# WORLD TRADE ORGANIZATION

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**Negotiating Group on Rules** Original: English


## SERIOUS PREJUDICE

Communication from Canada

The following communication, dated 13 September 2004, is being circulated at the request of the Delegation of Canada.

The submitting delegation has requested that this paper, which was submitted to the Rules Negotiating Group as an informal document (JOB(04)/120), also be circulated as a formal document.

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As Canada noted in TN/RL/W/112, the WTO *Agreement on Subsidies and Countervailing Measures* (the "ASCM"), requires an effective remedy to respond to the import/export displacing and impeding effects of subsidies. In this regard, the "serious prejudice" provisions and related remedies in the ASCM were intended to fill a void in previous GATT rules and to complement WTO rules/disciplines in respect of prohibited subsidies and countervailing duties. However, while the ASCM clarified the circumstances that could give rise to a finding of serious prejudice and the action Members could take in response to such measures, the lack of recourse to these provisions, together with the lapsing of certain serious prejudice provisions on 31 December 1999, suggest a need to revisit this part of the ASCM with a view to identifying and correcting current deficiencies. In this regard, Canada notes Korea's observation in TN/RL/W/17 that the difficulty of seeking a remedy under Part III is due to a structural problem in the ASCM itself.

### I. ISSUES

The following are among the factors that have contributed to the current state of the serious prejudice provisions of the ASCM. The list does not purport to be exhaustive:

1. The lapsing of the deeming clause in paragraph 6.1 on 31 December 1999, deprived Members of an important evidentiary advantage in respect of the specific measures therein described[1],

[1] Once it had been established that a subsidy was one described in Article 6.1, there was a rebuttable presumption of serious prejudice, which relieved the complainant of the initial burden of having to demonstrate adverse effects.

2. The cost-to-government approach prescribed in Annex IV for the calculation of total *ad valorem* subsidization under subparagraph 6.1(a) of the ASCM, is inherently difficult to administer[2];

3. The requirements for establishing displacement and impedance causation under subparagraph 6.3(a) are unclear;

4. It is not entirely clear whether the percentage threshold prescribed in paragraph 4 of Annex IV of the ASCM is strictly in respect of subsidies attributed to (i.e., expensed in) the start-up period or includes subsidies allocated over a multi-year period. Moreover, paragraph 4 of Annex IV seems anomalously situated in that, unlike the other provisions of the Annex that relate directly to the calculation of the amount of subsidization for the purposes of subparagraph 6.1(a), it deems serious prejudice in its own right for certain start-up subsidies;

5. The remedy prescribed in current paragraph 7.8 of the ASCM (i.e., removal of adverse effects or withdrawal of the subsidy), arguably does not extend to a subsidy (e.g., a lump-sum grant) that was fully disbursed prior to the expiration of the period for compliance with an adopted panel or Appellate Body report, notwithstanding the fact that the subsidy also benefits future production of subject products; and

6. WTO panels, which for the most part are charged with addressing specific legal questions regarding the consistency of a particular measure with WTO rules/disciplines, might not be particularly well suited to conducting "fact-intensive" serious prejudice investigations. In this regard, Annex V to the ASCM, which establishes procedures for the gathering of information to be considered by panels, does not provide much in the way of guidance on the detailed economic analysis that would be required to work through such cases.

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[2] The deficiency in practical guidance on the application of paragraph 6.1(a) is acknowledged in footnote 62 to the ASCM in relation to Annex IV:

> 62. An understanding among Members should be developed, as necessary, on matters which are not specified in this Annex or which need further clarification for the purposes of paragraph 1(a) of Article 6.

In this regard, the *Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures* (G/SCM/W/415/Rev.2 of May 15, 1998) on Annex IV to the ASCM notes the difficulties inherent in trying to measure the cost of funds to government, e.g. (at paragraphs 17-22):

> *It was recognized that the cost to government approach mandated in paragraph 1 of Annex IV raises the question, affecting all types of subsidies, of how a government's cost of funds should be measured. That is, governments raise funds in two ways, taxation and borrowing, each of which carries some cost. Some Group members viewed these costs as limited to the observable ("monetary") costs associated with raising the funds. Others believed that these costs also include certain non-observable costs, in particular the opportunity cost to the government associated with using such funds, and potential indirect costs of taxation...The Group noted that to calculate a weighted average monetary cost in a relatively precise way, detailed data would be needed on the government's monetary costs incurred in raising tax revenue, as well as on the different rates of interest paid by the government on its various outstanding debt instruments. Also necessary would be information on the relative proportions of total government revenues accounted for by borrowed funds and tax revenues, respectively…the Group concluded that trying to apply [a weighted average monetary cost] in Article 6.1(a)/Annex IV calculations might prove not to be feasible. Of particular concern in this regard would be data availability (especially where several levels of government might be involved), as well as practical difficulties of collecting and analysing the data.*

