the undertaking of the Brazilian government to impose a tax on exports of the product in question that would completely neutralize the effect of the subsidy.²⁷⁵

²⁶⁸ VAN BAEL & BELLIS, *supra* note 215, at 562.

²⁶⁹ Regulation, *supra* note 211, art. 17.

²⁷⁰ *Id.*, arts. 19, 20.

²⁷¹ *Id.*, art. 21.

²⁷² *Id.*, art. 18.

²⁷³ *Id.*

²⁷⁴ *Id.*, art. 13.1.

²⁷⁵ Commission Decision 81/901/EEC, OJ 1981 (L 327) 39.

In sum, EU CVDs law largely corresponds to that of WTO. The main differences between the two systems arise with regard to three areas where EU law goes beyond WTO rules. First, the EU law requires an additional element to allow the imposition of CVDs, i.e. the existence of a “Union interest” calling for intervention. Second, EU law, unlike WTO law, contains a circumvention provision. Finally, under EU law an investigative authority should apply a lesser duty than the subsidy margin if this is sufficient to remove injury, while WTO law does not impose such an obligation.

VI. U.S. RULES ON SUBSIDIES

U.S. law does not contain any rules governing granting or controlling subsidies by any level of government; states are not allowed to countervail the subsidies of other states. On the other hand, U.S. countervailing duty (CVD) law, which allows the imposition of countervailing duties on foreign goods receiving subsidies is a fully developed body of law. Over more than a century, U.S. CVD law has changed considerably; the most significant modifications are the result of implementation of GATT/WTO rules: first, after the Tokyo Round, and then, after the Uruguay Round.

Since the United States is a WTO Member, the WTO agreements constitute a binding international obligation of the United States.¹ They are not directly effective, however, in the domestic legal order.² Consequently, the provisions of these agreements may only be invoked in U.S. law if the U.S. act expressly refers to or incorporates such provisions. Likewise, WTO dispute settlement decisions have no direct effect on U.S. law.³

¹ Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 4 (1999), 1867 U.N.T.S. 154, 33 I.L.M. 1144 (1994), art. II:2 [hereinafter WTO Agreement].

² The U.S. Congress stated that “no provision of any of the Uruguay Round Agreements, nor the application of any such provision to any person or circumstance, that is inconsistent with any law of the United States shall have effect.” (19 U.S.C.A. § 3512(a)(1) (1999).)

³ *Footwear Distributors and Retailers of America v. United States*, 852 F. Supp. 1078 (Ct. Int'l Trade 1994) (“However cogent the reasoning of the GATT panels . . . , it cannot and therefore does not lead to the precise domestic, judicial relief for which the plaintiff prays.”).

A. THE EVOLUTION OF U.S. COUNTERVAILING DUTY LAW

1. Early U.S. Countervailing Duty Law

The United States was the first country to enact CVD law. It was contained in the Tariff Act of 1890 and initially only imposed a CVD on refined sugar coming from countries paying an export bounty.⁴ Seven years later, in the Tariff Act of 1897, Congress broadened the law to apply to *all dutiable* imports coming from countries which “pay or bestow, directly or indirectly, any bounty or grant” upon their export.⁵ In order to provide relief from the effects of such subsidies, the Act stipulated that a CVD, equal to the net amount of the bounty, be imposed on the import.⁶ Since the amount of the tariff was assumed to be necessary to provide the desired protection, any subsidized dutiable import was presumed to cause injury to the U.S. industry. Therefore, no injury test was required.⁷ For the same reason, CVDs were designed to offset the exact amount of the foreign subsidy and thereby maintain the integrity of the tariff protection.⁸ This first

⁴ Tariff Act of 1890, ch. 1244, § 237, 26 Stat. 567, 584 (McKinley Tariff).

⁵ Tariff Act of 1897, ch. 11, § 5, 30 Stat. 151, 205 (Dingley Tariff).

⁶ *Id.*

⁷ John J. Barceló III, *A History of GATT Unfair Trade Remedy Law – Confusion of Purposes*, in CORNELL LAW FACULTY PUBLICATIONS, Paper 517, 311, 322 (1991) (suggesting that the restriction of the Tariff Act of 1879 to dutiable imports “could be seen as an implicit injury test, or a presumption of injury, because industries already receiving some protection were presumably those sensitive to import competition”); Kevin C. Kennedy, *An Examination of Domestic Subsidies and the Standard for Imposing Countervailing Duties*, 9 LOY. L.A. INT’L & COMP. L. REV. 1, 2 & n.4 (1986) (Also noting that “[b]y the same token, merchandise entering the United States duty free was deemed by Congress not to be in competition with comparable merchandise produced by the U.S. industry. Accordingly, since U.S. producers needed no tariff protection, they likewise did not require protection through countervailing duty law.”); JERRY COHEN, CHRISTOPHER A. DUNN & HARVEY KAYE, INTERNATIONAL TRADE PRACTICE 6, vol. 2 (2015) (“The countervailing duty provisions were enacted as a means of ensuring that the protective effect of the new tariff would not be neutralized by foreign subsidy Moreover, since the acknowledged intent of the law was to protect U.S. industry by means of duties, that law contained no requirement that the domestic industry demonstrate that it had been injured by the imports.”).

⁸ Kennedy, *supra* note 7, at 2 (“Because tariffs were set by Congress at a level judged to be sufficient to provide the desired protection to targeted industries, foreign subsidies were viewed as attempts to breach the tariff wall erected by Congress.”).

general CVD law in the United States became “the true forerunner of the modern American countervailing duty law.”⁹

The Tariff Act of 1922 further expanded the scope of the CVD law in two ways. First, it allowed CVD’s to be imposed on private bounties given by a “person, partnership, cartel, or corporation.”¹⁰ Second, it broadened the law to cover bounties bestowed “upon the manufacture or production” of goods, as well as on their exportation.¹¹ Although the United States only countervailed against a domestic (production) bounty for the first time in 1973,¹² in general, as Professor Viner observes, at the time, CVDs were “strictly, perhaps even harshly, enforced.”¹³

Early case law adopted a very broad interpretation of the meaning of “bounties or grants.” In 1903, in *Downs v. United States*, the U.S. Supreme Court considered whether a Russian tax scheme, under which the government taxed all sugar produced but then remitted the tax upon export of the sugar, constituted “a bounty upon exportation.”¹⁴ The Court concluded that “[w]hen a tax is imposed on all sugar produced, but remitted upon all sugar exported, then, by whatever process, or in whatever manner, or under whatever name, it is disguised, it is a bounty upon exportation.”¹⁵ The Court also rejected the argument of the Russian government there was no *intent* to encourage export; their only goal was to help control the domestic price of sugar by limiting the domestic supply.¹⁶ Instead, the Court focused at on the harmful *effects* that

⁹ Barceló, *supra* note 7, at 322.

¹⁰ Tariff Act of 1922, ch. 356, § 303, 42 Stat. 858, 935-36 (Fordney-McCumber Tariff).

¹¹ *Id.*

¹² *X-Radial Steel Belted Tires from Canada*, TD 73-10, 7 Cust. B. 24, 38 Fed. Reg. 1018 (1973).

¹³ JACOB VINER, *DUMPING: A PROBLEM IN INTERNATIONAL TRADE* 173 (1923).

¹⁴ *Downs v. United States*, 187 U.S. 496, 504-05 (1903).

¹⁵ *Id.* at 515.

¹⁶ *Id.* at 503.

the bounty had on the U.S. industry.¹⁷ In *Nicholas & Co. v. United States*, an even broader meaning was applied to the term “bounty or grant”:

If the word “bounty” has a limited sense, the word “grant” has not. A word of broader significance than “grant” could not have been used. Like its synonyms “give” and “bestow,” it expresses a concession, the conferring of something by one person upon another. And if the “something” be conferred by a country “upon the exportation of any article or merchandise,” a countervailing duty is required.¹⁸

The language of Section 303 of the Tariff Act of 1930 was basically identical to that of the Tariff Act of 1922;¹⁹ this provision eventually became the main source of U.S. CVD law and remained essentially unchanged until 1979.

Anti-subsidy policy has been an integral part of U.S. trade policy, in particular tariff policy, and, therefore, should be understood in a broader context. As Professor Taussig points out, the period of the economic history of the United States, which started in 1808,²⁰ was characterized by the protection of young industries.²¹ Complications with Europe, resulted from the war between Britain and France, led to an embargo in 1807; and the war with England was declared in 1812.²² During the war, trade with England was prohibited and all import duties were doubled. This series of restrictive measures blocked the customary channels of exchange and production, and gave a stimulus to those branches of U.S. industry whose products had before

¹⁷ *Id.* at 515.

¹⁸ *G.S. Nicholas & Co. v. United States*, 249 U.S. 34, 39 (1919).

¹⁹ Tariff Act of 1930, ch. 497, § 303, 46 Stat. 590, 687 (Smoot-Hawley Tariff) (varying from Tariff Act of 1922 only by requiring the Secretary of the Treasury to measure and declare each distinct subsidy applied to an imported item and not simply their sum).

²⁰ The previous period was chiefly a continuation of the colonial period, when “the colonies had been necessarily engaged almost exclusively in agriculture, and in the occupations closely connected with it.” See F.W. TAUSSIG, *THE TARIFF HISTORY OF THE UNITED STATES* 8 (8th ed. 1931).

²¹ *Id.*

²² *Id.* at 16.

been imported.²³ Professor Taussig observes that “[t]he consequent rise of a considerable class of manufacturers, whose success depended largely on continuance of protection, formed the basis of a strong movement for more decided limitation of foreign competition.”²⁴ This kind of protectionist tariff philosophy prevailed through the first third of the Twentieth century.

CVD law, therefore, should be viewed as a part of this philosophy. On the one hand, one can argue that the rationale for this law was that subsidies create an “artificial” advantage for the exporting country, which if left uncorrected, would destroy the competing industry of the importing country. As Senator Caffery put it in 1897, “natural advantages possessed by one country ought not to be offset by artificial aids afforded by another.”²⁵ On the other hand, however, it seems fairly clear that, at the time, the main goal of CVD law was to preserve the level of protection established by existing tariffs. The first general CVD law was introduced as a part of the Tariff Act of 1897, which was “the outcome of an aggressive spirit of protection.”²⁶ With some amendments these provisions were included in the Tariff Act of 1930, which established “the highest general tariffs rate structure that the United States had ever experienced.”²⁷ Given that CVDs only applied to dutiable imports, and no injury test was required, it is logical to conclude that the main object of CVD law was to maintain the status quo in extremely high tariff protection. In the words of E. Kwaku Andoh, “both sets of arguments

²³ *Id.* at 16-17 (noting that “the restrictive legislation of 1808-15 was, for the time being, equivalent to extreme protection”).

²⁴ *Id.* at 17.

²⁵ 30 CONG. REC. 2203, 2225-26 (1897) (remarks of Sen. Caffery). *See also* *Zenith Radio Corp. v. United States*, 437 U.S. 443, 451-55, 459-62 (1978) (“[the] purpose [of the CVD law] is relatively clear from the face of the statute and is confirmed by the congressional debates: The countervailing duty was intended to offset the *unfair competitive advantage* that foreign producers would otherwise enjoy from export subsidies paid by their government”) (emphasis added).

²⁶ TAUSSIG, *supra* note 20, at 358.

²⁷ JOHN M. DOBSON, TWO CENTURIES OF TARIFFS: THE BACKGROUND AND EMERGENCE OF THE UNITED STATES INTERNATIONAL TRADE COMMISSION 34 (1976).

seek not a ‘level’ playing field, but rather, a ‘static’ playing field – one on which the advantages in trade secured by the United States (both ‘natural’ and ‘artificial’) are protected by countervailing duties and other trade policies.’²⁸

The first shift towards a more liberal trade policy began with adoption of the Reciprocal Trade Agreements Act of 1934, which gave the President power to negotiate and conclude bilateral, reciprocal tariff agreements with other countries without approval of Congress.²⁹ By linking tariff setting to international obligations, an executive branch prerogative, members of Congress sought to protect themselves from the direct, one-sided pressure from producer interests.³⁰ By the middle of the Second World War, 30 bilateral trade agreements with 25 countries were in force; they led to the reduction of many tariff rate levels.³¹ Weaknesses of the bilateral approach became apparent, however, and a multilateral approach seemed to offer better solutions.³² Hence, the more dramatic shift towards liberal trade policy happened after completion of the General Agreement on Tariffs and Trade in 1947.³³ As a result of a series of GATT negotiations, U.S. average tariff levels on dutiable imports had gradually been reduced from 60 percent in 1931 to 5.7 percent in 1980.³⁴

²⁸ E. Kwaku Andoh, *Countervailing Duties in a Not Quite Perfect World: An Economic Analysis*, 44 STAN. L. REV. 1515 n.53 (1992).

²⁹ Reciprocal Trade Agreements Act of 1934, ch. 474, 48 Stat. 943, 19 U.S.C. § 1351.

³⁰ I.M. DESTLER, *AMERICAN TRADE POLITICS* 14-17 (3d ed. 1995).

³¹ DOBSON, *supra* note 27, at 36 (also noting that because the agreements “simultaneously stimulated increased trade, the total amount of the duties collected under the reciprocity agreement’s trade concession was actually higher than it had been under the original Smoot-Hawley rates of duty”).

³² JOHN H. JACKSON, WILLIAM J. DAVEY & ALAN O. SYKES, JR., *INTERNATIONAL ECONOMIC RELATIONS: CASES, MATERIALS AND TEXT ON THE NATIONAL AND INTERNATIONAL REGULATION OF TRANS NATIONAL ECONOMIC RELATIONS* 230 (6th ed. 2013).

³³ General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT 1947].

³⁴ DOBSON, *supra* note 27, at 34.

These developments, however, did not affect U.S. law related to the imposition of CVDs, which remained unchanged. Moreover, although Article VI of the GATT only allows CVDs when subsidized imports “cause or threaten material injury to an established domestic industry . . . or retard materially the establishment of a domestic industry,”³⁵ under U.S. law, CVDs could still be imposed merely upon determination of a subsidy, without assessing the injury to the domestic industry caused by the subsidized imports. Since this law was dated before GATT 1947, it was grandfathered from Article VI of the GATT.³⁶

In the Trade Act of 1974, Congress amended Section 303, expanding the scope of the law to cover *any* subsidized article or merchandise, regardless of whether it was a dutiable good.³⁷ Since the extension of countervailing procedure to these imports was not covered by the grandfather clause, the Act required a determination of injury to U.S. industry before imposing a CVD on duty-free imports, but only if such a test is required by international obligations.³⁸ Furthermore, the Act imposed specific time limits on administrative determinations by requiring the Department of Treasury, which then administered the CVD law, to reach a final decision on each case within twelve months³⁹ and, for the first time, made judicial review available to domestic producers.⁴⁰ Both because of extension of the scope of products subject to CVDs and because the Treasury was moving faster under the new timetable, the number of CVD

³⁵ GATT 1947, *supra* note 33, art. VI.

³⁶ Protocol of Provisional Application of the 1947 GATT (Part II of the GATT applied only “to the fullest extent not inconsistent with existing legislation.”) (UNTS 308, BISD IV/77, TIAS 1700).

³⁷ Trade Act of 1974, Pub. L. No. 93-618, § 303(a)(1), 88 Stat. 1978, 2049 (1975).

³⁸ *Id.* § 303(b), 88 Stat. 2049.

³⁹ *Id.* § 303(a)(4), 88 Stat. 2049.

⁴⁰ *Id.* § 516(c), 88 Stat. 2052.

investigations rose sharply, from 5 in 1974 to 38 in 1975.⁴¹ It was also during this period that Treasury, for the first time, countervailed against a domestic subsidy in a foreign country.⁴²

In sum, the early U.S. CVD law was highly protectionist and originally served to supplement tariff protection. The law was not designed to secure a level playing field, but rather to provide greater protection to U.S. producers. As Professor Robert O'Brien has written, "[t]he system is seen to respond to domestic American industry seeking protection from competition rather than a decision on the effect of subsidies."⁴³ The shift of the policy toward lower tariffs did not affect the main provisions of the CVD law; this could be explained by the fact that while the Reciprocal Trade Agreements Act of 1934 transferred the authority to negotiate tariff reductions from Congress to the President, trade-remedy law remained within the power of Congress, which was more susceptible to pressure from domestic industry. Nevertheless, since tariffs were reduced the perception of the CVD law shifted from a pure tariff approach to an antitrust-related approach, which views CVD law as a device to control trade distortions caused by unfairly subsidized imports.

2. Changes Resulting from the Tokyo Round

After the Tokyo Round, the focus of GATT negotiations moved from tariff reduction to non-tariff barriers. The Trade Act of 1974 granted so called "fast track" negotiating authority

⁴¹ DESTLER, *supra* note 30, at 145-48 (Noting, however, that since the EC was not ready to negotiate at the Tokyo GATT round, which was dealing with the subsidy issue, "if the United States simultaneously began enforcing a tough antisubsidy statute," Congress granted the secretary of the Treasury the authority to waive imposition of CVDs for four years if the foreign government was taking steps to reduce a subsidy's effect. As a result, from 1976 through 1978, for example, the Treasury made 35 affirmative CVD decisions but the secretary then exercised the waiver in 19 of the cases.)

⁴² See *supra* note 12 and accompanying text.

⁴³ ROBERT O'BRIEN, SUBSIDY REGULATION AND STATE TRANSFORMATION IN NORTH AMERICA, THE GATT AND THE EU 24 (1997).

concerning non-tariff matters to the President.⁴⁴ Unlike the previous system of trade authority delegation regarding tariff reduction, however, Congress had to implement the agreement through legislation.⁴⁵ Consequently, U.S. negotiators had to take into account the opinions of members of Congress, as well as the interests of industry groups they represented.⁴⁶

The main purpose of the Trade Agreements Act of 1979 (TAA)⁴⁷ was to bring U.S. law into conformity with the agreements on non-tariff measures negotiated in the Tokyo Round, in particular the Subsidies Code.⁴⁸ The four most distinctive features of the new CVDs law were: (1) a more explicit definition of the term “subsidy”;⁴⁹ (2) an injury test for dutiable imports;⁵⁰ (3) a new provisional remedy available early in the investigation;⁵¹ and (4) stricter time limits and the authorization for the Customs Court, predecessor to the Court of International Trade (CIT), to review preliminary and final decisions of the Department of Commerce and the International Trade Commission (ITC).⁵² The law applied only to the signatories of the Subsidies Code or countries that assumed substantially equivalent obligations.⁵³ Thus, exports from all other countries was still governed by Section 303 of the Act, which imposed CVDs on subsidized imports without reference to injury to U.S. producers.⁵⁴

⁴⁴ Trade Act of 1974, *supra* note 37, 19 U.S.C. §§ 2101-2497(b).

⁴⁵ *Id.*

⁴⁶ ROBERT E. BALDWIN, *THE POLITICAL ECONOMY OF U.S. IMPORT POLICY 74-77* (The MITT Press 1985).

⁴⁷ Trade Act of 1979, Pub. L. No. 96-39, 93 Stat. 144 (1979) (codified in scattered sections of 19 U.S.C.).

⁴⁸ Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (MTN/NTM/W/236, 5 Apr. 1979) [hereinafter Subsidies Code]; *see also supra* Chapter III, Part C, for a more detailed discussion of the Subsidies Code’s negotiating history and the resulting agreement.

⁴⁹ 19 U.S.C.A. § 1677(5)-(6).

⁵⁰ *Id.* §§ 1671, 1677(7).

⁵¹ *Id.* § 1671(b).

⁵² *Id.* §§ 1516, 1671.

⁵³ *Id.* § 1671(b)(1)-(2).

⁵⁴ *Id.* § 303.

Prior to 1979, the determination whether to impose CVDs involved a one-step test conducted by the Treasury Department.⁵⁵ The new law imposed a two-step test that must be satisfied before CVDs can be imposed:⁵⁶ (1) the Commerce Department must determine whether there is a *subsidy* under the statutory definition;⁵⁷ (2) if the Commerce Department finds a subsidy, the ITC must determine whether there has been *material injury* to a U.S. industry.⁵⁸

a. Subsidy Section 771(5) of the TAA defined *subsidy* as having “the same meaning” as “bounty or grant” in section 303 of the Tariff Act of 1930.⁵⁹ “Subsidy” was further broken down into (1) export subsidies⁶⁰ and (2) domestic subsidies “if provided . . . to a specific enterprise or industry, or group of enterprises or industries.”⁶¹ As a result, countervailable domestic subsidies were limited to those domestic subsidies that were directed at specific targets as opposed to those that were generally available.⁶² Based on the statutory definition of domestic subsidy, the Commerce Department went beyond the U.S. international obligations under the Subsidies Code and developed the “specificity test,” according to which domestic subsidies are only countervailable when available to a specific enterprise or industry.⁶³

⁵⁵ See *supra* note 39.

⁵⁶ 19 U.S.C. §§ 1671-1677k.

⁵⁷ *Id.* §§ 1671(a)(1), 1677(1).

⁵⁸ *Id.* §§ 1671(a)(2), 1677(2).

⁵⁹ *Id.* § 1677(5).

⁶⁰ *Id.* § 1677(5)(a) (“Any export subsidy described in Annex A to the [Subsidies Code] Agreement (relating to illustrative list of export subsidies.)”).

⁶¹ *Id.* § 1677(5)(b).

⁶² William K. Wilcox, *GATT-Based Protectionism and the Definition of a Subsidy*, 16 B.U. INT’L L.J. 129, 138 (1998). See also Michael J. Sussman, *Countervailing Duties and the Specificity Test: An Alternative Approach to the Definition of ‘Bounty or Grant,’* 18 LAW & POL’Y INT’L BUS. 475, 484 (1985) (“Current law and the legislative history of 1979 and 1984 amendments make clear that ‘bounty or grant’ is not intended to be given its broadest reading when applied to domestic subsidies.”).

⁶³ See, e.g., *Anhydrous and Aqua Ammonia from Mexico*, 48 Fed. Reg. 28, 522, 28, 523-24 (1983); *Certain Softwood Products from Canada*, 48 Fed. Reg. 24, 159, 24, 171-72 (1983); *Certain Steel Products from France*, 48

The early decisions of the CIT on the specificity test, however, were rather “unclear and inconsistent.”⁶⁴ In *Carlisle Tire and Rubber Co. v. United States*, the CIT explicitly found the specificity test to be a reasonable interpretation of the statute.⁶⁵ The court rejected the plaintiff’s argument that “benefits from governmental programs are countervailable even if they are generally available on a nonpreferential basis,”⁶⁶ determining that allowing CVDs to be imposed against generally available benefits would lead to the “absurd result” that almost all imports could be countervailed, a result that would create an overwhelming administrative burden and make impossible the calculation of benefits.⁶⁷ It was only a year later that the CIT, in *Bethlehem Steel Corp. v. United States*, rejected the specificity test stating that general availability is not a relevant consideration and will not place a government program beyond the reach of the CVD law on that basis alone.⁶⁸ The court expressed doubts that Congress had implicitly adopted the specificity test in the TAA⁶⁹ and explained that:

The fundamental purpose of the countervailing duty law is to provide a special duty to eliminate the advantage an imported product may obtain from forms of assistance termed “subsidies”. . . . *The extent to which subsidization is practiced in the country of production is entirely immaterial.*⁷⁰

Fed. Reg. 39, 332, 39, 338 (1982); *Certain Steel Products from the Netherlands*, 47 Fed. Reg. 39, 372, 39, 373-74 (1982).

⁶⁴ Pieter Matthijs Alexander, *The Specificity Test under U.S. Countervailing Duty Law*, 10 MICH. J. INT’L L. 807, 819 (1989); Wilcox, *supra* note 62, at 139 (stating that “issues regarding specificity play a major role in the confusing case law that results.”); Kennedy, *supra* note 7, at 7 (also noting the CIT “reached divergent conclusions regarding the specificity question.”); *Fresh, Chilled, and Frozen Pork*, Panel No. USA-89-1904-06, 1990 FTAPD LEXIS 12, at 57 (U.S.-Can. Free Trade Agreement Binational Panel Review Sept. 28, 1990) (“[d]espite continuing efforts of Commerce and the courts to explain and clarify this issue . . . the standards for finding . . . specificity remain underdeveloped, opaque, contradictory, elusive, and unsatisfying.”).

⁶⁵ *Carlisle Tire and Rubber Co. v. United States*, 564 F. Supp. 834 (Ct. Int’l Trade 1983).

⁶⁶ *Id.* at 837.

⁶⁷ *Id.* at 838-39.

⁶⁸ *Bethlehem Steel Corp. v. United States*, 590 F. Supp. 1237, 1240-41 (Ct. Int’l Trade 1984).

⁶⁹ *Id.* at 1243-44.

⁷⁰ *Id.* at 1241 (emphasis added).

In the decisions immediately following *Carlisle* and *Bethlehem Steel* the CIT, although reaffirming the specificity test as a means of defining an actionable subsidy, was not clear about the limits of the test and its correlation with the actual distortion of trade. For example, in *Agrexco v. United States*, the Commerce Department found no subsidy in a research and development program provided by the government of Israel to its rose growers because the results of the research were equally available to rose growers worldwide, including those from the U.S.⁷¹ The CIT disagreed, however, and concluded that the question is not whether the information is generally available, but rather “whether the research and development is targeted to assist a particular, rather than a general industry.”⁷² Thus, since the program was targeted at the production of roses, it constituted a subsidy.⁷³ The *Agrexco* language, therefore, suggests that nominal specificity is sufficient for a subsidy to exist regardless of whether the government program *in fact* bestows a competitive advantage upon the specific group.

In *Cabot Corp. v. United States*, on the other hand, the court concluded that when a government program, nominally available to all industries, only works to confer a benefit on specific enterprises or industries, the program meets the test for a countervailable subsidy.⁷⁴ The focus, therefore, is on “the *de facto* case by case effect of benefits provided to recipients rather than on the nominal availability of benefits.”⁷⁵ The *Cabot* *de facto* specificity standard was further clarified in *PPG Industries v. United States* to mean that when a government program is

⁷¹ *Agrexco, Agricultural Export Co., Ltd.*, 604 F. Supp. 1238, 1241-42 (Ct. Int’l Trade 1985).

⁷² *Id.* at 1242.

⁷³ *Id.*

⁷⁴ *Cabot Corp. v. United States*, 620 F. Supp. 722 (Ct. Int’l Trade 1985).

⁷⁵ *Id.* at 732.

nominally generally available *and in fact widely used*, the program is not a countervailable subsidy.⁷⁶ In 1988, U.S. law was subsequently amended to include the de facto specificity test.⁷⁷

b. Material Injury If the Commerce Department finds a subsidy, the second stage of inquiry is whether there is a material injury to a U.S. domestic industry. Material injury is defined as “harm which is not inconsequential, immaterial, or unimportant.”⁷⁸ Congress made it clear that the “material injury” standard was to be generally the same as the test applied in antidumping cases after the Trade Act of 1974,⁷⁹ which suggests that the standard is much softer than the “serious injury” standard under the escape clause.⁸⁰

The post-Tokyo Round CVD law also adopted the causation requirement of the prior antidumping law: material injury must be “by reason of” the subsidized imports.⁸¹ At the same time, competing causes of injury are not to be weighed against each other.⁸² Thus, the ITC may

⁷⁶ PPG Industries v. United States, 662 F. Supp. 258 (Ct. Int’l Trade 1987).

⁷⁷ See section 1312(b) of the Omnibus Trade and Competitive Act of 1988 Pub. L. No. 100-418, 102 Stat. 1107, 1184-85 (codified as amended at 19 U.S.C. § 1677(5)(b) (1988)), amending subsection B of § 771(5) of the TTA, regarding domestic subsidies (“[T]he administering authority, in each investigation, shall determine whether the bounty, grant, or subsidy in law or in fact is provided to a specific enterprise or industry, or group of enterprises or industries. Nominal general availability, under the terms of the law, regulation, program, or rule establishing a bounty, grant, or subsidy, of the benefits thereunder is not a basis for determining that the bounty, grant, or subsidy is not, or has not been, in fact provided to a specific enterprise or industry, or group thereof.”).

⁷⁸ 19 U.S.C.A. § 1677(7)(A).

⁷⁹ S. REP. NO. 249, 96th Cong., 1st Sess. 45, at 87 [hereinafter SENATE REPORT]; H.R. REP. NO. 317, 96th Cong., 1st Sess. 46 (1979) [hereinafter HOUSE REPORT].

⁸⁰ John J. Barceló III, *Subsidies, Countervailing Duties and Antidumping After the Tokyo Round*, vol. 13, Issue 2 CORNELL INT’L L.J. 257, 271-72 (1981). See also John J. Barceló III, *The Antidumping Law: Repeal It or Revise It*, in MICH. Y.B. INT’L LEGAL STUDIES 53, 54-57 (1979) (comparing the injury test under the escape clause with the injury test under the antidumping law, as amended by The Trade Act of 1974).

⁸¹ 19 U.S.C.A. § 1671(a)(2).

⁸² SENATE REPORT, *supra* note 79, at 74-75; HOUSE REPORT, *supra* note 79, at 47.

determine that even though other factors have affected the industry adversely, the subsidized imports nonetheless are the cause of material injury.⁸³

The conventional approach to injury analysis, favored by the majority of the ITC, was first to determine whether the industry is injured and then to inquire whether the subsidized imports are a cause of that injury.⁸⁴ In other words, the test investigates the condition of the domestic industry and the imports separately and tries to establish a causal link in a third step.

A longstanding issue in CVD injury determination was whether the ITC must take into account the level of subsidies found by the Commerce Department in deciding whether material injury is caused by subsidized imports. As David Palmeter put it, should it make any difference whether the amount of subsidy of the imports is one percent or 100 percent?⁸⁵ In 1982, in *Certain Carbon Steel Products from Spain*, for the first time, a majority of the ITC expressly declined to consider the amount of the net subsidy in determining whether there is material injury stating that “the statute does not direct the Commission” to do so since it speaks of material injury “by reason of import,” and not “by reason of subsidy.”⁸⁶ Since then, a majority of the ITC has consistently declined to consider net subsidy in its analysis of causation.⁸⁷ Individual Commissioners, however, have continued to take it into account in some cases. In particular,

⁸³ N. David Palmeter, *Injury Determination in Antidumping and Countervailing Duty Cases – A Commentary on U.S. Practice*, 21 J. WORLD TRADE L. 7, 31 (1987); see also, e.g., *Carton Closing Staples and Nonautomatic Carton-Closing Staple Machines from Sweden*, Inv. Nos. 731-TA-1, 16 and 117 (Final), USITC Pub. 1454 (Dec. 1983); *Certain Tool Steels from Brazil and the Federal Republic of Germany*, Inv. Nos. 701-TA-187 and 731-TA-100 (Final), USITC Pub. 1403 (July 1983).

⁸⁴ HANS-JÜRGEN BLINN, *THE INJURY-TEST UNDER U.S. ANTIDUMPING AND COUNTERVAILING DUTY LAWS AS INTERPRETED BY THE INTERNATIONAL TRADE COMMISSION AND THE DEPARTMENT OF COMMERCE: A COMPARISON STUDY OF THE CONVENTIONAL “TREND-ANALYSIS” AND THE “ELASTICITY-TEST”* 21, 43 (1991).

⁸⁵ Palmeter, *supra* note 83, at 38.

⁸⁶ *Certain Carbon Steel Production from Spain*, Inv. Nos. 701-TA-155, 157-160 and 163 (Final), USITC Pub. 1331 at 14 (Dec. 1982).

⁸⁷ Judith Hippler Bello & Alan F. Holmer, *Recent Developments Regarding Antidumping and Countervailing Duty Injury Determination*, in *THE ANTIDUMPING AND COUNTERVAILING DUTY LAWS: KEY LEGAL AND POLICY ISSUES* 153, 162-67 (Judith Hippler Bello & Alan F. Holmer eds., 1987); Palmeter, *supra* note 83, at 39.

Commissioner Stern argued that the proper basis for assessing causality is not to judge the full impact of the subject imports, which happen to benefit from a subsidy, but rather to judge the effect of the subsidy in causing the injury through the subject imports.⁸⁸ Thus, according to her opinion, the ITC is required “to trace, to whatever extent possible, the actual effects of the subsidies on the domestic industry.”⁸⁹ Nevertheless, the court held that the ITC is not required to consider the amount of subsidy. In *Republic Steel Corp. v. United States*, it concluded that “[o]ur law does not go so far as to require that the *subsidy itself* be shown to be the cause of injury.”⁹⁰ Consequently, the size of the net subsidy is only a “discretionary factor in determining injury.”⁹¹

In sum, the reforms following the Tokyo Round mark a change in direction from the 100-year trend in U.S. CVD policy of ever-increasing protection of U.S. industries to establishing more “equal” competitive conditions between foreign firms and their U.S. counterparts, as well as increasing emphasis on the welfare of consumers and the economy generally. This was mainly achieved by limiting the use of CVDs through imposing the specificity test and the material injury test. On the other hand, however, as a result of these changes, the United States had two different CVD laws – one that applied to countries that had signed the Subsidies Code or a similar agreement (requiring a determination of material injury before imposing CVDs), and a second law that applied to all other countries (not requiring the establishment of material injury). Furthermore, the lower threshold of injury compared to that for the escape clause,⁹² the

⁸⁸ Certain Steel Wire Nails from Korea, Inv. No. 701-TA-145 (preliminary), USITC Pub. 1223 at 12 (Mar. 1982).

⁸⁹ *Id.* at 11.

⁹⁰ *Republic Steel Corp. v. United States*, 591 F. Supp. 640 (Ct. Int’l Trade 1984), *reh’g denied*, slip op. 85-27 (Mar. 11, 1985), *dismissed* (order of Aug. 13, 1985), at 646 (emphasis in original).

⁹¹ Certain Carbon Steel Production from Spain, *supra* note 86, at 14.

⁹² *See supra* note 80 and accompanying text.

expedited procedure, and the new provisional measures resulted in an increase the number of complaints filed.⁹³

Despite the changes, however, CVD laws remained one of “the costliest, in terms of net economic welfare, of U.S. import restraint programs.”⁹⁴ A study conducted by Gallaway, Blonigen and Flynn demonstrated that the magnitude of the impact is due not only to the large number of CVD orders.⁹⁵ Orders are applied on the subject product indefinitely, and thus, there is an accumulation of orders over time.⁹⁶ Moreover, a large number of CVDs are imposed in manufacturing sectors that are upstream to many significant U.S. production sectors.⁹⁷ Consequently, these distortions result in larger welfare losses not only for U.S. consumers, but also for U.S. producers and exporters downstream to the sector subject to an order.⁹⁸

3. Changes Resulting from the Uruguay Round

In 1994, Congress amended U.S. CVD law⁹⁹ to conform to the agreements reached during the Uruguay Round negotiations, in particular the new Agreement on Subsidies and Countervailing

⁹³ While CVDs had only been used by the United States 58 times before 1974, they had been used 289 times between 1980 and 1987. See Alan O. Sykes, *Countervailing Duty Law: An Economic Perspective*, 89 COLUM. L. REV. 199, 200 (1989).

⁹⁴ Michael P. Gallaway, Bruce A. Blonigen & Joseph E. Flynn, *Welfare costs of the U.S. antidumping and countervailing duty laws*, 49 J. INT. ECON. 211, 236 (1999) (the study demonstrates that the collective net economic welfare cost of anti-dumping and CVD orders in 1993 is \$4 billion which is larger than any other U.S. restraint import program in place in 1993).

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.* at 237.

⁹⁸ *Id.* at 236-37.

⁹⁹ The implementation of the new WTO rules on countervailing measures is embodied in the Tariff Act of 1930, as amended by the Uruguay Round Agreements Act (“URAA”) (Tariff Act of 1930 §§ 701-09, *as amended by* 19 U.S.C. §§ 1671-71h and Uruguay Round Agreements Act §§ 211-34, Pub. L. No. 103-465, 1994 U.S.C.C.A.N. (108 Stat.) 4842-4901).

Measures.¹⁰⁰ Unlike the 1979 Subsidies Code, which only applied to the signatories of the Code, the SCM Agreement binds all WTO members;¹⁰¹ thus, imports from *all* WTO members are now entitled to an injury test and CVDs may not be imposed absent an affirmative determination of injury. The most distinctive features of the post-Uruguay Round CVD law are: (1) a more detailed and comprehensive definition of subsidy;¹⁰² (2) new *de minimis* limitations;¹⁰³ (3) “domestic industry” requirements;¹⁰⁴ and (4) “sunset” review.¹⁰⁵

a. Definition of Subsidy Among the most notable changes in CVD law prompted by the Uruguay Round agreements was the inclusion of the statutory definition of subsidy. The amended Tariff Act closely follows the language of Articles 1 and 2 of the SCM Agreement stating that, for a measure to constitute a countervailable subsidy it must: (1) represent a financial contribution or income/price support by a government, which (2) confers a benefit¹⁰⁶ (3) to a specific recipient.¹⁰⁷ All three elements must be cumulatively present for a countervailable subsidy to exist.

