

2007

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## Recommended Citation

8 J. World Investment & Trade 85 (2007).

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# Subcentral Governmental Investment Incentives

## *Assessing their Lawfulness under the GATT and the SCM Agreement*

Rex J. ZEDALIS\*

### I. INTRODUCTION

According to the calculations of World Bank experts, total world gross domestic product (GDP) in 2004 ran in the vicinity of US\$ 41.3 trillion.<sup>1</sup> That same year, economic statistics from the World Trade Organization placed total world trade in goods and commercial services at US\$ 11 trillion; goods accounting for US\$ 8.9 trillion and commercial services for US\$ 2.1 trillion.<sup>2</sup> The United Nations Conference on Trade and Development (UNCTAD) reported that for 2004 outflows of foreign direct (as distinct from portfolio) investment (FDI) world-wide hovered around US\$ 730 billion, and inflows of the same sort of investment reached US\$ 648 billion.<sup>3</sup> It is clear that it is investment commitments made principally by home-country investors, not those considered foreign, that are likely to have accounted for the lion's share of the approximately one-quarter contribution to total world GDP made by trade in goods and commercial services during 2004. After all, in view of the level of FDI, without such supportive domestic entrepreneurial commitments the wheels of industry would likely never generate sufficient volumes of products to meet demands of consumers on the world market. Investments taking the form of FDI inflows would be, at least in theory, capable of making some contribution to demanded export trade in goods and services. Though the empirical evidence appears to substantiate that conclusion, debate continues in scholarly

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<sup>1</sup> See: <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf>, last accessed 25 April 2006.

<sup>2</sup> See WTO, *International Trade Statistics 2005*, at 3, Table: "World Exports of Merchandise and Commercial Services 2000-04"; available at: [http://www.wto.org/english/res\\_e/status\\_e/its2005\\_e/its2005\\_e.pdf](http://www.wto.org/english/res_e/status_e/its2005_e/its2005_e.pdf), last accessed 25 April 2006.

<sup>3</sup> See UNCTAD, *World Investment Report 2005: Overview (2005)*, at 1, UNCTAD/WIR/2005(Overview); available at: [http://www.unctad.org/en/docs/wir2005overview\\_en.pdf](http://www.unctad.org/en/docs/wir2005overview_en.pdf), last accessed 25 April 2006. This represents a two-fold increase in both outflow and inflow levels over essentially a 10-year period. For FDI levels of a decade earlier, see *Foreign Direct Investment, Part II, Foreign Direct Investment: Facts, Conceptual Issues and Costs and Benefits for Developing Countries*; available at: <http://www.southcentre.org/publications/fdi/fdifinaltrans-03.htm#P226-28657>, last accessed 25 April 2006 (1996 outflow level of US\$ 347 billion; 1995 inflow level of US\$ 315 billion).

circles about the extent to which FDI inflows foster or, to the contrary, actually serve to displace export trade.<sup>4</sup>

This article does not attempt to weigh in on that debate. Nevertheless, it seems relatively clear that national laws affecting import trade in goods and services have served to move various foreign business entities from commercial models focused on exports to models focused instead on financial investment in manufacturing and production facilities in countries to which exports would have otherwise been made. One classic example can be found in the experience of the automotive industry. When foreign auto manufacturers assessed the presence or threat of trade measures that would obstruct exports as being too grave to accept, they commenced investing in production facilities in the countries to which they would have otherwise exported. This phenomenon was quite evident at the beginning of the 1980s when, under the Askew/Yasukawa Agreement (May 1980), Japanese auto producers moved to open U.S. production facilities that would employ U.S. workers rather than risk continued exports through U.S. Customs of finished products manufactured and produced in Japan.<sup>5</sup> The 1980 Agreement served to blunt U.S. auto worker dissatisfaction with the implications of Japan's growing share of the U.S. auto market. It is also clear that the Agreement, by moving Japan towards a commercial model focused on FDI within, rather than exports to, the United States, reduced the need for U.S. authorities to resort to national laws affecting international trade to address what was perceived to be an especially troublesome auto industry problem.

But just as surely as the potential use of national laws to affect import trade can serve to stimulate foreign interest in contributing to FDI inflows, so domestic incentives to encourage investment by local entrepreneurs in home-grown commercial enterprises can stimulate exports, and have an impact on imports of overseas competitors, by vesting relevant goods with competitive advantages they would not otherwise possess. Imagine a local enterprise that produces particular goods. It stands to reason that the bestowal of a domestic investment incentive on such an enterprise could provide it with an advantage on the international commercial market. Domestic investment incentives would obviate the need for the producing enterprise to cover some specific cost or expense, thereby affording it increased pricing latitude. To the extent that any such

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<sup>4</sup> This debate involves the matter of whether FDI inflows "complement" export trade, by simply providing supplemental financing that stimulates further exports, or serves as a "substitute" for export trade, as a consequence of those who invest being entities that would have otherwise exported goods to the investment host country. See generally M. Blomstrom, R.E. Lisky, K. Kulchyyck, *U.S. and Swedish Direct Investment and Exports*, in R.E. Baldwin (ed.), *Trade Policy Issues and Empirical Analysis* (1988); WTO Secretariat, *The Link Between Trade and Foreign Direct Investment* (1996), available at: <http://usinfo.state.gov/journals/ites/0497/ijee/ej6fact3.htm>, last accessed 15 September 2006; Li-Gang Liu and Edward M. Graham, *The Relationship Between Trade and Foreign Investment: Empirical Results from Taiwan and South Korea*, Working Paper 98-7, Institute for International Economics, available at: [http://www.iie.com/publications/wp/wp\\_efm?ResearchID=148](http://www.iie.com/publications/wp/wp_efm?ResearchID=148), last accessed 15 September 2006; F. Kimura and K. Kiyota, *Exports, FDI, and Productivity: Dynamic Evidence from Japanese Firms* (2006), available at: [http://www.ut-mmrc.jp/dp/PDF/MMR.C69\\_2006.pdf](http://www.ut-mmrc.jp/dp/PDF/MMR.C69_2006.pdf), last accessed 25 October 2006.

<sup>5</sup> See William C. Duncan, Director-General, JAMA USA, *The Twenty Fifth Anniversary of the Askew/Yasukawa Agreement* (July 2005); available at: [http://www.jama.org/commentary/latest\\_commentary.html](http://www.jama.org/commentary/latest_commentary.html), last accessed 6 May 2006.

benefiting enterprise is involved abroad or at home in competitive international commercial activities, its product is able to then occupy a price position different from the one in which it might otherwise find itself in the absence of such an incentive. Clearly, then, it would seem reasonable to expect that such investment incentives could affect trade by creating artificial pricing conditions, as assuredly as the threat of or potential for trade sanctions could affect direct investment decisions by exporters who historically have supplied products from abroad.

One of the interesting developments in recent years has been the rise of domestic investment incentives provided by subcentral governmental units—municipal, county, state, or provincial governmental authorities. Illustrations of such incentives are varied. They include packages offered by state governments to lure semiconductor fabricators to locate in New York rather than Texas,<sup>6</sup> as well as tax credit and infrastructure improvement packages to attract pharmaceutical research and production facilities to Massachusetts rather than neighboring states to the south.<sup>7</sup> Further, they also extend to combination state and local government incentive packages aimed at attracting biotech research institutes to cluster their development in South Florida rather than elsewhere<sup>8</sup> and to investment incentives targeting specific industries, such as efforts by New Mexico to attract the film and entertainment industry<sup>9</sup> and Oklahoma to court interest by the aircraft and other innovative industries.<sup>10</sup> Indeed, a few years ago, one city in Oklahoma, in the face of growing competition from others around the United States for job and economic opportunities, worked feverishly on an incentive package to secure favorable consideration from one of the world's major international aircraft companies as it examined options for locating manufacturing facilities associated with a new product line.<sup>11</sup>

<sup>6</sup> See Dennis Yusko, *City hopes AMD brings opportunity*, Albany Times-Union, timesunion.com (28 June 2006); available at: <http://www.timesunion.com/AspStories/story.asp?storyID=495398&category=REGION&newsdate=6/28/2006>, last accessed 5 July 2006 (US\$ 1 billion package for AMD Semiconductor to locate in Saratoga County, New York instead of in Texas).

<sup>7</sup> See Stephen Heuser, *Government, business, colleges came together as serious force*, The Boston Globe, boston.com (3 June 2006); available at: [http://www.boston.com/news/local/massachusetts/articles/2006/06/03/teamwork\\_landed\\_bristol\\_myers](http://www.boston.com/news/local/massachusetts/articles/2006/06/03/teamwork_landed_bristol_myers), last accessed 5 July 2006 (Bristol-Myers Squibb to get US\$ 30 million in tax credits and US\$ 34 million in waste improvements in return for locating in old army base at Ft. Devens instead of in Syracuse, New York).

<sup>8</sup> See *Seed & Venture Capital: State Expenses & Options* (May 2006), at 15 (NASVF); available at: [www.nasvf.org/web/nasvfinf.nof/pages/svcp.html/\\$file/Seed%20and%20Venture%20Capital%20Report%20-%20Final.pdf](http://www.nasvf.org/web/nasvfinf.nof/pages/svcp.html/$file/Seed%20and%20Venture%20Capital%20Report%20-%20Final.pdf), last accessed 15 July 2006 (Scripps Research Institute offered package of US\$ 300 million by State of Florida, and US\$ 200 million by Palm Beach County, to locate in South Florida).

<sup>9</sup> See Andrew Webb, *Some Film Loans Lack Bank Backing*, A1, at col. 5, Albuquerque Journal (11 July 2006) (discussing the New Mexico effort and some of the financial complications involved).

<sup>10</sup> See generally Oklahoma Department of Commerce, *Oklahoma Business Incentives and Tax Information Guide*, at 22–24 (2006); available at: [http://www.okcchamber.com/media/PDFs/Oklahoma\\_Tax\\_Guide\\_5\\_23\\_2006.pdf](http://www.okcchamber.com/media/PDFs/Oklahoma_Tax_Guide_5_23_2006.pdf) (discussing the aircraft industry in particular but also providing information on incentives for other significant industries as well).

<sup>11</sup> See generally David Pritchard and Alan MacPherson, *Industrial Subsidies and the Politics of World Trade: The Case of the Boeing 7e7*, 1 *Industrial Geographer* (No. 2) 57, at 69 (2004); available at: <http://www.pravco.com/PDF/7e7.pdf>, last accessed 5 August 2006 (reviewing aspects of the Oklahoma investment incentives proposed by the City of Tulsa). See also *2004 Report of the Governors Aerospace Task Force*; available at: [http://www.okaero.com/pdf/aerospace\\_taskforce\\_final\\_report.pdf](http://www.okaero.com/pdf/aerospace_taskforce_final_report.pdf), last accessed 5 August 2006 (describing proposed incentives to increase aerospace investment in Oklahoma).

And this phenomenon is far from unique to the United States. In Europe, it has been reported that Austria has various subcentral governmental subsidies ranging from state government premiums paid for job creation to local tax incentives for investment.<sup>12</sup> Germany has available a host of state government research and regional development grants and loans, as well as financial incentive programs designed to accomplish other objectives associated with stimulating investment.<sup>13</sup> Even on the Asian subcontinent, India is reported to have subcentral governmental incentive programs aimed at safeguarding employment, stimulating capital investment, and spurring the development of new industrial units.<sup>14</sup>

In the pages that follow, an attempt will be made to delineate the exact parameters of lawful subcentral governmental investment incentives under the General Agreement on Tariffs and Trade (GATT)<sup>15</sup> and the Agreement on Subsidies and Countervailing Measures (SCM Agreement).<sup>16</sup> While it is true that the terms of the relevant GATT provision speak only of subsidies provided by “contracting parties”,<sup>17</sup> which could raise questions since it was the central, not the subcentral, governmental units that became parties to the GATT, it is equally true both that the GATT<sup>18</sup> and that the SCM Agreement’s prohibition on subsidies speaks very broadly on incentives provided by the “government” or any “public body”.<sup>19</sup>

The focus herein will thus be not on whether incentives provided by official municipal, county, state, provincial, and regional bodies are susceptible to examination by trading partners for compliance with relevant provisions of the GATT and the SCM Agreement. Rather, it will be on the requirements established by pertinent GATT and SCM Agreement dictates that govern such incentives whenever subcentral units embark on a course designed to provide support or benefits to those engaged in commercial activities and the support or benefits prove to affect trading partners. Attempting to delineate the precise requisites of compliance through a focus on subcentral

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<sup>12</sup> See U.S. Department of Commerce, Import Administration, Electronic Subsidies Enforcement Library; available at: <http://www.ia.ita.doc.gov/eses/eselframes.html>, last accessed 15 August 2006 (Click on “Select a Country” and select “Austria”, then click on “General:1”).

<sup>13</sup> *Ibid.*, using “Germany” instead of “Austria”.

<sup>14</sup> *Ibid.*, using “India” instead of “Germany”.

<sup>15</sup> See General Agreement on Tariffs and Trade 1947, as amended, reprinted in J. Jackson, W. Davey and A. Sykes (eds.), *1995 Documents Supplement to Legal Problems of International Economic Relations*, 3rd edition, at 15 (1995).

<sup>16</sup> See Agreement on Subsidies and Countervailing Measures, in Jackson *et al.*, *ibid.*, at 253.

<sup>17</sup> See GATT Article XVI.

<sup>18</sup> See GATT Article VI(3), allowing the use by an importing nation of countervailing duties against “bounty or subsidy” on the manufacture, production or export of any product.

<sup>19</sup> See SCM Agreement Article 1.1. It might also be recalled in this connection that, apart from language in the new WTO Agreements that might appear sufficiently broad to include subcentral governmental units and other entities, there also exists the 1994 Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994, contained in Annex 1A accompanying the Agreement Establishing the World Trade Organization; available at: [http://www.wto.org/english/docs\\_e/legal\\_e/10-24.htm](http://www.wto.org/english/docs_e/legal_e/10-24.htm), last accessed 10 August 2006. That Understanding, in paragraphs 13 and 14, makes clear a point left confusing in Article XXIV(12) of the GATT regarding the applicability of GATT rules to subcentral units. The Understanding leaves no question that the central governmental unit can face invocation of WTO dispute settlement procedures as a consequence of what subcentral units are doing or failing to do. See also text accompanying *infra* notes 205–207 (GATT and WTO cases involving subcentral units).

governmental incentives proves valuable in assisting subcentral governmental policymakers contemplating increased use of such financial devices in their battles to attract investors and those charged with the task of scrutinizing for legality all the incentives employed by subcentral governmental units. The relevance of the many excellent earlier analyses examining central governmental incentives cannot be doubted<sup>20</sup> but, in view of the potential differences in the range and structure of incentives subcentral units can provide investors, the wisdom of reflection from a different perspective on the outer limits of what the GATT and the SCM Agreement permit seems somewhat apparent.

