

Chapter 6

SUBSIDIES AND COUNTERVAILING MEASURES

1. OVERVIEW OF RULES

Subsidies are used throughout the world by countries as a tool for realizing government policies. They can take the form of grants, tax exemptions, low-interest financing, equity infusion and export credits and are generally categorized as either specific subsidies, which are limited to specific businesses and industries, or non-specific subsidies, which are not limited. More specifically, subsidies usually take the form of: (1) export subsidies; (2) subsidies contingent upon the use of domestic over imported goods; (3) industrial promotion subsidies; (4) structural adjustment subsidies; (5) regional development subsidies; and (6) research and development subsidies.

Although governments defend subsidy programmes under ostensibly legitimate goals, it is generally perceived that government subsidies may unfairly protect domestic industries. Where this is the case, subsidies act as a barrier to trade by distorting the competitive relationships that develop naturally in a free trading system. Exports of subsidized products may injure the domestic industry producing the same product in the importing country. Similarly, subsidized domestic goods may decrease imports that compete with such goods. In addition, subsidized products may gain artificial advantages in third-country markets and impede the exports of other countries to those markets. The WTO Agreement on Subsidies and Countervailing Measures (ASCM) broadly defines “subsidies” as any government measure that can benefit the recipient, including grants, loans, equity infusion, loan guarantees, tax deductions or tax exemptions, government procurement and government provision of goods and services. In principle, the ASCM disciplines subsidies granted to any product except agricultural products, which fall under the scope of the Agreement on Agriculture. However, the ASCM does cover forestry and fishery products. The ASCM prohibits export subsidies

and subsidies that are contingent upon the use of domestic over imported goods because they have a particularly high trade distorting effect. Where subsidies are not specifically prohibited, the ASCM allows Members importing subsidized goods to impose countermeasures, such as countervailing duties, if the goods are found to injure that Member's domestic industry and provided that certain procedural requirements are met. For agricultural products, disciplines on subsidies are provided in the Agreement on Agriculture, which contains obligations to reduce export subsidies and domestic supports.

2. LEGAL FRAMEWORK

The definitions, principles and legal disciplines covering subsidies are contained in Articles VI and XVI of the GATT. General implementation provisions for subsidies are found in the ASCM. As noted above, the Agreement on Agriculture provides separate disciplines for agriculture, but the ASCM covers forestry and fishery products.

The ASCM was established during the Uruguay Round negotiations as a new discipline to replace the 1979 "Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade." In comparison with the previous agreement, the ASCM more explicitly defines subsidies and provides stronger and clearer disciplines on countervailing measures.

The ASCM first defines the subsidies covered and classifies them into three types, based on their nature and intended purpose. The ASCM then defines, for each category, the point at which countervailing and relief measures may be imposed and outlines the procedures that must be followed. The ASCM also provides special and differential treatment for developing country Members and a transitional arrangement for Members in the process of moving from a centrally planned economy into a market, free-enterprise economy.

However, the disciplines regarding "serious prejudice," as defined in Article 6.1,¹ and so-called "green subsidies," as defined in Articles 8 and 9,² were only provisional

1 The ASCM defines three main categories of subsidies that are deemed to constitute "serious prejudice" to the interests of other Members: (1) the total *ad valorem* subsidization of a product exceeding 5 percent; (2) subsidies to cover operating losses sustained by an industry or an enterprise; and (3) direct forgiveness of debt. The existence of "serious prejudice" may trigger elimination of the subsidy or other remedies to offset the "serious prejudice" of the subsidy.

2 Subsidies that are not subject to countervailing measures ("green subsidies") include generally available subsidies that lack specificity and subsidies that have specificity but meet certain criteria. The following are "green subsidies": (1) research and development subsidies; (2) regional development subsidies; and (3) environmental conservation subsidies (Article 8). Green subsidies that have specificity and exert significant detrimental impact on trading partners are subject to consultations and relief measures (Article 9).

and were scheduled to terminate by the end of 1999 (*see* Article 31 of the ASCM). A decision on extending these provisions was expected to occur before the end of 1999. However, no consensus was reached because some developing country Members would only accept an extension if it contained additional preferential measures for them, while developed country Members sought an extension of the disciplines without linkage to preferential treatment. Thus, provisions on "serious prejudice" and "green light subsidies" expired at the end of 1999. What this means for Members is that when "yellow light subsidies" (subsidies that are subject to countervailing duties and remedies) seriously prejudice the interests of another Member and are referred to dispute settlement, the previous quantitative standard that assumed "serious prejudice" existed when the subsidy accounted for 5% or more of the product's price is no longer applicable. Instead, "serious prejudice" now must be proved using the qualitative standards found in Article 6.3.³

The expiration of the "green light subsidies" provisions set forth in Articles 8 and 9 means that all specific subsidies may be countervailed. In other words, even subsidies once exempted from countervailing duties by Article 8.2--(a) research and development subsidies; (b) regional development subsidies; and (c) environmental subsidies--are now subject to countervailing duties if specificity can be demonstrated.

