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Selective Issues on Industrial Subsidy Rules: Some Implications from Discussions in World Trade Organization

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Selective Issues on Industrial Subsidy Rules
– Some Implications from Discussions in WTO –

Tsuyoshi Kawase
Professor of Law, Sophia University
Faculty Fellow, RIETI

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Chapter 1

GOALS SET BY TRILATERAL JOINT STATEMENT IN JAN. 2020 MEETING



Six goals set by the trilateral ministerial meeting in Jan. 2020

1. Expanding a too short list of prohibited subsidies
2. Creating a new "amber" category of subsides with reversal burden of proof regarding serious prejudice and effective transparency
3. Creating a new type of serious prejudice caused by capacity-distorting (overcapacity?) subsidies
4. Creating a new incentive for subsidies notifications to improve transparency
5. Specifying situations where "out-of-country" benchmarks can be used regarding provision of goods or services or purchase of goods by a government
6. Redefining "public body"



State of play

- Issue 1 (prohibited subsidies):
  - Partly achieved in FTA rules (ex. Japan-EU FTA art.12.7)
- Issue 2 (new “amber” categories) and 3 (overcapacity):
  - Never addressed so far
- Issue 4 (transparency)
  - Several proposals are on the table in the context of WTO reforms
- Issues 5 (“out-of-country” benchmark) and 6 (“public body”)
  - Partly interpretative question
  - Already addressed in WTO disputes to some extent



Objective of my presentation

- Stock-take ongoing arguments regarding Issues 4 through 6 in WTO
- Draw implications for talks in APEC/WTO
- Access how far we have achieved our goals set by the trilateral ministers



Chapter 2

“OUT-OF-COUNTRY” BENCHMARKS



Input subsidy and CVD investigation

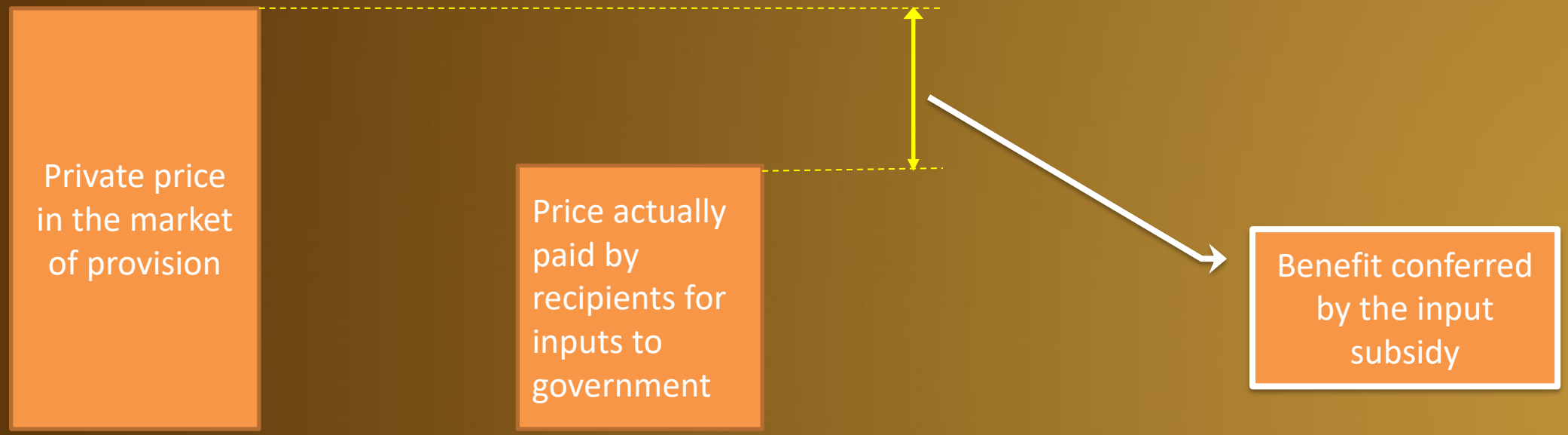
- Sometimes a government (or a government-related entity) provides domestic private companies with inputs at a below-market price, *e.g.*,
  - standing timbers in government-owned land to lumber producers
  - polysilicon to solar panel producers
  - iron ore to carbon steel producers

etc…



Input subsidy and CVD investigation

- In CVD investigation, an investigation authority (IA) must confirm benefits conferred by such provision of inputs, comparing…