When attempting to identify and expressly state the precise requirements of the GATT and the SCM Agreement pertinent to incentives provided by subcentral units of government, one must keep in mind two important facts. The first is that both the GATT and the SCM Agreement distinguish between support or benefits that aid products that are exported and similar incentives that could be regarded as purely domestic in nature—that is to say, incentives provided to industries that sell into the local or domestic market alone.<sup>21</sup> It is important here to stress that, just like export subsidies that place the products benefiting from them in an artificially improved competitive position *vis-à-vis* like products in the country to which they are shipped, so domestic subsidies can disadvantage like imported products competing in the country to which they are shipped.<sup>22</sup>

The second fact that bears keeping in mind has to do with the character of the support or benefit provided, whether on exported or domestic products. Neither the GATT nor the SCM Agreement attempts to articulate rules that prescribe the legal limits of incentives of every imaginable stripe. Those concentrated on by both instruments must rise to the level of so-called “subsidies”.<sup>23</sup> In many instances, when subsidies that benefit exported products are the concern, the country to which such products have been exported may consider imposing a countervailing duty (CVD) to offset the use of the subsidy. Clearly, because of the absence of such a benefited export product in the context of purely domestic subsidies, CVDs are not an available remedy and any adequate relief resides exclusively in the relevant rules governing the limits of the use of subsidies. Both the GATT and the SCM Agreement speak to the use of subsidies and CVDs. The principal focus in what follows, however, is essentially confined to subsidies

<sup>20</sup> See generally Gary C. Hufbauer and Joanna S. Erb, *Subsidies in International Trade* (1984); Schwartz and Harper, *The Regulation of Subsidies Affecting International Trade*, 70 Mich. L. Rev. 831 (1972); Goetz, Granet and Schwartz, *The Meaning of “Subsidy” and “Injury” in the Countervailing Duty Law*, 6 Int'l Rev. L. & Econ. 17 (1986).

<sup>21</sup> In this connection, compare GATT Article XVI(1), which speaks generally about the use of subsidies, and GATT Article XVI(3) and (4), which speaks about export subsidies. Compare also, for example, SCM Agreement Article 5, on so-called actionable subsidies, and SCM Agreement Article 3.1(a), on subsidies contingent on exportation of a product.

<sup>22</sup> This reality is reflected in the notification and consultation obligations imposed by Article XVI(1) of the GATT.

<sup>23</sup> See GATT Article XVI generally, which is limited to benefits characterized as “subsidies”. This should be contrasted with GATT Article VI (on anti-dumping and countervailing duties), which does not tie the imposition of countervailing duties to the existence of anything more than what is characterized as a “bounty or subsidy”. On the SCM Agreement's requirement of a subsidy, see SCM Agreement Articles 1,3,5,8 and 10.

and the rules concerning whether financial incentives subcentral governmental units are likely to offer fall within such. With the exception of a few general comments offered in the Conclusion of this article, little will be said on either the matter of CVDs or on the matter of GATT/SCM Agreement standards surrounding when an incentive of admittedly questionable legality as a subsidy will qualify as fully violative of either the GATT or the SCM Agreement because of its use in impermissibly affecting exports or imports.<sup>24</sup>

## II. THE ECONOMIC COMPONENT OF A SUBSIDY

Article XVI(1) of the GATT encompasses subsidies, both domestic and export, while Article XVI(3) and (4) speaks to export subsidies alone.<sup>25</sup> This is made clear by the explicit reference in the latter two provisions to their application to export subsidies and by the fact that Article XVI(1)'s language speaks of subsidies generally. In connection with the SCM Agreement, its Articles 3, 5, and 8 seem to maintain similar recognition that subsidies can be domestic in nature or on the export of products into the international market.<sup>26</sup> The question in all cases, though, regards whether the particular financial or economic incentives offered, whether on exports or domestically, rise to the level of a "subsidy", so as to trigger the relevant obligations and limits established by those, and other, GATT or SCM Agreement provisions.

If one looks only at Article XVI of the GATT, there can be little doubt that it offers a paucity of guidance on that score. Though the opening paragraph of the Article does reference "any form of income or price support" as a subsidy,<sup>27</sup> it offers no general definition of the term "subsidy", and that term is not self-defining. The interpretive Annex accompanying the GATT does provide a modicum of assistance, however.<sup>28</sup> In particular, the opening paragraph of the Annex's ad Article XVI points out that no subsidy is present when an exported product has benefited from an "exemption" or "remission" of a duty or tax otherwise imposed on a like product consumed domestically.<sup>29</sup> Beyond considering such exemptions or remissions as not rising to the level of a subsidy when connected with products that are exported, though, the interpretive Annex offers no

<sup>24</sup> The point here is that both Article XVI of the GATT and the various provisions of the SCM Agreement referenced *supra* note 23 determine a subsidy's ultimate lawfulness based not only on whether the financial incentive of concern constitutes a "subsidy" as such but also on whether the use of that subsidy has been consistent with the relevant GATT/SCM Agreement rules about the bestowal of such on exports or domestic products. In this article, it will be the standards concerning whether particular incentives can be considered "subsidies" that will provide our focus. Nonetheless, the Conclusion will offer some general observations on the need for suspect subsidies to prove objectionable in their bestowal on exports or domestically produced products in order ultimately to be determined in violation of the GATT or the SCM Agreement. And the Conclusion will also offer some general observations on the matter of CVDs designed to respond to subsidies. Beyond these general observations, however, no effort will be made to sedulously examine either of these two other important matters.

<sup>25</sup> See GATT Article XVI(1), (3) and (4). It should be recalled that when the GATT was originally completed in 1947, Article XVI contained only the language now found in paragraph 1. The language reflected in paragraphs 3 and 4, dealing with export subsidies, was added during GATT negotiations in 1954–1955.

<sup>26</sup> See SCM Agreement Articles 3, 5, and 8.

<sup>27</sup> See GATT Article III(1).

<sup>28</sup> See GATT, Annex I, Notes and Supplementary Provisions.

<sup>29</sup> See *ibid.*, at ad Article XVI.

further insight. Nonetheless, additional guidance on the matter of prohibited subsidies was offered by the GATT in 1960 in the form of a Working Party Report that has come to be known as the Illustrative List of Export Subsidies.<sup>30</sup> While specifically limited in its reach to export subsidies alone, thus not affecting incentives of a purely domestic nature, the List does offer explication on a few financial incentives that may prove relevant in regard to our focus on subcentral governmental entities. These would include such things as government measures designed to remit taxes or social welfare charges, measures to exempt goods from charges or taxes that would have to be paid if the goods were sold for domestic consumption, or measures that involve the government bearing costs associated with the extension of commercial credit.<sup>31</sup>

The adoption in 1994 of the Uruguay Round Agreements establishing the WTO also proves helpful in attempting to develop an understanding of what constitutes a subsidy as well as of the rules concerning when the use of such is or is not considered lawful. With particular regard to the light cast on the meaning of the term “subsidy” by the SCM Agreement, initial reference should be made to its Article 1.<sup>32</sup> The term “subsidy” is therein defined as being a two-pronged concept. First, to be considered a subsidy for the purposes of the Agreement, there must be a beneficial economic contribution made to an entity and the contribution must involve either a transfer of something of value, even though effected through the government foregoing the collection of something otherwise owed by the recipient of the transfer, or involve the government using an income or price support program to provide benefit.<sup>33</sup> And secondly, whatever the form taken by the benefit conferred, it must meet very particular and detailed “specificity” requirements set forth in Article 2, all of which look toward distinguishing between permissible, generally available benefits and suspect, limited or targeted benefits.<sup>34</sup> Beyond the assistance of Articles 1 and 2, Annex 1 of the SCM Agreement provides its own Illustrative List of Export Subsidies,<sup>35</sup> thereby helping to further illuminate the reach of the Agreement’s rules on subsidies.

#### A. ARTICLE XVI AND THE GATT CASES

Concentrating, for the moment, on the concept of subsidy in the context of GATT Article XVI, it might be suggested that some assistance regarding what constitutes an Article XVI subsidy can be gained by examination of other provisions of the GATT. Prominent in this connection would be the language in GATT Article III(8)(b), which references subsidies.<sup>36</sup> That reference is designed to signify that Article III’s national

<sup>30</sup> See Report adopted 19 November 1960, GATT Doc. L/1381, 9th Supp. B.I.S.D. 185 (February 1961).

<sup>31</sup> See *ibid.*, para. 5. On the non-exhaustive nature of this List, see *id.* (“The Working Party agreed that this list should not be considered exhaustive or to limit in any way the generality of the provisions of paragraph 4 of Article XVI.”).

<sup>32</sup> See SCM Agreement Article 1.

<sup>33</sup> See *ibid.*, at Article 1.1(a)(1)-(2) and Article 1.1(b).

<sup>34</sup> See *ibid.*, at Article 2.

<sup>35</sup> See *ibid.*, at Annex 1.

<sup>36</sup> See GATT Article III(8)(b).



treatment obligation is not violated by the use of subsidies paid to domestic (and not foreign) producers.<sup>37</sup> Interestingly, in setting forth this exemption from the application of the national treatment obligation, Article III(8)(b) states that the exemption includes “payments to domestic producers derived from the proceeds of internal taxes or charges” that are applied on a non-discriminatory basis.<sup>38</sup> It also references subsidies “effected through governmental purchases of domestic products”.<sup>39</sup> As the latter reference speaks to how a subsidy might be transferred to a recipient rather than to what actually constitutes a subsidy in the first place, it provides little enlightenment concerning the meaning of the term “subsidy”. Taking GATT Article XVI, the relevant language of the GATT interpretive Annex, and SCM Agreement Article III(8)(b) all into consideration, the suggestion would certainly appear to be that “subsidy” should be understood as incorporating not just income or price support schemes but payments derived from internal taxes or charges. Not included, however, would be exemptions or remissions on exports of duties or taxes otherwise applied to like products consumed domestically.

GATT case law confirms and elaborates on this definition of the term subsidy. In the 1950 Decision concerning *Australian Subsidy on Ammonium Sulphate*,<sup>40</sup> an Australian government program to encourage agricultural use of fertilizer through establishing artificially low sales prices and then paying the seller the difference between revenues produced by the sales and the costs incurred by the seller in initially acquiring the fertilizer was subjected to examination under the GATT.<sup>41</sup> What proved objectionable to the Chilean Complainant concerned the discontinuance of the program with respect to sales of certain imported fertilizer while sales of other competitive fertilizers benefited from the program’s continued operation. In addressing Australia’s Article XVI(1) notification obligation, the Decision leaves little doubt that the practice utilized constituted a subsidy.<sup>42</sup> As the Decision observes: “... the type of subsidy which [XVI(1)] was intended to cover was ... financial aid given by a government to support its domestic production and to improve its competitive position either on the domestic market or on foreign markets.”<sup>43</sup>

In line with this approach is the 1958 Decision in the case of *Italian Discrimination Against Imported Agricultural Machinery* (hereinafter *Italian Discrimination*).<sup>44</sup> Specifically, that case involved a U.K. complaint against Italy concerning GATT Article III(8)(b)’s exemption of domestic production subsidies from Article III’s national treatment

<sup>37</sup> For an illustration of a GATT decision involving discussion about Article III(8)(b), see *United Kingdom Complaint on Italian Discrimination Against Imported Agricultural Machinery*, 15 July 1958, GATT Doc. L/833, 7th Supp. B.I.S.D. 60 (1958).

<sup>38</sup> See GATT Article III(8)(b).

<sup>39</sup> See *id.*

<sup>40</sup> See *Report of Working Party G on the Australian Subsidy on Ammonium Sulphate*, 31 March 1950, GATT/CP.4/39.

<sup>41</sup> See *ibid.*, at paras. 3–5.

<sup>42</sup> See *ibid.*, at para. 10 (characterizing the Australian practice as subsidization).

<sup>43</sup> See *id.*

<sup>44</sup> See *supra* note 37.

obligation. Though the Decision itself turned not on Article XVI but rather on particular language appearing in Article III(4), the Panel acknowledged that the financial incentive in use by Italy involved special credit terms offered to domestic purchasers who bought Italian instead of foreign agricultural machinery.<sup>45</sup> The Opinion of the Panel contains nothing that would suggest it failed to regard the financial incentive in use as anything other than a subsidy. To the contrary, the Panel's concern about Italy's inability to meet the strict terms of Article III(8)(b)'s exemption from the national treatment obligation focused only on the fact that the subsidy involved was being provided to purchasers of Italian agricultural machinery and not "producers" of such, as required by the very language of the exemption.<sup>46</sup>

The case of *Assistance to Exports of Wheat and Wheat Flour*, also a 1958 Decision,<sup>47</sup> complements the *Italian Discrimination* approach. It criticizes French government payments to exporters of wheat and wheat flour when such were made under a program where domestic prices for wheat and wheat flour were fixed at a high price level and sales by French exporters into the world market faced consequent lower-priced competitors, with the government basically picking up the price difference.<sup>48</sup> The Decision augments our understanding of the term subsidy by noting that, if, unlike what was found in the Australian complaint before it, government payments to exporters were made wholly from funds collected from producers of the beneficiary products exported, then such payments would not be considered the kind of financial contribution necessary to constitute a subsidy under Article XVI(3).<sup>49</sup>

In the 1976 *DISC* case,<sup>50</sup> the GATT's criticism of a U.S. tax scheme designed to bolster exports offers additional insight. There, parent companies based in the United States received tax "deferral" on income earned by subsidiaries through export activity until such income had been transferred to the parent.<sup>51</sup> Since the very nature of a deferral contemplates eventual payment, the Decision refused to equate a deferral of taxes as identical to the prohibition of tax "remissions" or "exemptions" referenced in the 1960 Illustrative List of Export Subsidies.<sup>52</sup> However, the Panel had no trouble concluding that the particular deferral at issue was at least tantamount to a prohibited "remission" or "exemption" given that, unlike other deferrals under U.S. tax law, the deferral in the *DISC* case did not require interest to be paid for the period during which the deferral had been effective.<sup>53</sup> The companion GATT Decision in *Income Tax Practices*

<sup>45</sup> See *ibid.*, at para. 2.

<sup>46</sup> See *ibid.*, at para. 5.

<sup>47</sup> See *French Assistance to Exports of Wheat and Wheat Flour*, 21 November 1958, GATT Doc. L/924, GATT 7th Supp. B.I.S.D. 46.

<sup>48</sup> See *ibid.*, at paras. 4–7.