3 The Agreement describes four cases in which "serious prejudice" exists: (1) where imports displace or impede the imports of a like product of another Member into the market of the subsidizing Member; (2) where imports displace or impede the exports of a like product of another Member from a third country market; (3) where there is significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market; or (4) where there is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous three-year period and this increase follows a consistent trend over a period when subsidies have been granted.

Figure 6-1
General Rules on Preferential Measures
and Transitional Arrangements of Red-light Subsidies

| | Export Subsidies | Subsidies Contingent upon the Use of Domestic over Imported Goods |
|---|---|--|
| Least-Developed Country (LDC) Members | Not applied | Not applied for a period of eight years from the date of entry into force of the WTO Agreement |
| Developing Country Members described in Annex VII (b) ⁴ | Not applied | Not applied for a period of five years from the date of entry into force of the WTO Agreement |
| Other Developing Country Members | Not applied for a period of eight years from the date of entry into force of the WTO Agreement ⁵ | Not applied for a period of five years from the date of entry into force of the WTO Agreement |
| Developed Country Members | Not applied for a period of three years from the date of entry into force of the WTO Agreement | Not applied for a period of three years from the date of entry into force of the WTO Agreement |
| Members in the process of moving from a centrally-planned economy into a market economy | Not applied for a period of seven years from the date of entry into force of the WTO Agreement | Not applied for a period of seven years from the date of entry into force of the WTO Agreement |

4 The Doha Ministerial Declaration stipulates in Paragraph 10.1 that a country shall remain a developing country under Annex VII(b) unless, based on data from the World Bank, its per capita GNP exceeds US \$1,000.00 for three consecutive years in 1990 dollars.. Paragraph 10.4 of the Declaration allows countries previously excluded, to be re-included in Annex VII if their per capita GNP again falls below US \$1,000.00.

5 However, as described in (3), below, transitional arrangements for export subsidies were extended for 21 countries.

3. AGREEMENT ON AGRICULTURE

Subsidies on agricultural products or those granted to agricultural producers are subject to the disciplines laid out in the Agreement on Agriculture (Article 21.1). As previously noted, forestry and fishery products are not covered by the Agreement on Agriculture, but by the ASCM.

1) Domestic Support (Article 6 and 7)

- (a) Domestic support measures are divided into “amber” (subject to reduction commitments) and “green”/ “blue” (not subject to reduction commitments) categories.
- (b) The following policies are deemed “green” as long as certain criteria are met:
- Research, extension, inspection, infrastructural services, marketing and promotion services and other general services
 - Public stockholding for food security purposes
 - Domestic food aid
 - Decoupled income support (i.e., not linked to production)
 - Income insurance and safety-net programmes
 - Relief from natural disasters
 - Structural adjustment assistance provided through producer retirement, resource retirement, and investment aid programmes
 - Payments under environmental programmes
 - Payments under regional assistance programmes

“Blue” categories include direct payments under production-limiting programmes as long as any of the following conditions are met.

- Payments are based on a fixed area (such as acreage subsidies paid to crop producers based on the EU Common Agricultural Policy *etc.*).
- Payments are made on 85 percent or less of the base level of production (such as Japan's "Rice Farming Income Stabilisation Programme" *etc.*).
- Livestock payments are made on a fixed number of head (such as subsidies paid under the EU Common Agriculture Program to producers of cows with calves subject to base year-linked head count ceilings).

- (c) All programmes not considered to be “green” or “blue” are included in an “Aggregate Measurement of Support (AMS)”, which must be reduced by 20 percent over a six-year period beginning from the base period of 1986 to 1988. The AMS expresses the level of support given to agricultural products or agricultural producers. The AMS consists of market price support, non-exempt direct payments, and any other subsidy not exempted from the reduction commitment provided by a given country. Total AMS is calculated as the sum of all aggregate measurements of support for basic agricultural products, all non-product-specific aggregate measurements of support and all equivalent measurements of support for agricultural products. However, product-specific AMS or non-product-specific AMS, where each does not exceed 5% of a Member’s total value of production of a basic agricultural product or of the value of a Member’s total value of production respectively, are not required to be included in total AMS.