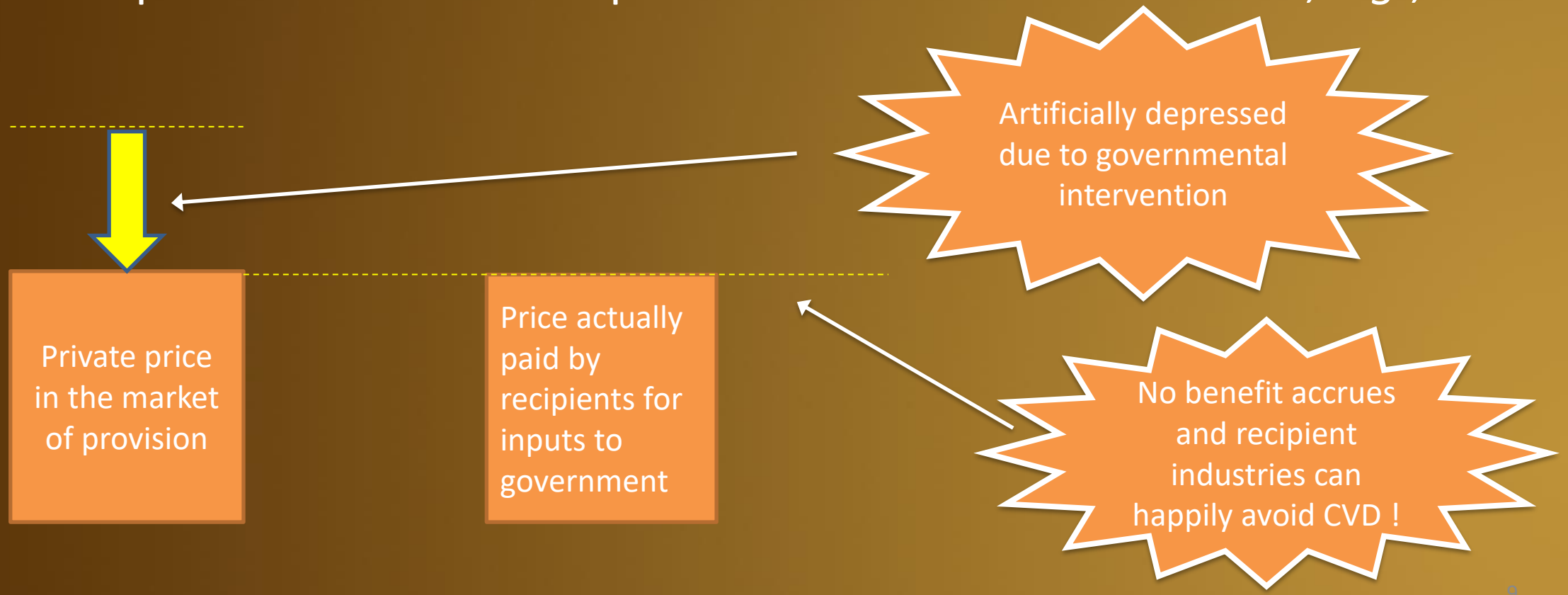
SCM Agreement art.14 (d) , first sentence provides…

- "[T]he provision of goods or services or purchase of goods by a government shall not be considered as conferring a benefit unless the provision is made for less than adequate remuneration, or the purchase is made for more than adequate remuneration."



