

ALLOCATION OF SUBSIDY BENEFITS

Paper from Brazil

The following communication, dated 15 November 2005, is being circulated at the request of the Delegation of Brazil.

I. INTRODUCTORY COMMENTS¹

1. This paper comments on the summary paper by the United States on when and how to allocate subsidy benefits over time.² In particular, we focus on how the US position relates to rights and obligations under Part III of the Agreement on Subsidies and Countervailing Duties (“SCM Agreement”). Specifically, we discuss whether, in the context of the multilateral disciplines covering serious prejudice:

- (a) the approach of allocating subsidy benefits used under Part V of the SCM Agreement should extend to other parts of the SCM Agreement; and
- (b) the effects of subsidies should be viewed as always coincident in time with the benefits from subsidies.

II. DISCUSSION

- (a) **Should the allocation of subsidy benefits be required in serious prejudice proceedings of Part III?**

2. The US summary paper seems to suggest that specific subsidy allocation rules should be applicable both to countervailing duty investigations under Part V of the SCM Agreement and to dispute settlement proceedings under Parts II and III of the SCM Agreement. Brazil disagrees with the United States and proposes to discuss the practical and legal issues of extending any obligation to precisely allocate subsidy benefits into the area of multilateral subsidy remedies. We are of the view that the advantages or disadvantages of doing so should be openly debated for the benefit of the Members.

¹ We reserve our rights to submit further contributions on the issues identified in this paper as well as on other aspects of the SCM Agreement.

² *Further Submission on When and How to Allocate Subsidy Benefits Over Time* (TN/RL/GEN/45).

3. The precise quantification of the benefit conferred by a subsidy is mandatory in the context of countervailing duty proceeding. Such quantification is necessary to calculate margins of subsidization individually for each exporter involved in order to apply countervailing duties at a level reflecting that margin, or at a level below the margin, if the latter suffices to offset the injury resulting from the subsidized imports.

4. In the calculation of the amount of the benefit, many investigating authorities categorize subsidies as “recurring” or “non-recurring”. The benefits conferred by “recurring subsidies” are usually fully absorbed (“expensed”) in the year of receipt, whereas the benefits from “non-recurring subsidies”, normally associated with the acquisition of fixed assets, are “allocated over time”; that is, distributed to the year of receipt and subsequent years.

5. The calculation of the amount of the subsidy is governed by Article 14 of the SCM Agreement, which deals exclusively with measures applied pursuant to a countervailing duty investigation under Part V. The question is then whether precisely calculating the amount of the subsidy is necessary in subsidies disputes under Part III of the SCM Agreement, which addresses subsidies causing “adverse effects,” including “serious prejudice”.

6. In this respect, we recall that the Appellate Body² concluded that, under Article 6.3(c) of Part III of the SCM Agreement, there is no requirement to calculate the precise amount of the subsidy. In particular, the Appellate Body stated:

{T}he apparent rationale for Part III differs from that for Part V of the *SCM Agreement*. Under Part V, the amount of the subsidy must be calculated because, under Article 19.4 of the SCM Agreement and Article VI:3 of the GATT 1994, countervailing duties cannot be levied in excess of that amount. In contrast, under Part III, the remedy envisaged under Article 7.8 of the *SCM Agreement* is the withdrawal of the subsidy or the removal of the adverse effects. This remedy is not specific to individual companies. Rather, it targets the effects of the subsidy more generally. Article 6.3(c) thus goes in the same vein and does not require a precise quantification of the subsidies at issue (emphasis added).³

7. The Appellate Body’s statement is part of a broader discussion on what should be the focus of a serious prejudice investigation. The Panel in *US-Cotton*⁴ correctly stressed that the analytical focus should ensure consistency between the nature of the analysis it carries out and the nature of the remedy. More concretely, the investigation should provide the necessary information on which to base the application of the remedy, i.e., removal or withdrawal of the adverse effects of the subsidy. The identification of the adverse effects of the subsidy depends on an evaluation of how and to what extent the subsidy adversely affects trade in the product under investigation. Such evaluation should be a comprehensive one, taking into account the structure, design, and operation of the subsidy. Therefore, the focus of the adverse effects/serious prejudice analysis under Article 6.3 of the SCM Agreement is not limited to a quantitative assessment, but also includes qualitative factors.

8. The additional consideration of qualitative factors does not mean, however, that the quantitative dimension of the granted subsidy is not also a relevant factor in evaluating serious prejudice, but precise quantification is not a sine qua non requirement.