2) Export Competition (Articles 8 to 11)

- (a) With regard to export subsidies listed in Article 9.1, budgetary outlays for export subsidies and quantities of subsidized exports must be reduced by 36 percent and 21 percent, respectively, over a six-year period.
- (b) The base period is 1986-1990.
- (c) Each Member agrees not to provide export subsidies other than those in conformity with this Agreement and with the commitments as specified in the Member’s Schedule.

The uniform dispute settlement procedures of the WTO apply to consultations and dispute settlements over subsidies covered under this Agreement.

3) Due Restraint; also known as the peace clause (Article 13 of the Agreement on Agriculture -- expired at the end of 2003 pursuant to Article 1(f) of the Agreement on Agriculture)

The ‘Due Restraint’ clause stipulates that domestic support measures, which are compatible with the Agreement, as well as domestic support measures and export subsidies reflected in a Member’s Schedule of Concessions, would not be subject to countervailing duties and remedies under the ASCM until 1 January 2004.

4. EXTENSION OF THE TRANSITION PERIOD FOR THE ELIMINATION OF EXPORT SUBSIDIES

Although Article 3.1(a) of the ASCM prohibits export subsidies, Article 27.2 exempts developing countries defined in Annex VII(a) and (b). Following the guidelines established under Paragraph 10.1 of the Doha Ministerial Declaration (*see* footnote 4, above), 18 countries qualify for the exemption. The Republic of Dominica, Guatemala and Morocco were no longer considered developing countries in 2003 when their GNP per capita had risen above the US \$1,000.00 threshold for three consecutive years⁶. (*see also* footnote 4, above, and Note <1>, below). Developing countries other than those listed in Annex VII(a) and (b) of the Agreement were exempted for eight years from the date of entry into force of the WTO Agreement (*i.e.*, until the end of 2002). Article 27.4 allows developing countries to consult with the Committee on Subsidies and Countervailing Measures on extending this period, but must have done so at least one year prior to the expiration of the grace period. Some 25 developing countries applied for extensions under this provision and the Committee began examining their requests in January 2002.

The deliberations over the extensions addressed two issues: (1) the special extension procedure granted to small economies, based on Paragraph 10.6 of the Doha Ministerial Declaration which generally allows extension until the end of 2007 if the Committee requirements are met (*see* G/SCM/39 for the other requirements); and (2) the normal extension procedure under Article 27.4 (one-year extension). By December 19, 2002, after a year of deliberations, the Committee approved extensions for the export subsidies of 21 Members. Four Members reserved the right to seek extensions (and were therefore not subject to examination) and one Member withdrew its application. In 2003, the Committee reviewed the export subsidies of the 20 countries for which the extensions had been approved and approved additional extensions for 20 of those countries except Thailand, which did not apply for further extension through the procedure. In 2004, 2005, and 2006, the Committee again reviewed the export subsidies of the 19 countries and approved extensions for all but Colombia, whose export subsidy program already had been extended until the end of 2003 and then granted an additional two-year phase-out period.

Under Article 27.4, subsidies not granted extensions will have a two-year transition period from the termination of the final extension under which they are to be phased out.

Regarding the issue mentioned above the current extension ends 31 December 2007; however in April 2006 14 countries including Barbados jointly requested a further extension of the current exceptions at the WTO Subsidies Committee meeting until 2018 (G/SCM/W/535). The Committee is currently considering the request.

6 *See* G/SCM/110

Members granted export subsidy extensions

<1> Members with export subsidies under Annex VII(b)(18 countries)

Bolivia, Cameroon, Congo, Cote d'Ivoire, Egypt, Ghana, Guyana, India, Indonesia, Kenya, Nicaragua, Nigeria, Pakistan, Philippines, Senegal, Sri Lanka and Zimbabwe.

<2> Members with export subsidies granted extensions under the special extension procedures for smaller economies found in Paragraph 10.6 of the Doha Ministerial Declaration:

Antigua and Barbuda (2), Barbados (5), Belize (4), Costa Rica (2), Colombia (2),⁷ Dominica (1), Dominican Republic (1), El Salvador (1), Fiji (3), Granada (3), Guatemala (3), Jamaica (4), Jordan (1), Mauritius (4), Panama (2), Papua New Guinea (1), St. Lucia (3), St. Kitts and Nevis (1), St. Vincent and the Grenadines (1), Uruguay (1)

<3> Members granted extensions for export subsidies under normal Article 27.4 procedures

Barbados (4), El Salvador (1), Panama (1), Thailand (2)⁸

<4> Rights reserved⁹

Bolivia, Honduras, Kenya, Sri Lanka

Note: numbers in parentheses () indicate the number of subsidy programs.

