DEFINITION OF SUBSIDY UNDER THE WTO AGREEMENT

Anoop Kumar*

Abstract

The attempt to define subsidy emerged with GATT. But, neither the GATT nor the Tokyo Round Subsidies Code contained a definition of the term subsidy. The situation changed when the WTO SCM Agreement came into being. It provides that there must be a financial contribution by the government or any public body. It is important to note that the concept of subsidy cannot be defined in general but depends substantially on its context, be legal, political, economic, etc. It is in this context that the present paper examines the legal definition of subsidy provided in SCM Agreement. The paper also examines the case law of WTO appellate body to understand whether the concept is defined too broadly.

Key words

Subsidies, Financial Contribution, Income and price support, benefit, Specificity.

I. INTRODUCTION

The international rules that affect subsidization in international trade may be classified in two sets of such rules: those regarding the use of countervailing duties and those providing certain substantive international obligations against the use of subsidies that may affect international trade. The Starting point of the quest for a 'Legal definition' of subsidy comes from the GATT. But neither the GATT nor the Tokyo Round Subsidies Code contained a definition of the term "subsidy". This changed when the WTO SCM Agreement came into being. It provides that there must be a "financial contribution by the government or any public body". The legal concept of subsides does not exist in *rerumnatura*: it is not a fact but an artificial construct of a given legal system with a given practical purpose.[1] The concept of subsidy cannot be defined in general but depends substantially on its context, be legal, political, economic, etc. The legal system, with its material prohibitions, procedural rules and remedies and ultimately its objectives, does influence the actual definition of subsidy in that 'legal system'. The second remark is that more than just a description, the definition of subsidy refers to the characteristics that are normally and positively present when that legal system concludes 'we have subsidy' or 'this subsidy' is objectionable or rather 'this subsidy' is permissible.

In this context the present paper brings to fore the discussion on provisions of Subsidies

---

*Assistant Professor (Law), Siddhartha Law College, Dehradun, email: anoopkumarlaw@gmail.com.

[1]Luca Rubini, *The Definition of Subsidy and State Aid, WTO and EC Law in Comparative Perspective* (New York: Oxford University Press, 2009 First Published) at 17

and Countervailing Duties Agreement (SCM) that have bearing on subsidy in international trade.

II. DEFINITION OF SUBSIDY UNDER WTO

One of the most important achievements of the Uruguay Round negotiations was the inclusion of a definition of 'subsidy' in the SCM Agreement. A subsidy within the meaning of the SCM Agreement exists if two distinctive elements are present (i) a financial contribution by a government (or any form of income or price support in the sense of article XVI of the GATT); and (ii) a benefit is thereby conferred. To be subject to the disciplines of SCM Agreement and contervailable, this subsidy must also be specific.[2]

It is important to note that the application and scope of SCM Agreement depends upon the definition of subsidy. If there is no subsidy in the term of SCM Agreement then no one could apply the WTO law to countervail those aids/ subsidies. Article 1 of the SCM Agreement provides the definition of subsidy.[3]

Financial Contribution

Article 1.1 (a) (1) of the SCM Agreement defines the term "financial contribution,"[4] which is the first point of the definition of a subsidy. It requires a financial contribution by a government or any public body, including quasi-governmental entities. Financial contribution is defined more broadly than a charge on the public accounts. The SCM

---

[2]Dominic Coppens, *WTO Disciplines on Subsidies and Countervailing Measures (Balancing Policy Space and Legal Constraints)* (United Kingdom: Cambridge University Press 2014 First Publish) at 39

[3]Article 1: Definition of a Subsidy: 1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:

(a) (1) There is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where: (i) A government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees); (ii) Government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits) (iii) A government provides goods or services other than general infrastructure, or purchases goods; (iv) A government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or (a) (2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and (b) A benefit is thereby conferred.

[4] In the dispute of *US - Exports Restraints*, the Panel considered the negotiating history of - financial contribution and concluded that: "Article 1 as ultimately adopted incorporates the requirement of a financial contribution by a government or other public body as a necessary element of a subsidy. The submissions by participants to the negotiations suggest that the proponents purpose behind including this element was to limit the kinds of government actions that could fall within the scope of the subsidy and countervailing measure rules. In other words, the definition ultimately agreed in the negotiations definitively rejected the approach espoused by the United States of defining subsidies as benefits resulting from any government action, by introducing the requirement that the government action in question constitute a "financial contribution" as set forth in an exhaustive list." (Para 8.69) US- Export Restraint, para. 8.73 Available at:

https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds194_e.htm accessed on 26 May 2015

Agreement points to the three[5] different kinds of financial contribution. It is an exclusive[6] list of financial contributions, not an illustrative one. It includes the following:

a) A government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);

b) Government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)

c) A government provides goods or services other than general infrastructure, or purchases goods;

The SCM Agreement contains an exhaustive list of measures that are deemed to be a financial contribution. The list identifies government practices that range from grants and loans to equity infusions, loan guarantees, fiscal incentives, the provision of goods or services and the purchase of goods. The SCM Agreement covers such measures even if they are carried out by a private entity, provided that a government has 'entrusted' or 'directed' the private entity to carry out one of the enumerated practices normally followed by governments. One of the most significant aspects of Article 1 is what is not included in that definition. 'Any government practice that does not meet one of the three criteria laid out therein cannot be considered a subsidy for the purposes of the Agreement'. Although Luca Rubini regret such as closed list in the light of the ingenuity of governments in inventing new form of assistance, moreover the three types of financial contribution are formulated, and interpreted, broadly, to cover a wide variety of financial contribution.[7]