The introduction of the specificity requirement into the definition of subsidy basically reflects acceptance by the WTO Members of prior U.S. practice. Section 771(5)(A) of the Tariff

¹⁰⁰ Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, 1999, 1867 U.N.T.S. 14 [hereinafter SCM Agreement]; *see also supra* Chapter III, Section D, subsection 2 for a more detailed discussion of the SCM Agreement’s negotiating history and the resulting agreement.

¹⁰¹ WTO Agreement, *supra* note 1, art. II:2.

¹⁰² 19 U.S.C. § 1677(5)(B), *as amended by* Uruguay Round Agreements Act, Pub. L. No. 103-465, 1994 U.S.C.C.A.N. (108 Stat.) 4902 (to be codified at 19 U.S.C. § 1677(5)(B)).

¹⁰³ 19 U.S.C. § 1671b(b)(4)(A), *as amended by* Uruguay Round Agreements Act § 263, Pub. L. No. 103-465, 1994 U.S.C.C.A.N. (108 Stat.) 4911 (to be codified at 19 U.S.C. § 1671b(b)(4)(A)).

¹⁰⁴ 19 U.S.C. §§ 1671a(c)(4), 1673a(c)(4), *as amended by* Uruguay Round Agreements Act § 212, Pub. L. No. 103-465, 1994 U.S.C.C.A.N. (108 Stat.) 4844, 4846 (to be codified at 19 U.S.C. §§ 1671a(c)(4), 1673a(c)(4)).

¹⁰⁵ 19 U.S.C. § 1675(c), *as amended by* Uruguay Round Agreements Act, Pub. L. No. 103-465, 1994 U.S.C.C.A.N. (108 Stat.) 4861 (to be codified at 19 U.S.C. § 1675(c)).

¹⁰⁶ 19 U.S.C. § 1677(5)(B).

¹⁰⁷ 19 U.S.C. § 1677(5)(A).

Act¹⁰⁸ mirrors the provision of Article 2 of the SCM Agreement dealing with specificity, which, in turn, reflects U.S. practice.¹⁰⁹ Likewise, following the pre-existing U.S. practice, Section 771(5A)(D) distinguishes between *de jure* specificity and *de facto* specificity.¹¹⁰

Similarly, the “benefit” requirement essentially reflects previous U.S. practice, which acknowledged it as a central element of a subsidy.¹¹¹ Yet, at the same time, measuring the benefit in each instance was one of the most challenging areas of U.S. CVD law. The earlier law neither defined the meaning of “bounty or grant” nor included any criteria for identifying and measuring them. The Trade Agreements Act of 1979 provided an “Illustrative List of Domestic Subsidies,”¹¹² which offered certain guidelines regarding the basis for identifying countervailable subsidies. The first item on the list included “the provision of capital, loans, or loan guarantees on terms *inconsistent with commercial consideration*.”¹¹³ The language of the provision suggests using a *market* benchmark to establish the benefit.¹¹⁴ On the other hand, the

¹⁰⁸ *Id.*

¹⁰⁹ See *supra* Chapter VI, Section A, subsection 2(a); see also The Uruguay Round Agreements Act – Statement of Administrative Action (19 U.S.C. § 3511(a)(2), at 932) stating that Section 771(5A)(D)(iv) of the Tariff Act “corresponds to the SCM Agreement Article 2.2, while codifying Commerce’s current specificity test.”

¹¹⁰ 19 U.S.C. § 1677(5A)(D).

¹¹¹ See, e.g., *Cabot Corp. v. United States*, *supra* note 74, at 729 (“a bounty or grant is a benefit which gives rise to a “competitive advantage.” See *British Steel Corp. v. United States*, 9 C.I.T., 605 F. Supp. 286, 294 (1985); *ASG Industries, Inc. v. United States*, 82 Cust. Ct. 101, 137 C.D. 4797, 467 F. Supp. 1200, 1230 (1979); *Zenith Radio Corp. v. United States*, 437 U.S. 443, 98 S. Ct. 2441, 57 L. Ed. 2d 337 (1978).); *Carlisle Tire and Rubber Co. v. United States*, at 837 (“in the view of the ITA, a condition precedent to finding that a domestic program provides a bounty or grant is that the program give *an advantage* to one or more industries vis-a-vis other industries within the same country”) (emphasis added); *Bethlehem Steel Corp. v. United States*, *supra* note 68, at 1243 (“It is true that the subsidies found to exist in past cases were selectively bestowed. But it was the element of *benefit*, not the element of selectivity, which made them subsidies.”) (emphasis in original).

¹¹² Trade Act of 1979, *supra* note 47, § 1677(A)(i).

¹¹³ *Id.* § 1677(5)(A)(ii)(I) (emphasis added).

¹¹⁴ Wentong Zheng, *The Pitfalls of the (Perfect) Market Benchmark: The Case of Countervailing Duty Law*, 19 MINN. J. INT’L L. 1, 11 (2010) (Arguing that “[w]hen determining whether the government provision of capital, loans, or loan guarantees confers a subsidy, the criterion is whether the government provision is consistent with commercial considerations. Logically, if the terms on which capital, loans, and loan guarantees are provided by the government differ from that would be justified by commercial considerations, recipients of such financial transfers must have received an advantage.”).

second item on the list – “the provision of goods or services *at preferential rates*”¹¹⁵ – introduced a competing, *preferentiality* benchmark. The Commerce Department explained that preferentiality typically means “only more favorable to some within the relevant jurisdiction than to others within that jurisdiction” and “it does not mean ‘inconsistent with commercial considerations.’”¹¹⁶ As Professor Zheng put it, according to the Commerce Department, the standard for determining preferentiality is preferential to “others,” not preferential to the “market.”¹¹⁷

The SCM Agreement, although it does not define “benefit,” sets forth guidelines for calculating the amount of a subsidy in terms of “the benefit to the recipient.”¹¹⁸ All of them embody a market benchmark. Likewise, WTO adjudicating bodies concluded that comparison with a market benchmark is indispensable.¹¹⁹ In *Canada – Aircraft*, the Appellate Body made it clear that the SCM Agreement adopts the market benchmark as the sole benchmark for identifying and measuring subsidies:

... 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.¹²⁰

To bring U.S. law into compliance with WTO rules, the Commerce Department adopted a new set of CVD regulations, which adopted the market benchmark analysis in identifying

¹¹⁵ Trade Act of 1979, *supra* note 47, § 1677(5)(A)(ii)(II) (emphasis added).

¹¹⁶ Final Negative Countervailing Duty Determinations; Certain Softwood Products from Canada, 48 Fed. Reg. 24167 (May 31, 1983).

¹¹⁷ Zheng, *supra* note 114, at 12.

¹¹⁸ SCM Agreement, *supra* note 100, art. 14.

¹¹⁹ Appellate Body Report, *Canada – Certain Measures Affecting the Renewable Energy Generation Sector*, WT/DS412/AB/R, adopted May 24, 2013, para. 5.164.

¹²⁰ Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 Aug. 2000, para. 157.

subsidies.¹²¹ In particular, when it comes to the government provision of goods or services, the regulations set forth a three-tiered hierarchy of benchmarks, all of which are market based: (1) market prices from actual transactions within the country under investigation; (2) world market prices that would be available to purchasers in the country under investigation; and (3) an assessment of whether the government price is consistent with market principles.¹²² Consequently, the market benchmark became the only officially recognized benchmark for identifying and measuring subsidies.¹²³

Section 771(5)(D), closely following the language of Article 1 of the SCM Agreement, defines *financial contribution* as:

- (i) the direct transfer of funds, such as grants, loans, and equity infusions, or the potential direct transfer of funds or liabilities, such as loan guarantees,
- (ii) foregoing or not collecting revenue that is otherwise due, such as granting tax credits or deductions from taxable income,
- (iii) providing goods or services, other than general infrastructure, or purchasing goods.¹²⁴

Prior to 1995, essentially *any* government action that caused a benefit to a certain enterprise or industry was considered a subsidy.¹²⁵ Likewise, this was the U.S. position on the

¹²¹ 19 C.F.R. § 351.511.

¹²² *Id.*

¹²³ Zheng, *supra* note 114, at 17.

¹²⁴ 19 U.S.C. § 1677(5)(D).

¹²⁵ See, e.g., Carbon Steel Wire Rod from Poland; Final Negative Countervailing Duty Determination, 49 Fed. Reg. 19375 (May 7, 1984) (“We believe a subsidy (or bounty or grant) is definitionally *any action* that distorts or subverts the market process and results in a misallocation of resources.”) (emphasis added); see also U.S. CODE CONG. & ADMIN. NEWS 1979, at 381, 470 (the Senate Finance Committee report stated that “[t]he reference to specific subsidies in the definition [section 771(5)] is not all inclusive, but rather is *illustrative* of practices which are subsidies within the meaning of the word as used in the bill. The administering authority may expand upon the list of specified subsidies consistent with the basic definition”) (emphasis in original); 125 CONG. REC. S10, 313 (daily ed. July 23, 1979) (Senator Heinz also commented that “[t]he point of this language . . . is to define subsidy broadly so as to catch within the scope of our law as many unfair trade practices as we can. That, of course, does not mean we countervail, because injury must also be found. It was the Committee’s intent, however, that the Treasury Department, or whatever administering authority ends up with this new law, not resolve petitions by arbitrarily

notion of subsidy in the Uruguay Round negotiations.¹²⁶ New WTO law substantially limited the coverage of the definition of subsidy by introducing the “financial contribution” requirement, which functions to ensure that not all government measures that confer benefits can be deemed to be subsidies.

In the landmark WTO decision for the definition of subsidy, *US – Export Restraints*, the issue was whether an “export restraint” could constitute a financial contribution in the meaning of Article 1.1(a)(1)(iii) and (iv) of the SCM Agreement.¹²⁷ The U.S. argument, which essentially mirrored its pre-existing practice, was based on an exclusive emphasis on the beneficial *effect* produced by the governmental intervention in the economy.¹²⁸ The Panel, however, disagreed with this “effect approach,” deciding that the determination of whether a financial contribution exists must concentrate on the examination of the *nature* of the action by the government and not on its effects. Thus, the SCM Agreement regulated *only certain forms* of government actions that are listed in items (i) to (iii) and the list should be considered exhaustive.¹²⁹ The Panel concluded that:

. . . the negotiating history confirms that the introduction of the two-part definition of subsidy, consisting of “financial contribution” and “benefit”, was intended specifically to prevent the countervailing of *benefits* from any sort of (formal,

concluding that various practices are not subsidies. Better to define the term broadly, as it ought to be defined, and then use the injury test as it is intended to be used.”).

¹²⁶ The United States proposed to define a subsidy as “any government action or combination of government actions which confers a benefit on the recipient firm(s).” (*Elements of the Framework for Negotiations, Submission by the United States*, GATT Doc. No. MTN.GNG/NG10/W/29. at 2 (Nov. 22, 1989).)

¹²⁷ Panel Report, *United States – Measures Treating Exports Restraints as Subsidies*, WT/DS194/R, adopted 1 Aug. 2001, para. 8.16 (there, the Panel considered as an export restraint “a border measure that takes the form of a government law or regulation which expressly limits the quantity of exports or places explicit conditions on the circumstances under which exports are permitted, or that takes the form of a government-imposed fee or tax on exports of the product calculated to limit the quantity of exports”).

¹²⁸ *Id.* para. 55 (In particular, the United States argued that “domestic purchasers of a restrained product may be able to purchase that product at a lower price than would otherwise be the case if the market for that product was not artificially limited by the government. In such a case, domestic purchasers of the restrained product would receive a benefit in the form of lower costs for their inputs.”).

¹²⁹ *Id.* para. 8.69.

enforceable) government measures, by restricting to a finite list the *kinds* of government measures that would, if they conferred benefits, constitute subsidies. The negotiating history confirms that items (i)-(iii) of that list limit these kinds of measures to the transfer of economic resources from a government to a private entity.¹³⁰

Therefore, under the post-Uruguay Round law, only certain government measures, listed in Section 771(5)(D), fall within the definition of subsidy.

To sum up, the definition of subsidy introduced in U.S. law as a result of the Uruguay Round agreements further limits the scope of the CVD law. The two elements of subsidy (“selectivity” and “benefit”), although for the first time included in the statutory definition of subsidy, do not substantially affect the pre-existing U.S. practice of viewing a government action that causes a benefit to a certain enterprise or industry as a subsidy. The most notable change, however, is the introduction of the “financial contribution” element, which narrows the definition of a countervailable subsidy to include only certain government measures.

b. *De Minimis* Countervailable Subsidy U.S. law provides for certain *de minimis* limitations: if the subsidies found do not exceed these limitations, CVDs may not be imposed. Before implementing the changes required by the Uruguay Round agreements, a *de minimis* subsidy margin was defined as 0.5 percent or less.¹³¹ WTO law sets a much higher threshold for challenging actionable subsidies.¹³² Consistent with the SCM Agreement, the new U.S. law provides for a *de minimis* threshold of 1% *ad valorem* for developed countries¹³³ and 2% for developing countries.¹³⁴ Moreover, for certain developing country the *de minimis* level is 3%.¹³⁵

¹³⁰ *Id.* para. 8.73 (emphasis in original).

¹³¹ 19 C.F.R. § 353.6.

¹³² SCM Agreement, *supra* note 100, arts. 11.9, 27.10 and 27.11.

¹³³ 19 U.S.C. § 167b(b)(4)(A).

¹³⁴ 19 U.S.C. § 167b(b)(4)(B).

By raising the threshold for challenging actionable subsidies, the WTO thus further limited the use of CVD measures.

c. Domestic Industry The SCM Agreement strengthened the requirements for initiating a CVD investigation. In the U.S, prior to 1995, a petition to start an investigation could be brought by any number of domestic producers. This allowed initiation of an investigation by representatives of a small portion of total domestic production of the like product and even where other members of the industry indicated their opposition to the petition, unless the opposition was shown to represent a majority of the domestic industry.¹³⁶

Under the new law, in order to prevent the CVD procedure from being captured in this manner, a sufficiently important part of the domestic industry must have expressed support for the application. The amended Tariff Act closely follows the language of Article 11.4 of the SCM Agreement, stating that the petition is considered to be filed “by or on behalf of” the domestic industry only if (1) the domestic producers who support the petition account for at least 25 percent of the total production of the domestic like product, and (2) the domestic producers who support the petition account for more than 50 percent of the production of the domestic like

¹³⁵ 19 U.S.C. § 167b(b)(4)(C) (Two categories of developing countries are eligible for the 3% standard: (1) least-developed countries identified in Annex VII of the SCM Agreement; (2) developing countries that eliminated their export subsidies on an expedited bases pursuant to Article 27.11 of the SCM Agreement.).

¹³⁶ *Suramerica de Aleaciones Laminadas, C.A. v. United States*, 966 F.2d 660, 667 (Fed. Cir. 1992) (“Based on the respective statutory provisions governing standing of parties to bring petitions to commence investigations, it [Commerce] relies upon the petitioner’s representation that *it has filed “on behalf of” the domestic industry until it is affirmatively shown that a majority of the domestic industry opposes the petition. . . .* [N]either the [statutory framework] nor its legislative history restricts access to the unfair trade laws by requiring that parties petitioning for relief . . . establish affirmatively that a majority of the members of the relevant domestic industry support the petition. The only requirement is that the party filing the petition act as the representative of the domestic industry.”) (emphasis added).

product produced by that portion of the industry expressing support for or opposition to the petition.¹³⁷

d. Sunset Provision Prior to the Uruguay Round, U.S. law did not contain a sunset provision and CVD measures could remain in effect for an unlimited period of time.¹³⁸ Consistent with Article 21.3 of the SCM Agreement, U.S. law now requires that all CVDs must be withdrawn five years after their imposition, unless the investigating authorities show that revocation of the duty is likely to lead to continuation or recurrence of subsidization and injury to the domestic industry.¹³⁹ As the Appellate Body explained in *US – Carbon Steel*, “termination of a countervailing duty is the rule and its continuation is the exception.”¹⁴⁰ Thus, absent a sunset review, all CVDs in place must immediately be withdrawn.

In sum, U.S. CVD law has undergone substantial change over the last century. In the first period, stretching from the 1890s until the late 1970s, CVD law played a primarily protectionist role. For that purpose, it was rather broad so as to embrace as many measures as possible, and it became even broader over time. Developments after the Tokyo and Uruguay Rounds demonstrate a move from pure protection of U.S. industry to a focus on the effect of subsidies. In order to limit the use of CVDs, the scope of application of the law has been substantially narrowed.

The following table demonstrates the evolution of the substantive law on CVDs:

¹³⁷ 19 U.S.C. § 1671a(c)(4).

¹³⁸ Some CVD orders had been in effect more than 15 years (*see* How the GATT Affects U.S. Antidumping and Countervailing Duty Policy 73 (Washington DC: Congressional Budget Office 1994)).

¹³⁹ 19 U.S.C. § 1675(c).

¹⁴⁰ Appellate Body Report, *United States – Countervailing Corrosion-Resistant Carbon Steel Flat Products from German*, WT/DS213/AB/R, adopted 19 Dec. 2002, para. 88.

Table 2. The Evolution of U.S. Substantive Law on Countervailing Duties

	1890s – 1970s	After Tokyo Round	After Uruguay Round
Subsidy	<ul style="list-style-type: none"> • Any government action that gives an advantage to recipient(s) 	<ul style="list-style-type: none"> • Any government action that gives an advantage to specific recipient(s) 	<ul style="list-style-type: none"> • Financial contribution or income/price support by a government • which confers a benefit to specific recipient(s)
Material injury test	Not required (except for duty-free imports since 1974)	Required only for imports from the countries that signed the Subsidies Code (24 countries)	Required for imports from all WTO Members (164 countries)

B. U.S. COUNTERVAILING DUTY LAW

CVD proceedings are now governed by Subtitle A of Title VII of the Tariff Act of 1930, as added by the Trade Agreements Act of 1979 and subsequently amended,¹⁴¹ and the relevant Customs Regulations.¹⁴² While the previous sections of this chapter outlined the development of the law over time, this section provides a more comprehensive view of the current state of U.S. law.

1. Substantive Elements

In order to impose countervailing measures against subsidized imports, two basic elements need to be established during the course of the investigation: (1) the Commerce Department must determine whether there is a countervailable subsidy under the statutory definition; (2) in the

¹⁴¹ 19 U.S.C. § 1671.

¹⁴² 19 C.F.R. pt. 351.

case of a country that is a WTO member, or that has assumed similar obligations with respect to the U.S., the ITC must determine whether there has been material injury to a U.S. industry.¹⁴³

a. Subsidy With regard to the definition of a subsidy, U.S. law closely follows the language of Article 1 of the SCM Agreement. In order to find the existence of a subsidy, the two cumulative conditions must be met: (1) there must be a financial contribution by a government in the country of origin or export or there must be a form of income or price support within the meaning of Article XVI of the GATT 1994; and (2) there must be a benefit conferred thereby.¹⁴⁴ The statute provides further guidance on the meaning of the term “benefit conferred” by stating that “a benefit shall normally be treated as conferred where there is a benefit to the recipient.”¹⁴⁵ In determining whether a subsidy exists, the Commerce Department is not required to consider the effect of the subsidy on the price or output of the merchandise under investigation.¹⁴⁶

Subsidies are subject to CVD measures only if they are specific.¹⁴⁷ While export subsidies and domestic content subsidies are automatically considered to be specific and therefore countervailable,¹⁴⁸ domestic subsidies must be specific in order to be countervailable.¹⁴⁹ A domestic subsidy is *de jure* specific when it is explicitly limited, by its own terms, to a company, industry, or group of companies or industries, or to a geographical region.¹⁵⁰ If the criteria and conditions governing eligibility for a subsidy are objective, however,

¹⁴³ 19 U.S.C. § 1671.

¹⁴⁴ 19 U.S.C. § 1677(5)(B).

¹⁴⁵ 19 U.S.C. § 1677(5)(E).

¹⁴⁶ 19 U.S.C. § 1677(5)(C).

¹⁴⁷ 19 U.S.C. § 1677(5)(A).

¹⁴⁸ 19 U.S.C. § 1677 5(A), (B) and (C).

¹⁴⁹ 19 U.S.C. § 1677 5(A), (D).

¹⁵⁰ 19 U.S.C. § 1677 5(A), (D)(i).

the subsidy is not specific.¹⁵¹ The statute follows the language of footnote 2 of the SCM Agreement, defining “objective” as criteria or conditions that are “neutral and that do not favor one enterprise or industry over another.”¹⁵²

Even if on its face a subsidy is not specific, it still can be specific *de facto*. The statute sets out the following factors that the Commerce Department is to use in determining *de facto* specificity: (1) whether only a small number of companies actually use a subsidy; (2) whether a subsidy is predominantly used by a company or industry; (3) whether a particular company or industry receives disproportionately large benefits under the program, and (4) whether the foreign governmental authority has used its discretion to grant the subsidy in a manner intended to benefit a particular company or industry.¹⁵³ In practice, the Commerce Department has placed the greatest emphasis on the number of firms or industries receiving a government benefit in determining whether a particular subsidy is specific *de facto*.¹⁵⁴

b. Injury After the Commerce Department has found a subsidy to exist, the ITC is required to determine whether an industry in the United States is materially injured, or threatened with material injury, or the establishment of a U.S. industry is materially retarded, “by reason of imports” of the merchandise under investigation.¹⁵⁵

¹⁵¹ 19 U.S.C. § 1677 5(A), (D)(ii).

¹⁵² *Id.*

¹⁵³ 19 U.S.C. § 1677 5(A), (D)(iii).

¹⁵⁴ *See, e.g.*, Certain Pasta from Italy (Final), 61 Fed. Reg. 30288 (June 14, 1996); Certain Textile Mill Products from Thailand (Final), 52 Fed. Reg. 7636-01 (Mar. 12, 1987); Certain Carbon Steel Products from Brazil (Final), 49 Fed. Reg. 17988-01 (Apr. 26, 1984).

¹⁵⁵ 19 U.S.C. § 1673(2).

Material injury is defined as “harm which is not inconsequential, immaterial, or unimportant.”¹⁵⁶ In accordance with Article 15.4 of the SCM Agreement, the statute provides a list of factors which the ITC *must* examine in order to reach a determination of material injury (the volume of imports, the effect of imports on prices in the U.S., the impact of imports on U.S. producers of the like product).¹⁵⁷ Therefore, following the statutory language, the ITC is required to discuss each of the factors listed in the statute in their opinion. Although the ITC may choose to give minimal weight to, or even to disregard, a particular factor, there must be a showing that the factor was considered in some form.¹⁵⁸

The concept of threat of material injury is not defined. Nevertheless, the statute states that the determination must be made “on the basis of evidence that the threat of material injury is real and that actual injury is imminent.”¹⁵⁹ Such determination may not be made on the basis of mere conjecture or supposition.¹⁶⁰

The statute provides a list of factors that must be considered by the ITC in making the material injury determination: unused productive capacity or increases in capacity in the exporting country; rapid increases in U.S. market share; the probability that low-priced imports could suppress or depress U.S. prices; increases in inventories of the product; and the possibility of product shifting by foreign producers.¹⁶¹ Generally, the ITC has been more reluctant to issue a determination of threat of injury when it finds no current injury.¹⁶²

¹⁵⁶ 19 U.S.C. § 1677(7)(A).

¹⁵⁷ 19 U.S.C. § 1677(7)(C).

¹⁵⁸ COHEN, DUNN & KAYE, *supra* note 7, at 54.

¹⁵⁹ 19 U.S.C. § 1677(7)(F)(ii); *see also* Republic Steel Corp. v. United States, 591 F. Supp. 640, 650 (Ct. Int’l Trade 1984) (stating that the “essence of a threat lies in the ability and incentive to act imminently”).

¹⁶⁰ *Id.*

¹⁶¹ 19 U.S.C. § 1677(7)(F)(i).

¹⁶² COHEN, DUNN & KAYE, *supra* note 7, at 60.

In 2015, Congress amended the definition of “material injury” and the factors the ITC must examine when evaluating material injury or threat of material injury. In particular, the new amendment prohibits the ITC from finding that there has been no injury “merely because that industry is profitable or because the performance of that industry has recently improved.”¹⁶³ Although even in previous years the ITC did not make its conclusions based on profitability alone, and always examined it together with other factors before finding injury, this change might be viewed by some industries as an “easing” of the injury standard.¹⁶⁴ As a result, it might encourage some U.S. industries that are only *beginning to experience* adverse financial impact from subsidized imports, but show other signs of injury, to file petitions *before* bad financial results appear.¹⁶⁵

CVDs may also be imposed when “the establishment of an industry in the United States is materially retarded” by reason of imports.¹⁶⁶ Nevertheless, such determinations are extremely rare because it is difficult to prove that the complainant would have been able to establish an industry “but for” the imports. Thus, U.S. producers are more likely to claim that they have an established industry that is being injured by a history of imports.¹⁶⁷

There is also a requirement to establish the causal link between the subsidized import and the material injury. The injury to the U.S. industry must be “by reason of imports of the

¹⁶³ Trade Preferences Extension Act of 2015, Pub. L. No. 114-27, § 503, 219 Stat. 385 (2015).

¹⁶⁴ COHEN, DUNN & KAYE, *supra* note 7, at 56; *see also* Arnold & Porter Advisory: AD/CVD and Customs Amendments Included in Recent US Trade Legislation, http://www.arnoldporter.com/en/perspectives/publications/2016/2/ad_cvd-and-customs-amendments-in-recent-us-trade (stating that “[t]he amendments pertaining to material injury will likely make it easier for domestic industries to demonstrate material injury in AD/CVD injury investigations”).

¹⁶⁵ Richard P. Ferrin, Douglas J. Heffner & Eric L. Johnson, *U.S. Antidumping and Countervailing Duty Laws Accompany Trade Preferences Extension Act*, THE NAT’L L. REV. (June 26, 2015), <http://www.natlawreview.com/article/us-antidumping-and-countervailing-duty-lawsaccompany-trade-preferences-extension-ac>.

¹⁶⁶ 19 U.S.C. § 1671b(a)(1)(B).

¹⁶⁷ COHEN, DUNN & KAYE, *supra* note 7, at 61.

merchandise,” which is the subject of the investigation.¹⁶⁸ As mentioned above, the conventional approach to injury analysis, favored by the majority of the ITC, was first to determine whether the industry is injured and then to inquire whether the subsidized imports are a cause of that injury.¹⁶⁹ In the mid-1980s, however, individual Commissioners began to assert that the proper basis for assessing causality is not whether there is material injury overall, but rather whether the impact of imports is such as to constitute material injury.¹⁷⁰ Courts have concluded that both tests constitute a permissible reading of the statute, and that neither test is prohibited.¹⁷¹

2. Procedure and Remedies

a. Procedure CVD investigations are conducted on the basis of a petition filed simultaneously with the Commerce Department and ITC on behalf of a domestic industry, or by the Commerce Department on its own initiative.¹⁷² The International Trade Administration (ITA), an agency within the Commerce Department, determines whether there is a subsidy and the ITC determines whether there is material injury.

If an investigation is initiated by a petition, the Commerce Department must, within 20 days, determine the sufficiency of the petition.¹⁷³ If the Commerce Department’s determination at this stage is negative, the petition is dismissed and the proceedings end.¹⁷⁴

¹⁶⁸ 19 U.S.C. § 1673(2).

¹⁶⁹ See *supra* notes 84-87 and accompanying text.

¹⁷⁰ See *supra* notes 88-89 and accompanying text.

¹⁷¹ See, e.g., *R-M Industries, Inc. v. United States*, 18 Ct. Int’l Trade 219, 848 F. Supp. 204, 16 Int’l Trade Rep. (BNA) 1338 (1994); *American Spring Wire Corp. v. United States*, 8 Ct. Int’l Trade 20, 590 F. Supp. 1273, 6 Int’l Trade Rep. (BNA) 1025 (1984), *judgment aff’d*, 3 Fed. Cir. (T) 123, 760 F.2d 249, 6 Int’l Trade Rep. (BNA) 2380 (1985).

¹⁷² 19 U.S.C. § 1671a(a).

¹⁷³ 19 C.F.R. § 351.203(b).

Upon receiving notice from the Commerce Department that the petition is sufficient, the ITC begins to investigate whether there is “a reasonable indication” of injury.¹⁷⁵ The ITC must make a preliminary determination of material injury within 45 days of receiving notice from the Commerce Department.¹⁷⁶ If the ITC’s determination is negative, the proceedings end.¹⁷⁷ This is, however, a relatively rare occurrence since the preliminary injury standard is much lower than required for the final determination.¹⁷⁸

If the ITC’s determination is affirmative, the Commerce Department begins its preliminary investigation to determine “whether there is a reasonable basis to believe or suspect that a subsidy is being provided.”¹⁷⁹ The preliminary determination must be made within 65 days unless the Commerce Department determines that the case is “extraordinarily complicated” and should be postponed.¹⁸⁰ Even if the Commerce Department’s determination is negative, both the Commerce Department and the ITC continue the investigation to the final stage.¹⁸¹

The Commerce Department must issue a final determination on the issue of subsidies within 75 days of an affirmative preliminary determination.¹⁸² Before issuing a final determination, the Commerce Department must hold a hearing upon the request of any party to the proceeding.¹⁸³ It also must conduct a verification of the information upon which the final

¹⁷⁴ 19 U.S.C. § 1671a(c)(3).

¹⁷⁵ 19 U.S.C. § 1673b.

¹⁷⁶ 19 U.S.C. § 1671b(a).

¹⁷⁷ 19 U.S.C. § 1671b(a)(1).

¹⁷⁸ LESLIE ALAN GLICK, ESQ., GUIDE TO UNITED STATES CUSTOMS AND TRADE LAWS: AFTER THE CUSTOMS MODERNIZATION ACT 130 (2008).

¹⁷⁹ 19 U.S.C. § 1671b(1).

¹⁸⁰ 19 U.S.C. § 1671b(c).

¹⁸¹ ITC: 19 C.F.R. § 207.20; ITA: 19 C.F.R. § 351.205 (Prior to the Uruguay Round, a final injury investigation by the ITA would only occur upon the ITA’s preliminary affirmative determination.).

¹⁸² 19 U.S.C. § 1671d(a)(1).

¹⁸³ 19 C.F.R. § 351.310.

determination is based.¹⁸⁴ Since the Commerce Department sends separate questionnaires to the government and to exporters, it must verify both the government's response and the responses of exporters. If for some reason the information cannot be verified, the Commerce Department will base the determination on "facts available," which could be the information in the petition.¹⁸⁵ Upon making the final determination the Commerce Department issues a final order which, if negative, ends the proceedings.¹⁸⁶ If a final determination is affirmative, the investigation continues to the final injury phase at the ITC.¹⁸⁷

The ITC must make its final determination: (1) within 120 days of the Commerce Department's preliminary subsidy determination; or (2) within 45 days of an affirmative final subsidy determination by the Commerce Department.¹⁸⁸ If the Commerce Department has made a negative preliminary subsidy determination and a positive final determination, the ITC must make a final injury determination within 75 days of the final subsidy determination.¹⁸⁹ If both the final injury determination and the final subsidy determination are positive, then the Commerce Department issues a CVD order.¹⁹⁰

A decision of the Commerce Department or the ITC may be appealed to the U.S. Court of International Trade, which has exclusive jurisdiction over such appeals.¹⁹¹ Appeals from decisions of the Court of International Trade are taken to the Court of Appeals for the Federal Circuit, which reviews the underlying agency determination to see whether it is supported by

¹⁸⁴ 19 U.S.C. § 1677e(a); 19 C.F.R. § 351.307(a).

¹⁸⁵ 19 U.S.C. § 1677e(b); 19 C.F.R. § 351.308(a).

¹⁸⁶ 19 U.S.C. § 1671d(c)(2).

¹⁸⁷ 19 U.S.C. § 1671d(c)(1).

¹⁸⁸ 19 U.S.C. § 1671d(b)(2).

¹⁸⁹ 19 U.S.C. § 1671d(b)(3).

¹⁹⁰ 19 U.S.C. § 1671d.

¹⁹¹ 19 U.S.C. § 1516a(2)(B); § 1516a(a)(1)(C).

substantial evidence or otherwise is in accordance with the law, rather than reviewing the decision of the Court of International Trade.¹⁹²

b. Remedies Consistent with WTO law,¹⁹³ U.S. law provides for two types of relief in CVD proceedings: (1) the imposition of CVDs (provisional and definitive duties); or (2) a suspension agreement (referred to as a price undertaking in the SCM Agreement).¹⁹⁴

Provisional duties are imposed when the Commerce Department makes an affirmative preliminary determination regarding the existence of countervailable subsidies.¹⁹⁵ The Commerce Department instructs the U.S. Customs and Border Protection to order the suspension of liquidation of all entries of merchandise subject to the determination which are entered, or withdrawn from warehouse, for consumption on or after the later of the date on which notice of the determination is published in the Federal Register, or the date which is 60 days after the date on which notice of the determination to initiate the investigation is published in the Federal Register.¹⁹⁶ All entries of subject merchandise are subject to a security requirement. The importer must, at the time the merchandise is entered, post security in an amount sufficient to cover the CVD liability as set forth in the preliminary determination. Although the statute provides for acceptance of security in the form of “a cash deposit, bond or other security,”¹⁹⁷ in

¹⁹² See, e.g., *Matsushita Elec. Indus. Co., Ltd. v. United States*, 3 Fed. Cir. (T) 44, 750 F.2d 927, 932, 6 Int'l Trade Rep. (BNA) 1465 (1984).

¹⁹³ SCM Agreement, *supra* note 100, art. 19.

¹⁹⁴ 19 U.S.C. § 1671.

¹⁹⁵ 19 U.S.C. § 1671b(d).

¹⁹⁶ 19 U.S.C. § 1671b(d)(2).

¹⁹⁷ 19 U.S.C. § 1671b(d)(1)(b).

2011 the Commerce Department announced that it would “normally” accept only cash deposit as security.¹⁹⁸

If the Commerce Department makes a preliminary affirmative determination of “critical circumstances,”¹⁹⁹ the suspension of liquidation applies retroactively.²⁰⁰ Retroactive liquidation applies to entries made beginning on the later of the date of publication of the notice of initiation of the investigation (normally, 20 days after the filing of petition), or 90 days after the preliminary determination.²⁰¹

If the preliminary investigation is negative, the Commerce Department conducts a final determination, although there is no suspension of liquidation.

Definitive duties are imposed when the ITC makes an affirmative final determination of injury. Within 7 days after being notified by the ITC of an affirmative final determination the Commerce Department publishes in the Federal Register a CVD order.²⁰² Once a CVD order is in effect, all entries are subject to a cash deposit requirement equal to the subsidies percentage found in the final determination.²⁰³ Duties are imposed on all subject merchandise entered on or after the date of suspension of liquidation (i.e. Commerce’s preliminary affirmative determination), unless the ITC’s final determination is based on threat of material injury or

¹⁹⁸ Modifications of Regulations Regarding the Practice of Accepting Bonds During the Provisional Measures Period in Antidumping and Countervailing Duty Investigations, 76 Fed. Reg. 61042.

¹⁹⁹ Critical circumstances exist if (1) the alleged countervailable subsidy is inconsistent with the SCM Agreement; and (2) there have been “massive imports” of subject merchandise over a relatively short period. *See* 19 U.S.C. § 1671b(e)(1).

²⁰⁰ 19 U.S.C. § 1671b(e).

²⁰¹ 19 U.S.C. § 1671b(e)(2).

²⁰² 19 U.S.C. § 1671e.

²⁰³ 19 U.S.C. § 1671d.

material retardation. In these cases, duties are imposed only on merchandise entered on or after the date of publication of the ITC's final affirmative determination.²⁰⁴

CVD orders are subject to annual administrative reviews, conducted upon request as frequently as once a year by the Commerce Department, and "changed circumstances" review, conducted by either the Commerce Department or the ITC, depending upon the nature of the change involved.²⁰⁵ "Sunset" review must be conducted on each CVD order no later than once every 5 years.²⁰⁶ The Commerce Department determines whether subsidies would be likely to continue or resume if an order were to be revoked, and the ITC conducts a similar review to determine whether injury to the domestic industry would be likely to continue or resume. If both determinations are affirmative, the CVD remains in place; if either determination is negative, the order is revoked.²⁰⁷

A compensation agreement is an alternative to imposing CVDs. A compensation agreement is an agreement between the Commerce Department and (1) the exporters and producers, or (2) the foreign government, whereby the latter agrees to modify their behavior so as to eliminate subsidization or the injury caused thereby.²⁰⁸ The statute provides for only three types of suspension agreements: (1) agreements to cease exporting the investigated product to the United States; (2) agreements to eliminate the subsidies (i.e. to eliminate the subsidies completely or to offset the subsidy with an export tax); and (3) agreements to eliminate injurious effects of subsidies (the agreement must eliminate or offset at least 85 percent of the subsidy and

²⁰⁴ 19 U.S.C. § 1671e.

²⁰⁵ 19 U.S.C. § 1675.

²⁰⁶ 19 U.S.C. § 1675(c).

²⁰⁷ 19 C.F.R. § 351.218.

²⁰⁸ 19 C.F.R. § 351.208.

must result in the elimination of the suppression or undercutting of U.S. prices).²⁰⁹ In practice, however, the first type of agreement doesn't happen, because there is no incentive for the exporter to enter into it. An exporter that intends to stop exporting to the United States could simply withdraw from the case rather than go through the procedural difficulties of a suspension agreement.²¹⁰ Therefore, there are basically two types of suspension agreements: to eliminate the subsidy and to eliminate injurious effects.