7 Colombia's export subsidy program was extended until the end of 2004 (to be phased out by the end of 2006 after an additional two-year transition period).

8 Since Thailand did not apply for an extension in 2003, its subsidies, including the phase-out period, were scheduled to terminate by the end of 2005.

9 Least developed countries are not prohibited from granting export subsidies (Article 27:2(a) and Annex VII of the Agreement), except with respect to products where that Member has reached "export competitiveness," in which case Article 27.5 requires that export subsidies be phased out over eight years.

5. RECENT DEVELOPMENTS

There was only one case that was investigated in Japan before the inauguration of the WTO. Japan initiated an investigation of DRAMs manufactured by Hynix of Korea in 2004 and issued a final determination on January 27, 2006, imposing countervailing duties.¹⁰ Japan has not been subject to an investigation by another country in recent years. However, elsewhere in the world, countervailing duties are almost as widely used as anti-dumping duties (*see* Figure 6-2). For example, the United States and the EU impose countervailing duties more frequently than any other WTO Member.

Figure 6-2

Number of Countervailing Duty Investigations

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | total |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|-------|
| US | 3 | 1 | 6 | 12 | 11 | 7 | 18 | 4 | 5 | 3 | 2 | 0 | 72 |
| Australia | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 1 | 3 | 0 | 0 | 0 | 6 |
| Canada | 3 | 0 | 0 | 0 | 3 | 4 | 1 | 0 | 1 | 4 | 1 | 1 | 18 |
| NZ | 1 | 4 | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 6 |
| EU | 0 | 1 | 4 | 8 | 19 | 0 | 6 | 3 | 1 | 0 | 3 | 0 | 45 |
| Japan | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 1 |

Number of Countervailing Measures

| US | Australia | Canada | NZ | EU | Japan |
|----|-----------|--------|----|----|-------|
| 45 | 1 | 10 | 4 | 23 | 1 |

Source: GATT/WTO Documents

Notes:

1. Figures in parentheses indicate number of cases involving agricultural products
2. There have been no investigations against Japan.

Subsidies and countervailing measures have triggered many disputes. One reason for the frequency of subsidy complaints under the GATT was the ambiguity of the previous Subsidies Agreement. Countries interpreted differently the definition of

¹⁰ Japan initiated an investigation on imports of cotton thread from Pakistan in April 1983, but did not impose a countervailing duty because Pakistan eliminated the subsidy in February 1984. An application requesting a countervailing duty against Brazilian ferro-silicon was filed in March 1984, but was withdrawn in June of that year and an investigation was never initiated.

subsidies and the procedural rules for invoking countervailing duties. Underlying this disagreement was a basic conflict between the various Contracting Parties on how to address government assistance designed to protect and nurture a domestic industry.

Exporting countries frequently initiated GATT disputes involving subsidies. The exporting countries often claimed that countervailing duties had been imposed unfairly on the basis of arbitrary determinations of subsidies, injury, or causation. Other disputes concerned domestic subsidies that nullified the benefits gained through tariff reductions by effectively excluding exports from the domestic market. While there has been a decline in the number of cases brought before panels since the WTO Agreement went into force, there are still quite a few cases that have reached a panel such as prohibited subsidy disputes. (See Figures 6-3 and 6-4)

Figure 6-3

Number of Disputes Concerning Subsidies

| | 1981-1985 | 1986-1991 | 92 | 93 | 94 | 95 | 96 | 97 | 98 | 99 | 00 | 01 | 02 | 03 | 04 | 05 | 06 |
|--------------|-----------|-----------|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|
| CVD Measures | 0 | 5 | 1 | 2 | 1 | 0 | 0 | 0 | 0 | 1 | 1 | 0 | 1 | 3 | 2 | 1 | 2 |
| Others | 3 | 2 | 1 | 0 | 0 | 0 | 0 | 1 | 7 | 2 | 5 | 1 | 0 | 2 | 2 | 0 | 1 |
| Total | 3 | 7 | 2 | 2 | 1 | 0 | 0 | 1 | 7 | 3 | 6 | 1 | 1 | 5 | 4 | 1 | 3 |

Source: GATT/WTO Documents.

Note: CVD = countervailing duties.