But…

- Private price in the market of provision is sometimes distorted, *e.g.*,





In such a case, IA can refer to “out-of-country ” benchmarks (OCBM)

- If prices of the input in the market of provision is distorted by governmental intervention??
  - IA can refer to private market prices of such input in any other country (“out-of-country” benchmarks (OCBM))
- “Investigating authorities may use a benchmark other than private prices in the country of provision under Article 14(d), if it is first established that private prices in that country are distorted because of the government's predominant role in providing those goods…Whenever the government is the predominant provider of certain goods, even if not the sole provider, it is likely that it can affect through its own pricing strategy the prices of private providers for those goods, inducing the latter to align their prices to the point where there may be little difference, if any, between the government price and the private prices.” (*US–Softwood Lumber IV* (AB, DS257), paras.99–103)



Trilateral ministers feel necessity for clarification

- "The current rules of the ASCM are insufficiently prescriptive when it comes to the determination of the proper benchmark for subsidies consisting of the provision of goods or services or purchase of goods by a government in situations where the domestic market of the subsidizing Member is distorted. Therefore, the ASCM should be amended to describe the circumstances in which domestic prices can be rejected and how a proper benchmark can be established, including the use of prices outside of the market of the subsidizing Member."

(Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, US and EU, Jan. 14, 2020, para.5)



Governmental predominance is not determinative; Price distortion is central to IA's analysis

- "It is…price distortion that would allow an investigating authority to reject in-country private prices, not the fact that the government is the predominant supplier per se…. [P]rice distortion must be established on a case-by-case basis and that an investigating authority cannot, based simply on a finding that the government is the predominant supplier of the relevant goods, refuse to consider evidence relating to factors other than government market share." (*U.S. – AD and CVD (China)* (DS379, AB) para. 446)



No threshold of governmental predominance, but…

- "[W]e are not suggesting that there is a threshold above which the fact that the government is the predominant supplier in the market alone becomes sufficient to establish price distortion, but clearly, the more predominant a government's role in the market is, the more likely this role will result in the distortion of private prices…
- There may be cases … where the government's role as a provider of goods is so predominant that price distortion is likely and other evidence carries only limited weight…. (*U.S. – AD and CVD (China)* (DS379, AB), paras. 444, 446)"



In some cases, predominance is determinative

- "We observe that, with 96.1 per cent market share, the position of the government in the market is much closer to a situation where the government is the sole supplier of the good… Thus, while it is true that the USDOC's consideration of factors other than government market share … was somewhat cursory, this must be contrasted with the USDOC's finding that, with 96.1 per cent market share, the government had an "overwhelming" involvement in the [hot-rolled steel] market." (*U.S. – AD and CVD (China)* (DS379, AB), para.454)



What are other factors to be considered?

- No exclusive or illustrative list at all, purely on a case-by-case basis
- *e.g.*, in *U.S. – AD and CVD (China)* (DS379, AB)…
  - profitability of a government-related entity in question
  - state of private investment in an input industry in question
  - condition of competition in the input industry
  - (non-)existence of uniform or government-set price
  - price fluctuation of the input by time, region or producer



Governmental predominance is NOT the only situation where IA can have recourse to OCBM

- "We do not consider the Appellate Body foreclosed the possibility that Article 14(d) permits the use of alternative benchmarks in situations where the government is not a predominant provider of the good in question." (*U.S. - Carbon Steel (India)* (DS436, AB), para.4.184)



What could be “other circumstances ” for OCBM?

- “Indeed, there may be other circumstances where an investigating authority would not be required to use in-country prices to determine a benchmark for the purposes of Article 14(d), for example, where information pertaining to in-country prices cannot be verified ….” (*U.S. - Carbon Steel (India)* (DS436, AB), para.4.189).
- Any other circumstances for OCBM? *e.g.*,
  - production subsidies for inputs in question
  - regulation on pricing



Implications from the WTO precedents

- Fundamental principle: If governmental intervention or any other condition results in price distortion in the market of provision, IA may have recourse to OCBM
- Governmental predominance in the market: most typical but not the only situation for OCMB
  - At least, price distortion is rebuttably presumed when a government or a government-related entity is virtually the only supplier of inputs in question
- Need to specify other situations where price distortion could happen



Then, how to determine OCBM?