3. Consistency with WTO Rules

In general, U.S. CVD law and administrative practice are consistent with WTO law. This has been achieved through the implementation of WTO rules by the Uruguay Round Agreements Act,²¹¹ as well as through implementing the Dispute Settlement Body's (DSB) decisions. At the same time, CVDs imposed by the United States have been the most challenged in the WTO. Of the 41 cases in which a CVD was challenged on the ground of its inconsistency with the SCM Agreement, 26 were brought against the United States.²¹² The disputes are various and distinct; at the same time, they address only certain, very specific aspects of U.S. law and administrative practice.

For example, in *US – Softwood Lumber IV*,²¹³ Canada granted a financial contribution in the form of the provision of goods by granting the right to harvest standing timber (“stumpage”)

²⁰⁹ 19 U.S.C. § 1675c(b)(1).

²¹⁰ COHEN, DUNN & KAYE, *supra* note 7, at 65.

²¹¹ URAA, *supra* note 99.

²¹² World Trade Organization, https://www.wto.org/english/tratop_e/dispu_e/dispu_agreements_index_e.htm?id=A20# (last visited Sept. 27, 2016).

²¹³ Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/R, adopted 17 Feb. 2004, para. 124.

at terms beneficial to harvesters. When the *stumpage* was harvested, the *logs* were further processed into *primary lumber* by sawmills. Part of such lumber was further processed by independent remanufacturers into *remanufactured lumber*. The Commerce Department imposed CVDs on both *primary* and *remanufactured lumber* on the basis of a determination that stumpage had been subsidized, without assessing whether the benefit was effectively passed through to independent lumber producers. The Appellate Body decided that where the CVDs are to be imposed on *processed* products, and where a downstream producer is unrelated to the alleged subsidized upstream producer of the input, the investigating authority is not allowed to simply assume that a benefit has passed through.²¹⁴ Similarly, in *US – Lead and Bismuth II*, the Appellate Body concluded that the Commerce Department should not have presumed that the non-recurring subsidies given to a state-owned enterprise would have passed through.²¹⁵

The United States has generally complied with DSB rulings. In one case, however, it failed to do so, resulting in retaliatory measures imposed against the United States. In *US – Offset Act (Byrd Amendment)*, the Appellate Body condemned the so-called *Byrd Amendment* by finding that it was inconsistent with the SCM Agreement.²¹⁶ Enacted on October 28, 2000, the Byrd Amendment mandated the distribution of the proceeds from CVDs to all U.S. producers supporting a domestic petition seeking such duties.²¹⁷ As Congress explained, the purpose of

²¹⁴ *Id.* paras. 141, 143 (in the absence of such a pass-through determination, “it cannot be shown that the essential elements of the subsidy definition in Article 1 are present in respect of the processed product”).

²¹⁵ Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel products Originating in the United Kingdom*, WT/DS138/R, adopted 7 June 2000, paras. 126-127.

²¹⁶ Appellate Body Report, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/AB/R, WT/DS234/AB/R, adopted 27 Jan. 2003.

²¹⁷ 19 U.S.C. § 1675c (“Duties assessed pursuant to a countervailing duty order . . . shall be distributed on an annual basis under this section to the affected domestic producers for qualifying expenditures. Such distribution shall be known as the ‘continued . . . subsidy offset.’”). The U.S. Customs Services distributed a total amount of \$231 million in 2001 and \$329 million in 2002 (*see* 2001 U.S. Customs Ann. Rep., CDSOA FY 2001 Disbursements, www.customs.gov).

U.S. unfair trade law is to restore the conditions of fair trade in order that economic investment and jobs that should be in the United States are not lost as a result of disingenuous market signals; and if foreign subsidization persists, U.S. producers will be hesitant to rehire employees that were laid off in order to survive and may be incapable of maintaining pension or health care benefits.²¹⁸

From the time of its enactment, the Byrd Amendment was controversial both domestically²¹⁹ and internationally. In the largest joint dispute resolution action in the history of the WTO, thirty countries challenged the Byrd Amendment.²²⁰ The Appellate Body found that the Byrd Amendment is inconsistent with Article 32.1 of the SCM Agreement because it is a specific action against a subsidy other than those permitted by the SCM Agreement.²²¹ Since the SCM Agreement allows only three measures in response to subsidies (provisional CVDs, definitive CVDs, or a price undertaking), the United States violated its obligations under the WTO by introducing a measure to counteract a subsidy other than the three permissible forms.

In June 2003, the United States was granted eleven months to bring the measure into conformity with its WTO obligations.²²² When the United States failed to do so, the WTO

²¹⁸ *Id.* (Historical & Statutory Notes – Findings of Congress Respecting Continued Dumping and Subsidy) (1999 & Supp. 2002).

²¹⁹ See, e.g., Jagdish Bhagwati & Petros C. Mavroidis, *Killing the Byrd Amendment with the Right Stone*, 3 *WORLD TRADE REV.* 1, 119-27 (2004); Hale E. Shepard, *The Continued Dumping and Subsidy Offset Act (Byrd Amendment): A Defeat before the WTO May Constitute an Overall Victory for U.S. Trade*, 10 *TUL. J. INT'L & COMP. L.* 121, 121-55 (2002); Claire Hervey, *The Byrd Amendment Battle: American Trade Politics at the WTO*, 27 *HASTINGS INT'L & COMP. L. REV.* 131, 131-44 (2003); Xuesong A. Yu, *The Byrd's View Might Not Give You a Whole Picture – The Battle in the World Trade Organization on the Continued Dumping and Subsidy Offset Act of 2000*, 17 *FLA. J. INT'L L.* 417, 417-38 (2005).

²²⁰ Eleven complaining parties (Australia, Brazil, Canada, Chile, the European Communities, India, Indonesia, Japan, Korea, Mexico and Thailand) and five third-party participants (Argentina, Costa Rica, Hong Kong, Israel and Norway). Together, the 15 parties represent 30 countries, given that the “European Communities” represented the 15 countries of the EC (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom).

²²¹ *US – Offset Act (Byrd Amendment)*, *supra* note 216, para. 265.

²²² Arbitrator Award, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/14, WT/DS234/22, at 83 (June 13, 2003).

authorized retaliation by eight complaining WTO Members, giving them the right to impose additional import duties having a total trade value of up to 72% of total Byrd Amendment disbursements.²²³

In February 2006, the United States eventually repealed the Byrd Amendment effective October 1, 2007.²²⁴ Nevertheless, while duties are no longer collected under the Byrd Amendment, distribution of “duties on entries of goods made and filed before October 1, 2007” continue.²²⁵ The WTO complaining Members asserted that the United States had not brought its measures fully into conformity with the DSB ruling.²²⁶ As a result, the EU continues to apply retaliatory tariffs.²²⁷

In three disputes, the compliance proceedings are still ongoing.²²⁸ In particular, in *US – Countervailing Measures (China)*, the Appellate Body found that the Commerce Department had applied unlawful standards and methodologies for determining the benefit to the recipient. The Appellate Body concluded that “government-related prices” other than the financial contribution at issue should not be automatically rejected and may serve as a benchmark in calculating the benefit for the purpose of determining the existence of a subsidy under Article 14 of the SCM

²²³ Arbitrator Decisions, *United States – Continued Dumping and Subsidy Offset Act of 2000 (Recourse to Arbitration by the United States under Article 22.6 of the DSU)*, WT/DS217/ARB/BRA, WT/DS217/ARB/CHL, WT/DS217/ARB/EEC, WT/DS217/ARB/IND, WT/DS217/ARB/JPN, WT/DS217/ARB/KOR (Aug. 31, 2004).

²²⁴ Deficit Reduction Act of 2005, Pub. L. No. 109-171, § 7601, 120 Stat. 4, 154.

²²⁵ *Id.*

²²⁶ Communication from the European Union, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/64, adopted 4 Apr. 2014, at 1.

²²⁷ Japan continued to apply the retaliatory measures until 2014, when they notified the DSB about non-application of the suspension of concessions because the authorized level was marginal. (See Current Status of *US – Offset Act (Byrd Amendment)*, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds217_e.htm (last visited Sept. 27, 2016)).

²²⁸ Appellate Body Report, *United States – Countervailing Duty Measures on Certain Products from China*, WT/DS437/AB/R, adopted 18 Dec. 2014; Appellate Body Report, *United States – Countervailing and Anti-Dumping Measures on Certain Products from China*, WT/DS449/AB/R, adopted 7 July 2014; Appellate Body Report, *United States – Anti-Dumping and Countervailing Measures on Large Residential Washers from Korea*, WT/DS464/AB/R, adopted 7 Sept. 2016.

Agreement, provided they are market determined.²²⁹ On this basis, it was found that the United States acted inconsistently with its obligation under Article 14(d) as it failed to conduct the necessary market analysis to verify whether in-country prices in China were market determined or not.²³⁰

In *US – Countervailing and Anti-Dumping Measures (China)*, the Panel addressed the issue of “double remedies,” where the simultaneous application of anti-dumping and CVDs on the same imported products results in the offsetting of the same subsidization twice. The Panel explained that (1) the imposition of double remedies arising from concurrent imposition of CVDs and anti-dumping duties calculated under non-market economy methodology is inconsistent with the obligation in Article 19.3 of the SCM Agreement to levy CVDs “in the appropriate amounts”; and (2) the burden is on an investigating authority imposing such concurrent duties to investigate whether it is offsetting the same subsidies twice.²³¹ Therefore, it was found that the United States acted inconsistently with Article 19.3 by failing to investigate whether double remedies arose in 25 CVD investigations.²³²

In the most recent case, *US – Washing Machines*, the Appellate Body concluded that the Commerce Department’s calculation of *ad valorem* subsidization rate fails to ensure that CVDs are not imposed in excess of the amount of subsidy found to exist.²³³ The Commerce Department originally found that tax credits Samsung received from the Government of Korea were not tied to any particular products and, therefore, attributed the subsidies received by Samsung under

²²⁹ Appellate Body Report, *US – Countervailing Measures (China)*, *supra* note 220, para. 4.64.

²³⁰ *Id.*

²³¹ Panel Report, *United States – Countervailing and Anti-Dumping Measures on Certain Products from China*, WT/DS449/R, adopted 27 Mar. 2014, para. 7.308 (quoting Appellate Body Report, *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R, adopted 25 Mar. 2011, paras. 547-583 and 596-602).

²³² *Id.* para. 7.396.

²³³ Appellate Body Report, *US – Washing Machines*, *supra* note 228, para. 6.8.

those programs across all products.²³⁴ According to the Commerce Department, a subsidy is tied to a product “only when the intended use is known to the subsidy giver”²³⁵ and in the present case the Government of Korea “had no way to know the intended use” of the subsidy at the time Samsung was authorized to claim the tax credits.²³⁶ Although the Appellate Body confirmed that the SCM Agreement does not dictate any particular methodology for calculating subsidy ratios and an investigating authority has the discretion to choose the most appropriate methodology for carrying out its calculation, the methodology, nevertheless, has to allow for a sufficiently precise determination of the amount of subsidization bestowed on the investigated products, as required under Article 19.4 of the SCM Agreement and Article VI:3 of the GATT.²³⁷ The Appellate Body explained that, rather than focusing on “the intended use,” the appropriate inquiry into the existence of a product-specific tie requires:

. . . a scrutiny of the design, structure, and operation of the subsidy at issue, aimed at ascertaining whether the bestowal of that subsidy is connected to, or conditioned on, the production or sale of a specific product. Based on this assessment, a subsidy that does not restrict the recipient’s use of the proceeds of the financial contribution may, nevertheless, be found to be tied to a particular product if it induces the recipient to engage in activities connected to that product.²³⁸

Thus, it was found that the Commerce Department acted inconsistently with the United States’ obligations under Article 19.4 of the SCM Agreement and Article VI:3 of the GATT by applying a flawed test for ascertaining whether the tax credits were tied to particular products.²³⁹

²³⁴ *Id.* para. 5.250 (quoting Panel Report, para. 7.301; *Washers* final CVD I&D memorandum, at 41-42; *Washers* final CVD determination, at 75976).

²³⁵ Issues and Decision Memorandum for the Final Determination in the Countervailing Duty Investigation of Large Residential Washers from the Republic of Korea, at 41 (18 Dec. 2012).

²³⁶ *Id.* at 41-42.

²³⁷ Appellate Body Report, *US – Washing Machines*, *supra* note 228, para. 5.269.

²³⁸ *Id.* at 5.273.

²³⁹ *Id.* at 5.285.

In conclusion, U.S. CVD law has undergone substantial change over the last century. The current law is the result of a certain synthesis between internal developing and evolving of CVD law and bringing it into conformity with GATT/WTO rules. Indeed, on the one hand, the United States has demonstrated historical leadership in developing CVD law. It is not surprising, therefore, that WTO law has accepted certain fundamental features of U.S. CVD law (such as “benefit” and “specificity” requirements). On the other hand, the United States was ready for the changes on a multilateral level and a number of changes in U.S. law over time have been specifically in response to developments in GATT and WTO rules (for example, “financial contribution” requirement, injury to the domestic industry, sunset provision).

VII. COMPARISON OF THE EU AND U.S. RULES ON SUBSIDIES

The United States and the EU have confronted the problem of subsidies over a long period of time and have responded differently to the issue. Having provided a general overview of the rules on subsidies in the EU (Chapter V) and in the United States (Chapter VI), this Chapter will focus on a comparison of the European and American approaches to subsidies regulation. Given that the current WTO discipline on subsidies in essence reflects a compromise between the opposing views of the United States and EU, it is striking that there is a very limited literature on a comparison of these two sets of rules.¹ The United States and the EU have rather similar approaches when it comes to assessing and addressing subsidies through countervailing duties (CVDs), with some minor although important distinctions. The major difference between U.S. and EU legal systems, which are less studied but significant, exists with regard to granting internal subsidies. In this Chapter, I compare: (1) rules on the use of CVDs in response to subsidized imported goods and (2) rules on internal subsidization in the United States and the EU, respectively.

¹ Alan O. Sykes, *The Questionable Case for Subsidies Regulation: A Comparative Perspective*, 2 J. LEGAL ANALYSIS 473 (2010) (comparing the WTO, EU, and U.S. approaches to subsidies regulation); Giuseppe Cacciato, *Subsidies, Competition Laws and Politics: A Comparison of the E.U. and the U.S.A.*, European Policy Paper Series (1996); Diane P. Wood, *Cuno v. Daimler Chrysler, Inc.: State "Aids" from an American Perspective*, 1 EUR. ST. AID L.Q. 3 (2007).

A. SUBSIDIZED IMPORTS AND COUNTERVAILING DUTIES

Both the United States and the EU are WTO Members. Thus, they have incorporated the terms of the Agreement on Subsidies and Countervailing Measures² in their national legislation.³ As a result, the basic structure and content of the countervailing duties (CVD) law in the United States and the EU are strongly influenced, if not determined, by obligations under the WTO agreements and, thus, are largely the same in both systems. Yet, certain differences exist which, in turn, reflect quite different understandings of the goals and purposes of CVD.

The only purpose of U.S. CVD law is to offset the unfair competitive advantage that foreign manufactures enjoy over U.S. producers as a result of subsidies granted by foreign government to their industries.⁴ This approach is largely based on the “entitlement theory,” which rests on the assumption that U.S. producers are entitled to protection from the effects in the domestic market of certain foreign subsidy programs.⁵ The U.S. CVD law, therefore, is primarily aimed at safeguarding U.S. *producers’* interests.

The approach of the EU to imposing CVDs, on the other hand, is more nuanced. While also aimed at defending its producers against subsidized imports, EU CVD law focuses on

² Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, 1999, 1867 U.N.T.S. 14 [hereinafter the SCM Agreement].

³ The United States has incorporated the SCM Agreement by amending title VII of the Tariff and Trade Act of 1930. The EU has included the provisions of the SCM Agreement in its Regulation (Council Regulation 597/2009 of 11 June 2009 on protection against subsidized imports from countries not members of the European Community (OJ L188/93) [hereinafter Regulation]).

⁴ *Zenith Radio Corp. v. United States*, 437 U.S. 443, 455-56 (1978) (“The purpose [of the countervailing duty statute] is relatively clear from the face of the statute and is confirmed by the congressional debates: The countervailing duty was intended to offset the unfair competitive advantage that foreign producers would otherwise enjoy from export subsidies paid by their governments.”).

⁵ Charles J. Goetz, Lloyd Granet & Warren F. Schwartz, *The Meaning of “Subsidy” and “Injury” in Countervailing Duty Law*, 6 INT’L REV. L. & ECON. 17, 18-19 (1986) (“We assume that American firms are entitled to that domestic market outcome which would have resulted from a ‘fair’, competitive process, by which is meant one which has not been ‘manipulated’ by foreign government subsidization. The idea then is to restore the competition in the American market to its ‘but for’ state by neutralizing the effect of the subsidy.”).

creating a level playing field and on taking into account wider *public interest* considerations, providing for a delicate balance between the various interests involved (end-users, importers, consumers, etc.). The EU has gone beyond its WTO obligations by tightening conditions for use of CVDs so that the remedy itself does not create additional trade distortions. As a result, the EU has produced a unique CVD law that is “arguably more open and more balanced than [that of] any other WTO Member.”⁶

1. Substantive Elements

Under both U.S.⁷ and EU⁸ law, in order to impose CVDs against subsidized imports, two basic elements must be established during the course of the investigation: (1) the imports concerned must benefit from a countervailable subsidy; and (2) the subsidized imports must cause or threaten to cause material injury to the domestic industry producing the like product. The key difference between U.S. and EU CVD laws, however, is that EU law requires proof of an additional element before the imposition of CVDs – Union interest.

From the EU perspective, it is indisputable that domestic producers are entitled to protection against subsidized imports. Yet, at the same time, the effect of imposing CVDs cannot be seen in isolation. As Professor Marco Bronckers has pointed out:

countervailing duty actions rarely if ever maximize economic welfare overall. They are, in fact, likely to reduce economic welfare by imposing costs on other

⁶ Communication from the Commission – Global Europe – Europe’s trade defence instruments in a changing global economy – A Green Paper for public consultation, COM/2006/0763 final (Dec. 6, 2006).

⁷ 19 U.S.C. § 1671.

⁸ Regulation, *supra* note 3, art. 15.1.

economic sectors (notably, consumers), which are not outweighed by the benefits to the industry receiving protection against subsidized imports.⁹

It seems reasonable, therefore, that in order to correct some of the inefficiencies that CVDs might entail, the investigative authorities should take into account Union interests in addition to just those of the complaining industry before they impose CVDs.

To strike a balance between the various competing interests, the EU has developed the concept of “Union interest.” After an affirmative finding of subsidization causing injury to a domestic industry, the Commission must examine whether Union interests as a whole call for adoption of CVDs. Article 31.1 of the Regulation provides that:

A determination as to whether the Community interest calls for intervention should be based on an appraisal of all the various interests taken as a whole, including the interests of the domestic industry and users and consumers. . . . In such an examination, the need to eliminate the trade-distorting effects of injurious subsidization and to restore effective competition shall be given special consideration.¹⁰

Thus, even though subsidization causing injury to a domestic industry is established, CVDs may not be applied if “it can be clearly concluded that it is not in the Union interest to impose such measures.”¹¹

When assessing the Union interest requirement, the Commissions examines, where appropriate, the interests of the Union industry, users, importers, and consumers. Examination of the interest of the Union industry is addressed first. The factors considered in the examination mostly overlap with those analyzed in the injury examination, but with the focus on the future because, even if subsidized imports have caused injury in the past, the imposition of CVDs may

⁹ M.C.E.J. BRONCKERS, *Private Remedies Against Foreign Subsidization: A European View*, in *SUBSIDIES AND INTERNATIONAL TRADE: A EUROPEAN LAWYERS’ PERSPECTIVE* 187, 192 (Jacques H.J. Bourgeois ed., 1991).

¹⁰ Regulation, *supra* note 3, art. 31.1.

¹¹ *Id.*

not necessarily render the domestic industry viable.¹² The interests the Commission may consider as worthy of protection include prevention of further unemployment;¹³ prevention of industry decline;¹⁴ safeguarding of sufficient earnings;¹⁵ and protection of an upstream industry.¹⁶

End-users may also be negatively affected by the imposition of CVDs if the measures may lead to a shortage of supply, increase in prices, or other harm. Here, the Commission will attempt to predict the effect of CVDs on the user's cost of production by considering, *inter alia*, the existence of alternative sources such as non-subsidized imports and domestic production. The Commission has often found that the negative effects of CVDs can be mitigated by the existence of alternative sources.¹⁷

Likewise, the Commission has traditionally given more weight to the interest of the complainant industry than to the interest of importers/distributors/traders. The Commission made it clear, when it stated:

on balance, the Community's interests lie more in maintaining employment in the manufacturing sector of the Community industry than in protecting a dealer and distributor business which depends to a great extent on imports.¹⁸

¹² EDMOND MCGOVERN, EUROPEAN COMMUNITY ANTI-DUMPING AND TRADE DEFENCE LAW AND PRACTICE 44:1 (2008).

¹³ Council Regulation No. 1799/2002 of 8 October 2002, OJ 2002 (L 274), at recital 114.

¹⁴ Commission Regulation No. 618/2000 of 22 March 2002, OJ 2000 (L 075/18), at recital 195.

¹⁵ *Id.*, at recital 194.

¹⁶ Commission Regulation No. 1556/1998 of 17 July 1998, OJ 1998 (L 202/40).

¹⁷ *See, e.g.*, Commission Regulation No. 1092/2000 of 24 May 2000, OJ 2000 (L 124/26), at recital 12 (“[T]he imposition of provisional countervailing measures, does not foreclose the Community to imports . . . [but] . . . will merely establish fair trading conditions. As to the availability of SBS [Styrene-butadiene-styrene thermoplastic rubber], there are a number of producers operating in the Community; these producers have unused production capacity, and there are other sources of imports which, under fair trading conditions, will find the Community market more appealing again.”).

¹⁸ Commission Regulation No. 1413/88 of 25 May 1988, OJ (L 130), at recital 12.

The imposition of CVDs generally does not benefit the consumer since the prices will increase and the choice of products available to the consumer may also be reduced. In *Laser Optical Reading System*, the Commission concluded that imposition of protective measures would “severely limit consumer choice” and that “this loss of choice as regard the current variety of models available could not be compensated in the foreseeable future by the Community industry.”¹⁹ In such circumstances the Commission considered that “the interests of consumers [were] by far outweighing the interest of the Community industry” and the proceeding was terminated without the imposition of a CVD.²⁰

Finally, when assessing the Union interest requirement, the impact of CVDs on competition within the EU is also a factor. For example, in *Typewriter Ribbon Fabrics*, where there was only one Union producer and one Chinese producer/exporter of the product in question, the Commission concluded that it was not in the Union’s interest that there would be only one supplier of this product and that, therefore, any protective measures should not lead to the withdrawal of Chinese imports from the Union market or eliminate competition between these imports and Union production. Consequently, a price undertaking was considered to be a more appropriate remedy than a CVD.²¹

By contrast, there is no equivalent to the concept of the Union interest in the U.S. CVD legislation. If the subsidization causing injury to a U.S. industry has been established, the U.S. Department of Commerce “*shall* issue a countervailing duty order.”²² In other words, the investigating authority is under an obligation to impose CVDs when a countervailable subsidy

¹⁹ Commission Decision 1999/55/EC, OJ (L 18) 62, at recital 18.

²⁰ *Id.*

²¹ Commission Regulation No. 1937/90 of 4 July 1990, OJ (L 174), at recital 19.

²² 19 U.S.C. § 1671d (emphasis added).

and material injury to domestic industry are found to exist. As a result, U.S. CVD legislation aims exclusively at protecting the interest of the U.S. industry affected by subsidized import. It does not seek to provide for a balance between other economic interests involved or to enhance general welfare.

2. Remedies

Under both U.S.²³ and EU²⁴ law, definitive CVDs may not exceed the total amount of countervailable subsidies established. Yet, at the same time, whereas in the United States, CVDs are based on the amount of the countervailable subsidy (i.e. subsidy margin),²⁵ EU law has established the “*lesser duty rule*,” which requires the CVDs imposed by the EU to be lower than the subsidy margin if such lower duty rate is sufficient to remove the injury suffered by the Union industry.²⁶

Pursuant to the lesser duty rule, the Commission imposes CVDs at the level of the lower margin between the subsidy margin and injury margin.²⁷ The injury margin is calculated by comparing the export prices of the subsidized products with the production costs of the Union production of the like product plus a reasonable profit margin.²⁸

²³ 19 U.S.C. § 1671(a).

²⁴ Regulation, *supra* note 3, art. 15.1.

²⁵ 19 U.S.C. § 1671(a).

²⁶ Regulation, *supra* note 3, art. 15.1.

²⁷ VASSILIKI AKRITIDIS & SVEN BALLSCHMIEDE, *Comparative Overview of EU and US Subsidies Regulation*, in WTO – TRADE REMEDIES 856, 904 (R. Wolfrum, P. Stoll & M. Koebele eds., 2008).

²⁸ VAN BAEL & BELLIS, *ANTI-DUMPING AND OTHER TRADE PROTECTION LAWS OF THE EC* 562 (Kluwer Law International 2004).

The lesser duty rule results in a lower level of duties overall,²⁹ which leads to reducing trade distortions. Unlike the United States, which uses CVDs exclusively to protect domestic industry interests, the EU provides for a more delicate balance “between the interest of the domestic industry to be safeguarded from unfair practices, the interests of the Community’s trading partners in applying the lesser duty rule thus ensuring that duties are imposed only to the extent necessary to remove any injury suffered, and the interests of other economic operators that might be negatively affected by measures.”³⁰ This makes the EU CVD law more balanced, nuanced and based on corrective philosophy, whereas the U.S. approach to imposing CVDs is more retaliatory than corrective.

B. DIFFERENT APPROACHES TO INTERNAL SUBSIDIES

EU State aid law prohibits EU Member States from granting State aid in a manner that distorts competition in the European internal market. As a result, the law requires EU Member States to obtain authorization from an EU institution – the Commission – prior to the implementation of a state aid.³¹ U.S. law, on the other hand, does not contain similar rules on granting or controlling subsidies given by the States. Nevertheless, certain constraints are imposed on State government actions under the dormant Commerce Clause (DCC).

²⁹ For example, as Fitch rating agency estimated: “Duties imposed by the Commission on Chinese cold-rolled flat steel products . . . were 13.4%-16%. But if the lesser duty rule had not been in force the duties imposed would have been 52.7%-59.1%” (Jorge Valero, *Rating Agency Says Ignoring ‘Lesser Duty Rule’ Could Protect European Steel Against China*, <http://www.euractiv.com/section/trade-society/news/rating-agency-says-ignoring-lesser-duty-rule-could-protect-european-steel-against-china/>).

³⁰ Thinam Jakob, *Lesser Duty Rule and Community Interest in Anti-dumping Proceedings: The Community System in Perspective*, INTERECONOMICS, July/August 191, 195 (2001).

³¹ Consolidated Version of the Treaty on the Functioning of the European Union, 26 October 2012, Official Journal of the European Union (C 326/47), art. 108 [hereinafter TFEU]; see *supra* Chapter V for a more detailed analysis of EU rules on subsidies.

The Commerce Clause, which is found in Article I, Section 8 of the U.S. Constitution, expressly grants to Congress the power to regulate commerce “among the several states.”³² The negative implication of this power for the federal government is known as the Dormant Commerce Clause (DCC). The DCC impliedly restricts state regulation of interstate commerce.³³

In *New Energy Co. of Indiana v. Limbach*, the Supreme Court stated:

It has been long accepted that the Commerce Clause not only grants Congress the authority to regulate commerce among the States, but also directly limits the power of the States to discriminate against interstate commerce. . . . This “negative” aspect of the Commerce Clause prohibits economic protectionism – that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competition. . . . Thus, State statutes that clearly discriminate against interstate commerce are routinely struck down, [. . .] unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism.³⁴

Although the DCC doctrine has been a feature of U.S. constitutional law for nearly two centuries,³⁵ it has undergone significant doctrinal evolution over the years.³⁶ Under the current approach, which was developed in 1970s, the Court applies a two tiered standard of review: (1) a State measure that discriminates against interstate commerce is prohibited unless the government can demonstrate both that a measure serves a legitimate (i.e., non-protectionist) purpose and that

³² U.S. CONST. art I, § 8, cl. 3.

³³ *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 35 (1980) (“although the Clause . . . speaks in terms of powers bestowed upon Congress, the Court long has recognized that it also limits the power of the States to erect barriers against interstate trade”); *West Lynn Creamery, Inc. v. Haely*, 512 U.S. 186, 192 (1994); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 522 (1935); *see also* LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 1024 (3d ed. 2000) (“All of the [dormant Commerce Clause] doctrine . . . is thus traceable to the Constitution’s negative implications; it is by interpreting ‘these great silences of the Constitution’ that the Supreme Court has limited the scope of what the state might do.” (quoting *H.P. Hood & Sons, Inc. v DuMond*, 336 U.S. 525, 535 (1949))).

³⁴ *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 273-74 (1988).

³⁵ *Gibbons v. Ogden*, 22 U.S. 1, 188-89 (1824) (interpreting the scope of the Commerce Clause and the extent of its restraints on states for the first time).

³⁶ For a historical review of the dormant Commercial Clause doctrine, *see, e.g.*, SUSAN LOW BLOCH & VICKI C. JACKSON, *FEDERALISM: A REFERENCE GUIDE TO THE UNITED STATES CONSTITUTION* 92-94, 129-34 (2013); Brannon P. Denning, *Reconstructing the Dormant Commerce Clause Doctrine*, 50 WM. & MARY L. REV. 417, 427-49 (2008).

“this purpose could not be served as well by available nondiscriminatory means;”³⁷ and (2) even a nondiscriminatory measure that nevertheless *burdens interstate commerce* may be barred if the interstate burden imposed by a measure outweighs the local benefit (the *Pike* balancing test).³⁸ Although the balancing test is still invoked, more cases currently turn on discrimination than on undue burdens.³⁹

The underlying rationale for the Commerce Clause, including its dormant aspects, is to create and foster the development of a common market among the states by imposing some self-executing limitations on the scope of permissible state regulation.⁴⁰ As Justice Cardozo explained:

What is ultimate is the principle that one state in its dealings with another may not place itself in a position of economic isolation . . . Neither the power to tax nor the police power may be used by the state of destination with the aim and effect of establishing an economic barrier against competition with the products of another state or the labor of its residents. Restrictions so contrived are an unreasonable clog upon the mobility of commerce. They set up what is equivalent to a rampart of customs duties designed to neutralize advantages belonging to the place of origin. They are thus hostile in conception as well as burdensome in result.⁴¹

Invoking the DCC doctrine, the Court has (1) condemned state customs duties;⁴² (2) held unconstitutional state regulations affecting interstate commerce (for example, price controls that

³⁷ *Maine v. Taylor*, 477 U.S. 131, 138 (1986); *see also Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978) (“where simple economic protectionism is effected by a state legislation, a virtually per se rule of invalidity has been erected”).

³⁸ *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970) (stating that a state measure having only “incidental” effect on interstate commerce “will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits”).

³⁹ BLOCH & JACKSON, *supra* note 36, at 218-19 (noting that “it is difficult to identify any Supreme Court cases in this period in which application of the *Pike* balancing test resulted in a statutory invalidation unless there were also ‘discriminatory’ aspects to the challenged law”).

⁴⁰ JOHN E. NOWAK & RONALD D. ROTUNDA, *CONSTITUTIONAL LAW* 281-82 (8th ed. 2010); *see also McLeod v. I.E. Dilworth Co.*, 322 U.S. 327, 330 (1944) (stating that the purpose of the Commerce Clause as well as DCC is to create an area of *free trade among the several states*) (emphasis added).

⁴¹ *Baldwin*, 294 U.S. at 527.

⁴² *Hood & Sons*, 336 U.S. at 539.

strip away advantages of out-of-state producers;⁴³ and facially neutral legislation that diverts market share to in-state sellers⁴⁴); and (3) invalidated discriminatory state tax laws, including credits or exemptions that favor local businesses.⁴⁵

The DCC covers a very broad scope of measures (regulations, taxation). In addition, in accord with the main objective of the clause – free trade among the states – the focus of DCC analysis is on discrimination and the burden on interstate commerce: whether the state measure has the purpose or effect of disadvantaging out-of-state goods in favor of goods produced within a state.

Given these characteristics of the U.S. DCC, the closest analogues to this doctrine are the “free movement” principle in EU law⁴⁶ and the “national treatment” principle in WTO law.⁴⁷ Just like the Commerce Clause is aimed at creating a common market among the states within the United States, the free movement is the fundamental principle of the internal market of the EU.⁴⁸ The means to achieve this goal are basically the same: (1) prohibition of customs duties between EU Member States;⁴⁹ (2) prohibition of measures having an effect equivalent to

⁴³ *Baldwin*, 294 U.S. at 521.

⁴⁴ *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333, 350 (1977).

⁴⁵ *Fulton Corp. v. Faulkner*, 116 S. Ct. 848, 860 (1996); *Associated Indus. of Mo. v. Lohman*, 511 U.S. 641, 647-54 (1994); *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 328-29 (1977).

⁴⁶ TFEU, *supra* note 31, arts. 26, 28-36, 110.

⁴⁷ General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 17 (1999), 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994) [hereinafter GATT], art. III (prohibiting discrimination between imported and domestically produced goods with respect to internal taxation and other government regulation); *see also* Daniel A. Farber & Robert E. Hudec, *Free Trade and the Regulatory State: A GATT's-Eye View of the Dormant Commerce Clause*, 47 VAND. L. REV. 1401 (1994) (comparing the DCC rule and national treatment principle under GATT).

⁴⁸ TFEU, *supra* note 31, art. 26(2) (“the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured”).

⁴⁹ *Id.*, arts. 28(1), 30.

quantitative restrictions,⁵⁰ i.e. any trading rules enacted by Member States which are capable of hindering intra-community trade;⁵¹ and (3) prohibition of discriminatory taxation.⁵²

At the same time, even though the EU State aid rules are not an exact equivalent to the U.S. DCC, enough commonality exists to justify comparison of both sets of rules. First, certain forms of government intervention that are considered State aid under EU law may be subject to the DCC rule.⁵³ Second, both sets of rules impose certain limitations (although different in nature) on the right of States to grant subsidies within their territory and, therefore, on the sovereignty of the States.⁵⁴ Finally, both sets of rules were introduced with the purpose of integration through creation and maintenance of an internal market.

EU State aid policy was primarily designed to contribute to the creation of a common market, which is widely viewed as the core component of the wider project of European unification.⁵⁵ In fact, it was not until the initiation of the single market project,⁵⁶ that the

⁵⁰ *Id.*, arts. 34, 35.

⁵¹ Case 8/74, *Procureur du Roi v. Dassonville*, [1974] ECR 837:125, para. 5 (“All trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade are to be considered as measures having an effect equivalent to quantitative restrictions.”).

⁵² TFEU, *supra* note 31, art. 110 (“No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products.”).

⁵³ See *infra* subsection 2 for a more detailed discussion on that topic.

⁵⁴ Whereas under the U.S. law certain State aid measures that discriminate against intra-state commerce are unconstitutional, the EU law requires the Member States to obtain authorization from a EU institution – the Commission – prior the implementation of State aid.

⁵⁵ See, e.g., MICHELLE CINI, *EU State Aid Policy – The Origins and Early Years*, in WHAT SHAPES THE LAW? REFLECTIONS ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES 17, 17 (Luca Rubini & Jennifer Hawkins eds., 2016); RAJ CHARI, HERWIG C.H. HOFMANN & CLAIRE MICHEAU, *State Aid Review in a Multi-Level System: Motivations for Aid, Why Control It, and the Evolution of State Aid Law in the EU*, in STATE AID LAW OF THE EUROPEAN UNION 3, 9 (Herwig C.H. Hofmann & Claire Micheau eds., 2016).

⁵⁶ Single European Act, 1987 OJ L 169/1, art. 8a [hereinafter SEA] (amending Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11) (requiring the progressive establishment of an internal, barrier-free market by 31 December 1992).

Commission started to prioritize State aid policy.⁵⁷ With the removal of intra-EC quotas and tariffs at the end of the 1960s, and with the removal of remaining non-tariff barriers as a result of the completion of the Single Market by 1992, subsidies and other forms of State aid were some of the few remaining tools used to unfairly advantage domestic industry. It was reasonable, therefore, for EU actors to focus attention on this type of non-tariff barrier. From the single market perspective, “a broad definition of State aid was necessary in order to cover all possible alternative barriers to trade created by States through financial regulatory and fiscal measures.”⁵⁸

Similarly, in the United States, the DCC has safeguarded the common market for more than a century. As Professor Richard Epstein has written, “free competition and the free movement of goods and services across state lines are the driving forces behind the Supreme Court’s take on the dormant Commerce Clause.”⁵⁹ Indeed, the DCC jurisprudence has played an important role in protecting against state legislation that would interfere with a common market in the United States, emphasizing the economic goal of the jurisprudence. In *Hood & Sons*, Justice Jackson, writing for the majority, expressly recognized the benefits of this free trade approach:

Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his export, and no foreign state will by customs duties or regulations exclude them. . . Such was the vision of the Founders; such had been the doctrine of this Court which has given it reality.⁶⁰

⁵⁷ For a more detailed discussion on the evolution of the EU State aid policy see Chapter V, Section B, subsection 1.