6. ECONOMIC ASPECTS AND SIGNIFICANCE

Government subsidy practices may have far-reaching implications. When a government subsidizes projects, such as research projects for advanced technology, the benefits may extend well beyond the targeted industry. The results of these projects spill over into a wide range of fields. Government assistance for research activities can contribute not only to domestic economic development, but also to the development of the world economy as a whole.

Subsidies may also be used to encourage less competitive industries to reduce excess capacity or to withdraw from unprofitable sectors. They may, therefore, smooth the way for structural adjustment and shifts in employment. Such subsidies promote appropriate allocation of resources and encourage imports of competitive goods.

On the other hand, subsidies used to protect a domestic industry despite its non-competitiveness can distort trade. Governments have often used subsidies to needlessly prolong the natural adjustment process among certain industries under the guise of structural adjustment. Over the short term, such subsidies may provide a domestic product with a competitive advantage or increase the profitability of the product and keep employment in that industry stable. Over the longer term, however, the disadvantages of the subsidies outweigh any gains. They impede the productivity gains that come from intensely competitive environments and undermine the efforts of companies to rationalize operations. Thus, from medium- and long-term perspectives, subsidies may obstruct an industry's development or impede the rational allocation of domestic resources.

On a global economic level, distortions in the allocation of resources and the international division of labor have also become serious problems. Even when subsidies are used to make up for short-term market failures, the potential for their purpose and terms of use to be subverted remains. Subsidies that are used as part of a “beggar-thy-neighbour” policy ultimately may induce counter subsidies, leading to “subsidy wars.” Subsidy policies will then be to blame not only for preventing a product from achieving its proper competitive position, but for needlessly draining the treasuries of the countries involved. The result is a larger burden for taxpayers. In no way, therefore, do such policies improve the economic welfare of anyone concerned.

Consequently, countervailing duties should be used properly or not at all. When improperly imposed, countervailing duties seriously affect the trade of the product concerned and distort the flow of world trade.

7. MAJOR CASES

Countervailing Measures by the United States and EU on Korean DRAMs (DS296, DS299)

The EU and the United States initiated countervailing duty investigations on July 25, 2002, and November 27, 2002, respectively, against imports of DRAMs (Dynamic Random Access Memory) manufactured by Hynix and Samsung Corporations of Korea. According to the petitions, Korean DRAM producers benefited from corporate bonds issued by the Korean Development Bank and other institutions, as well as from new investment and debt restructuring measures introduced by the Korean Government in 2001 to help rebuild Korea's industry after the Asian financial crisis. The EU issued a provisional determination on April 23, 2003, and a final determination on August 22, 2003, to impose countervailing duties of 34.8% against Hynix and all others; no duty was imposed against Samsung. The United States issued a provisional determination on April 7, 2003, and a final determination on June 23, 2003, to impose countervailing

duties of 44.71% against Hynix and all others¹¹; Samsung received a 0.04% *de minimis* margin.

In response to the measures imposed, the Korean Government requested WTO consultations with the United States on June 30, 2003 and with the EU on July 29, 2003. However, the consultations failed to reach settlements and the Korean Government requested the establishment of separate panels for each of the cases on November 21, 2003. The panels were established at the regular meeting of the DSB on January 23, 2004. (Japan, China, Taiwan, the EC and the United States participated as third parties.)

The Panel Report in DS296 was circulated on February 21, 2005. The Korean Government and the United States appealed certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel. Having found various errors in the Panel's consideration of the evidence, the Appellate Body reversed the findings of the Panel that had found that the measures taken by the United States were inconsistent with the ASCM. However, the Appellate Body made no findings with respect to the WTO consistency of the measures. This Appellate Body report was circulated on June 27, 2005 and was adopted by the DSB on July 21. The US reinvestigated the part of the case that the panel acknowledged to be a violation, but which the US did not appeal, and in its re-determination of the original decision found on February 13, 2006 that the domestic US industry did suffer material injury because of imports from Korea.

The Panel Report in DS299 was circulated on June 17, 2005. The Panel found that the EC failed to establish the existence of "entrusts or directs" for certain transactions, and to examine all relevant factors that were not attributable to the subsidized imports. However, the Panel found the existence of "entrusts or directs" by government for most of the other transactions. On August 3, 2005, the DSB adopted the Panel Report. Upon receiving this report from the panel, the EU conducted a review investigation and revised the countervailing duty rate to 32.9% in April 2006.

Countervailing Measures by Japan on Korean DRAMs (DS336)

As in the above mentioned case, suffering losses as a result of the Asian financial crisis, Korean semiconductor company Hynix Semiconductor was granted certain subsidies including new loans and debt relief by financial institutions, including banks managed by the Korean Government. Concerned that DRAMs produced by Hynix was causing injury to domestic industry in Japan, Elpida Memory Inc. and Micron Japan, Ltd. submitted a petition to the Government of Japan on June 16, 2004, requesting that countervailing duties be imposed upon Korean imports of DRAMs.