(a) The (potential) direct transfers of funds or liabilities

First type of financial contribution[8] refers to a government practice involving direct transfers of funds (e.g. grants,[9] loans, and equity infusion) or potential direct transfers of

---

[5]Article 1.1(a) (1) (iv) is not a type of financial contribution because it deals with the way, manely indirectly, in which the government provides a financial contribution. Panel Report, *US- Export Restraint,* para. 8.73 Available at: *https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds194_e.htm* accessed on 26 May 2015. Panel Report, EC-Countervailing Measures on DRAM Chips, para7.53 Available at:

https://www.wto.org/english/tratop_e/dispu_e/cases_e/1pagesum_e/ds299sum_e.pdf accessed on 26 May 2015. Appellate Body Report, US - Countervailing Duty Investigation on DRAMS, paras. 124-125. Available at: https://www.wto.org/english/tratop_e/dispu_e/cases_e/1pagesum_e/ds296sume.pdf accessed on 26 May 2015

[6]Appellate Body Report, *US-Large Civil Aircraft, para.*613 Available at:

https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds353_e.htm accessed on 26 May 2015

[7]*Supra* note 1 at 40

[8]Article 1.1(a) (1) (i) of the SCM Agreement

[9]In the dispute of Australia Automotive Leather the Panel considered the meaning of the word -grant and stated that - the ordinary meaning of the term "grant" means "the process of granting or a thing granted, and therefore includes both the government's commitment to make payments (that is, the grant contract), and the grant payments themselves, including all possible disbursements, whether past or future. (para 9.39). This meaning of the term -grant" was in the context of payments under grant contracts to the exporter. However similar meaning could be imputed to-grants‖ in Article 1.1. (a)(1) (i)

funds or liabilities (e.g. loan guarantees). The Appellate Body has concluded that view, the term 'fund' encompasses not only 'money' but also financial resources and other financial claims more generally.[10] 'A direct transfer of funds' captures all conduct on the part of the government by which money; financial claims are made available to a recipient. Transactions similar to those explicitly listed are thus equally covered.[11] Examples of other direct transfers of funds accepted in the case law are debt forgiveness; the extension of a loan maturity, an interest rate, debt-to-equity swaps and joint ventures.[12] This broad reading implies the change of ownership (by an equity infusion or debt to equity) to make financial contribution to itself (e.g. cash grant by a government to a government owned company). Appellate Body has emphasized that the scope of direct transfers of funds is confined to those transaction that have sufficient characteristics in common with one of the listed items. This means those acts which normally involve financing by the government to the recipient. The phrase 'government practice' in Article 1.1(a) (1) (i) of the SCM Agreement simply denotes the originator of the action (i.e., government) and does not restrict the scope to functions normally performed by government.

Export credit guarantees or insurance are considered examples of potential direct transfer of funds because funds are only transferred where the export credit is not repaid due to a covered risk.[13]

---

[10]Appellate Body Report, *Japan – Drams* (Countervailing Duties on Dynamic Random Access Memories) *(Korea) para*. 250 WT/DS336/AB/R 28 November 2007 available at:

https://www.wto.org/english/tratop_e/dispu_e/336abr_e.docaccessed on 26 May 2015

[11]Id., para.251 – 252

[12]Appellate Body noted that"We observe that the words "grants, loans, and equity infusion" are preceded by the abbreviation e.g., which indicates that grants, loans, and equity infusion are cited examples of transactions falling within the scope of article 1.1(a) (1) (i). This shows that transactions that are similar to those expressly listed are also covered by the provision. Debt forgiveness, which extinguishes the claims of a creditor, is a form of performance by which the borrower is taken to have repaid the loan to the lender. The extension of a loan maturity

enables the borrower to enjoy the benefit of the loan for an extended period of time. An interest rate reduction lowers the debt servicing burden of the borrower. In all of these cases, the financial position of the borrower is improved and therefore there is a direct transfer of funds within the meaning of article 1.1(a)(1)(i).

With respect to Korea's argument that debt-to-equity swaps cannot be considered as direct transfers of funds given that no money is transferred thereby to the recipient, the panel reasoned that "the relinquishment and modification of claims inherent in such transactions similarly result in new rights, or claims, being transferred to the former debtor." again, we see no error in the panel's analysis. Debt-to-equity swaps replace debt with equity, and in a case such as this, when the debt-to-equity swap is intended to address the deteriorating financial condition of the recipient company, the cancellation of the debt amounts to a direct transfer of funds to the company." *Japan –Drams (Korea) para. 250* WT/DS336/AB/R 28 November 2007 available at:

*https://www.wto.org/english/tratop_e/dispu_e/336abr_e.doc*accessed on 26 May 2015.