⁵⁸ Chari, Hofmann & Micheau, *supra* note 55, at 9.

⁵⁹ RICHARD A. EPSTEIN, *THE CLASSICAL LIBERAL CONSTITUTION: THE UNCERTAIN QUEST FOR LIMITED GOVERNMENT* 229 (2014); *see also* Richard A. Posner, *The Constitution as an Economic Document*, 56 *GEO. WASH. L. REV.* 4, 17 (1987) (“When so interpreted, the commerce clause becomes a charter of free trade.”); Jack L. Goldsmith & Alan O. Sykes, *The Internet and the Dormant Commerce Clause*, 110 *YALE L.J.* 785, 795 (2001) (“The primary justification is that the dormant Commerce Clause ensures free trade among the states and thereby secures the associated economic benefits.”).

⁶⁰ *H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 539 (1949).

Despite these similarities, however, the EU and U.S. systems also differ in significant ways.

1. EU State Aid Rules as Competition Law versus the Dormant Commerce Clause as Constitutional Law

The fundamental differences between the two legal systems stem from the fact that EU State aid rules and U.S. DCC represent two different bodies of law. In the EU, State aid rules – together with antitrust law – are a part of competition law.⁶¹ From the EU perspective, therefore, the main goal of competition law is the protection of economic freedom by ensuring that the competitive process and market structure are not distorted by *either* government interventions or private party behavior. The competition-policy reason for establishing State aid control is deeply embedded in EU law. Article 107(1) of the TFEU explicitly prohibits government intervention by means of aid which “distorts or threatens to distort competition” in the relevant market.⁶² The “competition model” basically seeks to avoid that positive effects of a state measure enjoyed in one jurisdiction do not produce negative effects in the form of distortions of competition in other jurisdictions.⁶³

The competition policy approach, just like the approach in antitrust cases, requires a reliance on an economic analysis, which is applied in two stages. First, economic analysis is used to ascertain whether a measure constitutes a State aid caught by the provisions of the TFEU.

⁶¹ TFEU, *supra* note 31, Title VII, Chapter I “Rules on Competition,” arts. 101-09 (containing rules regarding (1) *cartels*, controlling the collusion and other anti-competitive practices; (2) *market dominance*, preventing the abuse of firms’ market dominant positions; (3) *mergers*, controlling mergers, acquisitions and joint ventures involving companies that have a certain amount of turnover in the EU; and (4) *State aid control*).

⁶² *Id.*, art. 107(1).

⁶³ Chari, Hofmann & Micheau, *supra* note 55, at 6; *see also* Philip Lower, *The Design of Competition Policy Institutions for the Twenty-First Century*, in *COMPETITION POLICY IN THE EU: FIFTY YEARS FROM THE TREATY OF ROME* 21, 21-41 (Xavier Vires ed., 2009).

Article 107(1) defines State aid as a government measure which, *inter alia*, confers an advantage on the recipient.⁶⁴ To determine whether an advantage has been conferred, the “private investor test” is applied.⁶⁵ This is an objective test used to determine whether a rational private investor would have entered into the transaction in question on the same terms, having regard to the foreseeability of obtaining a return and leaving aside all social and policy considerations.⁶⁶ Second, when assessing the compatibility of State aid within the common market,⁶⁷ a “balancing test” is applied. State aid may be declared compatible with the common market and, therefore, permissible, when the positive impact of the aid (in terms of economic efficiency or equity) outweighs its potential negative effects (distortion of trade and competition).⁶⁸

In the United States, on the other hand, the DCC doctrine is a part of constitutional law. Although the U.S. Constitution expressly grants Congress the power to regulate commerce “among the several states”⁶⁹ (Commerce Clause), it is silent regarding what power, if any, is left to the states to regulate interstate commerce. It has been judicially established that the Commerce Clause is not only a “positive” grant of power to Congress, but it is also a “negative” constraint upon the States; that is, the doctrine of the “dormant” commerce clause. What is dormant is the *congressional exercise of the power*, not the clause itself, under which the Court may police state

⁶⁴ TFEU, *supra* note 31, art. 107(1).

⁶⁵ See, e.g., PARIS ANESTIS & STEPHEN MAVROGHENIS, *The Market Investor Test*, in THE EC STATE AID REGIME: DISTORTIVE EFFECTS OF STATE AID ON COMPETITION AND TRADE 109, 112 (Michael Sánchez Rydelski ed., 2006).

⁶⁶ See *supra* Chapter V, Section B for a more detailed discussion on this topic.

⁶⁷ Article 107(1) of the TFEU does not contain a direct prohibition against aid but only a declaration of incompatibility with the common market. State aid can be declared “compatible” under Article 107(3) when it is deemed (by the Commission) to be in the common interest.

⁶⁸ State aid Action Plan – Less and better targeted State Aid: a roadmap for State Aid reform 2005-2009, COM (2005) 107 final [hereinafter SAAP]; see *infra* Chapter V, Section B, Subsection 3(b) for a more detailed review of the balancing test.

⁶⁹ U.S. CONST. art I, § 8, cl. 3.

taxation and regulation of interstate commerce.⁷⁰ Defining the degree of exclusive federal power, however, has proven extremely difficult. A complex federal system gives rise to numerous constitutional problems inherent in the division of authority between federal and state governments.

The central question posed in DCC cases is whether, in the absence of congressional action, state laws that interfere with the free flow of commerce nonetheless stand. The 1824 case of *Gibbons v Ogden*⁷¹ was the first Supreme Court decision to discuss the Commerce Clause. Chief Justice John Marshall advanced the idea that the Constitution vested the power over interstate commerce *exclusively* in Congress, thereby divesting the states of authority over *any* interstate commercial activities, even in the absence of conflicting congressional legislation regulating those activities.⁷²

In 1851, in *Cooley v. Board of Wardens*,⁷³ Justice Curtis, writing for the majority, developed the concept of “*selective exclusiveness*,” rejecting the argument that Congress had been granted exclusive power to regulate commerce.⁷⁴ He maintained that if the Constitution stripped the states of all power to regulate commerce, then Congress could not delegate such a power to the states.⁷⁵ Under the *Cooley* rule, the power to regulate commerce must be viewed in terms of the *subject* being regulated. While some subjects of commerce that “imperatively

⁷⁰ *The Commerce Clause as a Restraint of State Power*, in CRS ANNOTATED CONSTITUTION, Cornell University Law School, https://www.law.cornell.edu/anncon/html/art1frag49_user.html.

⁷¹ *Gibbons*, 22 U.S. (1824).

⁷² *Id.* at 197-210 (“In imposing taxes for State purposes, [the States] are not doing what Congress is empowered to do. Congress is not empowered to tax for those purposes which are within the exclusive province of the States. When, then, each government exercises the power of taxation, neither is exercising the power of the other. But, when a State proceeds to regulate commerce . . . among the several States, it is exercising the very power that is granted to Congress, and is doing the very thing which Congress is authorized to do.”).

⁷³ *Cooley v. Board of Wardens*, 53 U.S. (12 How) 299, 317-18 (1852).

⁷⁴ *Id.*

⁷⁵ *Id.* at 318.

demand a single uniform rule” operating throughout the country are within the exclusive control of Congress, others require diverse regulation that only the states can provide and, thus, may be regulated by the States.⁷⁶ Nevertheless, *Cooley* provided little guidance for distinguishing between national and local subjects of commerce.⁷⁷ In particular, it left unanswered the question whether the Court would find any interstate commerce other than that which Congress had designated as such to be local.⁷⁸

In *Welton v. Missouri*,⁷⁹ the Court further developed the justification for the DCC doctrine. Justice Field explained that “[t]he fact that Congress has not seen fit to prescribe any specific rules to govern inter-State commerce does not reflect the question. Its inaction on this matter . . . is equivalent to a declaration that inter-State commerce shall be free and untrammelled.”⁸⁰ Likewise, in *Southern Pacific Co. v. Arizona ex rel. Sullivan*,⁸¹ the Court stated: “For a hundred years it has been accepted constitutional doctrine that . . . where Congress has not acted, this Court, and not the state legislature, is under the commerce clause the final arbiter of the competing demands of state and national interest.”⁸² In other words, when Congress has not

⁷⁶ *Id.* at 319 ([W]hen the nature of a power like this is spoken of, when it is said that the nature of the power requires that it should be exercised exclusively by Congress, it must be intended to refer to the subjects of that power, and to say they are of such a nature as to require exclusive legislation by Congress. Now the power to regulate commerce, embraces a vast field, containing not only many, but exceedingly various subjects, quite unlike in their nature; some imperatively demanding a single uniform rule, operating equally on the commerce of the United States in every port; and some, like the subject now in question, as imperatively demanding that diversity, which alone can meet the local necessities of navigation.).

⁷⁷ DAVID P. CURRIE, *THE CONSTITUTION IN THE SUPREME COURT: THE FIRST HUNDRED YEARS, 1789-1888*, at 233 (1985); *see also* R. KENT NEWMYER, *THE SUPREME COURT UNDER MARSHALL AND TANEY* 107 (1968) (noting that “Curtis have no clues beyond the case as to which aspects of commerce required uniformity, which diversity. Nor did he supply any specific criteria for determining these essential categories.”).

⁷⁸ CARL B. SWISHER, *THE OLIVER WENDELL HOLMES DEVISE HISTORY OF THE SUPREME COURT OF THE UNITED STATES: THE TANEY PERIOD, 1836-64*, at 53 (1974).

⁷⁹ *Welton v. Missouri*, 91 U.S. 257 (1875).

⁸⁰ *Id.* at 282.

⁸¹ *Southern Pacific Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761 (1945).

⁸² *Id.* at 769.

regulated the objects of commerce in question, the *Court itself* determines whether the nature of the commerce requires exclusive federal regulation.

A significant criticism of DCC jurisprudence is based in the argument that the doctrine has no foundation in text or history. From the bench, Justice Scalia has called the doctrine “a judicial fraud.”⁸³ In his view, “[t]he historical record provides no ground for reading the Commerce Clause to be other than what it says – an authorization for Congress to regulate commerce.”⁸⁴ Justice Thomas, too, has argued that “there is no basis in the Constitution” to interpret “the Commerce Clause as a tool for courts to strike down state laws that it believes inhibit interstate commerce.”⁸⁵ Likewise, many scholars have challenged the constitutional basis for the DCC doctrine.⁸⁶

From a comparative perspective, EU State aid rules and the DCC pursue different objectives. The principal objectives of EU State aid rules, as a part of competition law, are to maintain and encourage the process of competition in order to promote efficient use of resources while protecting the freedom of economic activity of various market participants. The effect-

⁸³ *Comptroller of Treasury of Maryland v. Wynne*, 135 S. Ct. 1787, 1808 (2015) (Scalia, J., dissenting).

⁸⁴ *Tyler Pipe Indus., Inc. v. Washington Dep’t of Revenue*, 483 U.S. 232, 263 (1987) (Scalia, J., concurring in part and dissenting in part).

⁸⁵ *United Haulers Ass’n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 349 (2007) (Thomas, J., concurring).

⁸⁶ See, e.g., CURRIE, *supra* note 77, at 230-34 (describing the early DCC cases as “arbitrary, conclusory, and irreconcilable with constitutional text”); Martin H. Redish & Shane V. Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 4 DUKE L.J. 569-617 (1987) (arguing that the DCC “lacks a foundation or justification in either the Constitution’s text or history, and . . . cannot be satisfactory rationalized outside the text of Constitution” and arguing that the DCC “alters the delicate balance of federalism clearly manifested in the constitutional text”); Julian N. Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425, 430 (1982) (“The commerce clause does not expressly prohibit the states from enacting protectionist economic legislation. It merely gives Congress the power to rectify such excess by superseding enactments.”); Richard D. Friedman, *Putting the Dormancy Doctrine Out of Its Misery*, 12 CARDOZO L. REV. 1745, 1745 (1991) (“[T]he dormancy doctrine ought to be abandoned . . .”); Amy M. Petragani, *The Dormant Commerce Clause: On Its Last Leg*, 57 ALB. L. REV. 1215, 1216 (1994) (“Not only is the doctrine absolutely without support in the text of the Constitution or the intent of the Framers, but the doctrine also violates two principles upon which the constitutional democracy of our nation was built – separation of powers and the balance of federalism.”).

based approach results in the use of economic analysis to identify State aid, and then to distinguish potentially harmful from less detrimental forms of aid.

By contrast, the main objective of the DCC, as a part of U.S. constitutional law, is to preserve a true balance of power between federal and state governments established by the Constitution (and to determine the locus of power over commerce within the three branches of the federal government). Even though the DCC is driven in part by concern about economic protectionism, eventually the Court invalidates economically protectionist state laws on the ground that such laws invade Congress's authority to regulate interstate commerce. As Professor Tribe has written:

the validity of state action affecting interstate commerce must be judged in light of the desirability, *in terms of the Constitution's structure and goals*, of permitting diverse responses to local needs and undesirability, again *evaluated by a constitutional metric*, of permitting local interference with such uniformity as the unimpeded flow of interstate commerce may require.⁸⁷

Therefore, from the DCC perspective, the court has to determine the constitutionality of state commercial regulation in a case where the federal government has been silent in the area. In other words, the question is whether certain types of state regulation offend the Congressional commerce power even in the absence of a conflicting act of Congress.

From the EU State aid rule perspective, on the other hand, the only question is whether a State measure – that confers an advantage to the recipient, distorts competition, and affects trade between Member States – may still be declared compatible with the common market and,

⁸⁷ TRIBE, *supra* note 33, at 1048-57 (emphasis added) (Also stating that “[b]ehind the Court’s [jurisprudence] stands an important doctrinal theme: the negative implications of the Commerce Clause derive principally from a *political* theory of union, not from *economic* theory of free trade. The function of the clause is to ensure national solidarity, not necessarily economic efficiency.”) (emphasis in original). See also Philip M. Tatarowicz, *The Dormant Commerce Clause and State Tax Discrimination: Parceling State Actions Between Permissible and Impermissible Burdens*, THE STATE AND LOCAL TAX LAWYER, Symposium Edition 135, 148 (2007) (Arguing that “[t]he Commerce Clause, as an instrument of federalism, facilitates a system of government that places a national government over fifty sovereign states. Federalism requires a balancing of the interest in a unified national approach to government with the competing interest in state sovereignty.”).

therefore, permissible because its benefits (in terms of economic efficiency or equity) outweigh the distortions of competition that the measure is likely to cause. Consequently, whereas in the United States, the main focus is on the *form* of a state measure, in the EU the only focus is on the actual *economic effect* of the same measure.

In addition, whereas EU State aid rules are well established and relatively unambiguously articulated in the EU Treaties⁸⁸ and regulations,⁸⁹ the DCC doctrine is solely a judicial creation. It is not expressly stated in the text of the Constitution. Rather, the DCC is implied from the text of the Constitution and the historical settings in which it was framed. In large part because of that, the doctrine, as mentioned earlier, has been questioned by a number of scholars and even some judges. Accordingly, judges have a tendency to be more cautious in applying it. As Judge Diane Wood has pointed out:

the constitutional approach has led U.S. courts to tread cautiously when they are asked to find that a State has taken actions that distort interstate commerce. The net result (oddly enough) that the States of the United States are in principle more free than the Member States of the EU to engage in behavior that would, at a minimum, raise eyebrows in Brussels, and that would often lead to corrective measures.⁹⁰

Indeed, as the next section will demonstrate, the exact same problem might have a different outcome in the two different systems.

⁸⁸ TFEU, *supra* note 31, arts. 107-09.

⁸⁹ Council Regulation (EC) 659/1999 of 22 March 1999 laying down detailed rules for the application of [ex] Article 93 of the EC Treaty [Article 108 of the TFEU], OJ 1999 L 83 (amended by Council Regulation (EU) No. 734/2013 of 22 July 2013 amending Regulation (EC) No. 659/1999, OJ L 204); Commission Regulation (EC) 794/2004 of 21 April 2004 implementing Council Regulation (EC) laying down detailed rules for the application of [ex] Article 93 of the EC Treaty [Article 108 of the TFEU], OJ 2004 L 140.

⁹⁰ Wood, *supra* note 1, at 3.

2. Prohibited and Permitted Measures under the DCC and EU State Aid Law

In the United States, the scope of the DCC has never been precisely defined. Whether a State measure is subject to the DCC rule is determined by the Court on a case-by-case basis. By contrast, Article 107(1) of the TFEU expressly lays down the conditions that a measure must satisfy in order to be classified as State aid: (1) it must be granted by the State Member and through state resources; (2) it must confer an advantage to the recipient; (3) it must favor certain undertakings and thus be selective; and (4) it must distort competition and affect trade between Member States.⁹¹ As a result, not every measure that falls under the scope of Article 107(1) of the TFEU and thus prohibited in the EU would also be a subject to the DCC rule and prohibited in the United States.

a. Regulatory Measures In the United States, state laws regulating trade violate the DCC when they establish “differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.”⁹² For example, in *Philadelphia v. New Jersey*,⁹³ the Court found unconstitutional a New Jersey statute that prohibited “the importation of most solid or liquid waste which originated or was collected outside the territorial limits of the State”⁹⁴ on the basis that it violates the principle of nondiscrimination. Likewise, in *Hunt v. Washington State Apple Advertising Commission*, North Carolina enacted a statute requiring that all closed

⁹¹ TFEU, *supra* note 31, art. 107(1). *See supra* Chapter V, Section B, subsection 2 for a more detailed analysis of the concept of State aid.

⁹² *Granholm v. Heald*, 544 U.S. 460, 472 (2005) (quoting *Oregon Waste Systems, Inc. v. Department of Environmental Quality of Oregon*, 511 U.S. 93, 99 (1994)) (“This rule is essential to the foundations of the Union.”).

⁹³ *Philadelphia v. New Jersey*, 437 U.S. 617, 618 (1978).

⁹⁴ *Id.* (quoting the state law).

containers of apples sold or shipped into the state bear “no grade other than the applicable U.S. grade or standards.”⁹⁵ The law was challenged by the State of Washington, which tested and graded its apples under a system superior to that of the U.S. Department of Agriculture. The Court found the North Carolina law to be an unconstitutional burden on interstate sales (because Washington apple growers would have to undergo substantial costs to comply with the regulation by removing their own grading system) and an unconstitutional discrimination against Washington apple growers (because the regulation deprived them of the competitive advantage of their superior grading system).⁹⁶

In the EU, on the other hand, the ECJ determined that “only advantages granted directly or indirectly *through State resources* are to be considered as aid” within the meaning of Article 107(1) of the TFEU.⁹⁷ In other words, State aid must entail some form of financial burden on public funds. In its landmark decision, *PreussenElektra*,⁹⁸ the ECJ concluded that the German law requiring private electricity supply undertakings to purchase electricity produced in their area of supply from renewable energy sources at minimum prices higher than the real economic value of that type of electricity did not constitute State aid because the transfer of resources took place *between private undertakings* and, thus, there was no impact on the public budget.⁹⁹

To sum up, in the United States the regulatory or administrative measures that discriminate against out-of-state goods violate the DCC and, thus, are prohibited. In the EU, on the other hand, the identical measures are not considered to be State aid within the meaning of

⁹⁵ *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333, 334 (1977) (quoting the state law).

⁹⁶ *Id.* at 350-53.

⁹⁷ Case C-379/98, *PreussenElektra AG v. Schleswag*, [2002] ECR I-2099, para. 58 (emphasis added).

⁹⁸ *Id.*, see also an opinion of Advocate General Jacobs arguing that “it seems preferable that legislation regulating the relationship between private actors is as a matter of principle excluded from the scope of the State aid rules” (Opinion in *PreussenElektra*, *id.*, para. 157).

⁹⁹ *Id.*

Article 107(1) and are not prohibited, even if they confer a commercial advantage to certain undertakings.¹⁰⁰

b. Taxation In the United States, the prohibition against state taxes that discriminate against interstate commerce has been a fundamental tenant of the Court’s Dormant Commerce Clause jurisprudence.¹⁰¹ Professors Hellerstein and Coenen summarize the existing case law in the following way: “a tax which by its terms or operation imposes greater burden on out-of-state goods, activities, or enterprises than on competing in-state goods, activities, or enterprises will be struck down as discriminatory under the Commerce Clause.”¹⁰² As a result, tax discrimination is forbidden equally if it is effected through a higher tax rate imposed upon interstate commerce¹⁰³ or through the denial of a tax exemption or tax credits to out-of-state interests.¹⁰⁴ For example, in *Boston Stock Exchange v. State Tax Commission*,¹⁰⁵ the Court struck down a New York stock transfer tax scheme that provided reduced rates for stock transfers when the sale of the stock was made through a New York rather than out-of-state broker. Likewise, in *Bacchus Imports, Ltd. v. Dias*,¹⁰⁶ the Court found unconstitutional an exemption from Hawaii’s excise tax on wholesale liquor sales for certain locally-produced alcoholic beverages.

¹⁰⁰ It should be emphasized though that trading rules enacted by Member States of the EU which are capable of hindering intra-community trade would still violate “free movement of goods” principle under Articles 34 and 35 of the TFEU and therefore prohibited.

¹⁰¹ *Welton*, 91 U.S. at 275.

¹⁰² Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 793 (1996).

¹⁰³ *See, e.g.*, *Associated Industries of Missouri v. Lohman*, 511 U.S. 641 (1994).

¹⁰⁴ *See, e.g.*, *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997).

¹⁰⁵ *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977).

¹⁰⁶ *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984).

Similarly, in the EU, a measure by which the public authorities grant certain undertakings tax treatment which places them in a more favorable financial position than other taxpayers constitute a State aid within the meaning of Article 107(1) of the TFEU.¹⁰⁷ In 1998, the Commission adopted a Notice on the application of the State aid rules to measures relating to direct business taxation, in which it explained that tax measures can provide an “advantage” because “the loss of tax revenue is equivalent to consumption of State resources in the form of fiscal expenditure.”¹⁰⁸

In 2014, the Commission announced a new focus on fiscal State aid which has been triggered by the OECD/G 20’s Base Erosion and Profit Shifting (BEPS) Action Plan.¹⁰⁹ The initiative seeks to protect the tax bases of all countries by creating a model that taxes a multinational’s profits based on where the economic value is created, rather than on the locations of corporate headquarters after allowing for inter-group “transfer pricing” (i.e. contracting between subsidiaries in different jurisdiction at prices that are not arm’s length). As a result, the EU has begun to rely more heavily on State aid prohibitions to address tax practices it perceives as harming the distribution of tax revenues among the Member States.¹¹⁰ By the end of 2014, the

¹⁰⁷ Case C-105/14, *Taricco and Others*, EU:C:2015:555, para. 61; Case C-6/12, *P Oy*, EU:C:2013:525, para. 18; Joined Cases C-106/09 P and C-107/09 P, *Commission and Spain v. Government of Gibraltar and United Kingdom*, paras. 72-73; Case C-387/92, *Banco Exterior de España*, EU:C:1994:100, para. 14.

¹⁰⁸ *Commission Notice on the Application of the State Aid Rules to Measures Relating to Direct Business Taxation* 98/C 384/03 (Oct. 12, 1998).

¹⁰⁹ OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing, http://www.oecd-ilibrary.org/taxation/action-plan-on-base-erosion-and-profit-shifting_9789264202719-en (Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits from low or no-tax locations where there is little or no economic activity).

¹¹⁰ The EU considered two options to attempt to reduce the effects of a lack of unified tax treatment of company profits throughout the EU: tax harmonizing legislation (which requires unanimity by the EU Member States and thus is very difficult to achieve) or State aid control (for which the EU has exclusive competence). In effect, the EC has begun focusing on the latter option while continuing to pursue options for introducing tax harmonizing legislation.

Commission asked all EU Member States to provide information about their tax ruling practice. It then selected certain rulings for a case-by-case review.¹¹¹

The EU inquiry into state tax rulings led to the opening of a formal State aid investigations by the Commission on tax rulings granted by Ireland (to *Apple*), Luxemburg (to *Fiat*, to *Amazon*, and to *McDonald's*), the Netherlands (to *Starbucks*) and by Belgium (*the Excess Profit scheme* that benefited to the 35 multinational companies).¹¹² The four investigations that have been finalized so far each led to a finding of State aid with a recovery decision.¹¹³ In particular, in August 2016 the Commission issued its largest-ever negative State aid decision for an individual measure, requiring Ireland to recover € 13 billion plus accrued interest from *Apple*.¹¹⁴ *Apple* had set up sales operations in Europe in such a way that customers were contractually buying products from Apple Sales International (ASI) located in Ireland rather than from the shops that physically sold the products to customers. *Apple* thus recorded all profits stemming from these sales in Ireland. Under the tax rulings issued by Ireland, most profits were then allocated away from Ireland to the “head office” that was not based in any country and did not have any employees or premises.¹¹⁵ As a result, only a small percentage of ASI’s profits

¹¹¹ Raymond Lujá, *EU State Aid Law and National Tax Rulings*, TAXE Special Committee, European Parliament 12 (2015), [http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/563453/IPOL_IDA\(2015\)563453_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/563453/IPOL_IDA(2015)563453_EN.pdf).

¹¹² Commission Decision of 11 June 2014 in Case SA.38373 (*Apple*), OJ C 369, 17.10.2014; Commission Decision of 11 June 2014 in Case SA.38375 (*Fiat*), OJ C 369, 17.10.2014; Commission Decision of 11 June 2014 in Case SA.38374 (*Starbucks*), OJ C 460, 19.12.2014; Commission Decision of 7 October 2014 in Case SA.38944 (*Amazon*), OJ C 44, 6.2.2015; Commission Decision of 3 February 2015 in Case SA.37667 (*Belgian excess profit rulings*), OJ C 188, 5.6.2015; Commission Decision of 3 December 2015 in Case SA. 38945 (*McDonald's*), OJ C 258, 15.07.2016.

¹¹³ Commission Decision of 21.10.2015 in Case SA.38375 (*Fiat*), OJ L 351, 22.12.2016; Commission Decision of 21.10.2015 in Case SA. 38374 (*Starbucks*), not yet published; Commission Decision of 11.01.2016 in Case SA.37667 (*Belgian excess profit rulings*), OJ L 260, 27.09.2016; Commission Decision of 30.08.2016 in Case SA.38373 (*Apple*), not yet published. All cases are under appeal.

¹¹⁴ *Apple*, *supra* note 112, para. 432.

¹¹⁵ *Id.*, paras. 39-48.

were taxed in Ireland, and the rest was taxed nowhere.¹¹⁶ The Commission concluded that this selective tax treatment of Apple in Ireland constituted illegal State aid because it gave Apple a significant advantage over other businesses that were subject to the same national taxation rules.¹¹⁷ In this decision – much like in the other three decisions mentioned above – the Commission relied primarily on the “arm’s length” principle. According to this principle, a *selective advantage* exists when a tax ruling “endorses a transfer pricing methodology for determining a corporate group entity’s taxable profit that does not result in a reliable approximation of a market-based outcome in line with the arm’s length principle.”¹¹⁸

To sum up, although the DCC does not go so far as to expand the investigation to targeting tax rulings in transfer pricing matters, both the DCC and the EU State aid rules cover discriminatory taxation. The two sets of rules differ, however, in one significant way. State aid rules govern *intra*-state distinctions in taxation between enterprises (within the same Member State) and the DCC rule governs *inter*-state distinctions in taxation between enterprises (distinctions between residents and non-residents or between cross-border income and domestic income). Despite this difference, however, in many cases discriminatory taxation may violate both the DCC and the State aid rules as it can be both benefiting certain businesses as compared to other (domestic) businesses *and* discriminating against foreign businesses. In the EU, in order to be classified as State aid a measure must “affect trade between Member States.”¹¹⁹

¹¹⁶ For example, in 2011 ASI recorded profits of €16 billion but under the terms of the tax ruling only around €50 million were considered taxable in Ireland, leaving €15.95 billion profits untaxed. As a result, the ASI paid less than €10 million of corporate tax in Ireland in 2011 – an effective rate of about 0.05% of its overall annual profits.

¹¹⁷ *Apple*, *supra* note 112, para. 414.

¹¹⁸ *Commission Notice on the Notion of State aid as referred to in Article 107(1) of the TFEU*, 2016/C 262/01 (June 19, 2016), para. 171.

¹¹⁹ TFEU, *supra* note 31, art. 107(1). *See supra* Chapter V, Section B, subsection 2d for a more detailed analysis of this criterion for establishing State aid.

Consequently, only the discriminatory taxation benefiting certain businesses that *affects intra-Union trade* falls within the scope of Article 107(1) of the TFEU.

In both the EU and the United States a prohibition on discriminatory taxation is not absolute. In the United States, the DCC does not apply when Congress authorises state action that would otherwise be invalid under the Commerce Clause since once Congress has legislated on the matter it is no longer dormant.¹²⁰ Congress can consent to State taxes that discriminate against inter-state commerce.¹²¹ Furthermore, the DCC is not violated when the state government can demonstrate both that a measure serves a legitimate (i.e., non-protectionist) purpose and that “this purpose could not be served as well by available nondiscriminatory means.”¹²² Similarly, in the EU, discriminatory taxation might be allowed if it falls under exceptions provided in Article 107(3) of the TFEU (i.e. it may be declared compatible with the common market and, therefore, permissible, when the Commission concludes that the positive impact of the measure outweighs its potential negative effects).¹²³

c. Direct Transfer of Funds In the EU, the notion of State aid includes, first and foremost, direct monetary payments to businesses by a Member State.¹²⁴ By contrast, in the United States

¹²⁰ See, e.g., *Western & Southern Life Ins. v. State Board of California*, 451 U.S. 648 (1981).

¹²¹ *Id.* (There, the Court held that the California law that imposes a “retaliatory” tax only on out-of-state insurance companies does not violate Commerce Clause. The McCarran-Ferguson Act, which leaves the regulation and taxation of insurance companies to the States, removes entirely any Commerce Clause restriction upon California’s power to tax the insurance business.)

¹²² *Maine v. Taylor*, 477 U.S. 131, 138 (1986).

¹²³ See *supra* Chapter V, Section A, subsection 3 for a more detailed discussion on the categories of State aid that might be declared compatible with the common market.

¹²⁴ See, e.g., C-39/94, *Syndicat Français de l’Express International (SFIE) and others v. La Poste*, [1996] ECR I-35-47, para. 58 (“... the notion of ‘aid’ did not only involve direct benefits, such as subsidies, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking.”) (emphasis added); Case 30/59, *De Gezamenlijke Steenkolenmijnen in Limburg v. High Authority*, [1961] ECR 1, para. 50. See also, GUSTAVO E. LUENGO HERNÁNDEZ DE MADRID, *REGULATION OF SUBSIDIES AND STATE AIDS IN WTO AND EC LAW: CONFLICTS IN INTERNATIONAL TRADE LAW* 307 (2007) (“... the notion of ‘aid’ would be

the DCC does not apply to State awards of cash grants to businesses. The Supreme Court has exempted “direct subsidization of domestic industry” from the DCC stating that this kind of subsidization “does not ordinarily run afoul of this prohibition.”¹²⁵ In *Camps Newfound/Owatonna v. Town of Harrison*,¹²⁶ the Court – while invalidating the discriminatory tax exemption – emphasized that the distinction between direct subsidies and discriminatory taxation “is supported by scholarly commentary as well as precedent, and we see no reason to depart from it.”¹²⁷

In *West Lynn Creamery*,¹²⁸ the issue was the constitutionality of a nondiscriminatory tax on milk dealers, the revenues from which were placed into a segregated fund and then distributed exclusively to in-state dairy farmers. The Court found that the tax-and-subsidy package was unconstitutional. Justice Stevens, writing for the majority, explained that the milk subsidy transformed the Massachusetts milk program into a “tax rebate” scheme “most similar to the law at issue in *Bacchus*.”¹²⁹ The Court expressly acknowledged that a subsidy paid to Massachusetts dairy farmers “would be constitutional standing alone”¹³⁰ and emphasized that they are only

broader than ‘subsidy’ since it includes not only direct payments’); CHRISTOPHER BOVIS, ROBERTO CISOTTA, AINDRIAS O. CAOMH, KATERINA PANTAZATOU, WOLF SAUTERN & ERICA SZYSZCZAK, *The Notion of State Aid, in STATE AID LAW OF THE EUROPEAN UNION* 68 (Herwig C.H. Hofmann & Claire Mechenau eds., 2016) (“The granting of an aid may take many forms. This includes inter alia direct grants”).

¹²⁵ *New Energy Co. v. Limbach*, 486 U.S. 269, 278 (1988); *see also West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 (1994) (“A pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business.”).

¹²⁶ *Camps Newfound/Owatonna v. Town of Harrison*, 520 U.S. 564 (1997).

¹²⁷ *Id.* at 606.

¹²⁸ *West Lynn Creamery*, 512 U.S. 186 (1994).

¹²⁹ *Id.* at 197. In a concurring opinion, Justice Scalia agreed with the decision of the Court but on the narrower ground that the milk taxes had gone into and back out of a “segregated fund.” According to him, if the milk subsidy had been paid “from the general revenues,” it would have been constitutional “with or without nondiscriminatory taxation of the industry.” *Id.* at 210 (Scalia, J., concurring).

¹³⁰ *Id.* at 199 (majority opinion).

addressing the problem of “*conjoining* a tax *and* a subsidy”¹³¹ here. The Court, therefore, distinguished a pure subsidy from the tax and subsidy scheme developed by Massachusetts and concluded that even though a nondiscriminatory tax and a subsidy may not individually violate the DCC, a violation may occur when the two are used in conjunction.¹³² As Professor Dan Coenen points out, the Court analysis “permitted, and indeed encouraged, lower courts to distinguish the subsidy that is ‘standing alone’ from an ‘integrated’ program that involves both ‘contributions to’ and ‘distributions from’ a subsidy fund.”¹³³

Although the Court acknowledged that pure subsidies are permitted, *West Lynn Creamery* signaled a potential retreat from the previous Court’s position that States possess basically unlimited powers to grant monetary subsidies for in-state producers.¹³⁴ In footnote 15 of its decision, the Court stated: “We have never squarely confronted the constitutionality of subsidies, and we need not to do so now.”¹³⁵ Many scholars and judges read the footnote as putting back on the table the question whether direct monetary subsidies to businesses violate the DCC.¹³⁶ The

¹³¹ *Id.* (emphasis added).

¹³² *Id.* at 200-01.

¹³³ Dan T. Coenen, *Business Subsidies and the Dormant Commerce Clause*, 107 YALE L.J. 965, 975 (1988) (footnotes omitted).

¹³⁴ See Hellerstein & Coenen, *supra* note 102, at 840-46 (discussing pre-*West Lynn Creamery* subsidy cases in detail).

¹³⁵ *West Lynn Creamery*, 512 U.S. at 199 n.15.

¹³⁶ Coenen, *supra* note 133, at 968; Peter Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 431 n.295 (1996) (Arguing that “[t]he Court left open the question whether a subsidy restricted to in-state businesses is constitutional if funded in a manner that does not burden out-of-state competitors”); Lisa Heinzerling, *The Commercial Constitution*, 1995 SUP. CT. REV. 217, 232 (“[In *West Lynn Creamery*,] the Court pointedly refused to express general approval of subsidies for in-state businesses.”); Christopher P. La Puma, Note, *Massachusetts tax and Subsidy Scheme Violates Commercial Clause: West Lynn Creamery, Inc. v. Healy*, 48 TAX LAW 641, 653 (1999) (concluding that *West Lynn Creamery* “has inadvertently cast doubt on the validity of subsidies themselves”); Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1196 (1986) (stating that “the Court should stand ready to reconsider what it has said about direct subsidies”); see also *Cumberland Farms, Inc. v. Mahany* (*Cumberland Farms II*), 943 F. Supp. 83, 90 (D. Me. 1996) (“In *West Lynn Creamery*, the Supreme Court did not directly address the issue of whether subsidies to in-state businesses are, in themselves, constitutional.”).

Supreme Court, nevertheless, continues to distinguish between pure subsidies, which are *ipso facto* constitutional, and discriminatory taxation, which is not.¹³⁷

Therefore, whereas under the EU law direct government grants – the most obvious form of subsidization – are considered a State aid which is, as a general rule, incompatible with the common market, U.S. law places no constraints on state subsidies unless they can be characterized as a tax that discriminates against interstate commerce. These diametrically different approaches reflect differences of goals of the EU State aid rules as a part of competition law and of the U.S. DCC doctrine as a part of *constitutional law*.

As the U.S. Supreme Court explained:

The Commerce Clause does not prohibit all state actions designed to give its residents an advantage in the market place, but only action of that description in connection with the State's regulation of interstate commerce. Direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufactures does.¹³⁸

In other words, subsidies are constitutional not because their effect is different from discriminatory taxation but because the DCC does not apply. This exemption – known as the “market participant” exception – relies on the distinction between States as regulators of the market and States as participants in the market. If the State is a market regulator it is subject to the restraints of the DCC. However, if the State is a market participant, it is treated as a private party rather than a governmental entity and the DCC does not apply.¹³⁹

¹³⁷ See *Camps Newfound/Owatonna*, 520 U.S. at 1605 (“a direct subsidy benefitting only those [businesses] serving [local] residents would be permissible”).