After receiving the petition, the Japanese Government initiated an investigation on August 4, 2004, to determine the existence of subsidies and any injury to the Japanese

¹¹ The United States subsequently took indication from Hynix and changed the countervailing duty rate for the company to 44.29 % in July 2003.

domestic industry (*see pp. 5 and 6 Official Gazette No.3906, August 4, 2004*). The investigation showed that the support for Hynix constituted a governmental subsidy and the importation of the subsidized DRAMs caused material injury to the Japanese industry. Based on this fact, the Japanese Government imposed countervailing duties of 27.2 % on imports of DRAMs produced by Hynix.

Taking the above into consideration, Korea requested bilateral consultations with Japan on March 14, 2006 under the WTO dispute settlement procedures, saying approval of subsidies in Japan's countervailing duty investigations were a violation of the ASCM. The consultations took place on April 25, 2006 in Geneva with third party attendance by the US and the EU. However, the consultations did not result in resolution and Korea requested establishment of a panel at a meeting of the WTO Dispute Settlement Body (DSB), and the DSB established a panel on June 19, 2006, with the US, the EU and China as third party participants. The panel will distribute a report to Member countries in the summer of 2007, based on panel meetings that took place December 5 and 6, 2006 and January 23 and 24, 2007.

EU and Korea disputes on Shipbuilding (DS273, DS301)

The EU requested the establishment of a WTO dispute settlement panel alleging that the Korean Government provided subsidies in the form of debt forgiveness and investment transfers to corporations manufacturing commercial shipping vessels. The panel was established on July 21, 2003, and on March 7, 2005, the Panel Report (DS273) was circulated to Members. The panel acknowledged the EU's claim with regard to prohibited subsidies and recommended that the Korean Government withdraw the relevant subsidies without delay. With regard to serious prejudice, the Panel rejected the EU's claim.

Korea also requested the establishment of a WTO panel alleging that the EU subsidies for commercial shipbuilding were inconsistent with WTO Agreements. The panel was established on March 19, 2004 and the Panel Report (DS301) was circulated to Members on April 22, 2005. Japan was concerned that these disputes could affect the international competitiveness of Japan's shipbuilding industry and participated as a third-party. Korea claimed that the alleged subsidies for commercial shipbuilding violated not only Article 32.1 of Agreement on Subsidies, Articles I.1 and III.4 of GATT, but also Article 23 of the WTO's Dispute Settlement Understanding (DSU), which prohibits the imposition of unilateral measures. Korea claimed that the EU subsidies for shipbuilders implemented under the TDM (Temporary Defensive Mechanism to shipbuilding) were solely designed to remedy the alleged harm experienced by EU shipbuilders as a result of the Korean subsidies.

The Panel rejected the claims by Korea that the measures at issue breached Articles I and III of the GATT and Article 32.1 of the SCM Agreement. Regarding Korea's claim under the Article 23.1 of the DSU, the Panel interpreted this provision as imposing a general obligation on WTO Members not to act unilaterally when seeking the redress of

violations of an obligation under the WTO Agreement. The Panel found that the EU had adopted the TDM mechanism that served to provide the same type of redress as the DSU, and that the EU was seeking to induce Korea to modify its allegedly WTO-inconsistent subsidies. Accordingly, the Panel concluded that the EU had acted inconsistently with Article 23.1 of the DSU. On June 20, 2005, the Panel Report was adopted by the DSB. The effective period for the TDM regulations ended March 31, 2005.

EU and United States – Measures Affecting Trade In Large Civil Aircraft (DS316, DS317)

In the late 1980s, European Airbus S.A. drastically increased its share of the civil aircraft market through the use of subsidies from many governments in the EU (the UK, France, Germany and Spain). In response, in May 1991, the US requested consultations under the Tokyo Round Subsidies Agreement with the then-EEC. The US claimed that the EU's aircraft subsidies were inconsistent with their obligations under the GATT Subsidies Agreement. In July 1992, the US and the EU signed the 1992 U.S.-E.U. Agreement on Trade in Large Civil Aircraft, which included a prohibition of future production support and a limitation on the share of government support for the development of new aircraft programs to 33 percent of the project's total development cost. The US withdrew its request for consultations.