- SCM Agreement art.14 (d) , second sentence: "[t]he adequacy of remuneration shall be determined in relation to prevailing market conditions for the good or service in question in the country of provision or purchase (including price, quality, availability, marketability, transportation and other conditions of purchase or sale)."
- "[Alternative, or out-of-country] benchmark relates or refers to, or is connected with, prevailing market conditions in the country of provision, and must … conditions of purchase or sale, as required by Article 14(d)."

(*US–Softwood Lumber IV* (AB, DS257), para.106)



Then, how to determine OCBM? (cont.)

- "[A]lternative methods … could include proxies that take into account prices for similar goods quoted on world markets, or proxies constructed on the basis of production costs."
- "[I]t cannot be presumed that market conditions prevailing in one Member … relate or refer to, or are connected with, market conditions prevailing in another Member…. There are numerous factors to be taken into account in making adjustments to market conditions prevailing in one country so as to replicate those prevailing in another country. "
- "[A]ny comparative advantage … would have to be taken into account and reflected in the adjustments made to any method used for the determination of adequacy of remuneration… ."

(*US–Softwood Lumber IV* (AB, DS257), paras.108–109)



Example

- USDOC: Compare Indian government price of iron ore with delivered price of Brazilian iron ore in India as OCBM
  - AB condemned USDOC's approach >>> delivery charges should have been deducted from the price

(*U.S. - Carbon Steel (India)* (DS436, AB), paras.4.304–4.317)



Implications from the WTO precedents

- Conceptual framework established by *US–Softwood Lumber IV* (AB, DS257) can be a good starting point of discussion
- Remaining issues
  - Priority and choice of proper basis of OCBM (foreign market price, world price, cost)
  - list of factors for and method of price adjustments etc.



Chapter 3

DEFINITION OF “PUBLIC BODY”



Definition of subsidies in SCM Agreement

1.1(a) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:

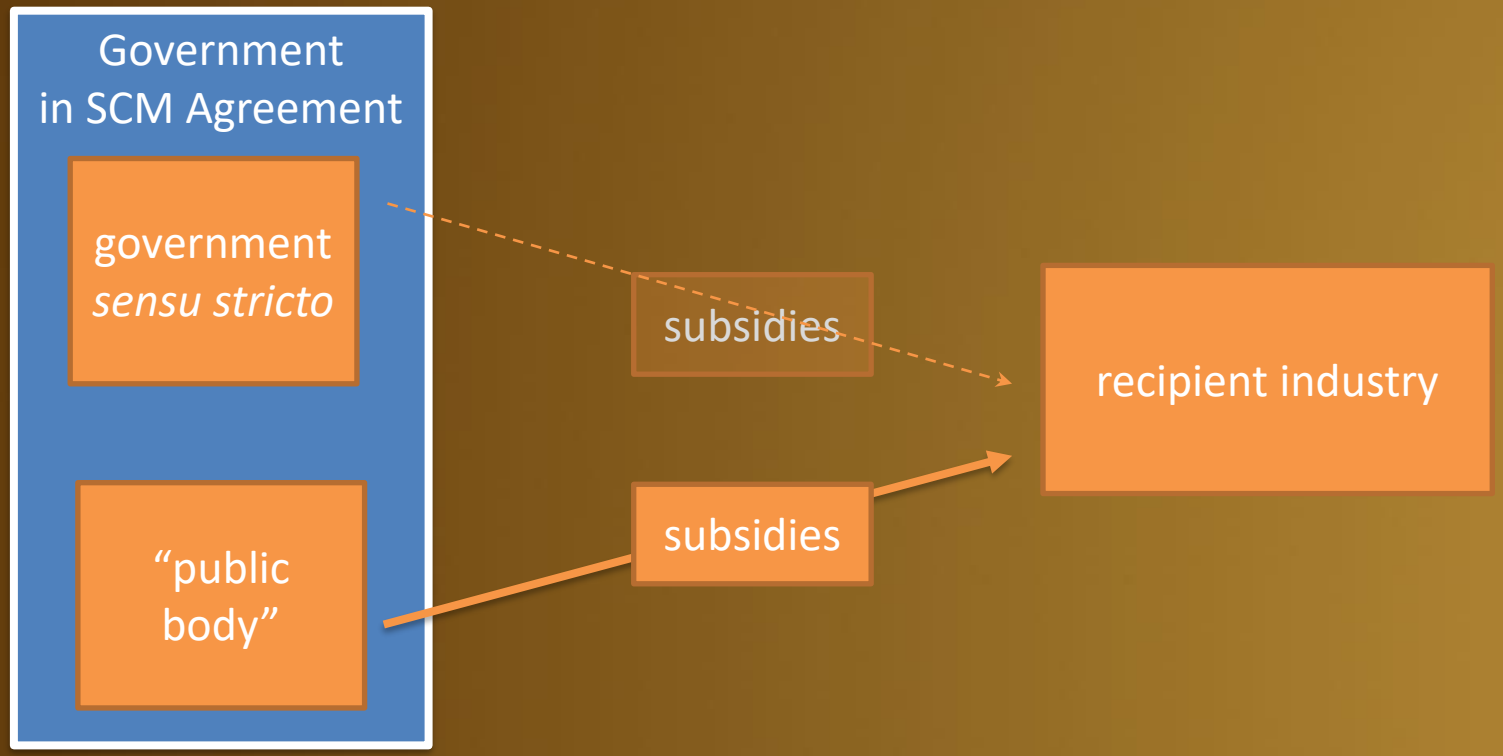
(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);