¹³⁸ *New Energy*, 486 U.S. at 278.

¹³⁹ *Reeves, Inc. v. Stake*, 447 U.S. 429, 438 (1980) (“The Commerce Clause responds principally to state taxes and regulatory measures impeding free private trade in the national market-place, and there is no indication of a constitutional plan to limit the ability of the States themselves to operate freely in the free market.”); *White v. Mass. Council of Constr. Employers*, 460 U.S. 204, 208 (1983) (holding that “when a state or local government enters the market as a participant it is not subject to the restraints of the Commerce Clause”); *S.-C. Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 93 (1984) (noting that “if a state is acting as a market participant, rather than as a market regulator the dormant Commerce Clause places no limitation on its activities”).

The market participant exception reflects the Supreme Court desire to protect States' autonomy.¹⁴⁰ The most important justification for this exception, therefore, arises from underlying notions of federalism.¹⁴¹ Restricting the freedom of a State to exploit its own resources is considered as a significant intrusion on its sovereignty.¹⁴² As Professor Coenen explains, when a state government regulates or taxes, it turns over nothing that belongs to it; rather, it compels private action through the exercise of raw governmental power. In contrast, when a state government grants a subsidy, it is controlling and distributing its own resources.¹⁴³

The market participant exception is also compatible with two key goals of U.S. constitutional federalism: the encouragement of novel state experiments and the fostering of governmental responsiveness to distinctive local needs.¹⁴⁴ Finally, there is a textual justification for the market participant exception. Because the text of the Commerce clause grants Congress the power to “*regulate*” interstate commerce,¹⁴⁵ it follows that the scope of the clause’s negative implication must also be limited to prohibiting the States from “*regulating*” commerce in certain respects. As the Court explained in *United Building & Construction Trades Council v. Mayor of Camden*,¹⁴⁶ “when the State acts solely as a market participant, no conflict between state

¹⁴⁰ *Reeves, Inc.*, 447 U.S. at 438 (“Restraint in this area also counseled by considerations of state sovereignty. . .”).

¹⁴¹ *See, e.g.*, THE FEDERALIST NO. 32 (Hamilton) (J. Cooke ed., 1961), at 310 (“the States will retain under the proposed Constitution a very extensive portion of active sovereignty”).

¹⁴² Dan T. Coenen, *Untangling the Market-Participant Exemption to the Dormant Commerce Clause*, 88 MICH. L. REV. 395, 427 (1989) (arguing that “[i]t is . . . a greater intrusion on state autonomy to restrict a state’s use of its own tangible resources that to cabin its otherwise limitless power to coerce through government fiat”); Coenen, *supra* note 133, at 1033 (“The Court’s general discomfort with invalidating state subsidies also stems from concerns about safeguarding ‘our Federalism.’”); Walter Hellerstein, *Hughes v. Oklahoma: The Court, the Commerce Clause, and State Control of Natural Resources*, 1979 SUP. CT. REV. 51, 75 (“to bar the states from making any distinctions between in-state and out-of-state interests in distributing state resources [would threaten] the essential fabric of our constitutional plan”).

¹⁴³ *Id.* at 422.

¹⁴⁴ *Id.* at 429-30; TRIBE, *supra* note 33, at 539 (“If a state . . . were forced to act evenhandedly in distributing its state-created ‘goodies,’ perhaps it would simply give up the effort to conserve or create them.”).

¹⁴⁵ U.S. CONST. art I, § 8, cl. 3.

¹⁴⁶ *United Building & Construction Trades Council v. Mayor of Camden*, 465 U.S. 208 (1984).

regulation and federal *regulatory* authority can arise.”¹⁴⁷ Consequently, since the main purpose of the DCC is to preserve a true balance of power between federal and state governments, the market participant exception aims to ensure that the DCC does not go further than that.

Given that the DCC is an instrument of federalism and constitutional law, in assessing whether a measure is subject to the DCC rule, the main focus is on the form of the State measure, i.e. whether a State is acting as a market regulator rather than a market participant. By contrast, the objective of EU State Aid, as a part of competition law, is to prevent distortions of competition as a consequence of governmental support for national market players to the detriment of competitors from other Member States. Achieving this goal requires a broad definition of State aid. Consequently, the aid granted by a Member State “in any form whatsoever” that provides a selective advantage, distorts competition, and affects trade between Member States constitutes a State Aid within the meaning of Article 107 of the TFEU.¹⁴⁸ What matters, therefore, is not the form of the measure but the economic effect of the measure.

To sum up, while both the DCC and the EU State aid rules would similarly prohibit certain types of state grants, they do have very different results when applied to the direct transfer of funds. In the United States, the DCC does not apply to pure subsidies because by granting them a State acts as a market participant rather than a market regulator. In the EU, on the other hand, a pure subsidy is considered an illegal State aid as long as it provides a selective advantage, distorts competition and affects trade between Member States.

d. Sale/Purchase of Goods/Services by a Government The difference seen in the direct transfer of funds also exists in regard to the sale or purchase of goods and services by a State

¹⁴⁷ *Id.* at 220 (emphasis added).

¹⁴⁸ TFEU, *supra* note 2, art. 107(1).

government. In the EU, when public authorities or public enterprises sell goods or services at a price below market rates, this implies granting an advantage and therefore can constitute an illegal State aid.¹⁴⁹ Likewise, when a Member State purchases goods or services from an enterprise (public or private) at prices above market rates, such a purchase can constitute a State aid.¹⁵⁰ The basic idea here is that transactions between a Member State and other enterprises should be carried out in line with normal market conditions. In the event that an agreement contains more advantageous conditions for enterprises than a normal market transaction, such an agreement would be considered to grant an advantage in the meaning of Article 107(1) of the TFEU. As the European Commission has explained:

The Union legal order is neutral with regard to the system of property ownership and does not in any way prejudice the right of Member States to act as economic operators. However, when public authorities directly or indirectly carry out economic transactions in any form, they are subject to Union State aid rules.¹⁵¹

In the United States, the distinction between States as regulators of the market and States as participants in the market¹⁵² supports the conclusion that government support through preferential sales or purchases should survive constitutional attack. The argument in favor of the constitutionality of below-market sales and above-market purchases by a State begins with the *Reeves, Inc. v. Stake*,¹⁵³ in which the Court extended the market participant exception to States as sellers. There, South Dakota restricted the sale of cement from a state-operated plant to residents of the State.¹⁵⁴ Upholding the resident preference, the Court relied on the market participant

¹⁴⁹ *Commission Notice on the Notion of State Aid as referred to in Article 107(1) of the Treaty of the Functioning of the European Union*, 2016/C 262/01 (July 19, 2016), para. 52.

¹⁵⁰ T-14/96, *BAI v. Commission*, [1999] ECR II-139, paras. 71-80.

¹⁵¹ *Commission Notice on the Notion of State Aid*, *supra* note 117, para. 73.

¹⁵² *See supra* notes 138-47 and accompanying text.

¹⁵³ *Reeves, Inc.*, 447 U.S. 429 (1980).

¹⁵⁴ *Id.* at 430-33.

exception and recognized the right of private traders to choose their own trading partners.¹⁵⁵ The Court explicitly stated that

the commerce clause responds principally to state taxes and regulatory measures impeding free private trade in the national market place. There is no indication of a constitutional plan to limit the ability of the States themselves to operate freely in the free market.¹⁵⁶

Thus, if a State “as a seller of cement, unquestionably fits the ‘market participant’ label,”¹⁵⁷ so should the State as a seller/buyer at prices below/above market rates.

Another reason which apparently would justify the application of the market participant exception to this category of government support is that State proprietary activity generally falls outside of the scope of the Commerce clause. As the Court has explained, once a State is spending its own funds, it is acting as a market participant, not as a market regulator.¹⁵⁸ Just as with subsidies, when a State government sells or buys, it is controlling and distributing its own resources; therefore, the market participant exception applies.

In the United States, then, the formal appearance of the State as a market participant provides a reason to exclude the situations when a State acts as a seller or a buyer from the scope of the DCC rule. In the EU, on the other hand, the mere fact that a State participates in an economic transaction does not automatically exclude its actions from the scope of State aid rules. The decisive question in the EU is whether the State acted as a private market participant would have done in a similar situation. If this is not the case, as in situations when the State sells at below-market prices or buys at above-market prices, the beneficiary enterprise has received an

¹⁵⁵ *Id.* at 438-39.

¹⁵⁶ *Id.* at 436-37 (1980); *see also* Mark P. Gergen, *The Selfish State and the Market*, 66 TEXAS L. REV. 1097, 1137 (1988) (“The commerce clause always has focused on state interference in commerce through taxes and regulations.”).

¹⁵⁷ *Id.* at 440.

¹⁵⁸ *White v. Mass. Council of Constr. Employers*, 460 U.S. 204, 215 (1983).

economic advantage which it would not have obtained under normal market condition, placing it in a more favorable position compared to that of its competitors. Thus, this category of government support constitutes an illegal State aid provided the other elements of State aid are satisfied.

3. Procedural Issues

The U.S. and EU procedures and remedies relating to subsidy control are also very different in large part as a consequence of the entirely different institutional arrangements, which in turn reflects a different level of readiness of States to abandon their sovereignty in the area of granting subsidies.

a. Procedures to Control Subsidies The EU is one of the few jurisdictions in the world that has introduced specific procedural provisions for controlling State aid. This occurred largely due to the explicit delegation of power in the area of State aid control by EU Member States to the supranational body – the European Commission, which is the EU executive body.¹⁵⁹ It follows that the EU State aid regime mostly relies “on a technocratic model empowering the executive branch of power whilst explicitly excluding the parliamentary component of legislation.”¹⁶⁰ The procedural rules to be applied by the Commission under Article 108 of the TFEU have been

¹⁵⁹ Consolidated Version of the Treaty on European Union, 26 October 2012, Official Journal of the European Union (C 326/15), art. 17 [hereinafter TEU].

¹⁶⁰ RAJ CHARI, HERWIG C.H. HOFMANN & CLAIRE MECHEAU, *Rationales for State Aid Rules*, in STATE AID LAW OF THE EUROPEAN UNION 3, 48 (Herwig C.H. Hofmann & Claire Micheau eds., 2016).

further refined and clarified by Council Regulation 659/1999¹⁶¹ and Commission Regulation 794/2004¹⁶² and thus constitute a fully developed and relatively unambiguous body of law.

EU law provides for *ex ante* control subjecting the State aids of Member States to extensive review prior to implementation: EU Member States are required to notify their aid to the Commission and obtain its authorization before they implement it.¹⁶³ In other words, Member States are under an obligation *not* to implement a State aid before the Commission has stated its position by declaring either that the measure does not constitute State aid under Article 106 or that it is compatible with the internal market under Article 107.

Nothing of the sort exists in the United States. States are not required to obtain an authorization from the federal authorities before granting any kind of subsidies. Accordingly, no federal agency has a power similar to that of the European Commission to prevent the State-driven distortion of competition that affects the United States *as a whole*. As a result, the procedure of granting subsidies in the United States has no clear procedural relationship to preservation of a free competitive market. Giuseppe Cacciato summarizes the process of granting subsidies in the United States in the following way:

[A] pluralistic process occurs by which each player attempts individually or in alliance with others to affect the initial decision. While the players converge around the authority that has the power to decide on the specific cases, *that authority might not have a watchdog role and it may not have explicit concern with preserving the level playing field* so central to European notions of competition policy and subsidy control.¹⁶⁴

¹⁶¹ Council Regulation (EC) 659/1999 of 22 March 1999 laying down detailed rules for the application of [ex] Article 93 of the EC Treaty [Article 108 of the TFEU], OJ 1999 L 83 (amended by Council Regulation (EU) No. 734/2013 of 22 July 2013 amending Regulation (EC) No. 659/1999, OJ L 204) [hereinafter Procedural Regulation].

¹⁶² Commission Regulation (EC) 794/2004 of 21 April 2004 implementing Council Regulation (EC) laying down detailed rules for the application of [ex] Article 93 of the EC Treaty [Article 108 of the TFEU], OJ 2004 L 140 [hereinafter Implementing Regulation].

¹⁶³ TFEU, *supra* note 31, art. 108.

¹⁶⁴ Cacciato, *supra* note 1, at 11 (emphasis added).

Unlike the EU, in the United States there is *ex post* control. The system is entirely complaint-driven: a private party has to challenge the measure by bringing a lawsuit before a remedy may follow. This, in turn, raises the question of finding parties with proper standing to sue in the courts. The U.S. Supreme Court has identified three requirements for constitutional standing to sue: (1) the plaintiff must have suffered a personal injury; (2) the defendant's action must have caused that injury; and (3) the court must be capable of redressing that injury.¹⁶⁵ In *DaimlerChrysler Corp. v. Cuno*,¹⁶⁶ a group of taxpayers brought suit claiming that a franchise tax credit under Ohio law, which was enacted to encourage the construction of a new automobile plant in Toledo, violated the DCC by granting preferential treatment to in-state businesses. The Court, nevertheless, ruled that the State taxpayers did not have standing to challenge State tax or spending decisions because their injury cannot be differentiated from that of the general public.¹⁶⁷ It thus seems that, in cases involving discriminatory taxation, the parties with standing would be, as Judge Diane Wood has argued, out-of-state businesses that themselves were disadvantaged by their ineligibility for the tax exemptions, or another State or municipality that had been competing to attract the relevant business to its territory.¹⁶⁸

In theory, Congress also has the power under the Commerce clause to block State subsidies.¹⁶⁹ In practice, however, it rarely exercises it. As Professor Sykes has observed,

¹⁶⁵ *Allen v. Wright*, 468 U.S. 737, 751 (1984) (“A plaintiff must allege personal injury fairly traceable to the defendant’s allegedly unlawful conduct and likely to be redressed by the requested relief.”).

¹⁶⁶ *Daimler Chrysler Corp. v. Cuno*, 547 U.S. 332 (2006).

¹⁶⁷ *Id.* at 433-34 (“the [taxpayer] must be able to show . . . that he sustained . . . some direct injury . . . and not merely that he suffers in some indefinite way in common with people generally” (quoting *Frothingham v. Mellon*, decided with *Massachusetts v. Mellon*, 262 U.S. 447, 388 (1923))).

¹⁶⁸ Wood, *supra* note 1, at 6-7.

¹⁶⁹ U.S. CONST. art I, § 8, cl. 3.

Congress is “vastly more likely to authorize industry assistance itself than to stand in the way of state measures.”¹⁷⁰

b. Remedies Discriminatory taxation is the only category of government support covered by both EU State aid rules and the DCC rule in the United States. Thus, any discussion of comparative remedies may be limited to this area of subsidy.

Under EU law, the general rule is that if a Member State has not notified State aid that is incompatible with the common market, or grants the aid that has been notified and authorized but in a manner contrary to the Decision of the Commission, that Member State has to recover the aid from the beneficiary.¹⁷¹ The recovery must also include interest on the aid, from the time the aid was first granted until the moment the aid is fully recovered.¹⁷² In the case of State aid in the form of tax measures, the amount to be recovered is calculated on the basis of a comparison between the tax actually paid and the amount which should have been paid if the generally applicable rule had been applied.¹⁷³ Interest is added to this basic amount.¹⁷⁴ The ECJ has made it clear that the main purpose of recovery is “to eliminate the distortion of competition caused by the competitive advantage afforded by the unlawful aid”¹⁷⁵ and “to re-establish the situation that

¹⁷⁰ Sykes, *supra* note 1, at 491.

¹⁷¹ Procedural Regulation, *supra* note 161, art. 14.1.

¹⁷² *Id.*, art. 14.2.

¹⁷³ *Commission Notice on the Application of the State Aid Rules to Measures Relating to Direct Business Taxation*, 98/C 384/03 (Dec. 10, 1998), para. 35.

¹⁷⁴ *Id.*

¹⁷⁵ Case C-277/00, *Germany v. Commission (SMI)*, [2004] ECR I-3925, para. 76.

existed on the market prior to the granting of the aid.”¹⁷⁶ The recovery process is not included in the Treaty text. It has been developed beginning with a 1982 decision ordering recovery.¹⁷⁷

In the United States, the current rules with regard to remedies for DCC incompatibility were first developed in the early 1990s. It has always been indisputable that once a State tax has been declared unconstitutional under the DCC, the State may not continue to collect the tax. The questions remained, however, whether the Court’s decision should be applied retroactively and whether it should require the payment of refunds to taxpayers.

For a long period of time, the Supreme Court declined to address the retroactivity issue.¹⁷⁸ Instead, the Court remanded each case for further proceedings in State courts relating to remedies.¹⁷⁹ As a result, whereas a very few State courts applied the decision retroactively and ordered a refund of taxes paid by out-of-state businesses,¹⁸⁰ numerous others ruled that a tax is unconstitutional on a prospective basis only, thereby allowing the States to retain the revenues collected under the unconstitutional tax.¹⁸¹ Courts usually refer to the State’s need for financial stability as a justification for the restrictions that make refunds unavailable.¹⁸² This approach

¹⁷⁶ *Id.*, para. 74.

¹⁷⁷ Decision No. 1982/312/EEC of 19 May 1982, OJ 1982 L 138/18.

¹⁷⁸ *See, e.g.*, *American Trucking Association, Inc. v. Scheiner*, No. 86-357, slip op. at 25 (U.S. June 23, 1987); *Tyler Pipe Industries, Inc. v. Department of Revenue*, Nos. 85-1963 and 85-2006, slip op. at 25 (U.S. June 23, 1987); *Ashland Oil, Inc. v. West Virginia State Tax Commissioner*, 107 S. Ct. 149 (1987).

¹⁷⁹ *Id.*

¹⁸⁰ *Huie v. Private Tuck Council of America, Inc.*, 466 N.E.2d 435, 437 (Ind. 1984).

¹⁸¹ *See, e.g.*, *Southern Pacific Co. v. Cochise County*, 92 Ariz. 395, 406, 377 P.2d. 770, 778 (1963); *Gulesian v. Dade County School Board*, 281 So. 2d 325, 326 (Fla. 1973); *Salorio v. Glaser*, 93 N.J. 447, 460, 461 A.2d 1100, 1111 (1983); *First of McAlester Corp. v. Oklahoma Tax Commissioner*, 709 P.2d 1026, 1036 (Okla. 1985); *Pen Mutual Life Ins. v. Department of Licensing and Regulation of the State of Michigan*, 162 Mich. App. 123, 412 N.W.2d 668 (1987).

¹⁸² *See, e.g.*, *Nettleton’s Ex’r v. Louisville*, 230 S.W. 957 (Ky. 1921) (“ . . . high, sound public policy that the orderly and efficient administration of municipal affairs should not be interrupted or interfered with by requiring [the city] to return to taxpayers taxes which have been voluntarily paid and which have been used or apportioned by the municipality to its various administrative bodies; for if such things may be done, it necessarily makes uncertain and precarious the funds which the city may properly set apart to its several departments.”).

resulted in reliance on the prospectivity doctrine and other devices to avoid the refund of unconstitutional taxes. This approach raised concerns amongst the experts.¹⁸³

In 1990, in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*,¹⁸⁴ the Supreme Court explicitly stated for the first time that “if a State places a taxpayer under duress promptly to pay a tax when due and relegates him to a postpayment refund action in which he can challenge the tax’s legality, the Due Process Clause of the Fourteenth Amendment obliges the State to provide *meaningful backward-looking relief* to rectify any unconstitutional deprivation.”¹⁸⁵ A State has several alternatives with regard to the form of relief: (1) it may pay a refund equal to the difference between the tax paid and the tax that would have been due under rates afforded to in-state competitors; (2) it may assess and collect back taxes from competitors; or (3) it may combine these two forms of relief.¹⁸⁶ The Court has explained that the main purpose of retrospective relief is that the “resultant tax actually assessed during the contested tax period reflects a scheme that does not discriminate against interstate commerce.”¹⁸⁷

In *American Trucking Ass’ns Inc. v. Smith*,¹⁸⁸ a sharply divided Supreme Court held that prospective-only relief may still be permissible in some circumstances, based on a three-part test

¹⁸³ Philip M. Tatarowicz, *Right to a Refund for Unconstitutionally Discriminatory State Taxes and Other Controversial State Tax Issues under the Commerce Clause*, TAX LAWYER, vol. 41, No. 1, at 103, 117 (1987) (Arguing that “[t]he use of the prospectivity doctrine detracts attention from the real interests at stake, which are the state’s sovereign right to preserve its treasury and the competing interest of taxpayers to a clear and certain remedy for constitutional violations. The complete denial of refunds resolves the tension between these competing interests entirely in favor of states. Such an unbalanced resolution threatens the very purpose of commercial clause.”); see also Walter Hellerstein, *State Tax Discrimination Against Out-of-Staters*, 30 NAT’L TAX J. 113, 118 (1997); Roger J. Traynor, *Quo Vadis, Prospective Overruling: A Question of Judicial Responsibility*, 28 HASTINGS L.J. 533, 555-59 (1977).

¹⁸⁴ *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990).

¹⁸⁵ *Id.* at 36 (emphasis added).

¹⁸⁶ *Id.* at 40-41.

¹⁸⁷ *Id.*

¹⁸⁸ *American Trucking Ass’ns Inc. v. Smith*, 496 U.S. 167 (1990).

established by the Court in *Chevron Oil Co. v. Huson*.¹⁸⁹ The three questions to be addressed are: (1) whether the decision to be applied retroactively establishes a new principle of law; (2) whether retroactive application of the new rule would further or retard the operation of the rule in light of its history and purpose; and (3) whether retroactivity would produce substantial inequity. In other words, *Chevron* allows federal courts to deny retroactive application to a new rule of law if retroactivity would impose undue hardship on the litigant. In *American Trucking Ass'ns*, the taxpayers challenged Arkansas's flat highway use tax that discriminated against out-of-state trucks in violation of the DCC under the Court's decision in *American Trucking Ass'ns, Inc. v. Scheiner*.¹⁹⁰ In *Scheiner*, the Court had overruled earlier precedents and concluded that an identical flat highway use tax imposed by Pennsylvania was unconstitutional because it discriminated against interstate commerce.¹⁹¹ Arkansas, nevertheless, continued collecting the tax even after the *Scheiner* decision, until the Arkansas Supreme Court ruled that the Arkansas tax was unconstitutional under *Scheiner*. The issue in *American Trucking Ass'ns, Inc.*, therefore, was whether taxpayers were entitled to relief with respect to taxes imposed prior to the decision in *Scheiner*.¹⁹² The Court held that, because *Scheiner* met *Chevron's* test, the Supreme Court decision should be applied prospectively only, and that taxpayers were entitled to meaningful retrospective relief only with respect to taxes imposed after *Scheiner* was handed down.¹⁹³

¹⁸⁹ *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106 (1971).

¹⁹⁰ *American Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266 (1987).

¹⁹¹ *Id.* at 286.

¹⁹² *American Trucking Ass'ns, Inc.*, 496 U.S. at 171.

¹⁹³ *Id.* at 188.

Just three years later, the Supreme Court rejected the prospective-only approach in *Harper v. Virginia Department of Taxation*.¹⁹⁴ The Court held that the decision must apply retroactively, because

When this Court applies a rule of federal law to the parties before it, that rule is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all event, regardless of whether such events predate or postdate the announcement of the rule.¹⁹⁵

The Court made clear that the legal imperative “to apply a rule of federal law retroactively after the case announcing the rule has already done so” must “prevail over any claim based on *Chevron Oil* analyses.”¹⁹⁶ No federal or state court after *Harper* has cited *Chevron* in a case involving unconstitutional taxes. It seems, therefore, that *Harper* overruled *Chevron*, and that decisions holding a tax unconstitutional on the basis of the DCC should be applied *retroactively* for purposes of remedies.¹⁹⁷

In *Harper*, the Court once again confirmed that the State is free to choose the form of relief it will provide: “the State must provide meaningful backward-looking relief either by rewarding full refunds or by issuing some other order that creates in hindsight a nondiscriminatory scheme.”¹⁹⁸

Both the U.S. DCC rule and the EU State aid rules now provide for retroactive remedies. However, whereas the retrospective character of remedies in the EU is aimed at *reestablishing of*

¹⁹⁴ *Harper v. Virginia Department of Taxation*, 509 U.S. 86 (1993).

¹⁹⁵ *Id.* at 94.

¹⁹⁶ *Id.* at 98.

¹⁹⁷ John F. Coverdale, *Remedies for Unconstitutional State Taxes*, 32 CONN. L. REV. 73, 90 (2000) (“ . . . all forms of prospective application of decisions now seem to be dead in tax cases . . . In tax cases decided since *Harper*, the Court has not even addressed the issue of retroactive application of its decisions. . . . By so doing, the Court seems to be indicating that it does not consider the question of nonretroactive application of decisions one that still needs to be addressed.”); *see also* JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, *STATE TAXATION*, vol. I, para. 4.16(4)(a) (3d ed. 1993); *Reynoldsville Casket Co. v. Hyde*, 514 U.S. 749, 753-54 (1995) (The Supreme Court suggested that it viewed *Harper* as overruling *Chevron*.).

¹⁹⁸ *Id.* at 87.

the previous situation on the market, in the United States the main purpose of remedies is to *eliminate discrimination against interstate commerce*. This has implications for the forms of remedies. In the EU, the only form of remedy available is a recovery of State aid from a beneficiary. In the case of taxation, this means the Member State has to recover unpaid taxes from the businesses that were granted favorable tax treatment. This type of recovery is the only logical consequence for situations when a Member State violated EU law by granting illegal State aid. In the United States, on the other hand, the DCC prohibits discrimination against interstate commerce. The main purpose of a remedy, is thus to create “in hindsight a nondiscriminatory scheme.”¹⁹⁹ This may be accomplished by recovering the unpaid taxes from the businesses that were granted a favorable tax treatment; by refunds to out-of-state competitors; or by a combination of the two. In practice, State and local governments mostly use the third option.²⁰⁰

C. CONCLUSION

Unlike the rules on internal subsidization, the rules on the use of CVDs are largely the same under the U.S. and the EU law. Nevertheless, when deciding on imposing CVDs and the appropriate level of CVDs, the European Commission takes into account other Union interests, besides those of the complaining industry (upstream industry, downstream industry, consumers, impact of CVDs on competition within the EU). Thus, due to Union interest requirement and lesser duty rule, the Commission has the discretion either to refuse to apply CVDs, even though

¹⁹⁹ *Id.*

²⁰⁰ Jeffrey A. Friedman, Pilar Mata & Mary C. Alexander, *Wynne-ing Isn't Everything: Remedies for Unconstitutional Taxes*, 41, 44 STATE TAX NOTES, Apr. 1, 2013.

the subsidization causing injury to domestic industry has been established, or to impose the CVDs lower than the total amount of countervailable subsidy if such lower duty rate is sufficient to remove the injury suffered by the domestic industry.

The U.S. CVD law, on the other hand, is tailored to serve the interests of the U.S. industry affected by subsidized import and does not seek to provide for a balance between other economic interests involved. The U.S. Department of Commerce does not have the discretion similar to that of the European Commission. When a countervailable subsidy and material injury to domestic industry are found, the Department of Commerce is under an obligation to impose CVDs which are assessed on the amount of the countervailable subsidy.

As a result, whereas the U.S. CVD law is primarily aimed at safeguarding the interests of the U.S. industry affected by subsidized imports, the EU more focuses on the protection of the competition process by ensuring that markets work efficiently and by assessing the effect of the CVDs on total welfare, i.e. the sum of consumer welfare and producer welfare. Likewise, the EU approach leads to reducing trade distortions at the international level that results by imposing CVDs. Generally, it seems the EU CVD law is more focused on correction of market distortions whereas the U.S. approach to imposing CVDs is more about offsetting injury to the domestic industry.

The major difference between U.S. and EU subsidy laws are found in the rules on internal subsidies. In fact, the U.S. and EU approaches to this issue are diametrically opposed, from the largely laissez-faire approach of the United States to the very elaborated rules on State aid control in the EU. To a large extent, this difference is rooted in a different level of readiness of States to abandon their sovereignty in the area of granting subsidies. In the EU, the power in the area of State aid control has been explicitly delegated by Member States to a supranational

body – the Commission. This, in large part, puts aside concerns about the intrusion on EU Member States’ sovereignty by restricting their freedom to grant subsidies. EU State aid law became a part of competition law, with its principal goal the protection of economic freedom by ensuring that the competitive process is not distorted by government intervention. In the United States, by contrast, there is no federal agency that has a power similar to that of the European Commission when it comes to the application of the DCC. In effect, subsidies granted by States raise exclusively constitutional law concerns under the DCC, *i.e.*, whether State laws invade Congressional authority to regulate interstate commerce. Consequently, in DCC cases the main focus is on preserving a balance of power between federal and state governments (and among the three federal branches of government) rather than on protection of the process of competition on the U.S. market. This difference has significant implications for the scope of EU State aid rules and the U.S. DCC rule.

From the EU perspective, a broad scope of application of State aid rules is necessary in order to cover all possible measures that might affect the competitive process within the EU. Under Article 107(1) of the TFEU, State aid is any measure whatsoever that (1) is granted by the State Member and through state resources; (2) confers an advantage to the recipient; (3) favors certain undertakings (*i.e.* selective); and (4) distorts competition and affects trade between Member States.²⁰¹ When deciding whether a measure at issue is a subject to EU State aid rule, the focus, therefore, is not only on the form of the measure (granted by the State Member and through state resources) but also on its economic effect (advantage to selective recipients; distortion of competition and effect on trade between Member States). As a result, State aid can take a variety of forms: direct transfer of funds, discriminatory taxation, sales of goods/services

²⁰¹ TFEU, *supra* note 31, art. 107(1).

by a Member State at a price below market rates; purchase of goods/services by a Member State at prices above market rates, etc. (except for regulatory measures which are not considered to be a State aid since they are not granted through State resources).²⁰²

In the United States, by contrast, when determining whether a measure is a subject to the DCC rule, the main concern is to find the right balance between prohibiting a State from interference into commerce in a way that discriminates against interstate commerce and the State's autonomy, and empowering a State to freely participate in the market and to exercise the right to favor its own citizens over others.²⁰³ Driven primarily by a concern about State sovereignty, the U.S. Supreme Court has developed the distinction between States as regulators of the market and States as participants in the market. If the State is a market regulator it is subject to the restraints of the DCC. If, however, the State is a market participant, it is treated as a private party rather than a governmental entity and the DCC does not apply even though the effect of the measure is exactly the same as in the former case.²⁰⁴ What matters, therefore, is not the economic effect but the form of the measure: a mere formal appearance of the State as a market participant provides a reason to exclude the measure from the scope of the DCC rule. As a result, only regulatory measures and discriminatory taxation are covered by the DCC rule.²⁰⁵ Direct subsidies, sales of goods/services by a State at a price below market rates, or purchases of goods/services by a State at prices above market rates, are not subject to the DCC rule.²⁰⁶ It follows, therefore, that discriminatory taxation is the only area in which both there is application of both the U.S. DCC rule and the EU State aid rules.

²⁰² See *supra* notes 97-99, 107-18, 124, 149-51 and accompanying text.

²⁰³ See *supra* notes 69-86 and accompanying text.

²⁰⁴ See *supra* notes 138-43 and accompanying text.

²⁰⁵ See *supra* notes 101-06 and accompanying text.

²⁰⁶ See *supra* notes 125-37, 152-58 and accompanying text.

Control is exercised differently in the two jurisdictions. The EU is one of the few jurisdictions in the world that has introduced specific procedural provisions for controlling State aid. Indeed, very few states, even federally organized ones, have national systems for controlling subsidies granted by their component parts. In fact, even Member States of the EU generally lack any powerful regime for controlling subsidies internal to those states. EU law, on the other hand, provides for *ex ante* control subjecting the State aids of Member States to extensive review prior to implementation: EU Member States are required to notify their aid to the Commission and obtain its authorization before they implement it. In other words, Member States are under an obligation *not* to implement a State aid before the Commission has stated its position by declaring either that the measure does not constitute State aid within the meaning of Article 107 of the TFEU or that it is compatible with the internal market.

In assessing the compatibility of a State aid with the internal market, the Commission applies a “balancing test,” determining (1) whether the State aid pursues an objective of common interest, e.g. by addressing a market failure or equity concern; (2) whether there is an incentive effect; and (3) whether the positive effect of the measure outweighs the negative effects (distortion of competition and trade). The goal is not only to reduce aid but to divert State aid to reasonable objectives of common interest. The key priorities recently defined for the Commission are creating high-value, innovative sectors; stimulating entrepreneurship, in particular in favor of start-ups and young, innovative SMEs; investing in human sectors by providing incentives for employers to provide appropriate trainings for workers; environmental protection.²⁰⁷ Moreover, in order to be approved, State aid must have an incentive effect, that is, it induces the beneficiary to undertake activities that it would not have done without the aid. In

²⁰⁷ State aid Action Plan-Less and better targeted State Aid: a roadmap for State Aid reform 2005-2009, COM (2005) 107 final, paras. 24-47 [hereinafter SAAP].

other words, aid must be necessary and proportionate to achieve a particular objective of common interest. Thus, in many cases, the Commission would refuse to authorize aid to large corporations since they are capable of undertaking the investment on their own and thus would have had carry out the investment even in the absent of the aid.²⁰⁸

As a result, over the years, the EU State aid control has become a sophisticated instrument of macro- and microeconomic coordination as well as an important tool for building the European model of social market economy. The EU State aid control rules ensure a level playing field for European companies and avoid subsidy races between Member States which are non-sustainable for individual Member States and detrimental to the EU as a whole.²⁰⁹ The Commission also encourages Member States to prioritize action to strengthen the competitiveness of their economy by redirecting aid to research and development, innovative SMEs, environmental protection, as well as increase social and regional cohesion.²¹⁰ Finally, State aid control ensures avoiding a wasteful use of public resources that could be more usefully utilized elsewhere.²¹¹

In the United States, on the other hand, the system for controlling subsidies granted by States is rather limited. With respect to regulatory measures and discriminatory taxation, there is *ex post* control under the DCC rule: a private party has to challenge the measure by bringing lawsuits in the courts before remedies follow. Thus, only the portion of the implemented

²⁰⁸ See *infra* Chapter VIII, Section B, subsection 2b for a more detailed analysis on an “incentive effect” test.

²⁰⁹ See, e.g., Chari, Hofmann & Micheau, *supra* note 55, at 6-10.

²¹⁰ Communication from the Commission – Guidelines on State aid for environmental protection and energy 2014-2020, OJ C 200, 26/06/2014; Communication from the Commission – Framework for State aid for research and development and innovation, OJ C 198, 27/06/2014; Guidelines on regional State aid for 2014-2020, OJ C 209, 23/07/2013.

²¹¹ Communication from the Commission, *EU State Aid Modernization*, COM/2012/0209 final, 08/05/2012, para. 6 (In the context of the 2012 Modernization of State Aid control, the Commission described its objective as being to “shape that instrument [State aid control] into a tool promoting a sound use of public recourses for growth-oriented policies.”).

measures that violate the DCC will be eventually found unconstitutional. With respect to direct payments and other forms of subsidies, U.S. law places no constraints on States to grant them.

As a result, as Giuseppe Cacciato put it, the U.S. process of granting subsidies:

seems likely to produce outcomes that are both economically irrational and distorting to competition. Since subsidies are granted on an ad hoc, individual basis and by a process of bilateral negotiation between the applicant and the grantor, neither consistency nor protection of broader interests is assured.²¹²

Recent studies seem to support this conclusion. A study by the U.S. National Bureau of Economic Research has shown that “states have strong incentives to subsidize firm relocation in order to gain at the expense of other states” and that “[w]hile some states still benefit from a subsidy war, the subsidies also create distortions which move the country inside its efficiency frontier.”²¹³ Another study found that 75 percent of the dollar value of state and local subsidies have gone to large corporations²¹⁴ which indicates a “profound bias against small businesses.”²¹⁵ More importantly, it shows that subsidies are often granted to the profitable companies and sectors that do not need government support to carry out the investment, meaning that subsidies

²¹² Cacciato, *supra* note 1, at 11.

²¹³ Ralph Ossa, *A Quantitative Analysis of Subsidy Competition in the U.S.*, 2 National Bureau of Economic Research, Working Paper 20975 (2015) (The study also shows that “manufacturing real income can be up to 3.9 percent higher if states stop competing over firms.”).

²¹⁴ Philip Mattera, *Subsidizing the Corporate One Percent* 1 (Good Jobs First, Feb. 2014), <http://www.goodjobsfirst.org/sites/default/files/docs/pdf/subsidizingthecorporateonepercent.pdf> (The study shows that, in dollar terms, the biggest recipients are Boeing, Alcoa, Intel, General Motors, and Ford Motor.).