<sup>49</sup> See *ibid.*, at paras. 8–14. See also GATT, Annex I, Notes and Supplementary Provisions, ad Art. XVI, para. 3, para. 2. For a later GATT case arriving at the same conclusion regarding a government-financed export plan, see *EEC—Refunds on Exports of Sugar*, 6 November 1979, GATT Doc. L/4833, GATT 26th Supp. B.I.S.D. 290, at paras. 4.2–4.4.

<sup>50</sup> See *United States Tax Legislation (DISC)*, 2 November 1976, GATT Doc. L/4422.

<sup>51</sup> See *ibid.*, at paras. 8–16.

<sup>52</sup> See *ibid.*, at paras. 70–71.

<sup>53</sup> See *ibid.*, at para. 71.

*Maintained by France*<sup>54</sup> took precisely the same kind of approach regarding the absence of taxation of income generated by export activity, even though the absence was legitimately explained as merely coincidental to the overall structure of France's longstanding approach to taxing only income generated by sales in France itself.<sup>55</sup> In the estimation of the Panel, it was the effects of such a tax system on export activity, and not the conscious intent of the implementing State party to somehow use the tax system to distort exports, that proved determinative.<sup>56</sup>

As with the earlier *Italian Discrimination* case, the 1990 GATT decision in *EEC—Oilseeds*<sup>57</sup> offered extensive insight into Article III(8)(b)'s reference to subsidies paid exclusively to domestic producers not violating the national treatment obligation of Article III.<sup>58</sup> Again, the relevancy in the context of Article XVI derives from the fact that Article III(8)(b)'s exemption applies to the payment of "subsidies". And with respect to the meaning of that term, the GATT Panel indicated clearly that it considered the EEC payments involved to constitute a subsidy, though not one eligible for Article III(8)(b)'s exemption due to the fact that the payments were made to domestic processors of oilseeds and could therefore not qualify as "exclusively to domestic producers".<sup>59</sup> The specific nature of the payments considered to be subsidies by the Panel involved government financial transfers amounting to the difference between what oilseeds sold for on the world market and a higher target price established for EEC-produced oilseeds.<sup>60</sup>

#### B. ARTICLE 1 OF THE SCM AGREEMENT AND THE WTO CASES

With regard to the rules set forth by the SCM Agreement on the matter of what is considered a subsidy, reference has been made to the requirements of its Article 1 that a financial contribution or an income or price support system that provides a benefit exist and that the benefit be provided in such a way as to meet the "specificity" requirements of Article 2.<sup>61</sup> The latter will be taken up in Section III of this article, with the present focus being limited to the question of the existence of a requisite benefit. As to the matter of a benefit provided in the form of a financial contribution or income or price support system, Article 1 of the SCM Agreement observes that a qualifying income or price support system may take "any form", as long as it can be considered such a system "in the sense of Article XVI of [the] GATT".<sup>62</sup> This reference is apparently to the notion expressed in GATT Article XVI(1) that it is income or price support systems having

<sup>54</sup> See *Income Tax Practices Maintained by France*, 2 November 1976, GATT Doc. L/4423.

<sup>55</sup> See *ibid.*, at paras. 8–11.

<sup>56</sup> On the arguments of the United States along this line, see *ibid.*, at para. 33. For the Panel's seeming agreement, see *ibid.*, at paras. 52–57.

<sup>57</sup> See *EEC—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, 25 January 1990, GATT Doc. L/6627, GATT 37th Supp. B.I.S.D. 86.

<sup>58</sup> See *ibid.*, at paras. 136–138.

<sup>59</sup> See *ibid.*, at paras. 137–141.

<sup>60</sup> See *ibid.*, at paras. 12–30.

<sup>61</sup> See text accompanying *supra* notes 33–34.

<sup>62</sup> See SCM Agreement Article 1.1(a)(2).

the effect of increasing exports or reducing imports that create concern.<sup>63</sup> According to Article 1 of the SCM Agreement, a qualifying financial contribution can arise in one of four particular ways.

The first of these would involve the “direct transfer of funds” or the “potential direct transfer of funds or liabilities”.<sup>64</sup> Identified examples of the former would include grants, loans or infusions of equity, with examples of the latter including guarantees associated with the securing of loans.<sup>65</sup> The second would involve the foregoing or non-collection of “government revenue that is otherwise due”.<sup>66</sup> Examples here would include the use of tax credits<sup>67</sup> but, in continuation of the general notion expressed in the interpretive Annex accompanying GATT Article XVI,<sup>68</sup> not exemptions or remissions on exports of taxes or duties otherwise owed on like products consumed domestically.<sup>69</sup> The third type of financial contribution qualifying as a sufficient benefit would involve the government “purchase of goods” or the provision of “goods or services other than general infrastructure”. Though specific examples are absent from Article 1 of the SCM Agreement, one might include the construction and maintenance for companies of on-site processing facilities. The final way in which a requisite financial contribution might arise would be through the making of “payments to a funding mechanism” for recipients or through the government “entrust[ing] or direct[ing] a private body to carry out” one of the previously referenced three ways of providing a financial contribution.<sup>70</sup> The clear objective here is to prevent the government from utilizing intermediaries to conceal or obfuscate its interference with normal competitive relationships between products.

The other point that should be noted about the SCM Agreement’s contribution to a better understanding of the term “subsidy” is its inclusion, in Annex I, of an updated and much more extensive and elaborately defined Illustrative List of Export Subsidies.<sup>71</sup> In addition to the practices set forth in the 1960 List, like the remission of taxes and social welfare charges, exemption of exports from charges and taxes paid on like goods otherwise consumed domestically, and government assumption of costs associated with the extension of commercial credit, the SCM Agreement List references internal transportation and freight charges on exports on more favorable terms than those received for domestic shipments,<sup>72</sup> the allowance of special deductions on direct taxes for exported products,<sup>73</sup> the exemption, remission or deferral of so-called prior-stage cumulative indirect taxes on goods or services,<sup>74</sup> the remission or drawback of import

<sup>63</sup> See GATT Article XVI(1).

<sup>64</sup> See SCM Agreement Article 1.1(a)(1)(i).

<sup>65</sup> See *id.*

<sup>66</sup> See *ibid.*, at Article 1.1(a)(1)(ii).

<sup>67</sup> See *id.*

<sup>68</sup> See text accompanying *supra* note 29.

<sup>69</sup> See SCM Agreement Article 1.1(a)(1)(ii), footnote 1. Of course, the exemption or remission cannot be in excess of amounts that have accrued.

<sup>70</sup> See SCM Agreement Article 1.1(a)(1)(iv).

<sup>71</sup> See *ibid.*, at Annex I.

<sup>72</sup> See *ibid.*, at para. (c).

<sup>73</sup> See *ibid.*, at para. (f).

<sup>74</sup> See *ibid.*, at para. (h).

charges,<sup>75</sup> as well as the catch-all “[a]ny other charge on the public account” that is considered an export subsidy in the sense of GATT Article XVI.<sup>76</sup> Again, though, the SCM Agreement List is confined to subsidies on exports, and thus has limited relevancy when it comes to domestic subsidies.

Several WTO cases provide better understanding of Article 1’s definition of the term “subsidy”. One of the most significant is the 1999 Appellate Body Decision in *Canada—Measures Affecting Export of Civilian Aircraft* (hereinafter *Canada—Aircraft*),<sup>77</sup> involving a Brazilian complaint that Canada was, among other things, using government loans and financial offerings that need not be repaid in the absence of business success—and, when repayment was required, it could be made at below-market interest rates—to assist its civilian aircraft industry. The Decision in that case revolved around the fact that without the existence of a “benefit” there could be no “subsidy”. But interestingly, the very notion of a “benefit” has at least two prominent dimensions: that emphasizing what has been given up; and that emphasizing what has been received. The Appellate Body Decision in the case noted that for a subsidy to exist any alleged “benefit” must provide the recipient an “advantage” of sorts, something that proves a “favourable or helpful factor or circumstance”.<sup>78</sup> Without the recipient finding itself in the possession of something it would not otherwise have had, there could be no “benefit” and, thus, no subsidy.

In further addressing whether the need for the existence of a “benefit” focused on what was given up rather than what was received, the decision in *Canada—Aircraft* left no doubt that, for a subsidy to be present, three specific reasons suggested attention should be paid entirely to what has been received. The first reason had to do with SCM Agreement Article 1.1(b)’s clear statement that there can be no subsidy without a financial contribution in which “a benefit is thereby *conferred*” (emphasis added), implying that the matter of principal importance is what has been received.<sup>79</sup> Second, Article 1.1(a)(1)(iv) of the SCM Agreement mentions, as we have seen, that non-government contributions can constitute subsidies,<sup>80</sup> therefore suggesting that the significant consideration is what has been received, not what the government has given up.<sup>81</sup> And third, since Article 14, from that part of the Agreement dealing with the imposition of CVDs in response to subsidies, speaks to calculating CVDs on the basis of the amount of “benefit to the recipient” provided by such subsidies, the suggestion would again appear to be a focus on what was received, rather than what was given up.<sup>82</sup> In further explication of the nature of a “benefit”, and thus “subsidy,” the Appellate Body seems to indicate that the search is always to look for whether a recipient has received a financial contribution “on terms more favorable than those available ... in the market”.<sup>83</sup>

<sup>75</sup> See *ibid.*, at para. (i).

<sup>76</sup> See *ibid.*, at para. (l).

<sup>77</sup> See *Canada—Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, 20 August 1999.

<sup>78</sup> See *ibid.*, at para. 153.

<sup>79</sup> See *ibid.*, at para. 154.

<sup>80</sup> See text accompanying *supra* note 70.

<sup>81</sup> See *Canada—Aircraft*, *supra* note 77, at para. 160.

<sup>82</sup> See *ibid.*, at para. 155.

<sup>83</sup> See *ibid.*, at para. 158.

The WTO companion 1999 Appellate Body Decision of *Brazil—Export Financing Programme for Aircraft* (hereinafter *Brazil—Aircraft*)<sup>84</sup> concerned a reciprocal Canadian complaint against the Brazilian government for Brazil’s own financing measures involving Brazilian civil aircraft. The measures receiving attention resulted in Brazil paying part of the interest on loans made by private lenders to foreign borrowers who purchased Brazilian-made aircraft. Though much of the Opinion is devoted to various other matters related to subsidies, a point is made about providing a bit of elaboration on *Canada—Aircraft*’s discussion regarding a subsidy being a benefit and a benefit constituting an “advantage”.<sup>85</sup> The elaboration arose in connection with the Decision’s examination of some language in the SCM Agreement’s Illustrative List of Export Subsidies.<sup>86</sup> The particular language indicates that one form of prohibited export subsidy would involve government payment of all or part of the costs associated with securing credit in so far as the payment resulted in the beneficiary obtaining a “material advantage”.<sup>87</sup> The Decision in *Brazil—Aircraft* observed that, since the drafters of the SCM Agreement and its Annexes had used both the term “benefit” in Article 1.1(b) and the term “material advantage” in paragraph (k) of Annex 1’s Illustrative List, the two terms were not equivalents.<sup>88</sup> The implication thus suggests that the kind of benefit sufficient to meet the test for a subsidy need not get to the level of a “material advantage”.<sup>89</sup> This appears to be a reasonable implication, given that the notion of a “material advantage” is connected with so-called prohibited subsidies, and the general test for an Article 1 “subsidy” is applicable not only to prohibited subsidies but also to those that might qualify as merely actionable, as well as to those that might be deemed non-actionable.<sup>90</sup>

*Brazil—Aircraft* is also important for the contribution it makes to emphasizing that the SCM Agreement’s economic aspect of its term “subsidy” requires not only the existence of a “benefit” but also that the benefit must be the result of a “financial contribution”.<sup>91</sup> Subsequent WTO Panel decisions, such as the 2001 Decision in *United States—Measures Treating Export Restraints as Subsidies* (hereinafter *U.S.—Export Restraints*), have stressed this point and noted that the reason for the distinction has to do with the intention of the SCM Agreement drafters to “foreclos[e] the possibility of the treatment of *any* government action that result[s] in a benefit [being regarded] as a subsidy” (emphasis original).<sup>92</sup> In the words of that Panel Decision, “the requirement of a financial contribution from the outset was intended by its proponents precisely to ensure that not all government measures that conferred benefits could be deemed

<sup>84</sup> See *Brazil—Export Financing Programme for Aircraft*, WT/DS46/AB/R, 20 August 1999.

<sup>85</sup> See text accompanying *supra* notes 77–78.

<sup>86</sup> See text accompanying *supra* notes 71–76.

<sup>87</sup> See SCM Agreement, Annex 1, at para. (k).

<sup>88</sup> See *Brazil—Aircraft*, *supra* note 84, at para. 179.

<sup>89</sup> See *ibid.*, at para. 182.

<sup>90</sup> Again, this draws on the fact that the SCM Agreement defines “subsidy” in Article 1 and then notes that subsidies can be either Article 3 prohibited subsidies, Article 5 actionable subsidies, or Article 8 non-actionable subsidies.

<sup>91</sup> See *Brazil—Aircraft*, *supra* note 84, at para. 179. For the textual basis legitimating that position, see SCM Agreement Article 1.1(a)(1) (“financial contribution”) and Article 1.1(b) (“benefit”).

<sup>92</sup> See *United States—Measures Treating Exports Restraints as Subsidies*, WT/DS194/R, 29 June 2001, at para. 8.38.

subsidies”.<sup>93</sup> Given that many sorts of government programs result in benefits being acquired by recipients, the significance of this point cannot be emphasized strongly enough.<sup>94</sup> Likewise, it is important to emphasize that WTO decisions, such as that in the so-called *U.S.—Lead and Bismuth II* dispute, decided in 2000,<sup>95</sup> indicate that it is not essential that the benefit of concern in a subsidy investigation go to the very same entity that is then subject to legal action. As the Appellate Body noted there, the fact that it had been a predecessor to the entity then under investigation that had earlier received a subsidy would not insulate the successor, assuming that the successor could be shown to have received some “flow-through” benefit.<sup>96</sup>

### C. ANALYSIS IN THE CONTEXT OF SUBCENTRAL GOVERNMENTAL INCENTIVES

Obviously, subcentral governmental units have a vast array of financial incentives that can be used to attract business ventures away from locating in competitor units. Let us examine the permissibility of some of these incentives for consistency with the dictates of both GATT Article XVI and Article 1 of the SCM Agreement. In this context, it should be recalled that our focus here is only on whether the incentives provided are of a sufficient economic nature to rise to the level of a GATT Article XVI or an SCM Agreement Article 1 “subsidy”. Restated, attention herein extends to nothing more than whether the economic characteristics of the incentives examined satisfy those required of a “subsidy” under the terms of the GATT or the SCM Agreement. As noted in the foregoing pages, the GATT decisions interpreting Article XVI have little beyond the barest description of the concept of subsidy to work with in deciphering and then enunciating the precise dimensions of the economic nature of “subsidy”. Article 1 of the SCM Agreement provides a much more fecund source on this score, and the WTO cases fully reflect that fact. With this in mind, we turn our attention to four specific examples of incentives that subcentral governmental units might employ.