However, responding to the fact that Airbus sold more large civil aircraft than Boeing in 2003, the US once again alleged that "launch-aid" and other forms of support by the EU and its member States to Airbus were inconsistent with the 1992 Agreement and the ASCM. On October 6, 2004, the US requested WTO consultations with the EU and with the Member States in WTO dispute settlement procedures (DS316) concerning measures affecting trade in large civil aircraft, and also notified its intention to repeal the 1992 Agreement, claiming that the EU's subsidies were in violation of the Agreement. At the same time, the EU requested WTO consultations with the US, claiming that the US's support for large civil aircraft violated the ASCM (DS317). The EU also rejected the US's unilateral abrogation of the EU-US 1992 Agreement.

Then, in January 2005, the US and the EU suspended the WTO dispute procedure and began negotiations toward a new bilateral agreement. However, the negotiations broke down on June 13, 2005, and both sides requested establishment of WTO dispute settlement panels. On July 20, 2005, the DSB established panels, and Japan, Australia, Brazil, Canada, China and Korea participated as a third parties. The panel is currently deliberating DS316 and DS317.

Furthermore, on January 31, 2006 the US requested new consultations on subsidies from the Government of Wales in the UK to Airbus UK and an additional panel (DS347) was established on April 10, 2006. (The additional panel procedures have been temporarily suspended until the panel examination of DS317 is completed. In the meantime, the EU established an additional panel on February 17, 2006 (DS353) in

order to take up broader points than DS317, but the procedures of this additional panel have been suspended.)

United States and Canada – Dispute on Softwood Lumber (DS236, DS257, DS264, DS277)

Most of Canada's forests are owned by the provincial or federal governments and the provinces administer tenure systems (known as the “stumpage program”) which provides harvesting rights for standing timber on provincial lands to the provincial lumber industry.

In April 2001, the US lumber industry filed a petition with the US government requesting the imposition of countervailing duties and anti-dumping duties on imports of softwood lumber from Canada. The US government initiated countervailing duty and anti-dumping investigations and imposed provisional measures after preliminarily finding that the Canadian industry likely was subsidized, dumping and injuring the US industry. On March 22, 2002, the US Department of Commerce definitively found that the Canadian lumber industry was subsidized and was dumping; on May 2, the International Trade Commission made a final determination that a US industry was threatened with material injury. Beginning May 22, the US government imposed a countervailing duty of 18.79% (flat rate) and an average anti-dumping duty of 8.43% (set by company).

The Canadian Government claimed that the countervailing duties imposed by the United States violated the WTO Agreements. Upon the request by the Canadian Government, a WTO panel was established regarding the provisional determination on December 5, 2001 (DS236), and another panel to examine the final determination on October 1, 2002 (DS257). With respect to the provisional determination (DS236), the panel circulated its final report on September 27, 2002, finding that: (1) the Stumpage Program constituted the subsidies defined under the ASCM; but (2) the US investigation violated the ASCM. The report was adopted at a special meeting of the DSB on November 1, 2002.

On August 29, 2003, the panel, with respect to the final determination (DS257), circulated its report including the same findings as DS236. However, the US government appealed the report to the Appellate Body on October 21, 2003. On January 19, 2004, the Appellate Body circulated its report reversing the finding of the panel report that the US method to calculate the subsidies violated the ASCM, upholding the finding that the US “pass through” analysis violated the ASCM. The Appellate Body report was adopted at a regular meeting of the DSB on February 17, 2004. On December 16, 2004 the DOC issued a revised countervailing duty determination, and then it published the final results of the first administrative review on December 20. Canada again claimed that these measures violated the WTO Agreements and requested the establishment of a WTO compliance panel under Article 21.5 of the DSU. The compliance panel was established on January 14, 2005. The panel

report was issued on August 1 and the Appellate Body report was circulated on December 5, finding that these measures were, again, inconsistent with the WTO Agreement.

In addition, another panel was established at the Canadian Government's request on January 8, 2003 (DS264), to examine the final US Antidumping determination on Softwood Lumber from Canada. The panel report was issued on April 13, 2004; following an appeal, the Appellate Body issued its report on August 11, 2004, finding that the final antidumping determination was inconsistent with the WTO Anti-dumping Agreement in determining the existence of margins of dumping on the basis of a "zeroing" methodology. These reports were adopted on August 31, 2004. Although the DOC issued a revised antidumping determination on April 15, 2005, Canada requested a compliance panel under DSU 21.5, claiming that the measure still violated the WTO Agreement and did not comply with the recommendations and rulings. As a result, a Compliance Panel was established on June 1, 2005. On April 3, 2006 the panel report was issued describing US measures as being consistent with the WTO and as complying with recommendations and rulings under the DSU, and Canada appealed to the Appellate Body. On August 15, 2006 the Appellate Body reversed the panel's conclusion and distributed a report saying that the US measures were a violation of the WTO Agreement and did not comply with the recommendation and rulings.