[13]In the dispute of Brazil Aircraft, the Panel observed that: "potential direct transfer of funds" exists only where the action in question gives rise to a benefit and thus confers a subsidy irrespective of whether any payment occurs. In arriving at this view, we have taken contextual guidance from the example of loan guarantees provided in Article 1.1(a)(1) of the SCM Agreement. Whether or not a loan guarantee confers a subsidy does not depend upon whether a payment occurs (i.e., whether the beneficiary of the guarantee defaults and the government is required to make good on the guarantee). For example,

(b) The government foregone revenue which is otherwise due

This sub section explains that government can provide subsidy by negative action, when it refrains from collecting revenue which is otherwise due.[14] Revenue could be forgone in relation to all forms of taxation, such as internal taxes, covering direct taxes[15] (raised on Income) and indirect (raised on products) taxes[16] and import duties (tariffs).[17] Only one specific exception is included.[18] Rebates of indirect taxes and import duties upon exportation are explicitly excluded from the subsidy definition and thus from the scope of the SCM Agreement. Such rebates are not considered as revenue forgone. The Appellate Body has confirmed that rebates on direct taxes are not covered by this exception.[19]

(c) The provision of goods or services other than general infrastructure or purchase of goods

The second form of financial contribution[20] refers to the provision of goods or services by the government. This category has the potential for controversy regarding the question

---

Article 14 of the SCM Agreement provides that, when examining benefit to the recipient in a countervail context, "a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that a firm would pay on a comparable commercial loan absent the government guarantee." Thus, whether or not a loan guarantee confers a benefit depends on its effects on the terms of the loan and not on whether there is a default (Para 7.68)

If the category of potential direct transfers of funds referred simply to the situation where a government may in the future make a payment, almost any direct transfer of funds could, at an earlier date, be qualified as a potential direct transfer of funds. Nor do we see any reason to believe that a possible future payment is a "potential direct transfer of funds" merely because of a high probability that a payment will actually occur. The word 'potential' has been defined as 'possible as opposed to actual' or 'capable of coming into being'. If the determination whether a measure was a 'potential direct transfer of funds' depended upon the degree of likelihood or probability that a payment would subsequently occur, then the drafters surely would have chosen an adjective more suggestive of high probability than 'potential.'(Para 7.69)

[14] Article 1.1(a) (1) (ii) of the SCM Agreement

[15] Footnote 58 of SCM Agreement, for the purpose of this Agreement: Footnote 58 of SCM Agreement. The term 'direct taxes' shall mean taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership of real property.

[16] Footnote 58 of SCM Agreement, for the purpose of this Agreement: The term 'indirect taxes' shall mean sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges;

[17] Footnote 58of SCM Agreement, for the purpose of this Agreement: The term 'import charges' shall mean tariffs, duties, and other fiscal charges not elsewhere enumerated in this note that are levied on imports;

[18] Footnote 1of SCM Agreement, In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

[19] Appellate Body Report, US –Tax treatment for foreign sales Corporations (FSC), WT/DS108/AB/RW2, adopted 14 March 2006 pare 93. The exclusion of direct taxes is also confirmed by the different treatment of indirect and direct taxes under Annex I of the SCM Agreement (items (g) and (e)).

[20] Article 1.1(a) (1) (iii) of the SCM Agreement

of what constitutes a good and what constitutes a service. The advent of electronic commerce has raised the question of whether there exists another category of "thing" that is neither a good nor a service (e.g., in which category does intellectual property fall). If so, does the government provision or purchase of this third category ever constitute a financial contribution?[21]

The Appellate Body has endorsed an expansive definition of the terms 'goods' and 'provision'. First, goods include 'property or possessions' and thus also immovable property.[22] Second, goods or services are provided by the government not only when they are directly supplied but also when an intangible right is offered having the effect of making these goods/services available. What matters is that the transaction makes the goods/services available.[23] This only supposes a reasonably proximate relationship between the action of the government providing the goods or services on the one hand and the use or enjoyment of the good or service by the recipient on the other.[24] In the case *US – Softwood Lumber IV*, Canada argued that the United State preliminary determination that Canada's stumpage programs provided a good for less than adequate remuneration were not in accordance with the WTO. First it argued that "stumpage" (which Canada stated is the right to harvest standing timber) is not a good. The Panel however, concluded that what Canada was providing was standing timber; the "stumpage" at issue was merely the means of providing the timber. The Panel further found that "timber" was a good within the meaning of the ASCM, The Panel also rejected a Canadian argument that Article 1.1(a) (1) (iii) does not apply to rights to exploit natural resources in situ. According to the Panel, the term "goods and services" covers "the full spectrum of in-kind transfers the government may undertake by providing resources to an enterprise," the only exception being the one explicitly mentioned in Article 1.1(a)(1)(iii), the provision of general infrastructure.[25]

As an explicit exception, the government's provision of 'general infrastructure' is carved out from the subsidy definition. The ordinary meaning of infrastructure refers refers to installations and services (power stations, sewers, roads, housing, etc.) regarded as the economic foundation of a country. Such infrastructure is only excluded if it is 'general' in nature. This calls for a determination of the existence of de jure or de facto limitations on access to or use of infrastructure, but other factors could also be relevant (e.g. purpose of the infrastructure, nature and type of infrastructure). In *EC – Large Civil Aircraft*,[26] the

---

[21] *Supra* note 4 at 690

[22] The Appellate Body subsequently adopted a somewhat broader definition of the term "goods," noting that the French and Spanish terms used included a wide range of property. "tangible or movable personal property, other than money". *See United States—Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, AB-2003-6, WT/DS257/AB/R (2004) at 59

[23] Appellate Body Report, *US – Softwood Lumber*IV (United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada, WT/DS257/AB/R, adopted 17 February 2004available at: *https://www.wto.org/english/tratop_e/dispu_e/cases_e/1pagesum_e/ds257sum_e.pdf*accessed on 26 may 2015.

[24] Hence, a government must have some control over the availability of a specific thing being made available. *Ibid* paras70-71

[25] Peggy A. Clarke and Gary N. Horlick, 'The Agreement on Subsidies and Countervailing Measures' in Patrick F. Macro, et. al. (eds.) *The World Trade Organization: Legal, Economic and Political Analysis* (New York: Springer 2007, Vol. I)at 690.