## II. PROPOSED AMENDMENTS

In order to render the serious-prejudice and related remedial provisions in Part III of the ASCM more effective, it is proposed:

1. That lapsed subparagraph 6.1 be reinstated;

2. That the cost-to-government approach prescribed in (lapsed) Annex IV for the calculation of total *ad valorem* subsidization under subparagraph 6.1(a) of the ASCM, be replaced with a benefit-to-recipient methodology[3];

3. That consideration be given to extending, *mutatis mutandis*, the market-share analysis in paragraph 6.4 of the ASCM to causation assessment under paragraph 6.3(a), with an increase in the subsidized product's market share giving rise to a *prima facie* case of displacement or impedance;

4. That it be made explicit that any percentage threshold prescribed in paragraph 4 of Annex IV to the ASCM extends beyond subsidies expensed in the start-up period to include subsidies allocated over a multi-year period, including any subsidies that have been formally committed but not yet disbursed. Moreover, given the inherently trade-distorting nature of large investment incentives, should consideration be given, for example, to expanding the prohibited subsidy category to capture start-up subsidies exceeding a prescribed percentage threshold?;

5. That, in order not to frustrate the intent of the serious prejudice provisions of the ASCM by depriving Article 7.8 of remedial effect, it be made explicit that, in determining appropriate steps to remove adverse effects, the benefit of subsidies that were fully disbursed prior to the expiration of the period for compliance with an adopted panel or Appellate Body report, shall be allocated over the total production of the products to which the subsidy is properly attributable under GAAP[4]; and

6. That Article 7 of the ASCM be amended to require:

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[3] Canada notes Australia's observation in TN/RL/W/135, that Article 6.1 of the ASCM has been ineffective due to lack of clarity and complexities involved in the calculation of the *ad valorem* subsidization deeming level. In this regard, Australia also questions whether the calculation of amount of subsidy for this purpose should be done in terms of cost to the granting government (as required by paragraph 1 of Annex IV), given that the definition of "subsidy" is based on benefit to recipient.

[4] Canada is aware that the panel in the yet to be adopted report in *United States-Subsidies on Upland Cotton* (WT/DS267/R) found at paragraph 7.1171 that, unlike in countervail, *"the focus of a 'serious prejudice' analysis does not call for any precise quantification of the subsidy at issue"* and further found (at footnote 1305) that *"there is no textual analogue in Part III to the countervailing duty provisions in Part V of the Agreement…requiring any precise allocation of subsidies"*. However, because the withdrawal of a subsidy programme would not, in and of itself, be a sufficient remedy in those cases where subsidies fully disbursed under a withdrawn programme clearly benefited future production, allocation becomes necessary in order to ensure that the adverse effects of the measure are removed. This proposal is consistent with paragraph 7 of Annex IV, which made it clear that subsidies granted prior to the date of entry into force of the WTO Agreement, the benefits of which are allocated to future production, are to be included in the overall rate of subsidization for the purposes of the threshold calculation in Article 6.1(a) of the ASCM.

(i) that a Member, in its determination of whether there is *"reason to believe"* under paragraph 7.1, duly examine all evidence reasonably available to it on the existence, nature and amount[5] of the subsidy and its trade effects[6];

(ii) that a Member, in its *"statement of available evidence"* under paragraph 7.2, also provide a detailed assessment of such evidence in arriving at the *"reason to believe"* referred to in paragraph 7.1; and

(iii) that, in the event consultations failed to resolve a matter, the information referred to in subparagraph (ii) above, would form part of the panel record.

Canada reserves the right to make further submissions on this subject.

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[5] In *United States-Subsidies on Upland Cotton* the panel, while holding that the focus of paragraph 7.2 of the ASCM is largely on a qualitative assessment of the existence and nature of a subsidy and the serious prejudice caused, acknowledges (at paragraph 7.1173) that the provision may not necessarily preclude consideration of the magnitude of a subsidy where this information is relevant and readily available.

[6] Refer, in this regard, to the existing obligation of Members under Article 25.8 of the ASCM, to provide requested information on the nature and extent of "any" subsidies granted or maintained.