COLUMN:
DEVELOPMENTS REGARDING CROSS-BORDER SUBSIDIES

As described in the Report, under the Agreement on Subsidies and Countervailing Measures (the "ASCM"), a subsidy means: (i) a financial contribution (Article 1.1 (a)(1)(i)); by (ii) "a government or any public body within the territory of a Member" (chapeau of Article 1.1 (a)(1)); (iii) that confers a "benefit" on the recipient company (Article 1.1 (b)). If a product benefiting from a subsidy with specificity is exported to another country and causes injury to the domestic industry of the importing country, the importing country may impose Countervailing Duties (the "CVDs") on the subsidized products through an investigation procedure (Articles 10 through 23).

Since subsidies originally come in a variety of forms and methods (included grants, bailout loans, investments by sovereign wealth funds, preferential tax treatment, etc.), and information about grantors and benefits of subsidies is not fully disclosed, the determination of such subsidies is often difficult, resulting in many disputes over CVDs. As the latest example, this column introduces the discussions and examples of cross-border subsidies (CVD measures in the EU).

1. WHAT ARE CROSS-BORDER SUBSIDIES?

Although there is no clear definition of cross-border subsidies, it often refers to cases where the country that actually provides the subsidies and the country that exports the subsidized products are different. A typical case is where a country (Country A) provides capital export and financial support to a developing country (Country B), which increases the export competitiveness of Country B and causes injury to the industry of a third country (Country C). In this case, it is Country A that provides the funds, but it is the products of Country B, the recipient of the funds, that cause injury to the industry of the importing Country C. From the standpoint of the importing Country C, as in the usual case of the imposition of CVDs, the importation of foreign products that have gained a competitive advantage through public funding has caused injury, and there may be a practical need to remedy its injury through CVDs. In order to do so, the transfer of capital from Country A to the industries of Country B must be considered a "subsidy" by the government of Country B, and CVDs must be imposed on Country B, recognizing the injury caused by the exports of the subject products of Country B that received the "subsidy."

Such case is not necessarily limited to hypothetical example. In recent years, China's activities to expand capital exports and strategic assistance to developing countries under the so-called "Belt and Road Initiative" have led to rapid growth of export industries in the recipient countries, and there have been cases of causing injury to other countries (the following cases where the EU has imposed CVDs are all about the investigations on China's foreign investment and assistance).

On the other hand, however, it is important to be cautious about easily treating cross-border capital flows as "subsidies" to be subject to CVDs, since cross-border capital flows have long been widespread and many of them are solid economic activities. For example, various types of economic assistance from developed countries to developing countries (ODA by the Japanese government falls into this category), as well as investment activities in various international projects such as infrastructure exports (participation in project finance by Japanese trading companies and financial institutions), etc. It is not reasonable to assume that these solid foreign investments and assistance are recognized as "subsidies", and that the industrial development and export promotion of the recipient countries as a result of these activities are subject to the CVDs by third countries. While the need to deal with certain types of cross-border subsidies is not denied, how to distinguish them from legitimate foreign investment and assistance and how to establish appropriate subsidy rules is a major issue.

In addition, the current text of the ASCM was drafted in the 1990s, and at that time it seems to have been

assumed that the government of the exporting country would provide subsidies to companies located within the territory of the exporting country. Therefore, the provisions of the ASCM do not directly respond to the recent issues surrounding cross-border subsidies as described above. If the cross-border subsidies are to be recognized as "subsidies" by the government of the recipient country and subject to the CVDs as described above, there would be an interpretive issue as to whether they can be considered as contributions "by a government or any public body within the territory of a Member" (chapeau of Article 1.1 (a)(1)), and whether the industries in the recipient country are "within the jurisdiction of the granting authority ..." (chapeau of Article 2.1).

Based on the above, the following are the most recent examples.