[26] European Communities and Certain Member State – Measures Affecting Trade in Large Civil Aircraft, WT/DS

Muhlennberger Loch industrial site was not considered general infrastructure because it was specifically undertaken and tailor- made for airbus. Equally, the runway extension was not considered general because it was undertaken to cater for the specific needs of Airbus and its use was de jure limited to Airbus. In contrast, the road improvements challenged in *US –Large Civil Aircraft*[27] were considered 'general infrastructure', because they were accessible to the general public and designed to achieve a broad range of safety, environmental and economic objectives.

In addition to above government makes a financial contribution when it purchases goods.Yet the purchase of services in not covered in particular provision because the drafters (incorrectly) considered that these could only affect trade in services and should thus be disciplined under the GATS.[28] The panel decided that the purchase of services is excluded from the ASCM, even if such a services is purchased from a goods provider and could thus affect trade in goods.[29] The Appellate Body bypassed this question by characterizing the R&D work performed by Boeing for NASA and the US Department of defense as a part of joint ventures instead of purchases of services and joint venture were characterized as a financial contribution within the meaning of the SCM Agreement. The purchase of R&D that have the potential to distort trade in goods would share the essential characteristic of joint ventures and equity infusions and thus be covered under the SCM Agreement.[30]

(d) Financial contributions by a Government or a public body

An essential feature of subsidies is that financial contributions should directly or indirectly be made by the government. The Contribution could be made directly by the government in the collective sense which covers the government in the narrow sense as well as any public body within the territory of a member.[31] Financial contributions offered by a private body could be indirectly attributed to the government in the narrow sense [32]or by a public body.[33]

---

316 AB/R, adopted 1 June 2011.paras 7.1038, 7.1081 available at:

https://www.wto.org/english/tratop_e/dispu_e/316abr_e.pdf accessed on 26 May 2015.

[27]*United State– Measures Affecting Trade in Large Civil Aircraft* WT/DS 353 AB/R, adopted 23 March 2012. paras.7.444, 7.464-7.470- 7.470 available at:*https://www.wto.org/english/tratop_e/dispu_e/353abr_e.pdf* accessed on 26 May 2015.

[28]*Supra* note 2 at 44

[29]*United State– Measures Affecting Trade in Large Civil Aircraft, Supra* note 27

[30]The appellate Body approach is, however, less clear with regard to the purchase of services that do not share the features of an equity infusion (e.g. information technology services provided by a computer producer). Some element of Appellant Body report indicates that the payment for such services could qualify as a financial contribution under the item (i). If so, the potential loophole would be do facto closed, because any purchase of a services would be covered under item (i) as the payment for this service is covered as a transfer of funds. If not, a potential loophole exists which would only be closed if the Appellate Body finds that purchases of services are covered under item (iii) despite the lack of explicit reference therein.

[31]*Supra* note 1 at 49

[32] Government in the narrow sense covers: National and regional as well as local government. This conforms to the public international law principle that the conduct of any organ of the State, at whatever layer, is attributable to that state.

[33]The five factors for determination of public body: (i) government ownership; (ii) government presence on the board of directors; (iii) government control over activities; (iv) pursuit of governmental policies or interests;

(e) Indirect financial contributions: entrustment or direction of private body

Article 1.1(a) (1) (iv) of the SCM Agreement stipulates that such contributions can be made indirectly by a government. This occurs when the government makes payments to a funding mechanism or when it entrusts or directs a private body to carry out one of the three types of financial contribution. This provision is in essence an anti-circumvention provision. It prevents governments form circumventing the SCM Agreement by channeling their contribution through an intermediary or by using a private body as a proxy to make that contribution. Hence it assumes a demonstrable link between the government and the conduct of the private body.,[34,35]

Indirect subsidization occurs where, *inter alia*, (i) the government 'entrusts or directs'[36] a private body to subsidize, or (ii) the government provides one entity with a subsidy which then transfers or 'passes through' to another entity. The second case takes place when, for example, a producer of a subsidized input (upstream producer) sells the input to another producer who subsequently uses it in the manufacture of a processed good (downstream producer). Having obtained such an input product, the downstream producer can become an indirect recipient of the subsidy bestowed at the upstream level, as illustrated in Figure 1.[37]

Income or Price Support

Subsidies can exist not only when the government directly or indirectly provides a financial contribution but also when there is any form of income or price support in the

---

and (v) whether the entity was created by statute; *United States - Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, on 31 August 2012 para. 343. available at:

www.worldtradelaw.net/reports/wtoab/us-adcvdchina(ab).doc accessed on 26 May 2015.