For our first example, assume that a subcentral governmental unit holds title to a variety of properties. In order to induce an interested investor to locate in that jurisdiction, the government has committed itself to proposing to the local constituents and then supporting a series of votes on municipal bond funding designed to generate monies to assist the investor in purchasing and constructing its local production facilities. The revenues generated for the investor by the sale of the bonds is to be repaid by the investor, with interest at the prevailing market rate, at the end of a 10-year period. All this would be consistent with any such monies obtained by the investor if it had to approach a private lender on the open market. However, as the votes on the issuance of

<sup>93</sup> See *id.*

<sup>94</sup> In accord, see also *United States—Preliminary Determinations with Respect to Certain Softwood Lumber from Canada (U.S.—Softwood Lumber III)*, WT/DS236/R, 27 September 2002, at para. 7.24 (emphasizing the element of “financial contribution”).

<sup>95</sup> See *United States—Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/AB/R, 7 June 2000.

<sup>96</sup> See *ibid.*, at paras. 55–68.

the bonds are scheduled to occur over a period of three years and both the investor and the subcentral governmental unit would like to announce a long-term commitment to the local community, knowing that any particular future vote on bond funding could fail, the investor insists upon, and the subcentral governmental unit agrees to, a backup position that has title to several of the subcentral governmental units local properties pledged to a private financial institution as security for a loan in the event of the failure of any particular vote.

Just in terms of the GATT, there would appear to be no problem with the issuance of the municipal bonds. Revenues generated from their sale are to be repaid by the investor with interest under time and borrowing terms that seem to replicate what would exist had the investor sought a loan on the financial market. Absent some complaint regarding a subsidy extant in the fact that the organization and administration of the bond sale was borne by the subcentral governmental unit rather than by the investor who benefited by thus saving time, money, and effort in organizing and overseeing such,<sup>97</sup> there does not exist any payment, aid, special credit, or government involvement in transferring money to the investor on the basis of price, financial, or other economic differentials. The same would appear to be true with respect to Article 1 of the SCM Agreement. While issuance of bonds did prove a subsidy in the 2001 WTO Panel Decision in *Brazil—Export Financing Programme for Aircraft* (hereinafter *Brazil—Aircraft (Article 21.5-Canada II)*),<sup>98</sup> the problem was that an entity in the Brazilian aircraft industry had been the recipient from the government of redeemable bonds. The issuance of such was found to be a financial contribution under Article 1.1(a)(1)'s reference in the SCM Agreement to “direct transfer[s] of funds”.<sup>99</sup> After all, the bonds were nothing more than another form of cash.

The real question in our hypothetical concerns the government pledge of its properties as a backup for a loan in the event one of the future bond issues fails to secure adequate public support. This arguably would constitute a subsidy under Article XVI of the GATT, as there would seem to be little difference between such a pledge and a payment made to an investor. In both instances, the recipient receives something of value, albeit that the value received by way of the pledge comes through participation of an intermediary, since a pledge simply displaces equity that the investor may otherwise have been required to offer had the municipality not stepped forward. Under the terms of Article 1 of the SCM Agreement, the case for the pledge as a subsidy seems relatively strong. Clearly, the investor secures an advantage, a favorable or helpful factor.<sup>100</sup> Further, if the issuance of redeemable bonds is to be regarded as a financial

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<sup>97</sup> See text accompanying *supra* notes 39–40, suggesting that government payments to an investor may constitute an Article XVI subsidy; and text accompanying *supra* note 43, suggesting the same with regard to provisions of financial aid. See also text accompanying *supra* notes 47–49, taking the same position when it comes to programs designed around the government picking up differences in prices.

<sup>98</sup> See *Brazil—Export Financing Programme for Aircraft (Second Recourse by Canada to Article 21.5)*, WT/DS46/RW/2, 26 July 2001.

<sup>99</sup> See *ibid.*, at para. 5.22; and text accompanying *supra* note 64.

<sup>100</sup> See text accompanying *supra* note 78.



contribution rising to the level of a subsidy, why should it matter that the government substitutes instead a pledge, to a private financial institution, of properties owned by the government in order to ensure an investor receipt of a loan? In both instances, the government transfers, or potentially transfers, funds or liabilities, as referenced in Article 1.1(a)(1)(i) of the SCM Agreement. And, as if to leave no question regarding the conclusion that the pledge should be considered a subsidy, the SCM Agreement's Illustrative List of Export Subsidies notes, in paragraph (j), that credit guarantees constitute subsidies.<sup>101</sup> The 2002 WTO Panel Decision in *Canada—Export Credit and Loan Guarantees for Regional Aircraft* held loan guarantees to constitute transfers of funds under Article 1.1(a)(1)(i).<sup>102</sup>

Now assume that the incentive provided by the subcentral governmental unit involves the deferral, for the first 10 years of operation, of payment by the investor of a municipal business franchise tax. Payment of such tax is ordinarily due on an annual basis from all businesses operating within the jurisdictional limits of the municipality. Deferrals of payment are typically available only upon the showing of unusual, extraordinary, and unlikely to be repeated hardship, and when payment of any deferred amount is submitted, it must be accompanied by the payment of interest based on an average of market interest rates prevailing during the period of deferral. In the 150 years of the tax's existence, only three deferrals have ever been granted. With respect to our investor, at the end of the 10-year deferral period, the amount of tax due is to be submitted with accompanying interest fixed, not at the average of market interest rates prevailing during the deferral period, but at the lowest market rate available at any point over the deferral period.

Not only would such a deferral appear to be a subsidy under the terms of Article XVI of the GATT, it would also appear to fall within the SCM Agreement's view of what constitutes a subsidy. With respect to GATT Article XVI, the 1976 *DISC* case would leave little question about the permissibility of deferrals, given that they do contemplate eventual payment of what is owed.<sup>103</sup> However, as was true in connection with that case, so here the problem would arise from the fact of the interest payment due. If Article XVI is contravened as a result of the tax system permitting deferrals without accompanying interest payments in certain instances, then surely the same should obtain when it comes to deferrals accompanied, in certain instances, by payments of interest at rates below what others receiving the right to defer have to pay in interest. In terms of Article 1 of the SCM Agreement, there seems every reason to believe that the interest component of the franchise tax plan the investor is benefiting from falls within Article 1.1(a)(1)(ii)'s notion of the government foregoing or not collecting revenue "that is otherwise due".<sup>104</sup> As described, the hypothetical deferral incentive

<sup>101</sup> See SCM Agreement, Annex 1, at para. (j).

<sup>102</sup> See *Canada—Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, 28 January 2002, at paras. 7.389–7.393.

<sup>103</sup> See *DISC* case, *supra* notes 50–53.

<sup>104</sup> See text accompanying *supra* note 66.

available to our investor permits interest payments at the lowest prevailing market rate during any point in time over the entire 10-year deferral period. Though deferrals of franchise taxes typically are not permitted, in the unusual circumstances when they are available they carry an interest rate due and owing to the municipality that reflects the average of market rates extant during the deferral period. It is the rate average approach that captures what is “otherwise due”. Subcentral governmental incentives that entice investors with deferral interest payments envisioning rates at something less than an average of rates amount to foregoing or not collecting revenue the governmental unit could otherwise expect.

As a third example of subcentral governmental incentives, assume a wrinkle on the business franchise tax described above. Specifically, the local governmental unit adopts a measure that requires deferred tax payments made by the investor of concern to be accompanied by interest payments equivalent to what any other deferred payer of the franchise tax is obligated to submit. In other words, everyone entitled to a deferral, including potential outside investors, is to pay interest at precisely the same rate. However, the local measure also establishes a legal prohibition on financial institutions doing business within the municipality charging our particular outside investor more than 1 percent below their current lending rate on loans made to the investor in order to assist in the meeting of franchise tax payments. In so structuring the investment incentive package, the subcentral governmental unit hopes to avoid arguments suggesting violations of SCM Agreement Article 1.1(a)(1)(i) on direct transfers or potential direct transfers of funds or liabilities or of Article 1.1(a)(1)(ii) on foregoing or not collecting revenue otherwise due.

Despite these efforts, it appears that the restructured incentive package can be argued to contravene the language of SCM Agreement Article 1.1(a)(1)(iv), though admitted counter-arguments do exist. That SCM Agreement provision strikes at such stratagems by including within the concept of financial contributions that constitute subsidies all those measures that endeavor to utilize private entities to perform activities frowned upon when performed by public bodies. As suggested previously, a subcentral governmental unit could not charge a rate of interest more favorable than normally charged on business franchise tax deferrals without falling within Article 1.1(a)(1)(ii)’s proscription. Likewise, pursuant to Article 1.1(a)(1)(iv), it cannot “direct[] a private body” to carry out a comparable act. As the WTO Panel in *U.S.—Export Restraints* observed in 2001, the concept of direction connotes a “command”,<sup>105</sup> and the example under discussion clearly involves a legally obligatory command. Financial institutions operating within the municipality are left with absolutely no choice in the lending rate to be made available to investors the community seeks to attract.

Countering this approach, however, would be the claim that there is a clear difference between a situation in which the government provides monies to a private

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<sup>105</sup> See *U.S.—Export Restraints*, *supra* note 92, at para. 8.75.

entity in order to have such then transferred to a beneficiary or commands that a private entity charge a lower rate of interest on a loan, all the while underwriting the lender's lower interest rate by funneling monies to the participating lender, and a situation where the government orders unreimbursed transfers of private monies or the lending of private funds at sub-market interest rates. Also relying on *U.S.—Export Restraints*, this counter-argument would emphasize that the Panel therein stressed the aforementioned fact of Article 1's distinction between "financial contribution" and "benefit" in order to drive home that the drafters of the SCM Agreement did not intend to characterize every form of government benefit as a potential subsidy.<sup>106</sup> To qualify under Article 1.1(a)(1)(iv) as a potential subsidy, it might be maintained that some form of government reimbursement for mandated low-interest-rate loans would be required. In the absence of such, no government transfer of funds, or government foregoing of revenues, or government provision of goods or services would exist. Indeed, it might be noted that the situation would be little different from that in *U.S.—Export Restraints*, where no triggering of Article 1.1(a)(1)(iv) was found to be present merely because of government-directed limits on products being shipped out of the country. That is to say, without a government delegation or command accompanied by some transfer of government funds, or provision of goods or services by the government, or foregoing of government revenues, no requisite financial contribution exists. What proves troublesome about such a reading of *U.S.—Export Restraints*, though, is that the Panel seems to have rested its conclusion regarding Article 1.1(a)(1)(iv) not on the basis of an absence of a government transfer, provision, or foregoing but on the absence of a generally established export restraint amounting to an Article 1.1(a)(1)(iv) "direct[ion]".<sup>107</sup>

Under Article XVI of the GATT, there may be a bit more room for doubt about whether the investment incentive measure involved here (i.e. a commanded interest rate reduction) constitutes a "subsidy". Nothing in the express language of Article XVI or its relevant associated instruments speaks to commanding private entities to provide incentives. Nonetheless, paragraph 1 of Article XVI, which includes domestic subsidies, as well as paragraphs 3 and 4 on export subsidies, reference subsidies that "directly or indirectly" (emphasis added) produce implications for international trade.<sup>108</sup> The suggestion would seem to be that it doesn't matter how a non-permitted financial incentive is applied so as to distort trade, the intent of Article XVI is to establish rules that must be followed. Indirect procurement of trade consequences are equally as objectionable as those procured directly.

As a final example of subcentral governmental provision of investment incentives, let us assume the governmental unit involved offers to construct for a prospective investor an on-site and exclusively dedicated waste and industrial effluent treatment facility. As with all other analogous facilities within the jurisdictional confines of the

<sup>106</sup> See text accompanying *supra* notes 92–94.

<sup>107</sup> See *U.S.—Export Restraints*, *supra* note 92, at para. 8.75 ("an export restraint as defined in this dispute cannot constitute government-entrusted or government-directed provision of goods in the sense of subparagraph (iv) ...").

<sup>108</sup> See GATT Article XVI, at paras. (1), (3), and (4).

unit, the offered facility will be built from public sewer and water funds. Regular operating and maintenance expenses for the facility will be paid in part through monthly billing of the investor and in part by other patrons serviced by the sewer and waste department. The initial construction costs, however, will come from the sale of financial instruments issued by the governmental unit, no part of the construction costs being contributed at any time by the investor itself.

In terms of Article XVI of the GATT, this incentive would appear to constitute a subsidy. While it may seem peculiar to regard sewer and effluent treatment facilities as subsidies, it is as plain as day that the incentive here involves the courted investor receiving something that is dedicated to its sole use along with which there comes no corresponding financial burden. True enough, a portion of the regular operating and maintenance expense of the facility is to be paid by the investor through monthly utility bills. But the financial burdens associated with installation and start-up in the first place, costs that might otherwise have to be covered by the investor, are borne entirely by the subcentral governmental unit in return for securing an investment commitment. As with some of the other incentives discussed previously, the subcentral governmental unit's financial outlay places the investor in a better economic position than it might otherwise find itself. Though Article XVI does not explicitly address such incentives, the consequence of permitting them to escape regulation would be grave potential for the disruption of trading patterns. Avoided construction costs can be shifted to the pricing position of goods produced at the facility benefited, thus opening the potential for trade distortion.

Article 1.1(a)(1)(iii) of the SCM Agreement differs from Article XVI of the GATT in that it does take great pains to mention, as alluded to a couple of paragraphs earlier,<sup>109</sup> the government provision of "goods or services other than general infrastructure" as a financial contribution capable of constituting a subsidy.<sup>110</sup> The breadth of this subparagraph of Article 1 has been confirmed by WTO decisions.<sup>111</sup> The question likely to arise with respect to our current example focuses on the fact that sewer and effluent treatment facilities are typically considered infrastructure and therefore would seem ineligible for classification as the kind of a good or service within the scope of Article 1.1(a)(1)(iii). The obvious distinction the drafters attempted to get across by the subparagraph's exclusion of "infrastructure" is that every government provides some level of basic infrastructure and yet this should not be understood as sufficient to activate the subsidies disciplines of the SCM Agreement. It cannot be stressed strongly enough, however, that not all goods or services that might be regarded as infrastructure are accorded the status of an excluded piece of infrastructure. The very language of Article 1.1(a)(1)(iii) excludes only infrastructure that qualifies as "general" infrastructure. Sewers and effluent treatment facilities would ordinarily appear to satisfy this requirement of "generality". In the case of our particular investment incentive, though, is it just

<sup>109</sup> See text accompanying *supra* notes 106–107.