2. SPECIFIC CASES

(1) EU'S COUNTERVAILING DUTIES ON FIBERGLASS PRODUCTS FROM EGYPT

In May and June 2019, the EU initiated CVD investigations on fiberglass fabrics (GFF) and filament fiberglass (GFR) from Egypt, respectively. The companies under investigation were subsidiaries of Chinese companies, which produced GFF and GFR in the Suez Economic and Trade Cooperation Zone in Egypt and exported to the EU. The EU recognized the provision of electricity and land at discounted prices and tax exemptions by the Egyptian government, as well as the preferential loans from Chinese state-owned banks to the subject companies, and the inter-company loans from the Chinese parent company to its subsidiaries, as "subsidies" by the Egyptian government. It then imposed CVDs in June 2020.

According to the EU, in interpreting the term "by a government" in the chapeau of Article 1.1 (a)(1), "any relevant rules of international law applicable in the relations between the parties" (pursuant to Article 31 of the Vienna Convention on the Law of Treaties and other relevant provisions) should be taken into account. These "relevant rules of international law" include the ILC's Draft Articles on State Responsibility, which is customary international law, and Article 11 of the said Draft Articles provides that "Conduct which is not attributable to a State under the preceding articles shall nevertheless be considered an act of that State under international law if and to the extent that the State acknowledges and adopts the conduct in question as its own." The EU also cites the Commentary to this Article, which states that the term "acknowledges and adopts" makes it clear that what is required is that the State "identifies the conduct in question and makes it its own."

The EU then cited the following as evidence of "acknowledgement" and "adoption" by the Egyptian government in this case, and in its conclusion identified the above loan by the Chinese state-owned bank and its parent company as a subsidy by the Egyptian government:

- Memorandum of Understanding signed between China and Egypt in 1997;
- 2016 Bilateral Cooperation Agreement (a commitment by the Chinese government to encourage financial institutions to provide financial facilities to companies investing in the Suez Economic and Trade Cooperation Zone);
- The facts that China's "Belt and Road Initiative" was public knowledge and that the successive Egyptian presidents were aware that China's "Belt and Road Initiative" would involve substantial financing;
- The fact that the joint establishment of the Suez Economic and Trade Cooperation Zone with China was a clear act of acknowledgement and adoption of financing by China at the highest political level; and
- The fact that the parent company, a Chinese company, had obtained the necessary funds for intercompany loans from Chinese financial institutions and used the profits for production in Egypt.

Article 1.1 (a)(iv) of the ASCM provides that a financial contribution, even if made by a private body, is considered to be a financial contribution by a government or public body if it is made under the direction or entrustment of a government or public body. The EU has also made preliminary reference to this provision, suggesting that the provision of agreed financial support by the Chinese government to exporters has a demonstrable link to the Egyptian government and also satisfies the requirements of "direction" or "entrustment" discussed in the precedent cases.

In this case, the subject company challenged the CVDs as unjustified before the European General Court. However, in March 2023, the General Court's ruling held that the EU's anti-subsidy rules do not preclude financial contributions from being attributed to the government of the exporting country, even if there is no direct financial contribution by the government of the exporting country.

(2) EU'S COUNTERVAILING DUTIES ON STAINLESS STEEL COLD-ROLLED FLAT PRODUCTS FROM INDONESIA(DS616)

In February 2021, the EU initiated CVD investigations on Stainless Steel Cold-Rolled Flat Products from Indonesia. The company under investigation was a subsidiary of a Chinese stainless steel company, which produced stainless steel cold-rolled flat products at the Morowali Industrial Park in Indonesia and exported to the EU. The EU identified the provision of nickel ore at a reduced price, the provision of land, and tax incentives by the Indonesian government, as well as preferential loans provided by Chinese state-owned banks to the subject company, as "subsidies" by the Indonesian government. It then imposed CVDs in March 2022. This is the third CVD measure following the two measures discussed in (1) above.

Just the same as in the Egyptian case, the EU referred to Article 11 of the ILC's the Draft Articles on State Responsibility as a basis for interpretation. Quoting the Commentary to the ILC, it maintained that "acknowledgement" and "adoption" in the said Article do not mean mere support or endorsement, and that mere acknowledgement of the fact of an action or verbal approval of an action is not enough to attribute the action to the State concerned. In addition, the EU stated that in order to attribute the provision of preferential loans by the Chinese government to the Indonesian government, it is necessary to establish a demonstrable/explicit link between the actions of the Indonesian government and the actions taken by the Chinese government to provide the preferential loans. In conclusion, the EU found that the loans provided by Chinese state-owned banks were attributable to the Indonesian government, and the main basis for the EU's finding is as follows.