³ *United States - Subsidies in Upland Cotton*, WT/DS267/AB/R, Appellate Body Report, adopted 21 March 2005, para. 464.

⁴ The Appellate Body upheld all the panel’s rulings related to Article 6 of the SCM Agreement. On the issue of the magnitude of the subsidies, it observed that the panel “could have been more explicit and specified what it meant by large amounts” (paras. 461-468).

9. The Panel in *US - Cotton* found support for its conclusion in the text of numerous provisions of Part III of the SCM Agreement, including Articles 7.2, 6.3, and 7.8.⁵

10. In addition, the Panel noted that an excessive quantitative focus under Part III would impede a finding of serious prejudice in situations where efficiently applied small subsidies have a potent effect, in terms of guaranteeing an incremental competitive edge to the subsidized product and causing adverse effects, be it in the form of price depression, price suppression, or the displacement of exports. The Appellate Body confirmed this interpretation, observing that

“the size of a subsidy is only one of the factors that may be relevant to the determination of the effects of a challenged subsidy. A panel needs to assess the effect of the subsidy taking into account all relevant factors.”⁶

(b) Should the effects of subsidies, in serious prejudice proceedings, be viewed as always coincident in time with the benefits from subsidies?

11. Another question that the United States has not fully addressed in its submission is whether the effects of subsidies should be viewed as co-existing in time with the benefits from subsidies. The core issue in this regard is whether one can assume there is a “coincidence in time” between the benefits and the effects of subsidies. If so, then both the benefits and the effects of recurring subsidies would be limited to the year of receipt. Likewise, if the benefits of non-recurring subsidies were spread over the year of receipt and subsequent years, so would the effects of non-recurring subsidies. This approach, however, begs the obvious practical question of how to test for how much longer the effects of subsidies last than the benefits of such subsidies.

12. Brazil agrees with the Panel in *US - Cotton* that, given the mainly qualitative focus of a serious prejudice investigation, one cannot prejudge the effect of the subsidy by automatically relying on an a priori diagnosis, supported by a fixed calculation of subsidies and corresponding effects. Indeed, Article 6 of the SCM Agreement calls for a reasoned and adequate case-by-case assessment of the concrete interplay between the structure, design, operation, and magnitude of the programmes that may result in serious prejudice in terms of items a) through d) of Article 6.3.

13. An example of a recurring subsidy with medium or long terms effects would be a programme of price or income support, with regular disbursements, which guarantees a high level of profitability and/or robust cash flow to the receiving company. Such a programme would permit, for example, substantial capacity expansion.

14. The Panel’s findings in *US - Cotton* were confirmed by the Appellate Body. In the appeal, the United States argued that the effects of recurring subsidies were limited to the year in which they were “expensed”. While the Appellate Body recognized that the answers to this question may depend on the nature of the subsidy and the product in question, it found no textual support for the US position. In particular, the Appellate Body stated:

⁵ For example, Article 7.1 of the SCM Agreement, which sets to motion the consultation phase, the first step leading to the possible establishment of the panel, calls for an examination of “the existence and nature” of the subsidy as the basis for a request for consultations. There is no mention of “amount”. Article 6.3 focuses on the effect of the subsidy, not specifically on its magnitude. Moreover, the lapsed Article 6.1(a), which contains a presumption of serious prejudice based on quantitative thresholds, may be rebutted as a result of a broader qualitative assessment based on Article 6.3.

Article 7.8, the remedy provision that requires the Member granting or maintaining the subsidy to “take appropriate Steps to remove the adverse effects or withdraw the subsidy”, does not necessarily mean that there is a requirement to limit the conferred amount.

⁶ *United States - Subsidies in Upland Cotton*, WT/DS267/AB/R, Appellate Body Report, adopted 21 March 2005, paragraph 461.

“We see nothing in the text of Article 6.3(c) [of the SCM Agreement] that excludes *a priori* the possibility that the effect of a "recurring" subsidy may continue after the year in which it is paid. Article 6.3(c) deals with the "effect" of a subsidy, and not with the financial accounting of the amount of the subsidy” (footnote omitted).⁷

15. While recognizing that whether the effects of a recurring subsidy may continue after the year in which it is paid is a factual issue to be decided in each dispute, Brazil agrees with the Appellate Body that there is no legal requirement that the effect of the subsidy be coincident in time with the benefit. If the United States intends to imply otherwise in its paper, then Brazil disagrees with the United States.

⁷ *United States - Subsidies in Upland Cotton*, WT/DS267/AB/R, Appellate Body Report, adopted 21 March 2005, para. 476.