[34] In the dispute *US - Exports Restraints*, (*Supra* note 28) the Panel believed that: —the term 'private body' is used in Article 1.1(a)(1)(iv) as a counterpoint to 'government' or 'any public body' as the actor. That is, any entity that is neither a government nor a public body would be a private body. Under this reading of the term 'private body', there is no room for circumvention in subparagraph (iv). As it is a government or a public body that would have to entrust or direct under subparagraph (iv), any entity other than a government or a public body could receive the entrustment or direction and could constitute a 'private body'. (Para 8.49)

[35] Supra note 2 at 54

[36] Entrusts and directs must contain a notion of delegation and command respectively. Appellate Body held that-"we are of the view that, pursuant to paragraph (iv), '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. In both instances, the government uses a private body as proxy to effectuate one of the types of financial contributions listed in paragraphs (i) through (iii). It may be difficult to identify precisely, in the abstract, the types of government actions that constitute entrustment or direction and those that do not. The particular label used to describe the governmental action is not necessarily dispositive. Indeed, as Korea acknowledges, in some circumstances, 'guidance' by a government can constitute direction. In most cases, one would expect entrustment or direction of a private body to involve some form of threat or inducement, which could, in turn, serve as evidence of entrustment or direction. The determination of entrustment or direction will hinge on the particular facts of the case." (Para 116) US-Export Restraints. Available at:

https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds194_e.htm accessed on 26 May 2015

[37] Shadirhodjaev, Shezod, "How To Pass a Pass-Through Test: The case of Input Subsidies", 15(2) *Journal of International Economic Law*, 2012, pp.621-64, at 622

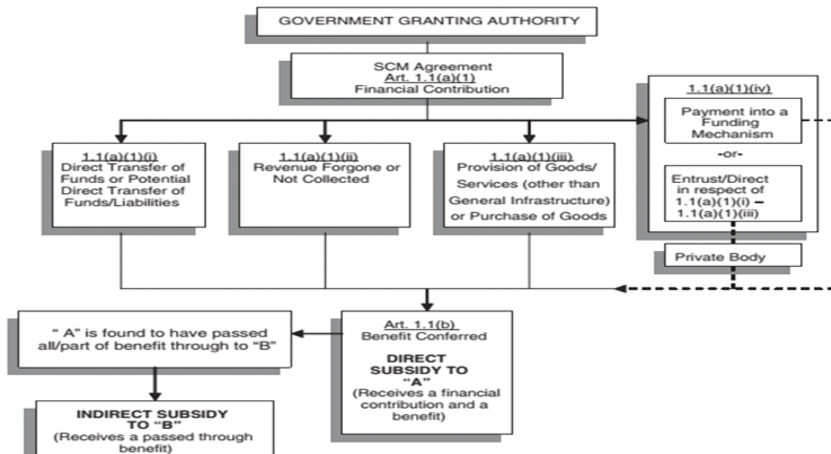

Figure 1. Subsidy pass-through.
Source: WTO, Negotiating Group on Rules—Benefit Pass-Through—Communication from Canada, TN/RL/GEN/7 (14 July 2004).

sense of Article XVI[38] of GATT 1994.[39] the notion of income and price support are not defined by either in GATT nor ASCM. The inclusion of second alternative in the definition of a subsidy was, as Luengo clarifies, away to include Article XVI of GATT in SCM Agreement.[40] It suggests an expensive interpretation, covering any government measure having an effect on income or prices. This would capture government measures that directly or indirectly have an impact on the recipient, without involving a financial contribution. Although there was an option for broad interpretation the penal considered a narrower interpretation because this second alternative was not intended to capture all manner of government measures that do not otherwise constitute a financial contribution but may have an indirect effect on a market including on prices. Similarly to the first alternative (financial contribution) the focus of income or price support should be on the nature of government action, rather than upon the effects of such action. The narrow reading of the scope of second one fit the purpose of the subsidy definition better than expensive interpretation which reintroduces an effect based approach.

Benefit

A financial contribution by a government does not constitute a subsidy unless it also

---

[38]Article XVI, Subsidies, Section A – Subsidies in General: 1. If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify the CONTRACTING PARTIES in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the Contracting Parties, the possibility of limiting the subsidization.

[39]Article 1.1(a) (2) of the SCM Agreement

[40]Supra note 2 at 57

confers a benefit[41] on a recipient. A benefit could not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient, which could be a person, natural or legal or a group of persons. Whereas the financial contribution element focuses on government in the determination of a benefit the focus shifts towards the recipient in the determination of a 'Benefit'.[42]

The SCM Agreement does not provide extensive guidance on the question of what constitutes a 'benefit'. In *Canada – Measures Affecting the Export of Civilian Aircraft* (Canada-Aircraft), the Appellate Body decided that the existence of a 'benefit' has to be determined by comparison with the market, that is to say, by comparing what the recipient of the financial contribution received from the government with what it would have received on the market.[43]

The Appellate Body stated:

> "We also believe that the word 'benefit', as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no 'benefit' to the recipient unless the 'financial contribution' makes the recipient 'better off' that it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a 'benefit' has been 'conferred', because the trade-distorting potential of a 'financial contribution' can be identified by determining whether the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market".[44]

The question of identifying the recipient has also proved controversial, with most countries objecting to the U.S. practice with respect to subsidies to privatized companies. Certain types of subsidies are considered to confer a benefit over several years. However, with the wave of privatization of formerly state-owned firms in the late 1980s and early 1990s, the question arose as to whether the newly private firm continues

---

[41]In the dispute of US - Exports Restraints, WT/DS194R, adopted 23 August 2oo1, the Panel considered the negotiating history and concluded that: —In short, the negotiating history confirms that the introduction of the two-part definition of subsidy, consisting of 'financial contribution' and 'benefit', was intended specifically to prevent the countervailing of benefits from any sort of (formal, enforceable) government measures, by restricting to a finite list the kinds of government measures that would, if they conferred benefits, constitute subsidies. 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. Under subparagraphs (i)-(iii), the government acting on its own behalf is effecting that transfer by directly providing something of value - either money, goods, or services-to a private entity. Subparagraph (iv) ensures that the same kinds of government transfers of economic resources, when undertaken through explicit delegation of those functions to a private entity, do not thereby escape disciplines. (Para 8.73)