- Citing the Joint Declaration to initiate cooperation in the mining and metallurgical sectors in 2005, and the action plans, cooperation agreements, joint statements, memoranda of understanding, etc. signed afterwards, the Indonesian government has actively induced the Chinese government to provide financial support for the development of the stainless steel industry through the Morowali Industrial Park since the start of bilateral cooperation in 2005;
- IMIP, a Chinese-Indonesian joint venture established in 2013 to operate the Morowali Industrial Park, was recognized by the Indonesian government as a national strategic project in 2016 and by China as an overseas investment zone project under the "Belt and Road Initiative." The Morowali Industrial Park and IMIP thus represent that the nickel ore processing operations are jointly managed by China and Indonesia for the benefit of companies producing in the zone;
- Indonesia had the objective of inducing China to introduce investment, know-how, and capital related to stainless steel to develop the entire value chain of the stainless steel industry and thereby maximize the added value of the country's large nickel ore reserves, while China has long relied on imports of Indonesian nickel ore, which is essential to its production process, and had no choice but to accede to Indonesia's request;

- In the cooperation agreements signed in 2011 and 2013, both governments agreed to encourage financial institutions and insurance companies to give priority in providing financial support for such projects, to encourage Chinese companies to invest in Indonesian industrial parks, to promote the development of industrial parks, and to provide policy support;
- Preferential financing by China was also an integral part of China-Indonesia cooperation, given China's rules for implementing its "Belt and Road Initiative" and steel policy;
- There was high-level approval and adoption of preferential loans, as successive presidents must have been aware that China's "Belt and Road Initiative" involves large-scale state financial assistance; and
- This case differs from the Egyptian case in that there was a mechanism for the Indonesian government to monitor China's implementation of the agreement; for example, the Indonesian government officials actively participated in the bilateral implementation mechanism, and the Indonesian government had procedures and systems to monitor the flow of funds from overseas.

Just the same as in the Egyptian case, the EU also mentions the possibility of direction or entrustment by the government to private body, and also states that there is an explicit link between the above-mentioned Chinese financial assistance and the activities of the Indonesian government.

Regarding this matter, Indonesia requested consultations on the WTO in January 2023, and a panel was established in May of the same year. In its consultation request, Indonesia argues that the EU's attribution of preferential loans by Chinese state-owned companies to the Indonesian government violates Article 1.1 of the ASCM. It further argues that recognizing the Indonesian government as the granting authority with respect to the financial contribution by the Chinese state-owned companies also violates the provision "within the jurisdiction of the granting authority" in Article 2.2, which establishes the specificity requirement. Japan is participating in the panel process as a third party to discuss the rules regarding cross-border subsidies.

3. CONCLUSION

As described above, the EU is currently the only example of imposing CVDs on cross-border subsidies, but awareness of the issue is spreading. For example, the U.S. has proposed revisions to its trade remedy regulations in May 2023 that would allow CVDs to be imposed on cross-border subsidies, and depending on future developments, the practice of actually imposing CVDs on cross-border subsidies may become more widespread.

Japan should closely monitor future developments, including those of other countries, in addressing the effects of subsidies that were not contemplated when the ASCM was adopted. In doing so, as described above, Japan should not only pursue to address cross-border subsidies, but also seek to ensure that the future interpretation and application of the ASCM does not impede sound foreign investment by Japanese companies. In addition, this issue is not only a matter of recent trade remedy practice, but also a broader issue of how to regulate international capital flows, such as development assistance to developing countries (in addition to the WTO Agreements, various international agreements, such as investment agreements and OECD export credit arrangements, may be relevant). We should not forget that it is desirable not only to reduce the negative impact on Japanese companies, but also to continue to communicate internationally from a broad, long-term perspective about what kind of discipline is possible under the current ASCM and what kind of international discipline is desirable.