Furthermore, a WTO panel was established on May 7, 2003 (DS277) to examine the US International Trade Commission's (USITC) injury determination. The panel found that the USITC's analysis violated WTO Agreements. The panel report was circulated on March 22, 2004, and adopted on April 26, 2004, at a regular meeting of the Dispute Settlement Body. The ITC made a revised determination on November 24, 2004, but Canada again objected to this measure and a DSU 21.5 compliance panel was established on February 25, 2005. On November 15, the compliance panel issued its report, concluding that the ITC determination is not inconsistent with the WTO Agreement. Canada appealed to the Appellate Body, and on April 13, 2006 the Appellate Body distributed a report finding that the revised decision by the US ITC was a violation of the WTO Agreement and overturning the panel's conclusion that the US measures followed the recommendations under the DSU.

The two countries came to a political agreement on September 21, 2006 to comprehensively resolve this dispute; it became effective on October 12, 2006. Under the agreement the US ended its anti-dumping duties and countervailing duties retroactively and returned to Canada \$4 of the approximately \$5 billion in accumulated taxes collected since 2002 (the remaining \$1 billion is to be applied to funds for the US lumber industry), and will not start a new investigation during the effective period of the agreement. Meanwhile, when export prices fall below a given standard, Canada should either collect an export tax, or combine an export tax with limitations on export quantities. Specifically, export taxes will be between 0% and 15%, depending on the monthly average of softwood lumber prices. When the market share of Canadian lumber in the US falls, Canada will return the export taxes it has collected to the exporters. The effective period for this agreement is seven years, but it can be extended two additional years based on agreement by both countries. (However, the agreement also includes a provision that it can be terminated 18 months after it becomes effective, with a six-month advance written notice to the other country.)

Disputes on EU Sugar Subsidies (DS265, DS266, DS283)

Among the subsidy disputes in recent years, EU sugar subsidies (DS265, 266 and 283) and below mentioned US cotton subsidies (DS267) have attracted much attention. The EU subsidies and the US subsidies were determined to be in violation of the Agreement on Agriculture and of the Agreement on Agriculture and ASCM, respectively. Both cases are worthy of attention in that the US and EU agricultural subsidies were found to be in violation of the WTO Agreements and this indicates that these subsidies, which have long been a concern for developing countries, can be successfully challenged under the WTO dispute settlement procedures.

With respect to EU sugar subsidies, Australia, Brazil and Thailand requested a WTO panel; the panel reports were issued on October 15, 2004, and appealed to the Appellate Body on January 13, 2005; the panel report was circulated on April 29, 2005, and was adopted at a regular meeting of the DSB on May 19, 2005. The EU adopted a decision regarding reforms of sugar programs at the Agriculture and Fisheries Council meeting on November 24, 2005; the reforms were to apply from July 1, 2006. The decision includes replacement of the existing intervention price with an indexed price, a sugar price reduction, and provision of a subsidy to sugar beet farmers to replace lost income. In addition, it also introduces a voluntary restructuring of the EU sugar industry in order to encourage uncompetitive farmers to change their trade. The EU targets reduction of production allocations of more than 6 million tons through this restructuring of its system.

Disputes on US Cotton Subsidies and others (DS267, DS357)

With respect to US cotton subsidies, Brazil requested a WTO panel; the panel report was circulated on September 8, 2004. Following a US appeal, the Appellate Body issued a report on March 3, 2005. The report of the Appellate Body was circulated on March 3, 2005, and was adopted at a regular meeting of the DSB on March 21, 2005. In February 2006, the US House of Representatives approved the Deficit Reduction Act of 2005, which repealed the export credit guarantee program determined to be a violation of the ASCM. However, a compliance panel was established on September 28, 2006, due to a claim by Brazil that the US was not sufficiently in compliance. Japan participated as a third party and a panel report is scheduled to be distributed in May 2007.

Also, with regard to other US agricultural subsidies, on January 8, 2007 Canada requested bilateral consultations (DS357) on subsidies for agricultural products such as corn. In this case Canada claims that its market has been significantly damaged because of US subsidies to the corn industry, and that the export credit guarantee program provides export subsidies.

Tax Treatment for Export Companies (ETI regime; formerly FSC regime)
(DS108)

See Chapter 1 in Part I.