[42]The Panel has given its clarification regarding the meaning of benefit. In its opinion - the ordinary meaning of 'benefit' clearly encompasses some form of advantage. We do not consider that the ordinary meaning of 'benefit' per se includes any notion of net cost to the government. *Canada - Measures Affecting the Export of Civilian Aircraft,* WT/DS70/AB/R, adopted 20 Aug. 1999 Para 9.112

[43]Steger, Debra P. 'The Subsidies and Countervailing Measures Agreement: Ahead of its Time or Time for Reform?' *Journal of World Trade* 44 (4) (2011) at 781

[44]Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 Aug. 1999, para 157

to benefit from such long-term subsidies bestowed on the state-owned entity.[45]

To determine whether such a recipient has received a benefit, the Appellate Body developed what could be labeled the *private market test*. A benefit arises if the recipient has received a financial contribution on the terms more favorable than those available to the recipient in the market. Thus, if private actors would have provided on the same conditions, the government's would not confer a benefit on the recipient. This private market test exactly fits the rationale behind the benefit element. If the government acts in the way similar to a commercial player, its action does not distort trade.[46] Determining whether a financial contribution by negative action is offered equally detects whether a benefit is conferred. In contrast, determining whether a financial contribution by negative action ('revenue forgone') is offered equally detects whether a benefit is conferred. Although the benefit threshold should formally still be passed, a substantive analysis will not be requisite because a benefit seems *ipso facto* conferred when revenue is forgone by the government.[47]

It is important to note that even if a practice does constitute a financial contribution and confers a benefit, it is not necessarily actionable, either multilaterally through the WTO dispute settlement mechanism, or unilaterally through the application of countervailing measures. Article1.2 provides that a subsidy is actionable only if it is also specific as defined in Article 2.

Specificity

The two constitutive elements (financial contribution and Benefit) of a subsidy have been explored. In this section the object to discuss the aspect of 'specificity'[48] elaborated under Article 2 of the SCM Agreement. Specificity is not a constitutive element of a subsidy, but a necessary condition for subsidies to be subject to the SCM Agreement discipline. Non-specific subsidies can be neither challenged nor countervailed.

---

[45] *Supra* note 25 at 692

[46] *Supra* note 1 at 60

[47] In the dispute US Lead Bismuth (WT/DS138/R adopted 7 June 2000) before the Panel US argued that Article 1.1(b) of the ASCM only requires 'benefit' to be established once, as of the time of bestowal of the 'financial contribution'. The United States based the argument on the fact that Article 1.1 describes the relevant 'financial contribution' and 'benefit' in the present tense. According to the United States, 'the ordinary meaning arising from the use of the present tense to describe both elements is that Article 1.1 is concerned with, and requires the identification of, the 'benefit' that is conferred at the time that the government provides the 'financial contribution'. The Panel was not convinced by the US interpretation of the use of present tense in Article 1.1. According to the Panel the use of the present tense simply means that the requisite 'financial contribution' and 'benefit' must exist during the relevant period of investigation or review. The use of the present tense does not speak to the issue of whether or not the existence of 'benefit' should be determined at the time of bestowal of the 'financial contribution', or whether or not there is any need for any subsequent review of the original determination of "financial contribution" and / or 'benefit'. It simply means that when an investigation or review takes place, the investigating authority must establish the existence of a 'financial contribution' and 'benefit' during the relevant period of investigation or review. Only then will that investigating authority be able to conclude, to the satisfaction of Article 1.1 (and Article 21), that there is a 'financial contribution', and that a 'benefit' is thereby conferred. (Para 6.73)

[48] Article 2 of the SCM Agreement, Specificity 2.1 In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to

a) Subsidies deemed to be specific

The specificity test should not be passed in cases where export subsidies and local content subsidies are challenged or countervailed. Both types of subsidy are presumed to be specific.To be precise, as the text of Article 2.3 of the SCM Agreement suggests and the case law confirms that the irrefutable presumption of specificity is not dependent on whether these subsidies are prohibited but on whether they qualify as export or local content subsidies. Hence, it includes a subsidy that is specific for the purpose of both part II (prohibited export subsidy) and part III (actionable subsidy) claims.[49] Likewise, such subsidies could be deemed to be specific in Subsidies and Countervailing (CVD) procedures.

Article 2 of the SCM Agreement sets forth principles for determining the following types of specificity: (1) enterprise specificity (a government targets a particular company or companies for subsidization); (2) industry specificity (a government targets a particular sector or sectors for subsidization); and (3) regional specificity (a government targets producers in specified parts of its territory for subsidization).

b) Specificity *de jure and de facto*

Regarding all other type of subsidy, specificity in the meaning of Article 2.1 and 2.2 of ASCM shall be clearly substantiated on the basis of positive evidence if challenged before the WTO adjudicating bodies or scrutinized in a CVD investigation. Positive means that the evidence should be of an affirmative, objective and verifiable character and that it must be credible.[50] The burden of proof for passing this test rests on the complaining party or CVD investigating authority.

---

in this Agreement as 'certain enterprises') within the jurisdiction of the granting authority, the following principles shall apply: (a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific. (b) Where the granting authority, or the legislation pursuant to which the granting authority pirates, establishes objective criteria or conditions governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification. (c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy. In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation. Article 2.2 A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific. It is understood that the setting or change of generally applicable tax rates by all levels of government entitled to do so shall not be deemed to be a specific subsidy for the purposes of this Agreement. 2.3 Any subsidy falling under the provisions of Article 3 shall be deemed to be specific. 2.4 Any determination of specificity under the provisions of this Article shall be clearly substantiated on the basis of positive evidence.