<sup>110</sup> See SCM Agreement Article 1.1(a)(1)(iii).

<sup>111</sup> See *U.S.–Softwood Lumber III*, *supra* note 94, at paras. 7.23–7.24 ("broad meaning" encompassing all "tangible or movable personal property, other than money").

possible that the close linkage to and sole use by the courted investor undercuts the nature of this infrastructure project as “general”? In other words, to be seen as “general” infrastructure, must it be not precipitated by the unique needs of or dedicated to the exclusive use of a certain entity? Or, conversely, does the concept of “general” infrastructure suggest nothing more than that the character or form of the project be in line with the infrastructure services normally provided by governmental units?

### III. THE “SPECIFICITY” COMPONENT OF A SUBSIDY

The “generality” requirement of Article 1.1(a)(1)(iii) of the SCM Agreement is an apparent problem in the context of the dedicated sewer and effluent treatment facility mentioned in connection with the incentives offered to our hypothetical investor in the previous Section. From the precise language of that provision, it would appear that the drafters intended to exclude from those financial benefits considered capable of rising to the level of subsidies meriting concern all infrastructure considered to be of a “general” nature. Presumably, things like roads, schools, heat and power, water, waste disposal, and police and fire service were thought to be so widely distributed, and so integral to the very essence of governmental structure and organization, that it would be inappropriate to regard their provision as the kind of financial contribution that could qualify as a subsidy. But unless the deployment by the drafters of the term “general” infrastructure is to be ignored, infrastructure that is too particular and specific to a beneficiary should be regarded as falling within Article 1.1(a)(1)(iii)’s phrase “government provi[sion of] goods or services”.<sup>112</sup> Such an approach makes perfect sense, given the fact that Article 1 of the SCM Agreement declares that for a financial contribution of any sort to rise to the level of a subsidy, it must not only benefit a recipient, as already discussed, but be “specific” in accordance with the requirements of Article 2 of the Agreement.<sup>113</sup> In other words, beneficial contributions that are general in nature are not to be considered subsidies. The SCM Agreement is designed only to establish rules concerning the use of contributions when they are “specific”.

Any quick reading of Article XVI of the GATT reveals that it contains absolutely no language suggesting a “specificity” requirement for its subsidy rules to apply. The same is obviously not the case for Article 1 of the SCM Agreement. Article 1.2 explicitly references the need to find a beneficial contribution that is “specific” if it is to be regarded as an Article 1 subsidy subject to the disciplines of the SCM Agreement.<sup>114</sup> There can be no question that the objective in inserting such a requirement into the SCM Agreement had to do with recognition that governments and public bodies are, by their nature, involved in the provision of a vast array of goods and services. In the event each and every effort of an official public character to provide such goods and services were to be thought of as a subsidy, not only would the terms of the Agreement itself

<sup>112</sup> See SCM Agreement Article 1.1(a)(1)(iii).

<sup>113</sup> See *ibid.*, at Article 1.2.

<sup>114</sup> See *id.*

become unmanageable, the rules concerning subsidies might come to be seen as antithetical to healthy and productive governmental organization.<sup>115</sup> Thus, a certain rationality accompanies the notion that only beneficial financial contributions which are limited to particular enterprises or groups of industries are to be viewed as subsidies. This is the heart of the “specificity” requirement. The provision of goods or services, the transfer of funds, the foregoing of revenues otherwise due, and any other form of financial contribution that proves beneficial is not to be seen as an SCM Agreement subsidy unless it is focused or limited in those considered its recipients.

#### A. HOW “SPECIFICITY” CAME TO BE ASSOCIATED WITH DISCIPLINES ON SUBSIDIES

Though Article XVI of the GATT nowhere references a “specificity” requirement, it is interesting to keep in mind the chronology leading up to the inclusion of such a requirement in the 1994 Uruguay Round WTO SCM Agreement. Before recounting that chronology, however, it bears mentioning that, even in the absence of an explicit GATT Article XVI reference to “specificity”, it seems indubitable that the GATT cases addressing the matter of subsidization involved facts in which the government-provided incentives in dispute proved much more than simply incentives that were widely and generally available. Indeed, in each of the GATT decisions recounted above,<sup>116</sup> the subsidies at issue were narrowly targeted to provide benefit to very particular enterprises or industries. No one would dare claim that the 1950 Decision in the *Australian Subsidy* case<sup>117</sup> or the 1958 Decision in the *Italian Discrimination* case<sup>118</sup> involved anything other than a subsidy aimed like a laser on a limited and restricted group or sector. Similarly with respect to the 1958 Decision in *Assistance to Exports of Wheat and Wheat Flour*<sup>119</sup> and the 1990 Judgment in the *EEC–Oilseeds* dispute.<sup>120</sup> The two 1976 export-promoting tax cases, *DISC*<sup>121</sup> and *Income Tax Practices Maintained by France*,<sup>122</sup> while involving practices having the potential to benefit much wider segments of the productive base than any of the other GATT subsidy decisions, were still limited in being tied to the need that a beneficiary undertake export activity. This fact alone resulted in them involving something other than a subsidy made generally available. Moreover, these two decisions, as well as the *Assistance to Exports of Wheat and Wheat Flour* Decision, concerned the highly condemned practice of providing subsidies to products that are exported. But, again, the basic point is that, even in the absence of a GATT Article XVI “specificity” requirement, the various disputes involving that provision have involved its application in such a way that specificity existed.

<sup>115</sup> For a Panel Decision in the context of the North American Free Trade Agreement recognizing such as the driving force behind the “specificity” requirement contained in U.S. domestic subsidy/CVD law, see *Pure and Alloy Magnesium From Canada*, Panel No. USA-92-1904-03, 16 August 1993.

<sup>116</sup> See the decisions discussed *supra* Section II.A of this article.

<sup>117</sup> See *supra* note 40.

<sup>118</sup> See *supra* note 44.

<sup>119</sup> See *supra* note 47.

<sup>120</sup> See *supra* note 57.

<sup>121</sup> See *supra* note 50.

<sup>122</sup> See *supra* note 54.

Now, as to the chronology of “specificity” creeping into the text of particular substantive provisions of international economic law regarding the use of subsidies, one of the earliest contributions to that development can be found in the 1979 Tokyo Round Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (hereinafter Tokyo Round SCM Code).<sup>123</sup> Though the Tokyo Round SCM Code does not establish the same kind of clear and explicit “specificity” requirement found in its successor Uruguay Round SCM Agreement, to be taken up below, it does lay the groundwork for that requirement. In particular, the Tokyo Round SCM Code begins the process of subjecting domestic subsidies to disciplines beyond the mere notification and consultation obligations prescribed in GATT Article XVI(1).<sup>124</sup> To a certain extent, this starts the move that culminates in the Uruguay Round SCM Agreement’s subjection of such subsidies to requirements analogous to those imposed on export subsidies. With respect to the matter of “specificity”, Article 11(3) of the Tokyo Round SCM Code notes that domestic subsidies tend to be focused on “certain enterprises” or seem to be granted “regionally or by sector”.<sup>125</sup> Though not expressly articulating the need for such subsidies to be “specific” if they are to be deemed of legal concern, this kind of language plainly suggests a growing awareness that some subsidies are generally or widely available and, thus, not viewed as particularly troublesome. Indeed, domestic subsidies of that sort are frequently tied to governmental provision of basic social services too tenuously connected to any trade-distorting benefit to merit expressions of international concern. The Tokyo Round SCM Code’s terms in Article 11(3) were translated in the internal subsidies and CVD law of the United States to mean that domestic subsidies would be actionable only if bestowed upon a “specific” enterprise or industry, or group of enterprises or industries. Generally or widely available domestic subsidies would not be seen as actionable under U.S. law.<sup>126</sup> This marked an important milestone on the road towards insisting upon “specificity” in the subsidy context.

A couple of decisions applying that new U.S. approach on domestic subsidies prove instructive on the matter of “specificity”. In a 1985 Preliminary Decision in *Oil Country Tubular Goods from Austria*,<sup>127</sup> the U.S. Department of Commerce’s International Trade Administration was faced with determining whether there had been subsidization of the sort that would result in the imposition of a CVD on goods that had been imported into the United States. Certain aspects of the Austrian financial support at issue were

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<sup>123</sup> See Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade, Agreements Reached in the Tokyo Round of the Multilateral Trade Negotiations at 259, House Doc. No. 96-153, Part 1, 96th Congress, 1st Session (1979).

<sup>124</sup> See Article 11(2), *ibid.*, at 22–23 (fixing an obligation to avoid use of domestic subsidies to cause certain effects).

<sup>125</sup> See *ibid.*, at Article 11(3).

<sup>126</sup> See Trade Agreements Act of 1979, Report of the Committee on Finance of the U.S. Senate on H.R. 4537, Senate Report No. 96-249, 96th Congress, 1st Session, at 84 (1979). For the relevant statutory language, see Trade Agreements Act of 1979, Section 101, amending Tariff Act of 1930 by adding Section 771(5) (definition of “subsidy” as requiring domestic subsidies be “specific”).

<sup>127</sup> See *Oil Country Tubular Goods from Austria, Preliminary Determination*, 50 Federal Register 23334 (Int’l Trade Admin, 1985).

determined to be subsidies eligible to be countervailed, but when it came to government-funded labor training programs, the Decision indicated that, since they were “available to all sectors of Austrian industry, and not just to the iron and steel industry or to export-related industries”, they were insufficiently “limited to a *specific* enterprise or industry ...” (emphasis added).<sup>128</sup> Clearly, the language of the Decision left no question about the commitment of the Department of Commerce to apply the “specificity” requirement as written. In the absence of a showing that a beneficial financial contribution was only available to a restricted group of enterprises or industries, it would not be found to constitute the kind of domestic subsidy capable of activating a CVD.

This same approach received the approval of the courts in the United States a few years later in the 1991 case of *PPG Industries*.<sup>129</sup> In that case, imports of so-called float glass from Mexico were subjected to CVD investigation as a result of certain domestic financial contributions the float glass industry was alleged to have received from the Mexican government. The Court determined that the imports appropriately had not been subjected to a CVD. A principal issue in the determination concerned whether the float glass industry, which uses large quantities of government-price-controlled natural gas to heat its burners, could be viewed as a “specific” industry because of being a consumer using, by comparison with all consumers, disproportionately large quantities of price-controlled gas. The Court rejected this contention, holding that the CVD investigation had accurately concluded that the requisite “specificity” was absent in order to find a countervailable subsidy. With respect to the argument of disproportionate usage meeting “specificity”, the Court observed that the U.S. Congress in 1984 had taken up and rejected a proposal that would have resulted in natural resource subsidies being countervailable *per se*.<sup>130</sup> As a consequence, the Court found it difficult to believe that the notion of “specificity” could be met when a widespread and generally available benefit was simply used by one particular industry more than by others. The Court also rejected arguments that “specificity” had been met by the natural gas purchasing program establishing particular and detailed eligibility requirements or that the float glass industry was an “energy-intensive user” among natural gas consumers.<sup>131</sup>

The interesting thing is that, in the same year as the *Oil Country Tubular Goods from Austria* Decision, the GATT Committee on Subsidies and Countervailing Measures, which had been set up pursuant to the Tokyo Round SCM Code, issued Draft Guidelines concerning the concept of “specificity” inherent in the above-referenced language of Article 11(3) of the Code.<sup>132</sup> The 1985 Guidelines seem roughly consistent with both the *Oil Country Tubular Goods* and *PPG Industries* decisions. While the

<sup>128</sup> See Decision, Section II.B.1 (Government-Funded Labor Training).

<sup>129</sup> See *PPG Industries, Inc. v. United States*, 928 F.2d 1568 (Court of Appeals, Federal Circuit, 1991).

<sup>130</sup> See *ibid.*, at 1576.

<sup>131</sup> See *ibid.*, at 1578–1579.

<sup>132</sup> See Draft Guidelines for the Application of the Concept of Specificity in the Calculation of the Amount of a Subsidy Other than An Export Subsidy, Committee on Subsidies and Countervailing Measures, SCM/W/89 (25 April 1985) (hereinafter Guidelines).



Guidelines refrain from enumerating instances in which financial contributions that prove beneficial will invariably be designated as being “specific”, it provides a listing that “shall be taken into account” in determining whether benefits are “specific”.<sup>133</sup>

Among the situations addressed in the Guidelines, several merit especial comment. With regard to instances where a benefit-granting authority explicitly has provided that access to a benefit is limited to only certain enterprises, the Guidelines indicate that “such a measure would be specific”.<sup>134</sup> As for instances in which no such explicit limitation is present yet the “granting authority acts to exclude certain enterprises from access”, it is provided that specificity “may or may not exist”.<sup>135</sup> Where the granting authority administers its benefit measures by “establish[ing] certain criteria or conditions for eligibility”, the benefit would “normally” not be deemed “specific”, at least when such criteria or conditions were based on “neutral factors” and their existence rendered one automatically eligible.<sup>136</sup> Recognizing that situations may be present where the foregoing suggest a determination of “nominal non-specificity” but a benefit program may still appear to be operating to provide limited recipients with a benefit, the Guidelines indicate that “[i]t may be necessary in those cases for the investigating authority” to look at “whether the measure [of concern] is ... *de facto* deliberately granting an advantage to certain enterprises”.<sup>137</sup> In cases of the latter sort, however, determinations of “specificity” must be “clearly substantiated”.<sup>138</sup>

#### B. “SPECIFIC” SUBSIDIES IN SCM AGREEMENT ARTICLE 2 AND THE WTO CASES

As has already been alluded to, the Uruguay Round SCM Agreement goes well beyond Article XVI of the GATT, the language of the Tokyo Round SCM Code, or even the 1985 Guidelines in articulating a “specificity” requirement in order for an objectionable subsidy to be present. Article 1.2 of the 1994 SCM Agreement explicitly requires that any contribution, to be designated a subsidy subject to the strictures of the Agreement itself, must be available to only “specific” recipients, as opposed to recipients generally.<sup>139</sup> Article 2 then contains a detailed and exhaustive definition of what is meant by the notion of “specificity”.<sup>140</sup> Again, as with the 1985 Guidelines, there are several aspects of this currently controlling definition that merit examination. Prior to looking at them, however, it must be stressed that the opening language of Article 2.1 of the SCM Agreement emphasizes the need for determining that an allegedly objectionable subsidy “is specific to” an enterprise or industry or group thereof. And while the aspects of Article 2’s definition of “specificity” shortly to be examined are extremely critical to finding that such a subsidy “is specific to”, it must not be overlooked that Article 2.4 of

<sup>133</sup> See *ibid.*, at Section II.