²¹⁵ Greg LeRoy, Carolyn Fryberger, Kasia Tarczynska, Thomas Cafcas, Elizabeth Bird & Philip Mattera, *Shortchanging Small Businesses: How Big Businesses Dominate State Economic Development Incentives* 3 (Good Jobs First, Oct. 2015), <http://www.goodjobsfirst.org/sites/default/files/docs/pdf/shortchanging.pdf>. (“An analysis of more than 4,200 economic development incentive awards in 14 states finds that large companies received dominant shares, ranging between 80 and 96 percent of their dollar values. The deals, worth more than \$3.2 billion, were granted in recent years by programs that, on their faces, are equally accessible to small and large companies. Yet big businesses overall were awarded 90 percent of the dollars from the programs analyzed . . .); see also Kasia Tarczynska & Thomas Cafcas, *Slicing the Budget Pie for Big Business: How Three States Allocate Economic Development Dollars, Large Companies versus Small* 2 (Good Jobs First, Mar. 2016), <http://www.goodjobsfirst.org/sites/default/files/docs/pdf/slicingthebudget.pdf> (“A detailed analysis of economic development budgets in three diverse states—Florida, Missouri, and New Mexico—finds that at least 68 percent of overall state economic development spending goes to large companies and programs that support those companies. Only a small fraction of state funds—typically about 19 percent—goes to small companies and programs that support their operations.”).

serve mainly to increase profits rather than to promote broad-based economic growth.²¹⁶ Furthermore, when subsidizing large corporations that pay low wages, tax payers money are used to expand low-quality employment and to intensify economic inequality.²¹⁷

²¹⁶ Philip Mattera, Kasia Tarczyska & Greg LeRoy, *Tax Breaks and Inequality: Enriching Billionaires and Low-Road Employers in the Name of Economic Development* 6-7 (Good Jobs First, December 2014), <http://www.goodjobsfirst.org/sites/default/files/docs/pdf/taxbreaksandinequality.pdf> (In particular, the study found members of the Forbes 400 list of the wealthiest Americans linked to 99 firms that have been awarded more than \$19 billion in cumulative subsidies.).

²¹⁷ *Id.* at 8-10 (“In some cases, both things are happening at the same time; i.e., subsidy awards have gone to corporations that are linked to the Forbes 400 and have low-road compensation practices When a state or local government subsidizes a Wal-Mart store or an Amazon.com warehouse, it is doing the most to intensify economic inequality by enriching individuals at the very top of the income hierarchy while also perpetuating poor quality jobs at the bottom.).

VIII. REFORMING THE WTO SUBSIDIES REGIME

Any changes to the current WTO subsidy regime must be based on a clear definition of the goals of that regime. Thus, in this Chapter, I first identify the object and purpose of a coherent subsidies regime, which is of crucial importance in order to approach the numerous technical issues of the subsidy discipline in a coherent and consistent manner. Since the SCM Agreement does not expressly define its objectives, I propose a more precise definition of the object and purpose of the SCM Agreement. I then focus on identifying the parts of the Agreement that are most inconsistent with the proposed object and purpose and recommend appropriate changes. In particular, I propose (1) changes regarding the causality requirement in establishing injury to the domestic industry in the case of actionable subsidies; (2) reinstating the category of non-actionable subsidies; and (3) changes regarding the unilateral use of CVDs by WTO Members.

A. THE OBJECT AND PURPOSE OF THE WTO SUBSIDIES REGIME

Identifying goals of any legal discipline is a crucial and obvious starting point. Nevertheless, the current WTO rules on subsidies lack clarity and thus generate controversy regarding their purpose and economic rationale. A Preamble to the Agreement on Subsidies and Countervailing Measures (SCM Agreement) would contribute to a better understanding of the object and purpose of the Agreement and the meaning of its provisions. Moreover, that preamble should

incorporate a clear object and purpose that should be identified as protecting competition in the market as a means of ensuring economic efficiency.

1. The Need for a Preamble to the SCM Agreement

The goal(s) of the SCM Agreement are not entirely clear due to the lack of a preamble, which usually provides some indication of the object and purpose of a treaty. Of all the WTO agreements, only two lack a preamble: the Anti-Dumping Agreement and the SCM Agreement. As has been established in Chapter III, the current WTO subsidy discipline embodies an uneasy compromise between diametrically opposed opinions: that of the United States, whose objective was more stringent rules on subsidies, and that of the EU and other members, whose objective was disciplining the extensive use of countervailing duties (CVDs) by the United States. As a result, some concepts of the SCM Agreement “may not have any obvious economic or policy rationale, but instead reflect a difficult and, in some respects, an incoherent political bargain.”¹

Despite quite elaborated subsidy rules, contained in the SCM Agreement, there is still no clear answer to the question: what is the ultimate purpose of the regime the Agreement establishes? As James Flett put it, “[t]he problem with the SCM Agreement is not to understand where it is *coming from*, but rather to understand where it is *going*.”² Answering this question is necessary to establish a workable regulatory framework for subsidies in two respects: first, for

¹ M. MATSUSHITA, T.J. SCHOENBAUM, P.C. MAVROIDIS & M. HAHN, *THE WORLD TRADE ORGANIZATION: LAW, PRACTICE, AND POLICY* 335 (3d ed. 2015). *See also* M. Cartland, G. Depayre & J. Woznowski, *Is Something Going Wrong in the WTO Dispute Settlement*, 46 *J. WORLD TRADE* 979, 992 (2012) (stating that the SCM Agreement “does not contain any preamble or explicit/implicit indication of its object and purpose because the drafters specifically decided that it would be impossible to agree on these matters. . . .”).

² JAMES FLETT, *Preserving the Balance Between Trade and Non-Trade Interests Through a Systematic Interpretation of WTO Subsidies Law*, in *WHAT SHAPES THE LAW? REFLECTIONS ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES* 91, 91 (Luca Rubini & Jennifer Hawkins eds., 2016) (emphasis in original).

interpreting the current provisions of the SCM Agreement in a coherent and consistent manner and, second, to propose the modifications and changes to this Agreement that are aimed at achieving its objective and purpose.

Under Article 3.2 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), the WTO dispute settlement system serves to clarify the existing provisions of the WTO agreements in accordance with “customary rules on interpretations of public international law.”³ The Appellate Body, in its first case, recognized the rules contained in the Vienna Convention on the Law of Treaties as “customary rules on interpretations of public international law.”⁴ Article 31.1 of the Convention states that a treaty shall be interpreted “in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”⁵ Although a hierarchy among the interpretative elements embedded in Article 31 (ordinary meaning of the terms of the treaty, context, object and purpose) is not entirely clear from the language of the Article, the Appellate Body has acknowledged that it exists:

A treaty interpreter must begin with, and focus upon, the text of the particular provision to be interpreted. It is in the words constituting that provision, read in their context, that the object and purpose of the states parties to the treaty must first be sought. Where the meaning imparted by the text itself is equivocal or inconclusive, or where confirmation of the correctness of the reading of the text

³ Dispute Settlement Rules: Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 354 (1999), 1869 U.N.T.S. 401, 33 I.L.M. 1226 (1994), art. 3.2 [hereinafter DSU].

⁴ Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, para. 17. See also Donald M. McRae, *The WTO in International Law: Tradition Continued or New Frontier?*, 3 J. INT’L ECON L 27, 39 (2000) (“... the careful articulation by the Appellate Body of the legal basis for its decisions, grounding its interpretative function in Article 31 of the Vienna Convention of the Law of Treaties, is evidence of an organ that understands its role in explaining the role in a way that will provide guidance not only for panels but also for WTO Members seeking to conduct themselves in accordance with their WTO obligations.”).

⁵ Vienna Convention on the Law of Treaties art. 31(1), May 23, 1969, 1155 U.N.T.S. 331 [hereinafter Vienna Convention].

itself is desired, light from the object and purpose of the treaty as a whole may usefully be sought.⁶

This means that the Appellate Body has adopted the “textual” method of interpretation, by which it determines the meaning of the existing rules through analyzing the *text* of the agreement and only looks beyond the text in limited cases, such as where the text leaves the question unanswered.⁷ According to Professor Joost Pauwelyn, the text of the treaty is the necessary *reference for* and, at the same time, *limitation of* the other tools of treaty interpretation.⁸

Establishing “ordinary meaning to be given to the terms of the treaty” means not only finding their dictionary meaning, but also considering words in their *context*. The Vienna Convention embodies a relatively narrow interpretation of context, which is defined to mean “the text (including the *preamble* and annexes).”⁹ An examination of the text and context of the treaty has to be made “in the light of its *object and purpose*.” The object and purpose is to be established from the treaty *as a whole*.¹⁰ In particular, this involves examining a preamble. Given the “textual” approach, however, the more precise the “object and purpose” is formulated in a preamble, the more weight it would likely be given.¹¹ For example, the International Law

⁶ Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 12 October 1998, para. 114. *See also* Panel Report, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269/R, adopted 30 May 2005 (explicitly acknowledging that this passage is evidence of the hierarchy amongst the various interpretative elements laid down in Article 31 of the Convention).

⁷ Michael Lennard, *Navigating by the Stars: Interpreting the WTO Agreements*, 5 J. INT’L ECON. L. 17, 20-24 (2002); *see also* Claus-Dieter Ehlermann, *Reflection on the Appellate Body of the WTO*, 6 J. INT’L ECON. L. 695, 699 (2003) (noting that “among the three criteria mention in Article 31.1 of the Vienna Convention . . . the Appellate Body has attached the greatest weight to the first, i.e. the ordinary meaning of the terms of the treaty”).

⁸ JOOST PAUWELYN, *CONFLICT OF NORMS IN PUBLIC INTERNATIONAL LAW: HOW WTO LAW RELATES TO OTHER RULES OF INTERNATIONAL LAW* 245 (2003).

⁹ Vienna Convention, *supra* note 5, art. 31.2 (emphasis added).

¹⁰ Lennard, *supra* note 7, at 27.

¹¹ *See, e.g.*, IAN SINCLARE, *THE VIENNA CONVENTION AND THE LAW OF TREATIES* 127-28 (2nd ed. 1984) (arguing that when the search for the object and purpose of a treaty is done through the search for the common intention of the parties “there can be no common intention of the parties aside or apart from the text they have agreed on. The

Commission considered the “object and purpose” of the treaty as referring to *expressed* objects and purposes, particularly as expressed in the preamble.¹²

Article 31 of the Vienna Convention, therefore, requires that the WTO adjudicating bodies establish the ordinary meaning of the terms of each WTO treaty “in the light of its object and purpose.” When it comes to interpreting the SCM Agreement, however, this crucial element of the interpretative rule is almost impossible to apply. The Appellate Body has admitted this, when it stated: “considerations of object and purpose are of limited use . . . [w]e do not see that the object and purpose of the SCM Agreement provides clear indications as to the intentions of the drafters of the SCM Agreement.”¹³ Similarly, in *Canada – Aircraft*, the Panel acknowledged that the SCM Agreement “does not contain any express statement of its object and purpose . . . [w]e therefore consider it unwise to attach undue importance to arguments concerning the object and purpose of the SCM Agreement.”¹⁴

Interpretation of the terms of the agreement “in the light of its object and purpose” ensures that a treaty’s text is interpreted to reflect the goals embodied in the document as a whole and that all articles are read together in a coherent and consistent manner. The exclusion of this element of interpretation considerably undermines the effectiveness and predictability of the WTO subsidy discipline. Thus, I propose that the SCM Agreement be amended by adding a Preamble that defines the object and purpose of the Agreement.

text is the *expression* of the intention of the parties; and it is to that expression of intent that one must first look”) (emphasis in original).

¹² International Law Commission Commentary on the draft Vienna Convention, *Yearbook of the International Law Commission*, 1996, vol. II, at 221.

¹³ Appellate Body Report, *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R, adopted 25 March 2011, paras. 302, 574.

¹⁴ Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999, para. 9.119 [hereinafter *Canada – Aircraft*].

2. Defining the Object and Purpose of the SCM Agreement

The WTO jurisprudence, although vague, provides a useful starting point for identifying the goals of the WTO subsidy regime. In *Brazil – Aircraft*, the Panel stated that “[t]he object and purpose of the SCM Agreement is to impose multilateral disciplines on subsidies which *distort international trade*.”¹⁵ Furthermore, in *US – Carbon Steel*, the Appellate Body concluded that “[t]aken as a whole, the main object and purpose of the SCM Agreement is to increase and improve GATT disciplines relating to the use of *both* subsidies and countervailing measures.”¹⁶ Finally, in *US – Countervailing Duty Investigation on DRAMS*, the Appellate Body explained that the SCM Agreement “reflects a delicate balance between the Members that sought to impose more disciplines on the use of subsidies and those that sought to impose more disciplines on the application of countervailing measures.”¹⁷

On the basis of the analysis of the WTO jurisprudence, it may be concluded that the SCM Agreement is aimed at discouraging WTO Members from taking unilateral actions that might harm international trade. Specifically, the Agreement could deter harm in two ways: first, by

¹⁵ Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/RW, adopted 4 August 2000, para. 7.26 (emphasis added); *see also* *Canada – Aircraft*, *supra* note 14, para. 9.119 (stating that the object and purpose of the SCM Agreement is “the establishment of multilateral disciplines on the premise that some forms of government intervention distort international trade [or] have the potential to distort [international trade]”); Panel Report, *United States – Measures Treating Exports Restraints as Subsidies*, WT/DS194/R, adopted 1 August 2001, para. 8.63 (acknowledging that “while the object and purpose of the [SCM] Agreement clearly is to discipline subsidies that distort trade, this object and purpose can only be in respect of ‘subsidies’ *as defined* in the Agreement. This definition, which incorporates the notions of ‘financial contribution,’ ‘benefit,’ and ‘specificity,’ was drafted with the express purpose of ensuring that not every government intervention in the market would fall within the coverage of the Agreement”) (emphasis in original).

¹⁶ Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/DS213/AB/R, adopted 19 December 2002, para. 73 (emphasis added); *see also* Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted 17 February 2004, para. 64 (stating that the object and purpose of the SCM Agreement is “to strengthen and improve GATT disciplines relating to the use of both subsidies and countervailing measures, while, recognizing at the same time, the right of Members to impose such measures under certain conditions”).

¹⁷ Appellate Body Report, *United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea*, WT/DS296/AB/R, adopted 20 July 2005, para. 115.

discouraging the grant of subsidies that distort international trade, and second, by controlling the unilateral responses to such subsidies by imposing CVDs, ensuring that they are justified and proportionate – thus, their distorting effect on international trade is limited.

Defining the object and purpose of the WTO subsidy discipline cannot be completed, however, without identifying the negative effect produced by the subsidy that has to be addressed. Put differently, in what ways might a subsidy cause harm to another country? Different interpretations of the word “harm” may result in different understandings of the ultimate purpose of the WTO subsidy regime.

Professors Gene Grossman and Petros Mavroidis persuasively argue that the main objective of the current SCM Agreement is not to advance global economic efficiency, but rather to discourage subsidies that may harm *producers* in importing countries.¹⁸ They point out that the SCM Agreement “does not confine the use of CVDs to situations in which an importing country has established the presumption of welfare loss.”¹⁹ Indeed, the Agreement makes no reference to market structure, to labor-market conditions, or to consumer welfare. To the contrary, CVDs are permitted only when there has been injury to a domestic industry in an importing country.²⁰ Likewise, Articles 14 and 19 of the SCM Agreement require that the

¹⁸ GENE M. GROSSMAN & PETROS C. MAVROIDIS, *Here Today, Gone Tomorrow? Privatization and the Injury Caused by Non-Recurring Subsidies*, in THE WTO CASE LAW OF 2001, at 170, 180-86 (Henrik Horn & Petros C. Mavroidis eds., 2003); see also Wentong Zheng, *Counting Once, Counting Twice: The Precarious State of Subsidy Regulation*, 49 STAN. J. INT’L L. 427, 470 (2013) (stating that the SCM Agreement “makes no distinction between subsidies that distort the market process and subsidies that correct the market process, belying any claim that the purpose of subsidy regulation under the SCM Agreement is to enhance efficiency”).

¹⁹ *Id.* at 185.

²⁰ Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 231 (1999), 1869 U.N.T.S. 14, art. 15 [hereinafter SCM Agreement].

maximum amount of CVDs be the amount of the subsidy found to exist,²¹ which can only be understood as an attempt to restore the status quo prior to the injury to the domestic industry.

Professor Luka Rubini, while agreeing with the conclusion that the SCM Agreement seeks to discourage subsidies that may harm producers' interest,²² makes another important observation. In its original version, the SCM Agreement, by permitting certain subsidies that targeted market failure and other policy objectives,²³ embraced a more complex, balanced, and welfare-oriented approach that went beyond producers' interests. The authorization of certain categories of subsidies was also a recognition of other (non-trade) interests pursued by subsidies. Since the expiry of non-actionable subsidies in 1999, however, the balance has moved "too far towards *subsidy aversion*."²⁴

This current understanding of the object and purpose of the WTO subsidy discipline is, to a large extent, the result of viewing subsidies from a *trade* perspective, particularly in terms of their impact on market access. Indeed, the WTO is a "trade" organization that primarily aims to gradually eliminate trade barriers (tariffs, quotas, and other obstacles to market access) among its members.²⁵ When the GATT of 1947 was drafted, tariffs and quotas were considered to be the primary obstacles to international trade. To address this issue, the GATT sets out a general

²¹ *Id.*, arts. 14, 19.

²² LUKA RUBINI, *THE DEFINITION OF SUBSIDY AND STATE AID: WTO AND EC LAW IN COMPARATIVE PERSPECTIVE* 57 (Oxford University Press 2009).

²³ SCM Agreement, *supra* note 20, art. 8 (Contained the list of non-actionable subsidies, i.e. subsidies that are allowed and thus may not be countervailed: research and development subsidies, regional, and environmental subsidies.).

²⁴ RUBINI, *supra* note 22, at 59 (emphasis in original).

²⁵ According to the Preamble for the WTO Agreement, the ultimate objectives of the WTO are rather broad and include the increase of standards of living, the attainment of full employment; the growth of real income, and the expansion of production of, and trade in, goods and services. At the same time, the principal means to achieve these objectives are limited to the *reduction of trade barriers* and the *elimination of discriminatory treatment in international trade*. (See Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 4 (1999), 1867 U.N.T.S. 154, 33 I.L.M. 1144 (1994) [hereinafter WTO Agreement].)

prohibition on quotas;²⁶ tariff duties have been substantially reduced through negotiated reciprocal concessions.²⁷ The effects of reduced tariffs, however, can be easily replaced with other policy tools that produce the same protective effect, including subsidies.²⁸ For example, the potential for market access for foreign steel producers due to a tariff reduction on steel can be nullified by subsidizing domestic steel production. This concern has resulted in considering subsidies primarily as *obstacles to international trade*, which frustrate market access and the relevant tariff commitments. The adoption of a trade approach, focusing more on trade expectations and opportunities, has led to a rather blunt mechanism of operation: export and import substitution subsidies are considered prohibited *per se* – there is no need to establish the distortion element;²⁹ the injury to a domestic industry is the only element that has to be established in order to impose CVDs;³⁰ and other legitimate policy objectives the subsidies may address are not considered.

This approach, however, suffers from at least three significant problems. First, subsidies may not only affect market access, but may also distort *competition*. As mentioned above, the current WTO subsidy discipline is primarily concerned with the negative impact that a subsidy may have on *competitors* (i.e. foreign producers of the like product), which aligns with considering subsidies from a trade (market access) perspective. From a competition perspective,

²⁶ General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194, art. XI [hereinafter GATT].

²⁷ *Id.*, art. II. In the late 1940s, before the creation of the GATT, the average duty on industrial products imposed by developed countries was about 40% *ad valorem*. After the tariff negotiations, this average has been reduced to about 3.9% *ad valorem*.

²⁸ See, e.g., André Blais, *The Political Economy of Public Subsidies*, vol. 19, No. 2 COMP. POLIT. STUD. 201, 210 (1986) (stating that as the rates of tariffs have decreased in the industrialized world, governments have chosen to increase disbursement of production subsidies; the study finds that a reduction of 3 percentage points in tariffs leads to an increase of 1 percentage point in public subsidies).

²⁹ SCM Agreement, *supra* note 20, art. 3.

³⁰ *Id.*, art. 15.

on the other hand, the main concern of the subsidy regulation should be the protection of the *process of competition*, rather than the protection of competitors. In the competitive markets, firms seek to bring products to market that are more highly valued by consumers than those of their competitors, and to do so at the lowest cost possible.³¹ Thus, a subsidy affects competition when it allows inefficient firms to survive artificially in a competitive market to the detriment of more efficient competitors. In other words, from a competition perspective, the subsidy discipline should not necessarily be concerned with *any* harm to competitors, but only harm to competitors that are *more, or at least equally, efficient*.³² To illustrate this point, under the predatory pricing rule developed in EU law, prices are generally not regarded as predatory as long as they exceed average total cost.³³ Indeed, a dominant firm that lowers its prices to its average total cost may harm some of its competitors. The underlying idea, however, is to protect equally efficient competitors. Equally efficient competitors are always able to match a price that equals average total cost and thus cannot be driven out of the market.

Second, subsidies may affect the *total welfare* of the importing country, i.e. the sum of consumer welfare and producer welfare.³⁴ In certain cases, however, this effect may be positive even when the competitors (producers of the like product in the importing country) have been injured. For example, subsidization often results in cheaper prices, which could be beneficial for the upstream industry and consumers in the importing country; thus, when benefits to the upstream industry and consumers outweigh the loss to injured competitors, the subsidy produces,

³¹ ALFRED MARSHALL, PRINCIPLES OF ECONOMICS 197-204 (8th ed. 1920).

³² RUBINI, *supra* note 22, at 382-84; CHRISTIAN AHLBORN & CLAUDIA BERG, *Can State Aid Control Learn from Antitrust? The Need for a Greater Role for Competition Analysis under the State Aid Rules*, in THE LAW OF STATE AID IN THE EUROPEAN UNION 41, 50 (Andres Biondi, Piet Eeckhout & James Flynn eds., 2004).

³³ Case C-62/86, AZKO v. Commission, [1991] ECR I-3359, para. 7.

³⁴ HAL L. VARIAN, MICROECONOMIC ANALYSIS 160 (3d ed. 1992).

from the welfare perspective, a positive effect.³⁵ More importantly, economic theory shows that state intervention may, in fact, improve the functioning of markets when market mechanisms left alone fail to achieve the best outcome for the economy. Under such circumstances, subsidies (a second-best option) may increase welfare by offsetting the consequences of market failures.³⁶ Moreover, some economists suggest that subsidies should be a preferred form of government involvement in trade matters, as they are not as distorting as tariffs.³⁷ This is because a subsidy distorts only one margin (a production margin), whereas a tariff distorts two margins (a production margin and a consumption margin). In this context, Professors Grossmann and Mavroidis have pointed to an inconsistency in the SCM Agreement that prohibits subsidies, or makes them actionable, even when they arguably expand trade, while in the same circumstances instruments that reduce trade (such as tariffs) are neither prohibited nor actionable.³⁸

Finally, the current approach to regulating subsidies may result in over-disciplining this area. As the previous analysis demonstrates, the assessment of whether a subsidy is good or bad depends on the “impact standard” adopted. If this is a purely “effect on competitors” standard, the subsidy is bad, because it adversely affects the competing industry. If we apply a “competition” or “total welfare” standard, the conclusion might be different. As a result, the adoption of an approach focusing more on trade opportunities rather than on actual effects and competitive process, typically results in prohibiting measures that may be permitted under a

³⁵ See, e.g., ROBERT J. CARBAUGH, *INTERNATIONAL ECONOMICS* 208-09 (16th ed. 2016).

³⁶ PAUL R. KRUGMAN, MAURICE OBSTFELD & MARC J. MELITZ, *INTERNATIONAL ECONOMICS: THEORY AND POLICY* 226-27 (9th ed. 2012); JOSEPH E. STIGLITZ, *ECONOMICS OF THE PUBLIC SECTOR* 77 (3d ed. 2000); HANS W. FRIEDERISZICK, LARS-HENDRIK RÖLLER & VINCENT VEROUDEN, *European State Aid Control: An Economic Framework*, in *HANDBOOK OF ANTITRUST ECONOMICS* 625, 632-34 (Paolo Buccirossi ed., 2007).

³⁷ Jagdish N. Bhagwati & V.K. Ramaswami, *Domestic Distortions, Tariffs and the Theory of Optimum Subsidy*, 71(1) *J. POLIT. ECON.* 44, 44-50 (1963); HARRY G. JOHNSON, *Optimal Trade Intervention in the Presence of Domestic Distortions*, in *TRADE, GROWTH AND THE BALANCE OF PAYMENT* 3, 3-34 (Richard E. Caves, Harry G. Johnson & Peter B. Kenen eds., 1965).

³⁸ GROSSMAN & MAVROIDIS, *supra* note 18, at 186.

more competition-oriented approach. As Professor Rubini puts it, this creates the risk of “over-inclusions.”³⁹ Some commentators express concerns about over-disciplining subsidies.⁴⁰ In fact, research shows that a significant strengthening of the WTO subsidies regime may ultimately undermine the goals of that regime, even if we view subsidies primarily from a trade perspective, i.e. focusing on the ability of tariff negotiations to serve as the mechanism for expanding market access. The findings of Professors Kyle Bagwell and Robert Staiger demonstrate that subsidies rules which are too restrictive may have a “chilling” effect on tariff negotiations: if governments are too limited in using subsidies, it makes them more reluctant to relinquish their capacity to use tariffs as a policy tool.⁴¹ As a broader conclusion, while a regime which is too lenient on the use of subsidies would deter tariff concession (since the effect of reduced tariffs can be replaced with subsidies), too strict a regime may lead to the same result. Taking both arguments together, the SCM Agreement needs to strike a balance “between the benefits of government discretion in using domestic subsidies to address market distortion and the need to limit governments’ flexibility as a mean to secure market access commitments.”⁴²

³⁹ RUBINI, *supra* note 22, at 422.

⁴⁰ PETROS C. MAVROIDIS, TRADE IN GOODS: THE GATT AND THE OTHER WTO AGREEMENTS REGULATING TRADE IN GOODS 527-28 (2012) (arguing that “if subsidies become costly (say because of retaliations), then WTO Members might have an incentive to say impose high non-discriminatory taxes. This could be the case, for example, when governments, because they cannot use subsidies to address climate change issues, have recourse to high sale taxes, imposed on goods, creating similar problem”); Alan O. Sykes, *The Limited Economic Case for Subsidies Regulation*, 1, 6-8 E15 Initiative. Geneva: International Centre for Trade and Sustainable Development and World Economic Forum (2015), www.e15initiative.org/ arguing that since the current WTO rules on subsidies are “highly flawed from an economic perspective” and “there are no simple solutions to these problem,” the “second-best” solution could be a developing more narrow industry or sector-specific arrangements instead of generally applicable rules on subsidies).

⁴¹ K. Bagwell & R.W. Staiger, *Will International Rules on Subsidies Disrupt the World Trading System?*, 96 AM. ECON. REV. 877, 891 (2006).

⁴² Daniel Brou & Michele Ruta, *A Commitment Theory of Subsidy Agreements*, World Trade Organization, Economic Research and Statistics Division 1, 3 (2012), https://www.wto.org/english/res_e/reser_e/ersd201215_e.pdf.

The different dimensions of subsidies require a more balanced and sophisticated treatment. The crucial question is what should be the ultimate purpose of the rules. Should it be the safeguarding of market access opportunities or the preservation of effective competition and increasing total welfare (i.e. economic efficiency)? On the one hand, subsidies may endanger trade liberalization and make a market less open. Yet, at the same time, if subsidies are viewed primarily as barriers to trade, this could result in counteracting a subsidy that negatively affects foreign producers, even though it has no impact (or has a positive impact) on the competitive process (total welfare) in an importing country. This would unjustifiably limit the ability of an exporting country to address the problem of economic inefficiency in the domestic market by granting subsidies that target market failures. Additionally, if importing countries impose CVDs when competition is not distorted by the subsidy, this may create distortion(s) and thus reduce competition, possibly even leading to a domestic producer monopoly.

The underlying problem with a trade approach, which is based on the “effect on competitors” standard, is that it does not directly assess the effect of the subsidy on either market, competition, or consumers. As Friederiszick, Röller and Verouden point out, although the “effect on competitors” standard is closely linked to the idea of a “level playing field,” the idea of a level playing field focuses on *ex ante* fairness: a subsidy is not distortive if it leaves the market position of all competitors unchanged.⁴³ Since the inherent effect of most subsidies is to change the relative market position of firms, this approach essentially leads to most subsidies being “bad” and is thus not particularly helpful in distinguishing bad from good subsidies. By failing to identify subsidies that do distort competition, rules on subsidies based exclusively on a

⁴³ FRIEDERISZICK, RÖLLER & VEROUDEN, *supra* note 36, at 34-35.

trade approach do not serve the objective of promoting economic efficiency in order to increase total economic welfare.

There is merit in implementing a competition approach to regulating subsidies. Building upon suggestions by Professor Rubini⁴⁴ and Professors Grossman and Mavroidis,⁴⁵ the WTO subsidies regime should ensure that positive effects of a subsidy enjoyed in one country do not produce negative effects *in the form of distortion of competition* in other countries. That is, the main focus of the analysis should be on the actual effects of the measure on competition in the relevant market. Only those subsidies which have the effect of distorting competition should be targeted. The “effect on competitors” standard could still play a role in identifying the dynamic effects of a subsidy on competition, but it should not be endorsed as a final (or singular) objective.

This suggestion does not mean that the competition approach will replace the trade approach; rather, they will have to be suitably reconciled. While there are significant differences between international competition law and international trade law, they should be, to a large extent, complementary. As Dr. Martyn Taylor, who advocated for incorporating an international competition agreement in WTO law, explains:

Competition theory views a “barrier to trade” as a form of structural barrier to market entry created by government border regulation. If trade barriers are significant in respect of a particular domestic market, foreign firms will have a reduced ability to enter that domestic market to compete with domestic firms, reducing competition. Conversely, if such trade barriers are reduced, foreign firms can more readily enter domestic markets to increase competition. To the extent

⁴⁴ RUBINI, *supra* note 22, at 25-90, 422 (arguing that “more than traditional ‘trade regulation’ (aimed at removing obstacles to free movement of economic factors), [WTO subsidy rules] should be looked at as ‘competition regulation’ (aimed at directly controlling the impact of subsidies on the cost/revenue structure of recipients and, via this, on their competitors)”).

⁴⁵ GROSSMAN & MAVROIDIS, *supra* note 18, at 201 (arguing that “the SCM Agreement would better serve the objective of promoting efficiency in trade relations if Members were limited in their application of countervailing measures to circumstances in which they demonstrated that foreign subsidies have been damaging to aggregate economic welfare”).

that international trade law reduces such trade barriers, it is complementary to competition law as it facilitates competition by promoting greater market entry.⁴⁶

EU State aid law is a good example of the co-existence of trade and competition approaches to regulating subsidies. On the one hand, State aid control is a part of competition law. Article 107(1) on the Treaty on the Functioning of the European Union (TFEU) is not only part of the chapter on competition law, but also explicitly prohibits State intervention by means of aid, “which distorts or threatens to distort competition,” in the relevant market.⁴⁷ On the other hand, Article 107(1) has the ultimate goal of contributing to integration through creating and maintaining the internal market (i.e. market access): the Treaty requires that the application of State aid rules must never produce a result that is contrary to the Treaty rules governing free movements.⁴⁸ Accordingly, as Professors Andrea Biondi and Piet Eeckhout have concluded, the EU State aid rules are based on “the recognition that both sets of rules [internal market and competition]” are pursuing an identical aim, namely that of *ensuring the free movement of goods under normal conditions of competition.*⁴⁹

Identifying the object and purpose of the SCM Agreement as protecting competition on the market as a means of ensuring economic efficiency would both better serve the objective of promoting economic efficiency and better distinguish bad subsidies from good subsidies. This object and purpose should be implemented by adding an appropriately-worded Preamble to the

⁴⁶ MARTYN TAYLOR, INTERNATIONAL COMPETITION LAW: A NEW DIMENSION FOR THE WTO? 177 (2006).

⁴⁷ Consolidated Version of the Treaty on the Functioning of the European Union, 26 October 2012, Official Journal of the European Union (C 326/47), art. 107(1) [hereinafter TFEU].

⁴⁸ ANDREA BIONDI & MARTIN FARLEY, *The Relationship Between State Aid and the Single Market*, in EUROPEAN HANDBOOK ON STATE AID LAW 277, 282 (Erika Szyszczak ed., 2011) (with reference to Case *Commission v. Italy (Sovraprezzo)*).

⁴⁹ ANDREA BIONDI & PIET EECKHOUT, *State Aid and Obstacles to Trade*, in *The Law of State Aid*, in THE LAW OF STATE AID IN THE EUROPEAN UNION 108 (A. Biondi, P. Eeckhout & J. Flynn eds., 2004) (emphasis added).

SCM Agreement. Using the Preambles of the other WTO Agreements as models, I suggest the following language:

Members,

Having in mind the overall objectives of the GATT 1994;

Recognizing the need to clarify and reinforce rules for the application of the provisions of GATT 1994 that relate to subsidies and countervailing duties, in particular the provisions of Articles III:8(b), VI and XVI;

Recognizing that Members should not use subsidies that distort competition and reduce economic efficiency in the markets of other Members;

Desiring to ensure that countervailing duties and other legal actions to counteract subsidies themselves do not create distortion of competition; and

Recognizing that Members should not be prevented from granting subsidies to domestic producers in order to pursue legitimate objectives, provided that they comply with the relevant provisions of the GATT 1994 and other applicable WTO agreements;

Hereby *agree* as follows:

This language would recognize both the trade and competition purposes of a proper WTO subsidies regime, and would provide clear objective and purpose to be applied in the interpretation and application of the text of the SCM Agreement.

B. MODIFYING THE SCM AGREEMENT IN ORDER TO BRING IT IN LINE WITH THE PROPOSED OBJECT AND PURPOSE OF THE WTO SUBSIDIES REGIME

Legal and economic scholarship points to numerous concerns regarding the existing WTO subsidy rules.⁵⁰ Likewise, 182 proposals for amendments to the SCM Agreement have been

⁵⁰ See, e.g., Bagwell & Staiger, *supra* note 41, at 877-95; R. Diamond, *Economic Foundations of Countervailing Duty Law*, 29 VA. J. INT'L L. 767-812 (1989); R. Diamond, *Privatization and the Definition of Subsidy: A Critical Study of Appellate Body Textualism*, 11/3 J. INT'L LAW 649-78 (2008); RUBINI, *supra* note 22; Warren F. Schwartz

submitted by WTO Members in the Doha Round negotiations on subsidies and countervailing measures.⁵¹ While acknowledging that there are many important issues in the current WTO subsidies regime that must be addressed, the focus of this section is on the most crucial changes that should be made in order to bring it in line with an object and purpose which takes into account both trade and competition concerns.

1. Actionable Subsidies

Any specific subsidy within the meaning of Articles 1 and 2 of the SCM Agreement is subject to challenge in the event that it causes “adverse effects” to the interests of another Member.⁵² Article 5 distinguishes between three types of “adverse effect”: (1) injury to the domestic industry of another Member; (2) nullification or impairment of benefits accruing directly or indirectly to other Members under the GATT 1994; and (3) serious prejudice to the interests of another Member.⁵³ The second and third categories of actionable subsidies seem to be more suitable for a “competition-oriented” analysis. With regard to notification or impairment of benefits, GATT jurisprudence⁵⁴ has recognized that subsidies may alter and distort the competitive relationship between domestic and imported products so as to nullify or impair the

& Eugene W. Harper, Jr., *Regulation of Subsidies Affecting International Trade*, 70 MICH. L. REV. 831-58 (1972); Alan O. Sykes, *The Questionable Case for Subsidies Regulation: A Comparative Perspective*, 2 J. LEGAL ANALYSIS 473-523 (2019); Alan O. Sykes, *Second-best Countervailing Duty Policy: A Critique of the Entitlement Approach*, 21 LAW & POL’Y INT’L BUS. 699-721 (1989); WHAT SHAPES THE LAW? REFLECTIONS ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES (Luca Rubini & Jennifer Hawkins eds., 2016); Wentong Zeng, *The Pitfalls of the (Perfect) Market Benchmark: The Case of Countervailing Duty Law*, 19 MINN. J. INT’L L. 1-54 (2010); Zheng, *supra* note 18, at 427-76.

⁵¹ John R. Magnus, *World Trade Organization Subsidy Discipline: Is This the “Retrenchment Round”?*, 38 J. WORLD TRADE 990 (2004).

⁵² SCM Agreement, *supra* note 20, art. 5.