[49]Panel Report, *Korea-Commercial Vessels*, WT/DS273/R, adopted 22 April 1998, para.7.514

[50]*Supra* note 17, If an investigating authority were to focus on an individual transaction, and that

Article 2.1 somewhat cryptically describes that the subsidy should be specific to 'an enterprise or industry or group of enterprises or industries'. On this basis the panel in *US-Softwood Lumber IV* [51]found that specificity has 'to be determined at the enterprises or industry level, not at the product level' and that a single industry may make a broad range of end products.[52]

Article 2.1 Subparagraph (a) stipulates that a subsidy is specific if it is explicitly limited to certain enterprises (i.e. de jure specific) whereas Subparagraph (b) stipulates that specificity would not exists if objective criteria or conditions are established governing the eligibility for subsidy. The focus under both paragraphs is on whether certain enterprises are eligible for subsidy not on whether they in fact receive it. As a result, the application of both provisions might point to opposite directions: Paragraph (a) might rise to indications of specificity, whereas paragraph (b) might suggest non specificity. A subsidy may still be considered de facto specific by virtue of paragraph (c). The application of these three paragraphs is examined below.

i. ***De jure* specificity**

Paragraph (a) of Article 2.1 of SCMA indicates that a subsidy is *de jure* specific if it is explicitly limited to certain enterprises. This could be an explicit limitation on the access to the financial contribution and access to the benefit or on access to both.[53]

AB suggests two step approaches for this inquiry. First, the proper subsidies scheme has to be identified. This covers not only those subsidies that have been challenged, but also other subsidies that are same. Such similar subsidies could be provided through different legal instrument or distributed through different granting authorities. This determination requires a careful scrutiny of broader legislative framework and pronouncements of the granting authority. Second, once subsidies scheme has to be identified, the question is that whether that subsidy scheme is explicitly limited to 'certain enterprises'.

This enquiry of de jure specificity is not per se conclusive on whether the subsidy is specific within the meaning of Article 2. A positive finding of de jure specificity could still

---

transaction flowed from a generally available support program me whose normal operation would generally result in financial contributions on pre-determined terms (that are therefore not tailored to the recipient company), that individual transaction would not.. become 'specific' in the meaning of Article 2.1 simply because it was provided to a specific company. 'Instead, an individual transaction would be 'specific' if it resulted from a framework programme whose normal operation: (1) does not generally result in financial contributions, and (2) does not predetermine the terms on which any resultant financial contributions might be provided, but rather requires (a) conscious decisions as to whether or not to provide the financial contribution (to one applicant or another), and (b) conscious decisions as to how the terms of the financial contribution should be tailored to the needs of the recipient company. (Para 7.374) *Japan - DRAMS CVDs*

[51] *United States—Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada,* AB-2003-6, WT/DS257/AB/R (2004)

[52]Id, Similarly, the panel in *US-Uplend* Cotton clarified that an industry covers producers of certain products but recognized that 'the breadth of this concept of industry may depend on several factors in a given case' in a different case appellant Body said that 'Certain enterprises' refers to a single enterprises or industry or a class of enterprises or industries that are known and particularized.US-Softwood Lumber IV, .

[53]Appellant Body Report, *US-Anti-dumping and Countervailing Duties (China),* WT/DS282/AB/R, adopted 28 November 2005.para. 369. In the dispute of *US – CVD China (AB),* China argued that relevant inquiry under Article 2.1(a) is whether the actual words of the legislation limit access to the particular financial contribution

be overturned on the basis of the objective criteria (paragraph (b)) whereas negative finding could be overturned by a de facto specificity determination (paragraph (c)).

Paragraph (b) of Article 2.1 of SCMA stipulates that specificity would not exist if financial assistance is granted on the basis of objective criteria or conditions are established governing the eligibility for subsidies. Such eligibility has to be automatic and the criteria should be strictly adhered to and clearly spelled out in law, regulation or other official document so as to be capable of verification. These criteria and conditions are considered objective[54] if they are neutral, do not favour certain enterprises over others and are economic in nature and horizontal in application.[55]

ii. *De facto* specificity

It is relevant to note that, even if the subsidy is not specific by law but there are reasons to believe that the subsidizing programme may in fact be specific. Even if the program appears on its face to be non-specific, the program may be found to be *de facto* specific. Four factors may be taken into consideration for the purpose of identification of *de facto* specificity: (i) Use by a limited number of enterprises; (ii) Predominant use by certain enterprises; (iii) The grant of disproportionately large amounts of subsidies to certain enterprises; and (iv)The manner in which discretion is exercised by administering authorities.[56] These elements define the landscape for assessing whether a subsidy appearing non-specific on the basis of paragraphs (a) and (b) would nonetheless be de facto specific.

It is not out of place to discuss in short three factors mentioned in paragraph (c) in the light of Appellant Body Interpretation. First, an assessment of whether a subsidy is used by 'a *limited number of enterprises*' focuses on the number of enterprises that use the programme, rather than the proportion of the subsidy granted to such enterprises[57].