<sup>134</sup> See *ibid.*, at Section II(c).

<sup>135</sup> See *ibid.*, at Section II(d).

<sup>136</sup> See *ibid.*, at Section II(e).

<sup>137</sup> See *ibid.*, at Section II(f).

<sup>138</sup> See *id.*

<sup>139</sup> See *supra* notes 113 and 114.

<sup>140</sup> See SCM Agreement Article 2.

the SCM Agreement plainly requires that each and every determination of “specificity” “shall be clearly substantiated on the basis of positive evidence”.<sup>141</sup> It is far from sufficient under this strict and demanding requirement to offer colorable claims based on broad and general evidence that fails adequately to articulate why a suspect financial contribution “is specific to” a certain enterprise or industry.

The first aspect of the definition of “specificity” meriting attention concerns Article 2.1(a). That provides, like the earlier Guidelines, that if the benefit-granting authority, or legislation under which it operates, “explicitly limits access” to the benefit to a confined group of enterprises, then the subsidy “shall be specific”.<sup>142</sup> This might be labeled *de jure* “specificity”. The chief difference from the earlier Guidelines revolves around the now mandatory implication of “specificity” associated with a determination that the benefit under review is explicitly restricted to certain recipients. This comes across both in the fact that Article 2, in contradistinction to the 1985 Guidelines, must be followed by all WTO Member States and in the stronger reference to the idea that the subsidy “shall be” regarded as specific, rather than just “would be” regarded as specific.<sup>143</sup>

Secondly, Article 2.1(b) declares, in similar sympathy with the Guidelines, that the establishment of “objective criteria or conditions governing ... eligibility for, and the amount of” a subsidy “shall not” invariably signify “specificity”, assuming eligibility is “automatic” and the criteria and conditions are “strictly adhered to”.<sup>144</sup> But here, too, important distinctions from the Guidelines exist, apart from the now mandatory character of Article 2.1(b). The main distinctions have to do with the fact that a beneficial financial contribution falling within the ambit of Article 2.1(b) is to be regarded as much more than “normally” non-specific but also that the ultimate characterization of such a benefit as non-specific hinges on the eligibility criteria and conditions being “strictly adhered to” and not just “automatic”.<sup>145</sup> The significance of this new approach reflected in Article 2.1(b) is to prevent criterion-based and condition-based eligibility measures from insulating themselves as non-specific if administering governments are not religious and faithful about providing benefits to those who meet the relevant standards. In other words, it would not be enough to simply show the existence of objective and automatic criteria or conditions; one must also show strict adherence to such.

A third aspect of Article 2’s definition of “specificity” meriting attention concerns the possibility that, as with the 1985 Guidelines, application of the usual rules might appear to indicate a particular benefit is, at least nominally, non-specific in nature. Close scrutiny, however, could suggest reasons to believe that the benefit is being granted or utilized in such a way as to make it “specific”. Stated differently, though a program may be structured so as to avoid *de jure* “specificity”, it may be nonetheless *de facto* “specific”.

<sup>141</sup> See *ibid.*, at Article 2.4.

<sup>142</sup> See *ibid.*, at Article 2.1(a).

<sup>143</sup> For the relevant language from the 1985 Guidelines, Section II(a), see text accompanying *supra* note 134.

<sup>144</sup> See SCM Agreement Article 2.1(b).

<sup>145</sup> For the corresponding language from the 1985 Guidelines, see text accompanying *supra* note 136.

Article 2.1(c) speaks to situations of this sort. It states that a variety of factors may be consulted in such situations. These are said to consist of:

- (i). whether the benefit program is “use[d] ... by a limited number of ... enterprises”;
- (ii). whether the program experiences “predominant use ... [by] certain enterprises”;
- (iii). whether “disproportionately large amounts” have been granted to “certain enterprises”; and
- (iv). the “manner in which discretion has been exercised” in administering the program.<sup>146</sup>

These factors prove extremely interesting in view of the 1991 *PPG Industries* case, which seemed to say that, as a matter of U.S. subsidy/CVD law, the requirement of “specificity” was not satisfied by showing that the Mexican float glass industry used a disproportionate amount of government-price-controlled natural gas or was an especially energy-intensive user of that price-controlled product.<sup>147</sup> It cannot be stressed strongly enough that this case represented U.S. thinking prior to the adoption of the 1994 Uruguay Round SCM Agreement, that there was evidence in *PPG Industries* of the U.S. Congress explicitly rejecting the imposition of CVDs merely on the basis of large-quantity energy use, and that Article 2.1(c) of the Agreement itself does not mandate a determination of “specificity” once any or all of the enumerated factors appear.<sup>148</sup>

Aside from the designation of all export subsidies, and subsidies contingent on the use of domestic over imported goods, as *per se* “specific”,<sup>149</sup> the fourth aspect of Article 2’s definition relates to the fact that Article 2.2 prescribes that beneficial financial contributions “limited to certain enterprises located within a designated geographical region” constitute subsidization that is to be considered “specific”.<sup>150</sup> That same Article then follows with a second sentence declaring the “setting or change of generally applicable tax rates ... shall not be deemed to be a specific subsidy ...”<sup>151</sup> The latter declaration harkens back to the GATT interpretive Annex, ad Article XVI’s insulation of certain tax exemptions or remissions from being labelled as subsidies.<sup>152</sup> That interpretive Annex provision, though, is limited to taxes on exports, while the second sentence of Article 2.2 of the SCM Agreement relates to “generally applicable tax[es]”. This emphasis

<sup>146</sup> See SCM Agreement Article 2.1(c).

<sup>147</sup> See text accompanying *supra* notes 129–131.

<sup>148</sup> See SCM Agreement Article 2.1(c), simply saying that such factors “may be considered”. It should also be noted that the last sentence of Article 2.1(c) provides that, in applying the call to consider the factors enumerated in the Article, “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”. The implication is that, despite the presence of any or all of the enumerated factors, there may be other reasons to conclude against the existence of “specificity”.

<sup>149</sup> See SCM Agreement Article 2.3.

<sup>150</sup> See *ibid.*, at Article 2.2.

<sup>151</sup> See *id.*

<sup>152</sup> See text accompanying *supra* note 29.

is also important for another reason. Specifically, the reference in the second sentence of Article 2.2 to taxes that are “generally applicable” would seem to suggest that taxes structured in such a way that they do not fall within the notion of general applicability would not be able to gain the protection of the provision’s insulation from “specificity”. Article 2.2’s former declaration, that concerning subsidies that are regional in nature, presents intriguing questions of its own. The most prominent, in that connection, emerges from the language’s reference to beneficial contributions limited to “certain enterprises” located in designated geographical regions. The way the language is written, the suggestion is that, whenever subsidies are available to every enterprise in a targeted geographical region, they would not rise to the necessary level of “specificity”. The only way “specificity” could be met would be to have a geographically regional subsidy scheme limited in the recipients eligible to benefit from it.

Several WTO cases have held forth on the “specificity” requirement of Article 2. Perhaps the earliest of the important cases was the 1998 Panel Decision in *Indonesia—Certain Measures Affecting the Automobile Industry* (hereinafter *Indonesia—Autos*).<sup>153</sup> The Panel was called upon to examine several domestic measures adopted by the Indonesian government to strengthen the economic condition of its fledgling domestic auto industry. Various financial incentives were used on this front, one of which involved exemption from tariffs on imported components made abroad by Indonesian labor and exemption from luxury car sales tax on units sold in Indonesia. On the question of whether these beneficial financial contributions constituted subsidies of a “specific” nature, the Panel held that the subsidies were in fact specific for two distinct reasons. To begin with, to the extent that the subsidies were contingent upon the use of domestic over imported goods, Article 2.3 of the SCM Agreement deemed them *per se* “specific”.<sup>154</sup> In the words of the Panel:

“... the European Communities, the United States and Indonesia agree that these subsidies are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b), and that they are therefore deemed to be specific pursuant to Article 2.3 of the [SCM] Agreement.”<sup>155</sup>

But even beyond that, the Panel, though not stating so in unequivocal terms, presumably found the subsidies to be sufficiently limited in distribution to meet Article 2’s “specificity” component. As it observed:

“In this case, the European Communities, the United States and Indonesia agree that these [tariff and sales tax exemption] measures are specific subsidies within the meaning of ... articles [1 and 2]. Specifically, they concur that the tariff and sales tax exemptions in question represent government revenue foregone ... and that the measures confer a benefit on PT TPN [i.e., the Indonesian auto industry].”<sup>156</sup>

Only the Indonesian auto industry was entitled to receive these special financial contributions. They were not available to other enterprises or industries.

<sup>153</sup> See *Indonesia—Certain Measures Affecting the Automobile Industry*, WT/DS59/R, 23 July 1998.

<sup>154</sup> See *ibid.*, at para. 14.155.

<sup>155</sup> See *id.*

<sup>156</sup> See *id.*

In the 2003 case of *U.S.—Softwood Lumber IV*,<sup>157</sup> another WTO Panel weighed in on the matter of “specificity” in a dispute concerning CVDs imposed by U.S. Customs officials on imported softwood lumber entering from Canada. The practice precipitating the long-simmering squabble involved Canadian authorities making timber on public lands available through measures the U.S. considered as resulting in subsidization. On the question of whether Canada’s practice constituted objectionable “specific” subsidization, the WTO Panel ruled in favor of the United States. In that context, the Panel offered several important insights with regard to “specificity”. Most significant was its rejection of the Canadian view about the absence of *de facto* “specificity” under Article 2.1(c) because of mere “limited use” of the suspect beneficial financial contribution. According to the Canadian view, the “limited use” possibility was a real method for showing “specificity”.<sup>158</sup> However, in a situation such as that involving softwood lumber, where the very nature of the good provided by the government limited the group of enterprises or industries interested therein, “specificity” through the claim of “limited use” was absolutely dependent upon showing not just that a circumscribed number of entities availed themselves of the alleged subsidy. Instead, as the Canadians put it, since the fact or pattern of use by a limited number of enterprises or industries was “merely indicative of [government limitations on access]”,<sup>159</sup> what had to be shown by a complainant in every case was a “total configuration of facts allow[ing] it to infer that government [was] deliberately limiting access to the [subsidy] programme”.<sup>160</sup> Again, in Canada’s words, “[t]he existence of an alleged limited number of users does not *ipso facto* establish specificity in fact”. Rather, it requires meeting the difficult evidentiary standards of Article 2.4,<sup>161</sup> with an eye towards satisfying Article 2.1’s basic and overarching standard of a subsidy that “is specific to” an enterprise or industry, or group of enterprises or industries.<sup>162</sup>

Though the Panel did not take exception to Canada’s assertions about the evidentiary dictates of Article 2.4 or its insistence about the primacy of Article 2.1’s opening standard of “is specific to”, it found itself diametrically opposed to Canada’s understanding that, in situations where the nature of government-provided goods serves to limit those interested in such, Article 2.1(c) required a showing of governmental deliberateness in further limiting access thereto. As the Panel stated:

“Article 2 ... is concerned with the distortion that is created by a subsidy which ... is not broadly available ... Article 2 speaks of the use by a limited number of certain enterprises or the predominant use by certain enterprises, not of the use by a limited number of certain eligible enterprises.” (emphasis added).<sup>163</sup>

<sup>157</sup> See *United States—Final Countervailing Duty Determination with respect to certain Softwood Lumber from Canada*, WT/DS257/R, 29 August 2003 (hereinafter *U.S.—Softwood Lumber IV*). For a review of the Appellate Body’s examination of other aspects of the dispute, see Henrick Horn and Petros Mavroidis, *United States—Final Determination with Respect to Certain Softwood Lumber from Canada*, 9 May 2005; available at: <http://www.econ-law.se/Final%20Softwood%Lumber%209%20May%202005.pdf>, last accessed 6 October 2006.

<sup>158</sup> See text accompanying *supra* note 146.

<sup>159</sup> See *U.S.—Softwood Lumber IV*, *supra* note 157, at para. 4.228.

<sup>160</sup> See *ibid.*, at para. 4.134. See also *ibid.*, at para. 7.116 for the Panel’s characterization of Canada’s argument in cases where goods are made available by the government but the very nature of the goods serves to limit those interested therein.

<sup>161</sup> See text accompanying *supra* note 141.

<sup>162</sup> See *U.S.—Softwood Lumber IV*, *supra* note 157, at para. 4.224.

<sup>163</sup> See *ibid.*, at para. 7.116.

The Panel also took pains to note a second point; specifically, the fact that Article 2 of the SCM Agreement provides no definition of the terms “enterprise or industry” or “group” of enterprises or industries. In the Panel’s considered opinion, this absence did not suggest that those terms could be read to mean that, to have a subsidy that “is specific to” an enterprise or industry or group thereof, the subsidy had to be going only to entities or groups of entities producing end-products similar in character. Canada argued that factually such was not the case, given that those receiving the alleged subsidized timber represented producers of 201 separate products, forming 23 separate industries.<sup>164</sup> As the Panel saw it:

“... the text of Article 2 ... does not require a detailed analysis of the end-products produced by the enterprises involved, nor does Article 2.1(c) ... provide that only a *limited number of products* should benefit from the subsidy ... [It is not] determinative ... that [the involved] industries may be producing *many different end-products* ... [S]pecificity under Article 2 ... is to be determined at the enterprise or industry level, not at the *product level*.” (emphases added).<sup>165</sup>

In view of the fact that the suspect Canadian subsidy benefited the wood products industries (i.e. pulp, paper, and lumber industries), it was sufficiently limited to meet the “specificity” requirement.<sup>166</sup>

Though reversed by the Appellate Body on various other grounds, the WTO Panel Decision in the 2005 case of *United States—Countervailing Duty Investigation of DRAMS* (hereinafter *U.S.—DRAMS*)<sup>167</sup> provides a slight bit more illumination with respect to the concept of “specificity”.<sup>168</sup> At issue in that case were activities of the South Korean government in creating, directing, and entrusting to State-controlled banks loan-restructuring programs aimed at assisting the South Korean semiconductor industry, in particular Hynix Semiconductor, in dealing with the down-turn in semiconductor business following the collapse of technology investment in the years immediately after 2000. The Panel Decision held that many of the financial programs put together and pushed by the South Korean government were not sufficiently “specific” to warrant U.S. imposition of CVDs on imported dynamic random access memory semiconductors.<sup>169</sup> Nevertheless, with respect to beneficial financial contributions provided to Hynix by so-called “Group A creditors”, it was determined that the United States had correctly concluded that such contributions were “specific”.<sup>170</sup> As the Panel saw it, instrumental in confirming the accuracy of the conclusion was the fact it was based on South Korean government “activity specifically focused on’ Hynix”, reflecting a government “policy to save Hynix”, a

<sup>164</sup> See *ibid.*, at para. 7.117.