⁵³ *Id.*

⁵⁴ There has been no jurisprudence on the application of this provision in the SCM Agreement’s context so far.

reasonable expectations of benefits under the GATT.⁵⁵ More importantly, the *Oilseeds* Panel emphasized that the main focus should be on “condition of competition for trade, not on volumes of trade.”⁵⁶ Thus, by offsetting an efficiency-enhancing reduction of a distortive trade barrier, usually in the form of a bound-tariff concession, subsidizing governments are able to tamper with the competitive process, decreasing global efficiency.⁵⁷

Similar conclusions may be drawn with regard to “serious prejudice” claims. According to Article 6.3 of the SCM Agreement, “serious prejudice” arises where a subsidy (1) displaces or impedes the imports of a like product of another Member into the market of the subsidizing Member; (2) displaces or impedes the exports of a like product of another Member from a third country market; (3) results in a significant price undercutting by the subsidized product or significant price suppression, price depression or lost sales in the same market; or (4) leads to an increase in the world market share of the subsidizing Member.⁵⁸ The notion of “serious prejudice” is thus much more complex than that of “injury to the domestic industry” and more easily can be “construed in a ‘distortion of competition’ way.”⁵⁹ Likewise, whereas “injury to domestic producers” must be the result of the “subsidized imports,”⁶⁰ the language of Article 6.3 makes it clear that “serious prejudice” must be the “effect of the subsidy,” which suggests the direct link between the subsidy and the distortion of competition. This means that “serious

⁵⁵ GATT Working Party Report, *The Australian Subsidy on Ammonium Sulphate*, adopted 3 April 1950, BISD II/188 335, paras. 12-14.

⁵⁶ GATT Panel Report, *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, adopted 25 January 1990, BISD 37S/86, paras. 150.

⁵⁷ Beviglia Zampetti, *The Uruguay Round Agreement on Subsidies: A Forward-looking Assessment*, 29 J. WORLD TRADE 5, 22-23 (1995).

⁵⁸ SCM Agreement, *supra* note 20, art. 6.3.

⁵⁹ RUBINI, *supra* note 22, at 415; *see also* Zampetti, *supra* note 57, at 23.

⁶⁰ *See infra* notes 65-70 and accompanying text.

injury” analysis does not focus exclusively on protecting market access opportunities; rather, it expands to concentrate on the actual effect of the subsidy in the market.

Much more problematic, in terms of the protection of competition, is the third category of adverse effect, i.e. “injury to the domestic industry.” This concept is used in the same sense as in Part V of the SCM Agreement, which regulates CVDs unilaterally imposed by WTO Members. As has been established in the previous section, the “effect on competitors” approach considers the effect on neither competition nor total welfare.⁶¹ It is, therefore, rather difficult to reconcile the “injury to the domestic industry” concept with the objective of preserving competition. The most straightforward way to address this problem is to abolish this element, which would require prohibiting WTO Members from imposing CVDs. For example, Professor Sykes has advocated this solution, arguing that existing national CVD laws have no convincing efficiency rationale, either from a national or an international perspective, and thus have to be abolished.⁶² Given that CVDs, along with anti-dumping measures, continue to be important trade protection tools for many WTO Members, such a radical solution is not appropriate. It is appropriate, however, to make adjustments in order to make this category of subsidies more consistent with the overall goals of the WTO subsidies regime.

a. Changing the Causality Requirement for Establishing Injury to the Domestic Industry

Subsidies causing injury to the domestic industry are subject to challenge when three conditions are fulfilled: (1) there are subsidized imports, i.e. imports of products from producers who benefited from specific subsidies within the meaning of Articles 1 and 2; (2) there is injury to the

⁶¹ See *supra* notes 31-38 and accompanying text.

⁶² Alan O. Sykes, *Countervailing Duty Law: An Economic Perspective*, 89 COLUM. L. REV. 199-263 (1989). See *infra* Chapter II Section C for a more detailed discussion of Professor Sykes’s arguments.

domestic industry of the like products; and (3) there is a causal link between the subsidized imports and the injury to the domestic industry.⁶³ Although the rules on this category of subsidies are elaborated in Article 15 of the SCM Agreement, the language of the provisions governing causation in CVD proceedings is “remarkably ambiguous.”⁶⁴

Indeed, the relevant provisions attribute a language of causality alternatively to *subsidized imports* or to *subsidization*. Under Article VI:6 of the GATT, a WTO Member may not impose CVDs “unless it determines that the effect of . . . *subsidization* . . . is such as to cause or threaten material injury to an established domestic industry.”⁶⁵ Similarly, according to Article 21.1 of the SCM Agreement, CVDs may remain in force only “as long as and to the extent necessary to counteract *subsidization which is causing injury*.”⁶⁶ Article 15 (paragraphs 1, 2 and 4) of the SCM Agreement, on the other hand, refers exclusively to *subsidized imports* as a cause of injury. In particular, a determination of injury to the domestic industry must be based on the examination of (1) the volume of *subsidized imports* and the effect of the *subsidized imports* on prices in the domestic market, and (2) the consequent impact of the *subsidized imports* on the domestic producers of such products.⁶⁷ The most puzzling language, however, is found in Article 15(5), which contains both terms:

It must be demonstrated that the *subsidized imports* are, through the *effect of subsidies*, causing injury within the meaning of this Agreement. The examination of a causal relationship between the *subsidized imports* and the injury to the domestic industry shall be based on an examination of all relevant evidence. . . .⁶⁸

⁶³ See, e.g., Panel Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/R, adopted 1 June 2011, paras. 7.2082, 7.2058.

⁶⁴ Diamond, *supra* note 50, at 673.

⁶⁵ GATT, *supra* note 26, art. VI:3(a) (emphasis added).

⁶⁶ SCM Agreement, *supra* note 20, art. 21.1 (emphasis added).

⁶⁷ *Id.*, art. 15.1.

⁶⁸ *Id.*, art. 15.5 (emphasis added).

It seems, therefore, that two alternative constructions of the causation requirement are possible. One of them is that an “injury to the domestic industry” claim requires demonstration of injury caused by subsidized imports rather than by the subsidy itself. Support for this reading can be found in case law. In *Japan – DRAMS*,⁶⁹ the Appellate Body found that “for determining whether the ‘subsidized imports are, through the effects of subsidies, causing injury’ to the domestic industry” only the examination of the “effects of the subsidized imports” on prices and consequently on domestic producers is required.⁷⁰

The main problem with this approach is that the demonstrated causal link between subsidized imports and injury does not prove that such injury has, in fact, been caused by subsidization. As Dominic Coppens points out, any volume or price effect of subsidized imports is simply assumed to be the effect of subsidization.⁷¹ This could lead either to false positive findings (for example, in cases where increased volumes of imports are the result of factors other than subsidies, such as better quality, design or innovations) or to higher CVDs than would otherwise be justified. In other words, this approach may result in permitting CVDs imposed to offset an injury that is not being caused by the subsidies in question. Furthermore, it creates unnecessary inconsistency in interpretation of the “injury” standard: an “injury to the domestic industry” claim requires demonstration of injury caused by subsidized imports, whereas a “serious injury” claim requires demonstration of trade effects caused by subsidies. In other words, when assessing injury to the domestic industry, the focus is on the impact of subsidized

⁶⁹ Appellate Body Report, *Japan – Countervailing Duties on Dynamic Random Access Memories from Korea*, WT/DS336/AB/R, adopted 17 December 2007, para. 264.

⁷⁰ The finding is in line with the previous GATT jurisprudence. In *US – Atlantic salmon* report, when applying the almost identical provision of the Tokyo Round Subsidy Code, the Panel concluded that the expression “through the effects of subsidies” referred to the effects set forth in provisions regarding volume increase, price effects and impact on industry all of which contain the term “subsidized import.” (See GATT Panel Report, *US – Atlantic Salmon*, para. 328.)

⁷¹ DOMINIC COPPENS, *WTO DISCIPLINES ON SUBSIDIES AND COUNTERVAILING MEASURES: BALANCING POLICY SPACE AND LEGAL CONSTRAINTS* 240-41 (Cambridge University Press 2014).

import on the domestic industry of another Member, whereas the focus of the serious prejudice analysis is on the actual effect of a subsidy in a market. There is no sound justification for this bifurcation. Indeed, as Professor Rubini put it, the SCM Agreement is about how “to regulate subsidies and responses to them.”⁷²

Interpreting the current provisions of the Agreement as requiring demonstration of injury to the domestic industry by *subsidies* would better serve the objective of protection of competition and would reduce the current inconsistencies in the SCM Agreement. If the injury is the result of factors other than subsidization, no determination of injury should be made and, thus, no CVDs imposed.

b. Revising the Non-contribution Requirement A requirement that the injury must be caused by subsidization, moves the analysis to a second question: what kind of injury caused by subsidization should be addressed? Although “injury to the domestic industry” is not the same as distortion of competition, the injury test still may be construed in a “competition-oriented” way.

According to Article 15.5:

The authorities shall also examine any known factors other than the subsidized imports which at the same time are injuring the domestic industry, *and the injuries caused by these other factors must not be attributed to the subsidized imports*. Factors which may be relevant in this respect include, *inter alia*, the volumes and prices of non-subsidized imports of the product in question, contraction in demand or changes in the patterns of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry.⁷³

When assessing this non-attribution requirement, the Panel in *Mexico – Olive Oil* applied a two-part analysis in which an investigating authority is obliged to (1) list those factors known to it

⁷² RUBINI, *supra* note 22, at 409.

⁷³ SCM Agreement, *supra* note 20, art. 15.5 (emphasis added).

either as a result of its own investigation or because they were raised by interested parties; and (2) “analyze each of these factors separately and to explain the nature and extent of the injurious effects of these other factors, separating and distinguishing them from the injurious effects of the subsidized imports.”⁷⁴

As mentioned earlier,⁷⁵ protection of competition is not about protecting *any* competitors, but rather *equally effective* competitors. The non-attribution requirement is supposed to serve this purpose. Indeed, bad management, for example, could be another factor that injures the domestic producer; thus, excluding this factor ensures that only injury to more effective competitors is offset by CVDs. Nevertheless, the current reading of Article 15 adopted by the Appellate Body – requiring the establishment of a causal link between injury and subsidized imports rather than between injury and subsidization – makes the non-attribution requirement less effective in this respect. Following the “injury by subsidized imports” approach, investigating authorities analyze and exclude factors *other than subsidized imports*.⁷⁶

Consider this example: the increased volume of sales of an imported product that injured the domestic producer was due to better quality and design, which made this product more attractive to consumers. Let us also assume that the company that imports this product happened to receive a subsidy from its government. If the improvements in quality and design were due to the subsidy, the injury to domestic industry would be found based on either injury standard, i.e. “subsidized imports” or “subsidy.” Alternatively, if the subsidy had no impact on quality and design of the products in question, the outcome will depend on the injury standard chosen. Under the “injury by subsidized imports” approach, quality and design of the subsidized product are not

⁷⁴ Panel Report, *Mexico – Definitive Countervailing Measure on Olive Oil from the European Communities*, WT/DS341/R, adopted 21 October 2008, para. 7.305.

⁷⁵ See *supra* notes 31-33 and accompanying text.

⁷⁶ *Japan – DRAMS*, para. 267.

factors “other than subsidized imports;” to the contrary, they are the factors attributed to the subsidized import that injures the domestic industry. As a result, CVDs may be imposed to protect less efficient domestic producers. Under the “injury by subsidization” approach, on the other hand, quality and design are considered as factors that do not result from subsidization and, based on the non-attributable requirement, the injury caused by them should therefore not be attributed to the subsidy. Thus, the main problem with the current non-attribution requirement is that it does not distinguish those factors related to the “subsidized imports” that do not result from subsidization,⁷⁷ which may lead to protection of less efficient domestic producers, to the detriment of more efficient foreign competitors.

A shift from “injury by subsidized imports” to “injury by subsidization,” would resolve the conceptual problem – that is, that the current subsidies regime should not be over-inclusive and only regulate subsidies and responses to them. It also would better serve the objective of protection of competition. Although the rules applicable to the injury to domestic industry claims concentrates almost exclusively on protection of the domestic industry, the concept itself is reconcilable with the protection of competition. The latter could be better achieved by excluding, based on the non-attribution requirement, factors causing injury to the domestic industry that do not result from subsidization, rather than those that are not attributable to the subsidized imports.

2. Non-actionable Subsidies

The original SCM Agreement distinguished between prohibited, actionable and non-actionable subsidies. Under Article 8 of the SCM Agreement, non-actionable subsidies – i.e. subsidies that

⁷⁷ COPPENS, *supra* note 71, at 242; *see also Japan – DRAMS*, para. 82 (South Korea raised this concern in their arguments.).

are allowed and thus may not be countervailed – included three types of subsidies: regional aid, environmental subsidies, and subsidies for research and development (R&D) purposes.⁷⁸ However, the provisions of Article 8 on non-actionable subsidies are no longer in force, having lapsed five years after the SCM Agreement’s entry into force, because there was no consensus in favor of continuing the application of Article 8. As of January 1, 2000, the above mentioned types of subsidies have been actionable, provided that they are specific.⁷⁹

From the perspective of economic efficiency (i.e. total welfare), subsidies need to be regulated so that they do not distort resource allocation and thus reduce economic efficiency.⁸⁰ The current WTO subsidies regime, however, cannot be fully reconciled with the efficiency rationale. Subsidies may cause various effects, both positive and negative. As shown previously,⁸¹ a subsidy may in fact enhance economic efficiency when it corrects “market failures.” This is clearly the case with regard to the environmental, R&D and regional aid subsidies.

Climate change has been recognized as the “greatest market failure the world has ever seen,” capable, if unaddressed, of shaving off 5% (and as much as 20% if other risks and impact are taken into account) of the world’s GDP “each year, now and forever.”⁸² In contrast, the cost of action – reducing greenhouse gas emissions – can be limited to around 1% of global GDP

⁷⁸ SCM Agreement, *supra* note 20, art. 8.

⁷⁹ *Id.*, art. 31.

⁸⁰ *See, e.g.*, Zheng, *supra* note 18, at 470.

⁸¹ *See supra* notes 36-38 and accompanying texts.

⁸² NICOLAS STERN, THE ECONOMICS OF CLIMATE CHANGE: THE STERN REVIEW 349-455 (2007); The most recent studies point to the fact that the size of the problem has been grossly underestimated. *See* Nicolas Stern, *The Structure of Economics Modelling of the Potential Impacts of Climate Change: Grafting Gross Underestimation of Risk onto Already Narrow Science Model* 51(3) J. ECON. LIT. 839-59 (2013); Robert S. Pindyck, *Climate Change Policy: What Do the Models Tell Us?*, 51(3) J. ECON. LIT. 860-72 (2013).

each year.⁸³ Environmental subsidies, therefore, may promote the production and consumption of clean energy as a substitute for conventional fuels. In fact, the Appellate Body has acknowledged the importance of the environmental rationale for the government intervention:

Governments intervene by reducing reliance on fossil energy resources and promoting the generation of electricity from renewable energy resources to ensure the sustainability of electricity markets in the long term. Fossil energy resources are exhaustible, and thus fossil energy needs to be replaced progressively if electricity supply is to be guaranteed in the long term. Government intervention in favour of the substitution of fossil energy with renewable energy today *is meant to ensure the proper functioning or the existence of an electricity market with a constant and reliable supply of electricity in the long term.*⁸⁴

Likewise, the development and adoption of advanced technology is critical for growth in productivity and employment.

The private market generally underinvests in R&D. First, R&D can be expensive and uncertain. It is difficult to predict the cost and duration of a project and the commercial success of its outcome.⁸⁵ Second, when a company undertakes R&D, this activity may have positive spillover effects for other companies (diffusion of knowledge, technological breakthrough, etc.), thus making them more productive. Firms contemplating investments in R&D do not profit from the increased productivity of other firms, and, consequently, lack incentives to invest.⁸⁶ As a result, the market failure in relation to R&D activity means that the social rates of return from

⁸³ *Id.*

⁸⁴ Appellate Body Report, *Canada – Certain Measures Affecting the Renewable Energy Generation Sector; Canada – Measures Relating to the Feed-In Tariff Program (Canada – Renewable Energy)*, WT/DS412/AB/R; WT/DS426/AB/R, adopted 6 May 2013, para. 5.186 (emphasis added).

⁸⁵ Johan Hauknes & Lennart Nordgren, *Economic Rationales of Government Involvement in Innovation and the Supply of Innovation-Related Services*, Step Group Report prepared for the European Commission 3 (1999).

⁸⁶ FRIEDERISZICK, RÖLLER & VEROUDEN, *supra* note 36, at 14; Keith Maskus, *Information as a Global Public Good*, in Expert Papers Series, Secretariat of the International Task Force on Global Public Goods, 59, 62 (2006); Keith Maskus, *Research and Development Subsidies: A Need for WTO Disciplines?*, E15 Initiative, Geneva: International Centre for Trade and Sustainable Development and World Economic Forum, 1, 3 (2015), www.e15initiative.org/.

R&D are commonly higher than private rates of returns.⁸⁷ One of the means to address this market failure and to stimulate private investments is R&D subsidies to private firms.

Finally, many countries experience extreme disparities in the cost of investment in different regions within their borders and extreme variations in income and employment opportunities in those areas.⁸⁸ This type of market failure could be corrected with regional subsidies, which are often used by governments as a development tool for underdeveloped areas.

The current SCM Agreement makes no distinction between subsidies that distort and subsidies that address distortions. Thus, by failing to separate subsidies producing a positive effect from subsidies producing a negative effect, the rules do not serve the objective of promoting economic efficiency and increasing total welfare. There is broad scholarly agreement that certain subsidies have to be permitted and that appropriate reforms of the WTO rules on subsidies are needed.⁸⁹ Similarly, in the Doha Round negotiations some WTO Members submitted their proposals to reinstitute the green subsidy category.⁹⁰ Express exceptions for certain categories of legitimate subsidies should be provided.

⁸⁷ Hauknes & Nordgren, *supra* note 85, at 3; *see also* Pierre Mohnen, *R&D Externalities and Productivity Growth*, 18 STI REV. 39, 64 (1996) (The research has shown that in the majority of OECD countries, the social rate of return on investments in R&D and human capital largely exceeds the private rate of return.).

⁸⁸ Gary H. Horlick & Peggy A. Clark, *WTO Subsidies Discipline During and After the Crisis*, 13 J. INT'L ECON. L. 859, 870 (2010).

⁸⁹ *See, e.g.*, Liesbeth Casier & Tom Morenhout, *WTO Members, Not the Appellate Body, Need to Clarify Boundaries in Renewable Energy Support*, International Institute for Sustainable Development 1-10 (2013), https://www.iisd.org/pdf/2013/wto_members_renewable_energy_support.pdf; Aaron Cosbey & Petros C. Mavroidis, *A Turquoise Mess: Green Subsidies, Blue Industrial Policy and Renewable Energy: The Case for Redrafting the Subsidies Agreement of the WTO*, 17 J. INT'L ECON. L. 11-47 (2014); Horlick & Clark, *supra* note 88, at 859-74; ROBERT HOWSE, *Do the World Trade Organization Disciplines on Domestic Subsidies Make Sense? The Case for Legalizing Some Subsidies*, in *THE LAW AND ECONOMICS OF CONTINGENT PROTECTION IN INTERNATIONAL TRADE* 85-103 (Kyle W. Bagwell, George A. Bermann & Petros C. Mavroidis eds., 2010); Luca Rubini, *Ain't Wastin' Time No More: Subsidies for Renewable Energy, the SCM Agreement, Policy Space, and Law Reform*, 15(2) J. INT'L ECON L. 525-79 (2012); Debra Steger, *The Subsidies and Countervailing Measures Agreement: Ahead of Its Time or Time for Reform?*, 44 J. WORLD TRADE 779-96 (2010).

⁹⁰ Proposals by the European Communities, TN/RL/W/30, at 3 (November 2002); Proposals by Canada, TN/RLW/1, at 1-2 (April 2002); TN/RFL/W/112, at 4 (June 2003); Proposals by Venezuela, TN/RLW/41, at 1-2 (December 2002); Joint Proposals by Cuba and Venezuela, TN/RL/W/131, at 2 (July 2003).

a. Options for (Re)instating of the Category of Non-actionable Subsidies There are three possible avenues for justifying certain types of subsidies, and thus for placing them in the green subsidy category: (1) applying Article XX of the GATT; (2) reinstating Article 8 of the SCM Agreement; or (3) introducing a revised Article 8.

1. Applying GATT Article XX Article XX of the GATT (General Exceptions) allows WTO Members to maintain otherwise GATT-inconsistent measures if they have been adopted to promote or protect certain societal values. According to Article XX, “nothing in this [GATT] Agreement shall be construed to prevent the adoption or enforcement” of certain measures.⁹¹ Measures satisfying the conditions set out in Article XX are thus permitted, even if they are inconsistent with other provisions of the GATT.

Professor Rubini⁹² and Professor Howse⁹³ have argued that since the SCM Agreement is *lex specialis* to the GATT provisions, Article XX can be used as a defense against a claim of violation of the more specialized rules in the SCM Agreement. If this option is followed, there is then no need to amend the SCM Agreement in order to accomplish the result.

Indeed, there is partial overlap between the GATT Article XX list and the list in Article 8 of the SCM Agreement. In particular, Article XX includes two provisions with regard to environmental measures. the Article XX(b) exception for measures “necessary to protect human, animal or plant life or health,” and the Article XX(g) exception for measures “relating to the conservation of exhaustible natural resources.”⁹⁴ The Appellate Body has concluded that

⁹¹ GATT, *supra* note 26, art. XX.

⁹² Rubini, *supra* note 89, at 558-70.

⁹³ Robert Howse, *Climate Mitigation Subsidies and the WTO Legal Framework: A Policy Analysis*, International Institute for Sustainable Development 17-19 (2010), www.iisd.org.

⁹⁴ GATT, *supra* note 26, art. XX.

paragraph (b) may cover climate change⁹⁵ and that clean air can be protected under the paragraph (g) exception.⁹⁶

The GATT Article XX approach to green subsidies presents certain problems. First, it raises a broader concern about the applicability of Article XX to WTO agreements other than the GATT. Article XX states that “nothing in *this Agreement* shall be construed to prevent the adoption or enforcement” of certain measures.⁹⁷ The language may suggest a narrow scope for exception: it only applies to GATT obligations, not to other WTO agreements or instruments. The Appellate Body has addressed this issue. In *China – Publications*,⁹⁸ the Appellate Body concluded that Article XX of the GATT could apply to Article 5.1 of the China’s Accession Protocol, because the language of this provision expressly referred to “the WTO Agreement.” By contrast, in *China – Raw Materials*,⁹⁹ the Appellate Body rejected applying Article XX to Article 11.3 of the China’s Accession Protocol, because it refers to Article VIII of the GATT “but leaves out reference to other provisions of the GATT 1994, such as Article XX.” It seems, therefore, that the current WTO jurisprudence supports the view that where the Article XX exceptions are meant to apply to other WTO agreements, those exceptions must be expressly incorporated in the other agreements.

⁹⁵ Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, adopted 17 December 2007, para. 151. But *see also* Panel Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/R, adopted 12 June 2007, para. 7.46 (stating that a party invoking an environmental justification under Article XX(b) “has to establish the existence not just of risks to “the environment” generally, but specifically of risks to animal or plant life or health”).

⁹⁶ Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, para. 18.

⁹⁷ GATT, *supra* note 26, art. XX (emphasis added).

⁹⁸ Appellate Body Report, *China – Measures Affecting Trading Rights and Distribution Services for Certain Publication and Audiovisual Entertainment Products*, WT/DS363/AB/R, adopted 21 December 2009, paras. 216-23.

⁹⁹ Appellate Body Report, *China – Measures Related to the Exportations of Various Raw Materials*, WT/DS394/AB/R, adopted 30 January 2012, para. 291.

The SCM Agreement does not contain an explicit reference to Article XX of the GATT. It does, however, refer to the GATT Agreement as a whole. Under Article 32.1 of the SCM Agreement “[n]o specific action against a subsidy of another Member can be taken except *in accordance with the provisions of GATT 1994, as interpreted by this Agreement.*”¹⁰⁰ Some scholars have argued that, based on the decision in *China – Publication*, Article XX is applicable to the SCM Agreement, since a measure satisfying an exception is “*in accordance with the provisions of GATT.*”¹⁰¹ Yet, at the same time, the exact wording of Article 32.1 is “in accordance with the provisions of *GATT*, as interpreted by this Agreement.” This suggests that the SCM Agreement is an “interpretation” of the subsidies provisions contained in the GATT. In *Brazil – Desiccated Coconut*, when addressing the issue of the relationship between Article 10 of the SCM Agreement and Article VI of the GATT, the Appellate Body concluded that:

A countervailing duty being a specific action against a subsidy of another WTO Member, pursuant to Article 32.1, it can only be imposed “in accordance with the provisions of GATT 1994, as interpreted by this Agreement”. The ordinary meaning of these provisions taken in their context leads us to the conclusion that the negotiators of the *SCM Agreement* clearly intended that, under the integrated *WTO Agreement*, countervailing duties may only be imposed in accordance with the provisions of Part V of the *SCM Agreement* and Article VI of the GATT 1994, *taken together*. If there is a conflict between the provisions of the *SCM Agreement* and Article VI of the GATT 1994, the provisions of the *SCM Agreement* would prevail as a result of the general interpretative note to Annex 1A.¹⁰²

In other words, the provisions of the GATT, although generally applicable, must not be read in isolation but rather in conjunction with the SCM Agreement. Consequently, even though certain provisions of the GATT are clearly applicable to the SCM Agreement, Article XX might not be.

¹⁰⁰ SCM Agreement, *supra* note 20, art. 32.1 (emphasis added).

¹⁰¹ Rubini, *supra* note 89, at 566 (stating that “[i]n the *China – Publications* decision, the gateway for the applicability of GATT Article XX to the Protocol of Accession of China was the phrase ‘in conformity with the WTO Agreement’s’ in the Protocol’s Article 5.1.”).

¹⁰² Appellate Body Report, *Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/AB/R, adopted 21 February 1997, at 16 (emphasis in original).

Article 8 of the SCM Agreement defines the environmental subsidies that are considered non-actionable in a rather narrow way, imposing a number of caps.¹⁰³ For example, to qualify for an exemption, a subsidy must be a one-time recurring measure and limited to 20% of the cost of adaptation.¹⁰⁴ This suggests that negotiators of the SCM Agreement clearly intended to construct the Agreement as a specific regime with its own exceptions and limitations for subsidies, instead of making them subject to the general exceptions provisions of Article XX of the GATT that potentially may have a much broader scope of application regarding environmental measures. Furthermore, Article 8 was introduced on a provisional basis to apply for a period of five years with a possibility to extend its application.¹⁰⁵ The provisions of the Article expired in 2000 specifically because there was no consensus to renew them.¹⁰⁶ Therefore, considering both the provisions and legislative history of Article 8 of the SCM Agreement and Article VI of the GATT, it seems unlikely that the Appellate Body would allow the much broader exceptions taken through the back door of GATT Article XX after WTO Members had explicitly rejected much narrower exemptions (Article 8).

Second, even assuming that GATT Article XX applies to the SCM Agreement, there is only a partial overlap between the Article XX list and the list in Article 8 of the SCM Agreement, *i.e.* environmental subsidies. R&D subsidies, regional aid subsidies, and many other subsidies that WTO Members may want to include in a green subsidy category in the future (for

¹⁰³ SCM Agreement, *supra* note 20, art. 8.2(c) (An environmental subsidy is non-actionable, provided that it: “(i) is a one-time non-recurring measure; and (ii) is limited to 20% of the cost of adaptation; and (iii) does not cover the cost of replacing and operating the assisted investment, which must be fully borne by firms; and (iv) is directly linked to and proportionate to a firm’s planned reduction of nuisances and pollution, and does not cover any manufacturing cost savings which may be achieved; and (v) is available to all firms which can adopt the new equipment and/or production process.”).

¹⁰⁴ *Id.*, art. 8.2(c)(i) and 8.2(c)(ii).

¹⁰⁵ SCM Agreement, *supra* note 20, art. 31.

¹⁰⁶ *See, e.g.*, Cosbey & Mavroidis, *supra* note 89, at 41 (discussing the possible reasons for abandoning Article 8).

example, subsidies to small and medium enterprises or public health subsidies) do not fall within a category of general exceptions under Article XX. The application of Article XX to the SCM Agreement, therefore, seems to be only a partial solution to the problem of legalizing certain subsidies, since it covers only a limited number of subsidies that correct market distortions.

Finally, nothing in the GATT or the SCM Agreement suggests that CVDs may not be imposed against subsidies that are justified under Article XX of the GATT.¹⁰⁷ Thus, the application of Article XX to subsidies may result in a rather incoherent system where multilateral actions against certain types of subsidies are prohibited, whereas unilateral CVD actions against the same subsidies are still possible.

Based on the above reasons, the application of general exceptions under GATT Article XX to the SCM Agreement is not the appropriate avenue for justification of certain types of subsidies. Introducing a special provision on non-actionable subsidies into the SCM Agreement itself is a more promising solution.

2. Reinstating Article 8 of the SCM Agreement The easiest way to achieve a special provision on non-actionable subsidies in the SCM Agreement would be to simply re-instate Article 8 as presently drafted. However, the rules of Article 8, “which were negotiated and designed in the 1980s and early 1990s, are not up to the job in the current climate.”¹⁰⁸ For example, an environmental subsidy must be only a one-time non-recurring payment limited to 20 per cent of

¹⁰⁷ COPPENS, *supra* note 71, at 194; Howse, *supra* note 93, at 19.

¹⁰⁸ Luka Rubini, *Rethinking International Subsidies Disciplines: Rationale and Possible Avenue for Reform*, E15 Initiative. Geneva: International Centre for Trade and Sustainable Development and World Economic Forum, 1, 1 (2015), www.e15initiative.org/.

the cost of adaptation.¹⁰⁹ As Cosbey and Mavroidis point out, if this provision were in force today, most measures aimed at the protection of the environment would not pass the test.¹¹⁰

In order to serve the objective of enhancing economic efficiency, the provisions of Article 8 must distinguish between those subsidies that actually address market failures (such as climate change) and those that simply transfer income from taxpayers to protect domestic producers. Instead, the overly strict eligibility criteria of Article 8 have significantly narrowed the scope of non-actionable programs so that they would be unlikely to serve this objective.¹¹¹ For example, Article 8.2(c) of the SCM Agreement, which provides an exemption for environmental subsidies, only applies “to promote adaptation of *existing facilities* to new environmental requirements imposed by law and/or regulations which result in greater constraints and financial burden on firms.”¹¹² In other words, the exception only applies to situations where governments provide financial assistance to private firms to upgrade their existing facilities to meet new environmental standards set by the government. As Professor Jaemin Lee observes, this means that various green programs, including programs to develop renewable energy, are not covered by this provision.¹¹³ Consequently, Article 8 “does not permit governments to freely pursue any type of governmental initiatives for green activities, but instead

¹⁰⁹ SCM Agreement, *supra* note 20, arts. 8.2(c)(i), 8.2(c)(ii).

¹¹⁰ Cosbey & Mavroidis, *supra* note 89, at 45.

¹¹¹ *Id.* at 43-45; Horlick & Clark, *supra* note 88, at 870-71; Howse, *supra* note 93, at 20-21 (“The detailed nature of the conditions and criteria in these provisions reflect the great difficulty in ensuring that subsidies are effective for “legitimate” goals, for example capturing public goods in the case of research and development, while not providing any real competitive advantage to particular domestic industries.”); *see also* Negotiating Group on Rules, *WTO Negotiations Concerning the WTO Agreement on Subsidies and Countervailing Measures: Proposals by the European Communities*, TN/RL/W/30, 21 November 2002, at 2 (stating that non-actionable category has proven to “be of very limited use since the definitions and procedures were so complicated that no Member could make serious use of it”).

¹¹² SCM Agreement, *supra* note 20, art. 8.2(c) (emphasis added), *see also* footnote 33 explaining the “the term “existing facilities” means facilities which have been in operation *for at least two years* at the time new environmental requirements are imposed” (emphasis added).

¹¹³ Jaemin Lee, *SCM Agreement Revisited: Climate Change, Renewable Energy, and the SCM Agreement*, 15 WORLD TRADE REV. 613, 626 (2016).

only allows certain, stipulated types of government support for private entities.”¹¹⁴ For these reasons, the current language of Article 8 is neither sufficient nor appropriate to address the underlying problem.

3. Introducing a revised Article 8 It is submitted that the best way to reinstate the non-actionable subsidy category is to introduce a new Article 8, which will expand the scope of exceptions from the SCM Agreement so that they are tailored to the needs of the economic justification. Furthermore, to ensure the effectiveness of subsidies in pursuing public policy objectives, two important questions must be asked: (1) whether a subsidy is well designed to deliver a chosen objective, and (2) whether there is an incentive effect (i.e. whether the subsidy affects the behavior of the recipient in a way which meets the objective).

b. Creating Effective Article 8 Language

1. Adding a necessity test The rationale for introducing the category of non-actionable subsidies is that certain subsidies produce positive effects by enhancing economic efficiency (total welfare).¹¹⁵ In this respect, simply demonstrating that a subsidy falls under one of the exceptions listed in Article 8 is not enough to ensure that the subsidy is, in fact, effective and will lead to a welfare enhancing outcome. Put differently, pursuing a legitimate objective is a necessary but not a sufficient condition for a subsidy to be effective. It thus becomes necessary to ensure that a subsidy is well designed to deliver a chosen objective.

¹¹⁴ *Id.*

¹¹⁵ *See supra* notes 35-39 and accompanying text.

One of the key questions here is whether the subsidy is the appropriate and necessary instrument for achieving the chosen objective. Indeed, from an economic point of view, there might be other more effective and less trade-restrictive instruments that may be used to improve the functioning of markets.¹¹⁶ In cases in which a subsidy is not an appropriate instrument to address a market failure, the subsidy might create distortion of competitions and trade that could be avoided or limited by using other policy instruments (education, regulatory measures, taxation, etc.).¹¹⁷ Thus, a subsidy is not appropriate and necessary where other less-distortive instruments can achieve the same results.

In this regard, GATT Article XX and the relevant case law can offer useful guidance. Paragraphs (b) and (d) of Article XX of the GATT set forth a necessity test: measures must be *necessary* “to protect human, animal or plant life or health” or “to secure compliance with law and regulations.”¹¹⁸ The standard for this test was developed in *US – Section 337*:

A contracting party cannot justify a measure inconsistent with another GATT provision as “necessary” in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions.¹¹⁹

Put differently, a measure is not “necessary” if there is a reasonably available alternative measure that is either fully consistent or less inconsistent with the GATT. The Appellate Body,

¹¹⁶ FRIEDERISZICK, RÖLLER & VEROUDEN, *supra* note 36, at 40.

¹¹⁷ See, e.g., Sadeq Z. Bigdeli, *Resurrecting the Dead? The Expired Non-Actionable Subsidies and the Lingering Question of “Green Space,”* 8 MANCHESTER J. INT’L ECONOMIC L. 2, 8 (2011) (pointing out to the fact that on numerous occasions, rather than correcting distortions, green subsidies have often introduced them, have encouraged inefficiency, rent-seeking, and protection; when introduced have been difficult to remove; and may ultimately have been ineffective towards their stated aims).

¹¹⁸ GATT, *supra* note 26, art. XX.

¹¹⁹ GATT Panel Report, *United States – Section 337 of the Tariff Act of 1930*, 36S/345, adopted 7 November 1989, para. 5.26.

in *Korea – Beef*, explained that, in assessing whether an alternative measure is reasonably available, the important issue to consider is the extent to which the alternative measure “contributes to the realization of the end pursued.”¹²⁰

In *EC – Asbestos*¹²¹ – the first case in which an environmental measure passed the necessity test – the measure at issue was a French law prohibiting the manufacture, sale, distribution or import of chrysotile asbestos fibres and products containing chrysotile asbestos fibres. Canada claimed that the prohibition violated Article III of the GATT (by discriminating against Canadian asbestos in favor of French substitute products) and Article XI (the import ban). The EC invoked a defense under Article XX(b), arguing that the prohibition was a necessary measure to protect human life and health. The central issue, therefore, was whether a “reasonably available” alternative measure existed. Canada argued that “control used of chrysotile-cement products” represents a “reasonable available” measure that would serve the same purpose.¹²² The Appellate Body, however, disagreed, stating that:

In this case, the objective pursued by the measure is the preservation of human life and health through the elimination, or reduction, of the well-known, and life-threatening, health risk posed by asbestos. The value pursued is both vital and important in the highest degree . . . In our view, France could not reasonably be expected to employ *any* alternative measure if that measure would involve a continuation of the very risk that the Decree seeks to “halt.” Such an alternative measure would, in fact, prevent France from achieving its chosen level of health protection.”¹²³

The necessity test, therefore, is aimed to ensure that GATT-inconsistent measures can only be justified by the appropriateness of the instrument in question to meet the public policy objective.

¹²⁰ Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, para. 164.

¹²¹ Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001.

¹²² *Id.*, para. 173.

¹²³ *Id.*, paras. 172, 174.

The necessity test can also play an important role in assessing whether a subsidy is designed well enough to deliver the chosen objective. For example, let us consider the situation where a government, in order to promote renewable energy, grants a subsidy that includes a local content requirement, *i.e.*, a subsidy prohibited under Article 3 of the SCM Agreement.¹²⁴ If a production subsidy (*i.e.*, an actionable subsidy, which is not prohibited) could be alternatively used to achieve the same result, the import substitution subsidy is not necessary, since a less WTO-inconsistent measure can be employed to achieve this purpose. If, on the other hand, the only reasonable alternative measure is an import ban (prohibited by Article XI of the GATT), it is possible to argue that the chosen measure is necessary since, although both measures are prohibited, the import substitution subsidy is less distortive than an outright ban.