---

and its associated benefit that the investigating authority has to satisfy the two part definition of a 'subsidy' under Article 1 of the SCM Agreement. The Appellate Body rejected China's argument and said that: "We also note that both provisions turn on indicators of eligibility for a subsidy. Article 2.1(a) thus focuses not on whether a subsidy has been granted to certain enterprises, but on whether access to that subsidy has been explicitly limited. This suggests that the focus of the inquiry is on whether certain enterprises are eligible for the subsidy, not on whether they in fact receive it. Similarly, Article 2.1(b) points the inquiry towards 'objective criteria or conditions governing the eligibility for, and the amount of, a subsidy.

We do not share China's view that the use of the word 'subsidy' in the chapeau of Article 2.1 of the SCM Agreement means that each of the definitional elements of a subsidy bears upon the question of whether a subsidy is specific under Article 2.1(a). Rather, what must be made explicit under Article 2.1(a) is the limitation on access to the subsidy to certain enterprises, regardless of how this explicit limitation is established. In this respect, we consider that, generally, a legal instrument explicitly limiting access to a financial contribution to certain enterprises, but remaining silent on access to the benefit, would nevertheless constitute an explicit limitation on access to that subsidy." (Paras 368, 377)

[54]Appellant Body Report, *US- Large Civil Aircraft* WT/DS 353 AB/R, adopted 23 March 2012. Para. 951 concluded that the conditions for the objective eligibility criteria could not alter the finding of *de jure* specificity because the challenged measure appears reeducation to a discrete category of business activity carried out by certain enterprises within a particular industry.

[55] Article 2.1 (b) foot not 2 of SCM Agreement, Objective criteria or conditions, as used herein, mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.

[56]*Supra* note 4 at 695

[57]According to the panel in *US- large Civil Aircraft*, WT/DS 353 AB/R, adopted 23 March 2012

Second, subsidy could be *predominantly used by certain enterprises,* which is, where a subsidy programme is mainly or for the most part, used by certain enterprises this does not show in and itself *de facto* specificity,[58] because the question whether it is predominant has to be assessed in the light of the diversification of the granting authority's economy and the length of time during which the subsidy programme has been in operation. Third, *de facto* specificity could be established on the basis of the manner in which discretion has been exercised by the granting authority in the decision to offer a subsidy. The frequency with which applications for subsidy are refused or approved and the reasons for such decisions should be considered.[59]

Regional Subsidy

Regarding regional Subsidies, Article 2.2 of the ASCM stipulates a subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific. It is understood that the setting or change of generally applicable tax rates by all levels of government entitled to do so shall not be deemed to be a specific subsidy for the purposes of this Agreement.

Subsidies are regionally specific by virtue of this provision, even if such a granting authority offers it to all enterprises within a geographical region of its jurisdiction. Article 2.2 states that a program available only to certain enterprises within a designated geographic region of the granting authority's jurisdiction is specific.[60]The second sentence of Article 2.2 stipulates that the change of generally applicable tax rates by all levels of government entitled to do so is deemed non-specific.[61] General tax policies were exempted from the specificity consideration.

A subsidy is non-specific if the granting authority (Center or state) makes a subsidy available to all enterprises in its territory (Nationwide or statewide), whereas it would be specific if it is limited to *certain enterprises*[62] within the authority's jurisdiction (by the virtue of Art. 2.1) or offered to all enterprises within a sub - geographical region authority's jurisdiction (by the virtue of Art. 2.2)

Article 2.4 requires that any determination of specificity must "be clearly substantiated on the basis of positive evidence." This requirement arguably places the burden of proof on the investigating authorities (or the complaining Member) to demonstrate specificity. Prior to this, at least in the United States, the practice was to presume a program was

---

[58]According to the panel in *EC- large Civil Aircraft,* WT/DS 316 AB/R, adopted 1 June 2011

[59]According to the panel in *EC- large Civil Aircraft,* WT/DS 316 AB/R, adopted 1 June 2011

[60]*Supra* note 4 at 695

[61]Under the original Dunkel Draft, this second sentence clearly served as an exception to the main principle set out in the first sentence.

[62] In the dispute of *US – CVD China,* (Supra note 37)US and China disagreed whether the reference to 'certain enterprises' meant that for specificity in the sense of Article 2.2 of the SCM Agreement to exist, there must be a limitation of a subsidy to a subset of enterprises allocated within a designated geographical region, or instead whether limitation of a subsidy on a purely geographical basis to part of the territory within the jurisdiction of the granting authority, is sufficient. The US argued that reference to

specific, unless positive evidence to the contrary was provided. Because the defending exporting member is the entity most likely to have access to the information regarding specificity or the lack thereof, this has the potential for creating a significant hurdle to taking action.[63]

III. CONCLUSION

The foregoing suggests that with SCM Agreement one long standing need to define the term subsidy got resolved. It is also realized that the concept seem to be defined in sufficiently broad language so that the most common forms of subsidy are included in the definition. The case law discussed in the paper also indicates the same. It is important to note that the concept may be realized upon by nations as legitimate policy tool to meets its specific needs. The clarity on the definition is required as the application of SCM Agreement depends on the concept. It is at the same time believed that further clarification by Appellate Body decisions is still required.

'certain enterprises' in Article 2.2 serves to distinguish those enterprises within the designated region from those outside it. On the other hand, China argued that the phrase means that only if a subsidy is limited to some subset of enterprises within the region is that subsidy regionally specific. The Panel concluded that certain enterprises' in Article 2.2 'refers to those enterprises located within, as opposed to outside, the designated geographical region in question, with no further limitation within the region being required.'(Paras 9.125-135)

[63] *Supra* note 4 at 696