<sup>165</sup> See *ibid.*, at para. 7.121.

<sup>166</sup> See *id.*

<sup>167</sup> See *United States—Countervailing Duty Investigation of Dynamic Random Access Memory Semiconductors (DRAMS) from Korea*, WT/DS296/R, 21 February 2005.

<sup>168</sup> For the Appellate Body Decision, see *United States—Countervailing Duty Investigation of Dynamic Random Access Memory Semiconductors (DRAMS) from Korea*, WT/DS296/AB/R, 27 June 2005.

<sup>169</sup> See *ibid.*, at paras. 7.206 and 7.208.

<sup>170</sup> See *ibid.*, at para. 7.207.

policy manifested through a loan “restructuring package tailor-made for Hynix”.<sup>171</sup> In light of these circumstances, the Panel found it extremely difficult to arrive at any conclusion but that “specificity” existed.

C. ANALYSIS IN THE CONTEXT OF SUBCENTRAL GOVERNMENTAL INCENTIVES

Recall now the waste and industrial effluent treatment facility discussed in Section II.C of this article in connection with the question of whether the provision of such by a local government to a potential investor who promises jobs and employment would constitute a beneficial financial contribution that rises to the level of an SCM Agreement Article 1 “subsidy”.<sup>172</sup> It was noted that Article 1.1(a)(1)(iii) certainly tilts in that direction when it comes to the provision of infrastructure that can be characterized as something other than “general” in nature.<sup>173</sup> To a great extent, this seems to parallel Article 2’s requirement that any subsidy deemed objectionable must exhibit indications of being granted to “specific” recipients and not made available on some “general” or widespread basis.<sup>174</sup> As the GATT does not speak to “specificity”,<sup>175</sup> if one were to focus on the WTO rules concerning such and endeavor to expose the implications of those rules for subcentral governmental investment incentives, it might be worthwhile to begin by re-examining each of the four hypothetical situations presented in regard to the question of an Article 1 “subsidy”,<sup>176</sup> with the building of a dedicated effluent treatment facility taken up first of all.

Concerning the hypothesized waste and effluent treatment facility, any quick analysis would seem to leave little doubt of a benefit for a “specific” recipient. Quite similar to both the *Indonesia–Autos*<sup>177</sup> and the *U.S.–DRAMs*<sup>178</sup> cases, a distinct and palpable limitation on who receives the benefit is present. Indeed, when it comes to the cost-free construction of such a facility by the subcentral governmental authorities, the construction is part of a *quid pro quo* designed to secure the investor’s commitment to locate in the community, and that promised bargaining-chip extends to the courted investor alone. In both the 1998 *Indonesia–Autos* Decision and the 2005 *U.S.–DRAMs* Decision, the financial incentives involved were targeted at particular local industries: the auto industry in the former; and the semiconductor industry in the latter. Limited numbers of potential recipients may have existed in those industries, but in our hypothetical involving the sewer and effluent treatment facility, the number of potential or even considered recipients is limited to one and only one.

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<sup>171</sup> See *id.*

<sup>172</sup> See text accompanying *supra* notes 108–111.

<sup>173</sup> See text accompanying *supra* notes 110–112.

<sup>174</sup> This is suggested in text accompanying *supra* notes 111–112.

<sup>175</sup> See Section III.A of this article: “How ‘Specificity’ Came to be Associated with Disciplines on Subsidies”.

<sup>176</sup> See Section III.C of this article: “Analysis in the Context of Subcentral Incentives”.

<sup>177</sup> See text accompanying *supra* notes 153–156.

<sup>178</sup> See text accompanying *supra* notes 167–171.

A couple of potential problems require addressing, however. Initially, could a subcentral governmental unit avoid “specificity” by implementing its facility construction projects through an official standing policy to so assist any and all interested investors who commit to bringing new job opportunities to the community? This would clearly erode the narrow, limited, and focused character of the originally hypothesized subcentral governmental incentive. Rather, the consequence would be to extend the offer on a widespread and general basis. The other potential problem has to do with the fact that a sewer and effluent treatment facility, by its very nature, is not a unique form of governmental service. When governments are economically able to do so, they provide such a common service throughout the community. As a result, since Article 2 of the SCM Agreement requires “specificity” in who receives subsidies before such are regarded as potentially objectionable, does not the common and non-unique nature of a sewer and effluent treatment facility weaken the claim that cost-free construction satisfies the requirement of “specificity”?

As to the latter question, it seems capable of being disposed of rather quickly. While it is correct that the provision of “general” infrastructure fails to meet the standard for the existence of a subsidy, if, as has earlier been suggested, the dedication of some infrastructure otherwise thought of as “general” for the sole and exclusive use of a courted investor occurs, there would seem every reason to consider such infrastructure no longer to be “general.” On the assumption that such a conclusion resonates as accurate, there would seem to be no reason to view the governmental commitment to provide such a dedicated facility to a single, interested investor as anything but the provision of a benefit to a “specific” recipient. Overlap may exist between the concept of “generality” in infrastructure in Article 1.1(a)(1)(iii) and that of “specificity” in Article 2 of the SCM Agreement. However, sight should not be lost of the fact that the former is designed to guide against judgments that every sort of government-provided infrastructure constitutes a potentially objectionable subsidy and the latter is designed to address the distinct concept that, even when a subsidy exists, it is not seen as potentially objectionable unless it is targeted for “specific” recipients. Theoretically, then, it would seem that one could find “specificity” present in cases where subsidies dealt with infrastructure so “general” in availability that there would be an absence of a legal “subsidy”. Or, conversely, a local community could offer to investors incentives involving infrastructure too unusual and unique to the investors’ needs to be considered “general”, yet they could be so widely provided to investors from every form of enterprise or industry as to be deemed not sufficiently “specific” to warrant potential objection under the SCM Agreement.

As to the question of avoiding “specificity” through a local governmental policy declaring availability of dedicated investment incentives to any and all interested investors, it must be kept in mind that such could be exactly the kind of *de facto* “specificity” situation contemplated by Article 2.1(c) of the SCM Agreement; that is, a situation where nominal general availability seems to provide the “appearance of



non-specificity”.<sup>179</sup> Again, the language of that provision speaks of trying to determine if the beneficial financial contribution is in fact specific, notwithstanding its appearance of non-specificity, with consideration being given to various factors, including “limited use” and “predominant use”.<sup>180</sup> The WTO Decision in *U.S.–Softwood Lumber IV* certainly indicates the viability of the “limited use” and “predominant use” factors.<sup>181</sup> Indeed, that Decision rested its conclusion regarding the presence of “specificity” on the notion of “limited use”.<sup>182</sup> Thus, despite a subcentral governmental policy of incentives available to any and all interested investors, a determination that a beneficial financial contribution of a potentially objectionable “specific” nature exists is quite possible. It should be recalled that Article 2.4 requires that such determinations be “clearly substantiated on the basis of positive evidence”<sup>183</sup> and that the last sentence of Article 2.1(c) requires that account be taken of the length of time a *de facto* “specific” subsidy program has been in operation as well as of the economic diversification in the granting jurisdiction.<sup>184</sup> Essentially, these conditions suggest that *de facto* “specificity” is not to be lightly relied upon.

Now consider a second of the previously hypothesized subcentral governmental investment incentives, that of the subcentral governmental unit pledging properties it holds in the local community in order to secure loans made by private financial institutions to a courted investor. Such loans would ensure the investor the funds necessary to purchase or construct local production facilities. It will be recalled that these pledges, and the loans they secure, will be triggered only in the event that one or more of several scheduled bond elections to finance the investor’s projects fail to receive the required public endorsement.<sup>185</sup> To highlight the “specificity” component of a suspect subsidy determination, assume the following with regard to how this property pledge has been structured by the subcentral governmental unit. The pledge is part of a program which, though informal and unwritten, has long been a staple of the local community’s approach to luring outside investor dollars to the area. Indeed, the community has half-a-dozen committed, career employees on the Economic Development staff of the local chief political official. These employees have been charged with the responsibility of negotiating with potential investors, and they represent themselves as making decisions about eligibility for property pledges, like that involved here, on the basis of “neutral, impartial, and investment success-predicting indicia” that have been developed over many years of experience. All potential investors are able to apply for participation in the pledge program, though not all who apply receive pledge commitments from the subcentral governmental unit.

It cannot be disputed that the pledge-receiving investor in our situation benefits

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<sup>179</sup> See SCM Agreement Article 2.1(c).

<sup>180</sup> See *id.*

<sup>181</sup> See *U.S.–Softwood Lumber IV*, *supra* note 157.

<sup>182</sup> See text accompanying *supra* notes 162–166.

<sup>183</sup> See text accompanying *supra* note 161.

<sup>184</sup> See SCM Agreement Article 2.1(c).

<sup>185</sup> See text accompanying *supra* notes 96–97.

from a commitment made specifically to it. Yet the notion of “specificity” addressed in Article 2 of the SCM Agreement exempts those situations in which a benefit-granting authority acts under a program that has eligibility criteria that are established and applied. The idea is to prevent characterizing as “specific” all those benefits granted under clear and objective triggering conditions, despite the fact that only certain entities are thus able to claim eligibility. Indubitably, Article 2.1(b) indicates that “specificity shall not exist” when a granting authority, or legislation governing the operation of such, fix and then apply criteria or conditions for eligibility for a subsidy.<sup>186</sup> The language of that provision, however, makes it abundantly clear that, if such non-specificity is to be more than just nominal and ineffective, its criteria or conditions must be “objective”, “clearly spelled out”, “strictly adhered to”, actually used to “govern[] ... eligibility” of the subsidy at issue, and result in eligibility that is “automatic”.<sup>187</sup> The case at hand poses problems on several of these fronts.

By virtue of the program’s criteria and conditions being informal and unwritten, in fact seemingly nothing more than within the institutional memory and administrative knowledge of the members of the chief political official’s Economic Development staff, it fails to satisfy the mandates of “clearly spelled out” and “objective” criteria or conditions. One of the two footnotes accompanying Article 2.1(b) defines “objective” criteria or conditions as “neutral”, “not favour[ing]” certain enterprises, “economic in nature”, and “horizontal in application”.<sup>188</sup> It would not appear sufficient to accept staff members’ self-serving representations regarding the impartial and neutral character of their determinations concerning the property pledge program. Further, that some investors are recipients under the pledge program does not, by itself, demonstrate that the criteria and conditions associated with the program actually “govern[] ... eligibility”. For a truly criteria-based program to merit protection under Article 2.1(b), real criteria must actually be used to make eligibility determinations and commitment to such an approach must be “strictly adhered to”.<sup>189</sup>

Moving to the third hypothesized investment incentive offered by a subcentral governmental unit—an incentive involving a 10-year deferral of the business franchise tax which, when eventually paid, is to be accompanied by interest payable at the lowest market rate available during the life of the deferral period. Others eligible for deferral are obligated to pay interest at a rate equal to the average of market rates available during the deferral period.<sup>190</sup> For purposes of “specificity” analysis under Article 2 of the SCM Agreement, it will be assumed that this particular investment incentive is written into state or provincial legislation at the behest of an aeronautical industry lobbying group which had long worked with key figures in the legislature interested in stimulating the growth of a higher-wage-earning and technologically sophisticated workforce. The

<sup>186</sup> See SCM Agreement Article 2.1(b).

<sup>187</sup> See *id.*

<sup>188</sup> See *id.*

<sup>189</sup> See text accompanying *supra* note 186.

<sup>190</sup> See text accompanying *supra* notes 102–103.

legislation itself indicates that the lower interest deferral incentive is available only to the “aircraft and aircraft parts manufacturing industry” as well as to the “aircraft service and repair industry”.

At the outset, it should be observed that the second sentence of Article 2.2 of the SCM Agreement declares that “specificity” is not met by showing that a governmental entity has exercised its legislative or regulatory power by “the setting or change of generally applicable tax rates”.<sup>191</sup> The establishment or adjustment of tax rates has the inherent potential to affect competitive positions of impacted companies. But as long ago as the GATT Decision in *Income Tax Practices Maintained by France*,<sup>192</sup> it was acknowledged that such was insufficient to view Article XVI of the GATT as depriving governments of the authority to exercise the taxing power as each saw fit. Presumably, Article 2.2’s second sentence is designed to reflect this notion. With regard to the instant investment incentive, however, the language of that SCM Agreement provision seems completely irrelevant, as the concern is not with the rate of taxation but rather with the interest due upon payment of the deferred tax. In that respect, the more appropriate provision to consult on “specificity” would seem to be Article 2.1(a).

In our hypothetical case, the state or provincial legislation is written in such a way that it “explicitly limits access ... to certain enterprises”.<sup>193</sup> Only the aircraft or aircraft parts manufacturing industry or the aircraft service and repair industry are eligible to receive low-interest deferral on obligated business franchise taxes. Consequently, there seems every reason to believe that this form of subsidization would be sufficiently “specific” to push the incentive program into the category of a potentially objectionable subsidy. The only conceivable question might have to do with whether the aircraft manufacturing, the aircraft parts, and the aircraft service and repair industries can be aggregated to form an “industry” or “group of industries” as required by the language of Article 2.1’s *chapeau*, or opening sentence. On that score, it would seem that the service and repair industry would have to be removed, as it is involved in a distinct and separate sector of the economy, not that involved with the production of goods. The aircraft and aircraft parts industries would seem to be associable without problem, since the WTO Decision in *U.S.—Softwood Lumber IV* indicates that “specificity” means to cover subsidies “not broadly available”,<sup>194</sup> including where recipients are involved in production activities that share nothing more than “similarity” or “relatedness”.<sup>195</sup> Indeed, in that particular case, it was suggested that “producers of a wide variety of steel products ... are a group of ‘steel industries’”.<sup>196</sup> And if producers of steel products of various sorts can be aggregated into a group of steel industries, what exists to impede producers of airplanes and producers of airplane parts from being aggregated as well?

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<sup>191</sup> See SCM Agreement Article 2.2, second sentence.

<sup>192</sup> See *Income Tax Practices Maintained by France*, *supra* note 54.

<sup>193</sup> See SCM Agreement Article 2.1(a).

<sup>194</sup> See *U.S.—Softwood Lumber IV*, *supra* note 157, at para. 7.116.

<sup>195</sup> See *ibid.*, at para. 7.120.