Introducing a necessity test into the subsidy determination is crucial for distinguishing good subsidies from bad subsidies, in order to ensure that exceptions are only applied to subsidies that are indeed designed to deliver the chosen objective and which do not create additional unnecessary distortions. Accordingly, the necessary test found in GATT Article XX should be incorporated into Article 8 of the SCM Agreement.

2. Considering the behavior of a subsidy recipient Another important question to be asked when assessing the effectiveness of a subsidy is whether it actually induces the recipient to change its behavior in such a way that the objective can be achieved. Indeed, from an efficiency perspective, it only makes sense to exempt a subsidy when it is capable of leading recipient firms to do something they would not normally do. In this way, as Professor Phedon Nicolaides points out, firms “can be induced to change their practices so that they facilitate the achievement of a particular public policy objective such as more research, training or environmental

¹²⁴ SCM Agreement, *supra* note 20, art. 3.1(b).

protection.”¹²⁵ Otherwise, a subsidy simply covers part of the costs of what firms would do anyway, and the subsidized activity cannot be presumed to be capable of achieving the objective. This kind of subsidy also distorts competition and thus reduces economic efficiency, because it keeps firms artificially afloat by covering costs they should be able to cover without government assistance.¹²⁶ Economic studies show that subsidies, especially in the areas of R&D and regional support, may lead to a significant reduction of private investment. Likewise, subsidies granted to larger firms are often found less effective than those granted to small and medium enterprises.¹²⁷

The EU system of State aid control offers valuable guidance in this regard. Under EU Law, a State aid must have an incentive effect. This principle was first established in the *Philip Morris* case¹²⁸ in 1980. There, the Dutch government granted aid to assist cigarette manufacturer Philip Morris in expanding its facility in the economically depressed region of Bergen-op-Zoom. Both the government and Philip Morris argued that the aid merited exemption under Article 107(3)(a) of the TFEU because it would help “promote the economic development” in the area, where the standard of living was “abnormally low.”¹²⁹ The European Court of Justice (ECJ) agreed that the region was economically depressed, but at the same time it noted that Philip

¹²⁵ Phedon Nicolaides, *Incentive Effect: Is State Aid Necessary when Investment is Unnecessary?*, 2 EUR. ST. AID L.Q. 230, 230 (2008).

¹²⁶ Phedon Nicolaides, *The Incentive Effect of State Aid: Its Meaning, Measurement, Pitfalls and Application*, 32 WORLD COMPETITION 579, 579-80 (2009); see also Bruce Lyons, John Van Reenen, Frank Verboven & Xavier Vives, *Commentary on EU Rescue and Restructuring Aid Guidelines*, Economic Advisory Group on Competition Policy 1, 2-4 (2008) (Summarizing the economic literature where it was found that many successful sectors witness productivity growth not because all firms present in the market gain in productivity, but rather because the more efficient and technologically advanced firms grow at the expense of the less efficient or innovative ones. To the extent that this process of exit, entry and expansion is disturbed by subsidies given to ailing firms, industry-wide productivity improvements are likely to be slowed down.).

¹²⁷ See, e.g., Chiara Criscuolo, Ralf Martin, Henry Overman & John Van Reenen, *The Causal Effects of an Industrial Policy*, National Bureau of Economic Research, Working Paper 17842, 1-27 (2012); Xulia González, Jordi Jaumandreu & Consuelo Pazó, *Barriers to Innovations and Subsidy Effectiveness*, 36 RJE 930, 930-50 (2005); Holger Görg & Eric Strobl, *The Effect of R&D Subsidies on Private R&D*, 74/294 *Economica* 215, 215-34 (2007).

¹²⁸ Case 730/79, *Philip Morris v. Commission*, [1980] ECR 2671.

¹²⁹ *Id.*, para. 17.

Morris, a healthy and profitable company, was capable of undertaking the investment on its own and did not require government assistance. The ECJ ruled that Member States are not allowed to “make payments which would improve the financial situation of the recipient undertaking although they were not necessary for the attainment of the objectives specified in [Article 107(3)].”¹³⁰

Similarly, in *Peugeot-Citroën*, France planned to grant €6 million aid to Peugeot-Citroën for the development of a hybrid diesel car. The Commission’s preliminary conclusion was that Peugeot-Citroën, the second largest automobile manufacturer in Europe, would have undertaken the project anyway, even in the absence of State aid. Moreover, since similar projects had already been announced by other car manufacturers, the Commission doubted that a market failure had existed in the first place.¹³¹ As EU Competition Commissioner Neelie Kroes explained: “The Commission strongly support the development of more environmentally-friendly cars. However, we have to ensure that the aid is not spent on R&D that would have been carried out by Peugeot-Citroën in any event or which its competitors may carry out without State aid.”¹³²

Over time, the Commission has substantially increased emphasis on an “incentive effect.”¹³³ In particular, the incentive effect test became a part of the balancing test, introduced

¹³⁰ *Id.*

¹³¹ Commission Decision N 530/2007, Opening of formal investigation on R&D Aid to Peugeot-Citroën (France). The case was withdrawn.

¹³² *State aid: Commission opens in-depth inquiry into proposed French R&D aid to Peugeot-Citroën for hybrid diesel car*, European Commission Press Release (November 2007), http://europa.eu/rapid/press-release_IP-07-1679_en.htm.

¹³³ See, e.g., VINCENT VERouden, *EU State Aid Control: The Quest for Effectiveness*, in WHAT SHAPES THE LAW? REFLECTIONS ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES 129-35 (Luca Rubini & Jennifer Hawkins eds., 2016); Fiona Wishlade, *To What Effect? The Overhaul of the Regional Aid Guidelines – The Demise of Competition Effects and Rise of Incentive Effect?*, 4 EUR. ST. AID L.Q. 659, 660-66 (2013).

by the 2005 State Aid Action Plan.¹³⁴ The completion of the State Aid Modernization¹³⁵ process in 2014 has led to a heightened increase in the requirements on the incentive effects.¹³⁶ The Commission has defined how the incentive effect has to be understood and measured in a number of recent policy documents, most notably the General Block Exemption Regulation,¹³⁷ the Guidelines on Environmental Protection,¹³⁸ the Framework for Research and Innovation,¹³⁹ and the Guidelines on Regional State Aid.¹⁴⁰ All the Guidelines have introduced a “substantive” incentive test. In order for a State aid to be exempted, it must be shown that (1) the beneficiary firm has changed its level of activity by doing something “extra,” which goes beyond its normal practices, and consequently corrects the market failure and improves the market outcome,¹⁴¹ and (2) without the aid the firm would not carry out this project, or it would carry it out in a restricted or different manner.¹⁴²

¹³⁴ State aid Action Plan – Less and better targeted State Aid: a roadmap for State Aid reform 2005-2009, COM (2005) 107 final [hereinafter SAAP]. See *supra* Chapter V section 1 for a more detailed discussion on the SAAP and the balancing test.

¹³⁵ Communication from the Commission, *EU State Aid Modernization*, COM/2012/0209 final, 08/05/2012 [hereinafter SAM].

¹³⁶ VEROUDEN, *supra* note 133, at 133-35.

¹³⁷ Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty Text with EEA relevance, O.J. L 187, 26/06/2014.

¹³⁸ Communication from the Commission – Guidelines on State aid for environmental protection and energy 2014-2020, O.J. C 200, 26/06/2014 [hereinafter Guidelines on Environmental Protection].

¹³⁹ Communication from the Commission – Framework for State aid for research and development and innovation, O.J. C 198, 27/06/2014 [hereinafter Framework for Research and Innovation].

¹⁴⁰ Guidelines on regional State aid for 2014-2020, O.J. C 209, 23/07/2013 [Guidelines on regional State aid].

¹⁴¹ Guidelines on Environmental Protection, *supra* note 138, para. 49 (“An incentive effect occurs when the aid induces the beneficiary to change its behaviour to increase the level of environmental protection or to improve the functioning of a secure, affordable and sustainable energy market. . . .”); Framework for Research and Innovation, *supra* note 139, para. 62 (“An incentive effect occurs where the aid changes the behaviour of an undertaking in such a way that it engages in additional activities. . . .”); Guidelines on regional State aid, *supra* note 136, para. 60 (“An incentive effect is present when the aid changes the behaviour of an undertaking in a way it engages in additional activity contributing to the development of an area. . . .”).

¹⁴² *Id.*

The incentive test plays an important role in ensuring that a subsidy is only granted in order to motivate a change in the beneficiary's behavior, achieving a public-interest objective rather than simply helping a firm stay in the market. As the EU case law demonstrates, the incentive effect test is not met when the firm would have to carry out the activity anyway, either because a market forces it or the law obliges it to do so.¹⁴³ Thus, an incentive test should be added to Article 8 of the SMC Agreement.

3. Countervailing Duties

In addition to subsidies themselves, measures used to counteract subsidies can also create market distortions and reduce welfare. Of all these remedies, CVDs represent the biggest concern from the welfare viewpoint. Having been designed to protect national producers from competing products, rather than protection competition itself, they often reduce the welfare of the importing country by creating additional distortions. As Professor Sykes has argued, CVD laws:

cannot be explained or justified as a mechanism for the imposition of welfare-enhancing duties in competitive markets competitive market. Existing law largely ignores the factors that would be essential to ascertain the welfare consequences of duties, and the central features of existing law . . . have little or no bearing on the welfare effects of duties in competitive settings. Thus, a net gain to the economy under existing law can arise only by chance.¹⁴⁴

To address this problem and to minimize the potential negative effects produced by CVDs, the use of CVDs should be restricted.

¹⁴³ Nicolaidis, *supra* note 125, at 235. Compare this with the provision of Article 8.2(c) of the SCM Agreement which only exempts the environmental subsidy granted to firms to upgrade their facilities *to meet new environmental standards set by the government*.

¹⁴⁴ Sykes, *supra* note 62, at 199.

a. Adding a Public Interest Requirement Countervailing duties assist a domestic producer in recovering from the injury caused by subsidized imports. Their effect, however, is not limited exclusively to domestic producers. They also affect the economy of an importing country as a whole. Accordingly, by imposing costs on other economic sectors and on consumers, which are not outweighed by the benefits to the industry receiving protection from subsidized imports, CVDs may result in reducing economic welfare.¹⁴⁵

Indeed, the effect of CVDs cannot be viewed in isolation. First, since CVDs often target raw materials or intermediate goods,¹⁴⁶ which are further used by domestic industries for processing purposes, the imposition of CVDs may result in an increase in production costs for other products. This, in turn, may impact the ability of downstream industry to compete both domestically and in export markets.¹⁴⁷ Second, CVDs may negatively affect importers of the product concerned since they cause their costs to increase. The extent of CVD's impact on the importer largely depends on the product's share of total turnover of the product's importers and profit margins, and to what extent importers are able to pass on the cost increase to their customers.¹⁴⁸ Third, the imposition of CVDs generally does not benefit consumers, since prices will increase and the product range available to the consumer may also be reduced. Finally, CVDs may lead to a reduction of competition and even to a domestic producer monopoly.

To address these concerns, and to strike a balance between the various competing interests, some WTO Members have introduced a "public interest" provision, which requires the investigating authorities to take into account broader public interest concerns before they impose

¹⁴⁵ M. C. E. J. BRONCKERS, *Private Remedies Against Foreign Subsidization: A European View*, in SUBSIDIES AND INTERNATIONAL TRADE: A EUROPEAN LAWYERS' PERSPECTIVE 187, 192 (Jacques H.J. Bourgeois ed., 1991).

¹⁴⁶ See, e.g., Commission Regulation No 1092/2000 of 24 May 2000, O.J. 2000 L 124/26.

¹⁴⁷ WOLFGANG MUELLER, NICHOLAS KHAN & TIBOR SCHARF, EC AND WTO ANTI-DUMPING LAW 722 (2009).

¹⁴⁸ Adinda Sinnaeve, *The "Community Interest Test" in Anti-Dumping Investigations: Time for Reform?*, 2 GLOBAL TRADE & CUSTOMS J. 157, 165 (2007).

CVDs. A public interest clause is incorporated into domestic CVD laws of Argentina,¹⁴⁹ Brazil,¹⁵⁰ Canada,¹⁵¹ China,¹⁵² EU,¹⁵³ Ukraine¹⁵⁴ and some others. For example, the EU developed the concept of the “Union interest,” which is established by analyzing “all the various interests taken as a whole, including the interests of the domestic industry and users and consumers.”¹⁵⁵ The Union interest is considered a substantial element (together with subsidized imports, injury and causation) in each and every CVD investigation conducted in the EU.¹⁵⁶ The EU investigative authorities must give consideration to the Union interest before imposing definitive, as well as provisional, measures.¹⁵⁷

In Canada, a public interest inquiry is not a mandatory part of every CVD investigation. Nevertheless, after having established that subsidized imports have caused injury to the domestic producer, the investigative authority may initiate a public interest inquiry either on its own initiative or on the request of an interested party.¹⁵⁸ During the public interest inquiry, the investigative authority must take into account “any factors . . . that it considers relevant.”¹⁵⁹

Ukraine has essentially adopted the EU approach, with language regarding public interest, but with minor differences. In particular, the public interest, apart from the interest of

¹⁴⁹ Decree No. 2121/94 of 30 November 1994, art. 51.

¹⁵⁰ Resolution No. 13 of 29 February 2012 on establishing the Technical Group for public interest assessment.

¹⁵¹ Special Import Measures Act, R.S.C., 1985 c. S-15, art. 45.1.

¹⁵² Anti-Subsidy Statute of 1 January 2002, art. 34.

¹⁵³ Council Regulation 597/2009 of 11 June 2009 on protection against subsidized imports from countries not members of the European Community O.J. L 188/93, art. 31.1 [hereinafter Regulation].

¹⁵⁴ The Law of Ukraine No. 331-XIV of 22 December 1998 on protection of the domestic producer against subsidized imports, lastly amended 11 August 2013, art. 35.

¹⁵⁵ Regulation, *supra* note 153, art. 31.1.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*, arts. 12.1(d), 15.1.

¹⁵⁸ Special Import Measures Act, R.S.C., 1985 c. S-15, art. 45.1.

¹⁵⁹ *Id.*, art. 45.3.

domestic industry and consumers, expressly includes “the assessment of the effect of subsidized imports on employment of population, investments of domestic industry and consumers, as well as international economic interests of Ukraine.”¹⁶⁰

To a certain extent, a public interest clause is incorporated into the SCM Agreement. Under Article 19.2 (Imposition and Collection of Countervailing Duties):

... it is *desirable* that ... procedures should be established which would allow the authorities concerned to take due account of representations made by *domestic interested parties whose interests might be adversely affected by the imposition of a countervailing duty*.¹⁶¹

As is evident from the language of the Article, however, the “public interest” inquiry in the WTO context is discretionary and limited to taking into consideration the interests of consumers and industrial users.¹⁶² As a result, many WTO Members, including the United States, have chosen not to introduce this factor in their domestic CVD law.

Although a mandatory public interest clause in the SCM Agreement has its undeniable merits from an efficiency viewpoint, WTO Members obviously have different opinions on this issue, which are reflected in their national laws. The negotiations regarding the possible inclusion of a mandatory public interest clause into the Anti-Dumping Agreement during the Doha Round can shed some light on their readiness to reconcile these differences. An initial proposal on public interest submitted by Brazil, Canada, China and others included a non-inclusive list of criteria for measuring public interest.¹⁶³ The proposal was strongly opposed by

¹⁶⁰ The Law of Ukraine No. 331-XIV of 22 December 1998 on protection of the domestic producer against subsidized imports, lastly amended 11 August 2013, art. 35 (the term “consumer” is understood as the final consumers as well as industrial users of the product subject to the investigation).

¹⁶¹ SCM Agreement, *supra* note 20, art. 19.2 (emphasis added).

¹⁶² *Id.* n.50 (“the term “domestic interested parties” shall include consumers and industrial users of the imported product subject to investigation”).

¹⁶³ WTO Negotiating Group on Rules, Paper from Canada, *Public Interest*, TN/RL/GEN/85, 17 November 2005, at 1; WTO Negotiating Group on Rules, Communication from Hong Kong, China; Israel; Japan; Korea, Rep. of

other Members, primarily the United States, which argued that a public interest clause would “impinge on Members’ sovereignty” and that this discretion should be left to individual Member States.¹⁶⁴ The subsequent proposals, submitted by Canada and supported by China and other Members, suggested including a public interest clause would only require WTO Members to provide in their national laws a mechanism for public interest consideration without specifying criteria for its measuring in the SCM Agreement.¹⁶⁵ At this point, it is unclear whether the WTO Members will agree on a provision on the public interest.

The inclusion of a public interest test in the SCM Agreement would be a positive change. WTO Members need a “policy space” to tailor the public interest concept to serve the best interest of their economies and societies. Criteria for the test have to remain at the discretion of Members. This may also help Members with opposing views to reconcile their positions, since this approach answers the sovereignty concern expressed by some Members. However, limiting public interest exclusively to the interests of consumers and industrial users (as the current language of the SCM Agreement does) will not offer much “policy space” for Members. To serve this purpose, the public interest clause must take into account much broader public interest concerns.

To better assess the potential effects of CVDs, a *mandatory* public interest clause should be included in the SCM Agreement. Borrowing from the solution proposed by some WTO

Norway; Singapore; Switzerland; the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu; and Thailand, *Further Submission on Public Interest*, TN/RL/GEN/53, 1 July 2005, at 1.

¹⁶⁴ WTO Negotiating Group on Rules, *Communication from the Chairman*, TN/RL/W/254, 21 April 2011, at 19.

¹⁶⁵ WTO Negotiating Group on Rules, Paper from Canada, *Procedures for Adversely Affected Domestic Interested Parties*, TN/RL/GEN/111, 21 April 2006, at 1; WTO Negotiating Group on Rules, *Communication from Colombia; Hong Kong, China; Israel; Japan; Norway; Singapore; Switzerland; the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu; and Thailand, Public Interest*, TN/RL/W/222, 12 March 2008, at 3.

Members with regard to the public interest inquiry for anti-dumping investigations,¹⁶⁶ the public interest provision should only require WTO Members to provide in their national laws a mechanism for consideration of the public interest, without specifying criteria for its assessment. The SCM Agreement should also define “public interest” more broadly, referring not only to the interests of consumers and industrial users, but also *other relevant interests*.

b. Revising the Lesser Duty Rule

1. The existing approach under SCM Agreement Article 19 Article 19 of the SCM Agreement provides that a CVD must never exceed “the amount of the *subsidy* found to exist.”¹⁶⁷ It also states that it is *desirable* that “the duty should be less than the total amount of the subsidy if such lesser duty would be *adequate to remove the injury* to the domestic industry.”¹⁶⁸ In other words, the lesser duty rule is encouraged but not mandatory: it may be implemented in domestic legislation at the discretion of a WTO Member. Some WTO Members, such as Argentina,¹⁶⁹ Australia,¹⁷⁰ Brazil,¹⁷¹ and EU¹⁷² have incorporated this provision in their CVD law and thus cap the level of a CVD at the level of injury to the domestic industry (*i.e.*, the injury margin). Yet, at the same time, the majority of WTO Members, including the United

¹⁶⁶ *Id.*

¹⁶⁷ SCM Agreement, *supra* note 20, art. 19.4.

¹⁶⁸ *Id.*, art. 19.2 (emphasis added).

¹⁶⁹ Decree No. 2121/94 of 30 November 1994, art. 50.

¹⁷⁰ Customs Tariff (Anti-Dumping) Act of 1975, Sec. 10.

¹⁷¹ Decree No. 1751 of 19 December 1995 on administrative procedures regarding the imposition of countervailing measures, art. 21.

¹⁷² Regulation, *supra* note 153, art. 15.1.

States and Canada, do not apply the lesser duty rule, and impose CVDs based on the amount of the countervailable subsidy (*i.e.*, the subsidy margin).

The current “amount of subsidy” approach, adopted by the SCM Agreement, is, to a large extent, the result of viewing subsidies from a *trade* perspective,¹⁷³ focusing on market access. This means that the emphasis is on the protection of the relevant tariff commitments and trade expectations of WTO Members. It is useful to recall that the U.S. CVD law – one of the first national CVD laws – originally only applied to dutiable imports and no injury test was required.¹⁷⁴ This suggests that, at that time, the main goal of the CVD law was to preserve the level of protection established by existing tariffs. Even though CVD laws have undergone significant changes since those nineteenth century provisions, the fact that the SCM Agreement caps the level of CVDs at the level of a subsidy rather than injury suggests that the primary goal of imposing CVDs is not to remedy injurious effects caused a subsidy, but instead to restore the status quo prior to the injury or, put differently, to “re-establish” the balance of concessions between the parties.¹⁷⁵

2. The purpose of the subsidy regime and the lesser duty rule If, however, the ultimate purpose of the subsidy regime is to protect competition and to increase economic efficiency, as is proposed above,¹⁷⁶ the main focus should be on the actual *effect* of a subsidy. CVDs are meant to remedy effects and, therefore, the level of a CVD should be limited to an amount necessary to

¹⁷³ See *supra* notes 25-30 and accompanying text.

¹⁷⁴ Tariff Act of 1897, ch. 11, § 5, 30 Stat. 151, 205 (Dingley Tariff). See *supra* Chapter VI Section 1 for a more detailed discussion on the early U.S. CVD law.

¹⁷⁵ See, e.g., DAVID PALMETER & STANIMIR ALEXANDROV, *Inducing Compliance, in* THE POLITICAL ECONOMY OF INTERNATIONAL TRADE LAW: ESSAYS IN HONOUR OF ROBERT E. HUDEC 646-47 (Daniel L.M. Kennedy & James D. Southwick eds., 2012) (arguing that the purpose of countermeasures under WTO law is limited to restoring the balance of concessions and nothing else).

¹⁷⁶ See *supra* notes 15-49 and accompanying text.

remedy such effects (*i.e.*, injury to the domestic producer). Likewise, downstream industry and consumers negatively affected by CVDs generally benefit from this limit on a CVD, because it reduces the burden of any resulting price increase. In this way, the lesser duty rule at least partially eliminates the negative effect of CVDs.¹⁷⁷ Thus, a mandatory lesser duty rule, which requires the imposition of CVDs based on the level of the injury to the domestic producers, better serves the objective of the WTO subsidies regime.

3. The lesser duty rule and conformity with other WTO procedures A mandatory lesser duty rule is also be more in line with the current WTO remedial regime. Under the WTO Dispute Settlement Procedures, if a responding Member fails to bring its WTO-inconsistent measure into compliance with its WTO obligation pursuant to the Dispute Settlement Body's recommendation, a complaining party may be authorized to apply countermeasures, *i.e.*, suspension of concessions or other obligations.¹⁷⁸ To ensure that Members do not abuse their right to impose restrictions on trade, the level of countermeasures is subject to limitation under Article 22.4 of the DSU, which provides that "the level of the suspension of concessions . . . shall be *equivalent to the level of the nullification or impairment.*"¹⁷⁹ In other words, the level of countermeasures must be limited based on the level of harmful effects caused by a violation. This effect-based approach was first developed in the *EC – Bananas III* case,¹⁸⁰ and has been

¹⁷⁷ See, *e.g.*, PAUL I.A. MOEN, PUBLIC INTEREST ISSUES IN INTERNATIONAL AND DOMESTIC ANTI-DUMPING LAW: THE WTO, EUROPEAN COMMUNITIES AND CANADA 5 (1998) (arguing that the lesser duty rule in the EU, as an instrument of balancing producer and non-producer interests, is more effective than the application of public interest clause in the EU and Canada).

¹⁷⁸ DSU, *supra* note 3, art. 22.

¹⁷⁹ *Id.*, art. 22.4 (emphasis added).

¹⁸⁰ Decision by the Arbitrators, European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities Under Article 22.6 of the DSU, WT/DS27/ARB, adopted 9 April 1999.

followed in all cases decided under the Article 22.4 equivalence standard.¹⁸¹ Similarly, the effect-based approach is applied to safeguard measures, which are imposed unilaterally by an importing Member when increased imports cause serious injury to an importing Member's domestic industry.¹⁸² According to Article 5.1 of the Agreement on Safeguards, “[a] Member shall apply safeguard measures only to the extent necessary to . . . remedy serious injury and to facilitate adjustment.”¹⁸³

The SCM Agreement also requires the effect-based approach with regard to counteracting actionable subsidies – *i.e.*, subsidies that cause adverse effects, including injury to the domestic industry – by using the WTO dispute settlement system. In this case, Article 7.9 of the SCM Agreement requires that countermeasures be “commensurate with the degree and nature of the adverse effects determined to exist.”¹⁸⁴ It is only with regard to prohibited subsidies that the Agreement sets forth another standard. If a subsidy is found by a WTO adjudicating body to be prohibited, the subsidizing Member has to “withdraw the subsidy without delay.”¹⁸⁵ Under Article 4.10 of the SCM Agreement, if this recommendation is not implemented, “the DSB shall grant authorization to the complaining Member to take *appropriate* countermeasures.”¹⁸⁶ The “appropriate countermeasures” have been interpreted to mean countermeasures based on the amount of a prohibited subsidy. In *Brazil – Aircraft (Article 22.6)*, the Arbitrators refused to apply the traditional effect-based approach and concluded that “when

¹⁸¹ See, e.g., R. RAJESH BABU, REMEDIES UNDER THE WTO LEGAL SYSTEM 292-96 (2012); Thomas Sebastian, *World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness*, 48 HARV. INT'L L.J. 337, 350-57 (2007).

¹⁸² Agreement on Safeguards, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 231 (1999), 1869 U.N.T.S. 154, art. 5.1 [hereinafter Safeguards Agreement].

¹⁸³ *Id.*

¹⁸⁴ SCM Agreement, *supra* note 20, art. 7.9.

¹⁸⁵ *Id.*, art. 4.7.

¹⁸⁶ *Id.*, art. 4.10 (emphasis added).

dealing with a prohibited subsidy, an amount of countermeasures that corresponds to the total amount of the subsidy is ‘appropriate.’”¹⁸⁷ This amount-of-subsidy approach has been applied in all subsequent arbitrations conducted with regard to prohibited subsidies.¹⁸⁸ Thus, the general rule is that countermeasures are meant to address injurious *effects* caused by violations of WTO obligations and, therefore, the level of countermeasures should be limited based on the level of these effects. The amount-of-subsidy approach is an exception to this rule and is only applicable to prohibited subsidies.

4. Applying WTO procedures to unilateral CVD determinations Unlike challenging subsidies by bringing the case to the WTO adjudicating body, where procedures and standards for prohibited¹⁸⁹ and actionable¹⁹⁰ subsidies are different, the unilateral procedure of imposing CVDs does not distinguish between prohibited and actionable subsidies. Indeed, the only basis for imposing CVDs is *injury* to the domestic industry caused by a subsidy, irrespective of whether it is actionable or prohibited.¹⁹¹ This fundamentally differs from specifically challenging prohibited subsidies through the WTO dispute settlement procedure. For example, a subsidy that falls within the scope of the Illustrative List of Export Subsidies is deemed prohibited; there is no need to establish injury caused by this subsidy.¹⁹² In other words, prohibited subsidies are prohibited *per se* and if a Member does not withdraw it, the countermeasures are based on the

¹⁸⁷ Decision by the Arbitrators, *Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil Under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS46/ARB, adopted 28 August 2000, para. 3.60.

¹⁸⁸ Sebastian, *supra* note 181, at 357-62.

¹⁸⁹ SCM Agreement, *supra* note 20, art. 4 (in particular, countermeasures are based on the amount of subsidies).

¹⁹⁰ *Id.*, art. 7 (countermeasures are effect-based).

¹⁹¹ *Id.*, art. 11.2 (For CVDs to be imposed, a WTO Member must establish the existence of (1) a subsidy, (2) injury to the domestic industry; and (3) a causal link between the subsidized imports and the alleged injury.).

¹⁹² Panel Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/AB/RW, adopted 4 August 2000, para. 6.31.

amount of subsidy specifically, as they are supposed to induce a Member to stop the violation, *i.e.*, granting a prohibited subsidy.

CVD investigations, on the other hand, are focused more on the effects caused by subsidies rather than the subsidies themselves. Even assuming that the imports are subsidized by a prohibited subsidy, imposing CVDs still requires establishing *injury to the domestic industry* caused by the subsidized imports. Actionable subsidies are not prohibited and can only be challenged when they cause injury to the domestic industry. It could be concluded, therefore, that imposing CVDs is meant to remedy the *effect* of a subsidy and nothing more. If, however, CVDs are intended to remedy effects on an importing country, it is illogical that the level of CVDs can legitimately exceed the level of effects they seek to remedy.

5. Including a lesser duty rule in the SCM Agreement A mandatory lesser duty rule should be included in the SCM Agreement. Under that rule, a WTO member should be required to impose a duty less than the total amount of the subsidy if such lesser duty would be adequate to remove the injury to the domestic industry. This rule will better serve the objective of protection of effective competition and enhancement of economic efficiency. Likewise, the rule better aligns with the general logic of the current remedial regime established by the WTO.

IX. CONCLUSION

Reforming the WTO subsidy regime is not possible without first identifying the object and purpose of SCM Agreement. Article 31 of the Vienna Convention requires that the WTO adjudicating bodies interpret the meaning of the terms of all WTO agreements “in the light of [an agreement’s] object and purpose.”¹ Yet, the object and purpose of the SCM Agreement is not obvious. WTO adjudicating bodies have applied a “textual” method of interpretation to the SCM Agreement, which focuses exclusively on the wording of the treaty.

In order to interpret the terms of the SCM Agreement “in the light of its object and purpose,” that object and purpose must be more clearly defined in the Agreement.² The SCM Agreement, however, does not contain any express statement of its object and purpose. As a result, this crucial element of the Vienna Convention’s interpretative rule is almost impossible to apply. This undermines the effectiveness and predictability of the WTO subsidies regime. To ensure that the SCM Agreement’s text is interpreted to reflect the goals clearly implied in that document, and to allow all its articles to be read together in a coherent and consistent manner, the SCM Agreement should be amended by adding a Preamble which clearly defines the object and purpose of the Agreement.

¹ Vienna Convention on the Law of Treaties art. 31(1), May 23, 1969, 1155 U.N.T.S. 331, art. 31.

² *See supra* Chapter VIII, Section A, subsection 1.

The multilateral subsidy regime has two possible purposes: safeguarding market access opportunities, and preserving effective competition while increasing total welfare. An analysis of the text of the SCM Agreement can lead to the conclusion that the WTO subsidies regime considers subsidies primarily as obstacles to international trade, and thus has as its goal the protection of market access, relevant tariff commitments, and trade opportunities for WTO Members. The problem with this approach is that it does not consider the effect of a subsidy, either on the process of competition or on total welfare (*i.e.* economic efficiency). Such a focus only on trade factors is not helpful in distinguishing bad subsidies from good subsidies.³

The object and purpose of the SCM Agreement should be clearly identified as protecting competition in the market as a means of ensuring economic efficiency. The WTO subsidies regime must seek to avoid sanctioning positive effects of a subsidy enjoyed by one WTO Member which do not produce negative effects in the form of distortion of competition in other WTO Members. The main focus of the analysis should be on the actual effects of the subsidy on competition in the relevant market. Only those subsidies that have the effect of distorting competition should be targeted within the framework of WTO law.

The SCM Agreement should be amended by adding a Preamble to read as follows:

Members,

Having in mind the overall objectives of the GATT 1994;

Recognizing the need to clarify and reinforce rules for the application of the provisions of GATT 1994 that relate to subsidies and countervailing duties, in particular the provisions of Articles III:8(b), VI and XVI;

Recognizing that Members should not use subsidies that distort competition and reduce economic efficiency in the markets of other Members;

Desiring to ensure that countervailing duties and other legal actions to counteract subsidies themselves do not create distortion of competition; and

³ See *supra* Chapter VIII, Section A, subsection 2.

Recognizing that Members should not be prevented from granting subsidies to domestic producers in order to pursue legitimate objectives, provided that they comply with the relevant provisions of the GATT 1994 and other applicable WTO agreements;

Hereby agree as follows:

The SCM Agreement should be amended in other ways as well. The most crucial of such amendments must bring the Agreement in line with the new Preamble's clearly stated object and purpose by (1) changing the causality requirement for establishing injury to the domestic industry; (2) reinstating the category of non-actionable subsidies; and (3) limiting the unilateral use of CVDs by WTO Members:

(1) The current interpretation of the relevant provisions of the SCM Agreement suggests that subsidies causing injury to the domestic industry are subject to challenge when there is a causal link between the subsidized imports and the injury to the domestic industry.⁴ The problem with this approach is that the demonstrated causal link does not prove that such injury has in fact been caused by subsidization. This may result in permitting CVDs imposed to offset the injury that was not being caused by the subsidies in question. Furthermore, it creates inconsistency in interpretation of the "injury" standard, since an "injury to the domestic industry" claim requires demonstration of injury caused by subsidized imports, whereas a "serious injury" claim requires demonstration of trade effects caused by subsidies. To better serve the objective of protection of the competitive process and to reduce the current inconsistencies in the SCM Agreement, I propose to interpret Article 15 of the Agreement as requiring demonstration of injury to the domestic industry by subsidies.

Article 15.5 also requires that damage caused by factors other than subsidized imports not be attributed to subsidized imports. Following the "injury by subsidized imports" approach,

⁴ See *supra* Chapter VIII, Section B, subsection 1a.

investigating authorities analyze and exclude factors other than subsidized imports.⁵ As a result, the factors attached to the “subsidized imports” that do not result from subsidization (for example, better quality and design) are included on the list of factors attributed to the subsidized imports. This may lead to protection of less efficient domestic producers to the detriment of more efficient ones.⁶ To better serve the objective of protection of the process of competition, I propose to interpret the non-attribution requirement of Article 15.5 as requiring the exclusion of factors causing injury to the domestic industry that do not result from subsidization.

(2) Since 2000, when the provisions of Article 8 on non-actionable subsidies expired, the SCM Agreement makes no distinction between subsidies that distort and subsidies that correct distortions, such as environmental subsidies, R&D subsidies and regional aid subsidies. By failing to separate subsidies producing a positive effect from subsidies producing negative effect, the current WTO subsidy discipline does not serve the objective of promoting economic efficiency and increasing total welfare. To address this problem, I recommend re-introducing the express exceptions for certain categories of legitimate subsidies.

Having analyzed three possible options for reinstating the green subsidy category (application of Article XX of the GATT; re-instating Article 8 of the SCM Agreement in its current form and introducing a new revised Article 8),⁷ I conclude that the most appropriate way is to introduce a new language of Article 8. The revised version of Article 8 will (1) expand the scope of exceptions from the SCM Agreement to tailor them to the needs of justification; and (2) include additional requirements for a subsidy to fall under the scope of this provision. Regarding the latter, I propose to incorporate the “necessity test” and “incentive test” into Article

⁵ Appellate Body Report, *Japan – Countervailing Duties on Dynamic Random Access Memories from Korea*, WT/DS336/AB/R, adopted 17 December 2007, para. 267.

⁶ See *supra* Chapter VIII, Section B, subsection 1b.

⁷ See *supra* Chapter VIII, Section B, subsection 2a.

8 of the SCM Agreement. Under the “necessity test,” a subsidy must be “necessary” for achieving a certain policy objective. That is, a measure is not “necessary” if there is a reasonably available alternative measure that is either fully consistent or less inconsistent with the WTO agreements.⁸ Under the “incentive test,” a subsidy must have an incentive effect. This means that in order for a subsidy to be exempted, it must be shown that (1) the beneficiary firm has changed its level of activity, going beyond its normal practices, (2) without the aid the firm would not carry out this project or it would carry it out in a restricted or different manner.⁹ Introducing these tests is crucial for distinguishing good subsidies from bad subsidies by ensuring that exceptions are only applied to subsidies that are well designed to deliver the chosen objective, which do not create additional unnecessary distortions and are only granted in order to motivate a change in the beneficiary’s behavior.

(3) Given that CVDs often reduce the welfare of the importing country by creating additional distortions, I propose certain changes that would minimize the potential negative effects produced by CVDs. First, to better serve the objective of enhancing economic welfare and to strike the balance between various competing interests, I propose that a mandatory public interest clause be included in Article 19.2 of the SCM Agreement. I recommend that the public interest clause only require WTO Members to provide in their national laws a mechanism for a public interest consideration without specifying criteria for its assessment. I also propose that the SCM Agreement defines “public interest” more broadly, referring to taking into account not only interests of consumers and industrial users, but also other relevant factors. Second, I propose that a mandatory lesser duty rule be incorporated into Article 19 of the SCM Agreement. Under the rule, a WTO member must be required to impose the duty less than the total amount of the

⁸ See *supra* Chapter VIII, Section B, subsection 2(a)(3)(a)(i).

⁹ See *supra* Chapter VIII, Section B, subsection 2(a)(3)(a)(ii).

subsidy if such lesser duty would be adequate to remove the injury to the domestic industry. This rule will better serve the objective of protection of the effective competition and enhancement of economic efficiency. Likewise, the rule is more in line with the general logic of the current remedial regime established by the WTO.¹⁰

¹⁰ See *supra* Chapter VIII, Section B, subsection 3.

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