<sup>196</sup> See *id.*

The fourth, and final, hypothetical investment incentive offered by a subcentral governmental unit continues with deferral of the business franchise tax, now at interest of precisely the same rate for all those eligible. In the original case concerning the question of whether a “subsidy” was present, it was hypothesized that the deferral of the tax was accompanied by a legal obligation imposed on local lenders to permit outside investors paying the tax to borrow from such lenders payment amounts at interest rates more favorable than those otherwise generally available.<sup>197</sup> Presently, however, rather than low-interest loans available for paying the business franchise tax, assume that the local government uses the availability of cheap electricity from a local government-owned wind power generating plant as an offset against the tax. Assume also that an additional offset comes in the form of below-market-rate sales of sludge from the local government-owned sewage treatment facility, with purchasers converting such into plant nutrient that is then made available for purchase by consumers.

The wind power electricity program works through local officials calculating the amount of interest paid by investors who have relocated to the community. Then, one-half of that interest is regarded as eligible for being used as an investment incentive. The incentive itself is given effect by providing electricity to the investor at a rate reduction equivalent to one-half the interest paid on the tax deferral obligation. Factually, the local government wind power facility is the source of all electricity—residential, commercial, and industrial—within the community; both indigenous home-grown investors and investors attracted from outside the community are completely dependent on the government-supplied electricity for their power needs; and the investment incentive program is available to, and has been actively used by, all interested outside investors creating and maintaining five or more new jobs, irrespective of the nature of their work activity. However, the investors under investigation concerning the receipt of impermissible subsidies consist of several intensive-electricity-usage manufacturing companies.

As for the sludge availability program, it works through sales at extremely favorable prices of the bacteria-cleansed and hazard-free biological residue left from the sewage treatment purification process. It is made available for purchase by any and all outside investors who fulfill their commitment of relocating to the local community and creating and maintaining five or more new jobs. Sales of the sludge by the local community to new and eligible investors are not limited to certain industries or groups of industry by either the terms of the law or the practices of the governmental officials administering the sales. But in view of the unique nature of the product made available by the local community to investors under this program, only investors currently active in, or willing to expand their product line to include, the plant nutrient business have reason to utilize the program. In large measure, this has resulted in 36 companies, all of whom produce various forms of plant fertilizer—from houseplant liquid varieties to agricultural anhydrous varieties—utilizing the sludge purchase program.

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<sup>197</sup> See text accompanying *supra* notes 104–105.

As concerns these two programs, there is no question that they involve sales by governmental entities at prices favorable enough to amount to subsidization benefiting purchasers. In terms of Article 2 of the SCM Agreement and its requirement of “specificity”, there is one basic difference between the electricity sold to the new investors who prove to be energy-intensive users and the nutrient-rich sludge sold to the new investors interested in purchasing it for their applications. That difference has to do with the fact that electricity is a resource of interest to an extremely wide and all-encompassing group of potential consumers. Apart from the typical residential consumer, outside investors representing every conceivable sector of the economy, running the gamut from banks to bakeries, from shoe retailers to stainless-steel rivet manufacturers, would have a need for and interest in cheap electricity. Conversely, sludge, given its very nature, is a resource of interest to an exceptionally narrow and limited group of potential consumers. It would be next to impossible to imagine one not involved in the fertilizer or plant food industry having an interest in taking advantage of the opportunity to purchase cheap sludge. As concerns this difference between the two resources, it might be thought that, when the government makes available a resource which, by its nature, limits the universe of interested purchasers, “specificity” exists only if a further effort is made to cut down or restrict the number of entities interested in making a purchase.<sup>198</sup> On the other hand, when it comes to a resource that is of widespread consumer interest, like electricity, “specificity” can be found on the basis of access thereto being limited merely by surrounding circumstances that lead to “limited use” or “predominant use” by certain industries or a group of industries (i.e. *de facto* “specificity”).<sup>199</sup>

With these observations in mind, the WTO Panel Decision in *U.S.—Softwood Lumber IV* must be recalled. When the Canadian government argued that its alleged subsidization of timber was not “specific” because, by its very nature, timber is a product in which only a handful of industries have an interest and, in such instances, “specificity” requires action by the subsidizing government to further limit the recipients eligible to benefit from the subsidy, that argument was flatly rejected. As noted earlier, the Panel stated: “Article 2 speaks of [a subsidy’s] use by a limited number of certain enterprises or the predominant use by certain enterprises, not of the use by a limited number of certain eligible enterprises.”<sup>200</sup> Additionally, in the Panel’s words:

“In the case of a good that is provided by the government ... and that has utility only for certain enterprises (because of its inherent characteristics), it is all the more likely that a subsidy conferred via the provision of that good is specifically provided to certain enterprises only.”<sup>201</sup>

The necessary implication from such statements is that sales of sludge to investors willing to relocate to the providing community would be highly suspect as “specific” subsidies.

<sup>198</sup> This was the argument made by the Canadian government in the WTO Decision in *U.S.—Softwood Lumber IV*, *supra* note 157, at paras. 7.115 (Panel’s characterization of Canada’s argument) and 4.219–4.232 (Canada’s argument in its own words).

<sup>199</sup> See text accompanying *supra* notes 179–184.

<sup>200</sup> See *U.S.—Softwood Lumber IV*, *supra* note 157, at para. 7.116.

<sup>201</sup> See *id.*

When it comes to the subsidized wind power electricity, however, the matter is more complicated. One reason for this is that, immediately following the just-quoted statement of the Panel in *U.S.—Softwood Lumber IV*, the Decision goes on to indicate that the Panel's aforementioned view should not be taken to:

“... imply that any provision of a good in the form of a natural resource automatically would be specific, *precisely because in some cases, the goods provided* (such as for example oil, gas, water, etc.) *may be used by an indefinite number of industries.*” (emphases added).<sup>202</sup>

In other words, there may be certain kinds of goods provided by the government that, by their nature, limit the number of consumers interested therein. “Specificity” can still be shown in such instances without proof of further efforts by the government to limit or restrict access. Nonetheless, this should not be taken to mean that, because the kinds of goods involved in such instances tend to be “resources” of one sort or another, the provision of “resources” automatically triggers “specificity”. After all, even though the item provided may be some sort of resource, if it is made available to and used by an “indefinite number of industries”, then “specificity” would be absent.

Interest in and usage of electricity is obviously widespread in our hypothetical, thus suggesting non-specificity of the government-subsidized rates. What cuts across any such final understanding, though, is the fact that the investigation focuses on intensive-electric-energy-using manufacturing industries.<sup>203</sup> “[L]imited use” or “predominant use” can satisfy the *de facto* “specificity” option in Article 2.1(c) of the SCM Agreement, as has already been alluded to.<sup>204</sup> What remains problematic is whether “limited use” or “predominant use” is synonymous with “intensive use”. To the extent that the latter is taken to imply that a particular industry or group of industries makes heavy or extensive use of the subsidized item, such a showing alone may be insufficient to demonstrate “specificity”, if “limited use” or “predominant use” really mean that focus should be on the proportion of total aggregated use represented by the investigated industries. Quite possibly, though, one could make intensive use of subsidized wind power electricity but account for no more than a fraction of the total usage by all consumers.

#### IV. CONCLUSION: EXPORTS AND IMPORTS, AND RESPONSES TO SUBSIDIZATION

Lest there be any question about the applicability of the GATT and the SCM Agreement subsidies disciplines to subcentral governmental bodies, it should be noted that both GATT and WTO cases raising such disciplines have involved subcentral governmental incentives without controversy on that point. The WTO Panel Decision in *U.S.—Softwood Lumber IV* concerned, among other things, subsidies in the form of inexpensive timber cutting rights offered by Canadian provincial governments.<sup>205</sup> And the earlier 1993 GATT Panel Decision in *United States—Measures Affecting Imports of*

<sup>202</sup> See *id.*

<sup>203</sup> See text accompanying *supra* notes 197–198.

<sup>204</sup> See text accompanying *supra* note 146.

<sup>205</sup> See *U.S.—Softwood Lumber IV*, *supra* note 157, at paras. 7.9–7.18.

*Softwood Lumber from Canada*,<sup>206</sup> associated with that longstanding timber dispute between the two North American neighbors, concerned precisely the same kinds of allegedly countervailable subcentral governmental subsidies.<sup>207</sup> Yet even putting aside the matter of whether the entity which has provided to a “specific” recipient a beneficial financial contribution amounting to a “subsidy” is subject to the regulatory authority of the GATT or the SCM Agreement, any analysis of subcentral governmental investment incentives would not be complete without taking into consideration if the subsidization affected imports or exports, as well as the general matter of responsive measures under international CVD law. Though it has not been the purpose of this article to focus on those concerns, by way of offering some concluding observations one might do well to recall some of the fundamentals regarding such.

With respect to the effect of the subsidization on imports or exports, the controlling law stated in the SCM Agreement makes clear that specific subsidization contingent, in law or in fact, on exportation of the subsidized product is explicitly prohibited.<sup>208</sup> The obvious reason for the prohibition is that such subsidization presents the possibility of distorting the price at which the exported product would otherwise sell. Also considered prohibited are subsidies made contingent on the use of domestic over imported goods.<sup>209</sup> Permitting such would disadvantage imported competitive products in an environment where competitive economic advantage is prized. Not flatly prohibited, however, but deemed sufficiently objectionable to warrant action, are subsidies of any sort, including domestic subsidies, that cause at least serious prejudice to another Member State, typically evidenced by subsidization exceeding 5 percent of the value of a product, subsidization covering a recipient’s operating losses or debts, or subsidization that displaces or impedes imports or exports of like products or results in significant price effects or trade pattern disruptions.<sup>210</sup> While the SCM Agreement does enumerate particular subsidies characterized as “non-actionable”,<sup>211</sup> both the Agreement’s prohibited and actionable categories of subsidies can lead, where the importation of a subsidized product is involved, to the imposition of a CVD. Thus, in the context of subcentral governmental investment incentives, if the subsidized product happens to be exported, it could be subject to a CVD investigation initiated by the country of importation.<sup>212</sup> In the more likely event that the incentive concerns

<sup>206</sup> See *United States—Measures Affecting Imports of Softwood Lumber from Canada*, 27 October 1993, 40th Supp. B.I.S.D. 358.

<sup>207</sup> See *ibid.*, at paras. 113–185 (discussing various requirements for subsidies that can warrant a responsive CVD under both the GATT and the Tokyo Round SCM Code but without noting objection based on the subsidies being offered by a subcentral governmental unit). Under U.S. subsidies/CVD administrative decisions, it has not proven especially controversial that subcentral governmental subsidies have been involved. See *Michelin Tire Manufacturing Co. of Canada, Ltd.*, U.S. Department of the Treasury (38 Federal Register 1018 (1973)), 7 Customs Bulletin 24 (1973) (provincial subsidies provided by Nova Scotia); *Oil Country Tubular Goods from Austria, Preliminary Determination*, *supra* note 127 (local and state subsidies, in addition to those from the national government, provided within Austria).

<sup>208</sup> See SCM Agreement Article 3.1(a).

<sup>209</sup> See *ibid.*, at Article 3.1(b).

<sup>210</sup> See *ibid.*, at Article 5.

<sup>211</sup> See *ibid.*, at Article 8 (including subsidies that are not “specific”, as well as “specific” subsidies for certain research activities, for the development of disadvantaged regions, and for environmental improvement).

<sup>212</sup> See *ibid.*, at Article 10, footnote 35.

products consumed domestically within the territory of the subsidizing country, the impact of the subsidy on imports from competitor nations would be addressed through the dispute settlement procedures of the WTO rather than through the use of a CVD.<sup>213</sup>

As concerns the possibility that subcentral governmental subsidization might unfairly advantage products that are exported and thus become subject to CVD investigation, it should also be recalled that the SCM Agreement establishes strict rules regarding the utilization of this offsetting remedy by importing nations. Generally speaking, a CVD is not to be imposed on an imported subsidized product in the absence of evidence that the importation causes injury to a domestic industry within the importing country.<sup>214</sup> Every domestic industry faces economic and innovation pressures from competitors at home and abroad. The standards of the SCM Agreement require that it be the subsidized imports that, as a result of the subsidization,<sup>215</sup> cause injury to the affected domestic industry. It is not enough that an alleged injury be suffered within the context of economic or innovation deficits that might happen to saddle that allegedly injured industry. The injury must be found to have a nexus with the subsidization of imports.<sup>216</sup> Further, since the SCM Agreement references Article VI of the GATT in connection with determining whether it is appropriate to impose a CVD,<sup>217</sup> the degree of injury required to be suffered by a domestic industry would be injury considered “material”.<sup>218</sup> Concerning injury determinations, it is clear that the SCM Agreement obligates Member States to look for significant increases in subsidized imports, resultant significant price undercutting, and consequent significant downward pressure on prices of competitive domestically produced products.<sup>219</sup> And finally, the alleged injury must be industry-wide if it is to trigger a CVD. Essentially, this means it must be the “whole of the like product[’s]” producers who are injured, or those whose output constitutes “a major proportion of the total domestic production of those products”.<sup>220</sup> The SCM Agreement, however, leaves open the possibility that a CVD may be used, even against exported products benefiting from subcentral governmental subsidies, when the effect of the subsidized imports is to cause injury regionally. In all such cases, very detailed requisites must be satisfied.<sup>221</sup>

Only time will tell whether the international community faces an increase in the number of instances in which it is investment incentives provided by subcentral governmental units that precipitate subsidy and CVD disputes that rise to the level of the WTO. In those few instances in the past where subcentral governmental subsidies have

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<sup>213</sup> See *ibid.*, at Article 4 (prohibited subsidies) and Article 7 (actionable subsidies).

<sup>214</sup> See *ibid.*, at Article 11.

<sup>215</sup> See *ibid.*, at Article 15.5 (“the subsidized imports are, *through the effects of subsidies*, causing injury” to the domestic industry) (emphasis added).

<sup>216</sup> See *ibid.*, at Article 15.4 and 15.5.

<sup>217</sup> See *ibid.*, at Article 10. On dispute settlement in the CVD context, see generally Edwin Vermulst and Folkert Graafma, *WTO Dispute Settlement: Antidumping, Countervailing Duties and Safeguards* (2002).

<sup>218</sup> See GATT Article VI(6)(a).

<sup>219</sup> See SCM Agreement Article 15.2.

<sup>220</sup> See *ibid.*, at Article 16.1.

<sup>221</sup> See *ibid.*, at Article 16.2 and 16.3.



proven a source of irritation eventuating in WTO involvement, the presumed objective of the subsidization has been to assist products in the export market. As economic development progresses and nations begin to witness local and regional governmental units competing with each other for job and production growth, the chances increase that subcentral governmental investment incentives will demonstrate their ability to distort trade patterns, thus catching the attention of competitor industries and trade regulators. The consequence could be a future in which subcentral governmental units will be required to pay close attention to a whole field of law given only passing consideration in bygone years. Both the GATT and the SCM Agreement are figurative minefields for subcentral government economic boosters uninitiated in the rigors of international trade law.