[…]

(iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;



Subsidies are sometimes granted by a “public body” on behalf of a government *sensu stricto*



Appellate Body, *US – Anti-Dumping and Countervailing Duties (China)* (DS379)

- U.S. regarded Chinese SOEs as "public body" based on the fact that these entities were majority government-owned
- AB condemned this U.S approach
  - "We see the concept of "public body" as sharing certain attributes with the concept of "government". A public body within the meaning of Article 1.1.(a)(1) of the *SCM Agreement must be an entity that possesses, exercises or is vested with governmental authority*." (para.317)
  - "[C]ontrol of an entity by a government, in itself, is not sufficient to establish that an entity is a public body." (para.320)



Fierce criticism by U.S.

- "The Appellate Body has adopted an erroneous interpretation of the term "public body" that is not found in the agreed text and is not consistent with the ordinary meaning of that term."
- " The Appellate Body's narrow interpretation favors non-market economies operating through SOEs over market economies and undermines the ability of WTO Members to counteract subsidies by non-market economies."

(USTR, *Report on the Appellate Body of World Trade Organization*, p.82)



Japan and EU also share U.S. concern

- “The Ministers agreed that the interpretation of “public body” by the WTO Appellate Body in several reports undermines the effectiveness of WTO subsidy rules. To determine that an entity is a public body, it is not necessary to find that the entity “possesses, exercises or is vested with governmental authority.” The Ministers agreed to continue working on a definition of “public body” on this basis.”

(Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, US and EU, Jan. 14, 2020, para.6)



In fact, governmental control really matters

- "[E]vidence that a government exercises meaningful control over an entity and its conduct may serve, in certain circumstances, as evidence that the relevant entity possesses governmental authority and exercises such authority in the performance of governmental functions." (*US – AD and CVD (China)* (DS379, AB) para.318)

But, control must be “meaningful”

- “[T]he existence of mere formal links between an entity and government in the narrow sense is unlikely to suffice to establish the necessary possession of governmental authority.…[T]he mere fact that a government is the majority shareholder of an entity does not demonstrate that the government exercises meaningful control over the conduct of that entity, much less that the government has bestowed it with governmental authority. (*U.S. – AD and CVD (China)* (DS379, AB) para.318)”
- “[M]eaningful control" is concerned with the government's exercise of control over an entity and its conduct” (*U.S. – Countervailing Measures (Art.21.5–China)*(Panel, DS437) para.7.68)



IA is also required to take a more comprehensive approach

- "Meaningful control" is one of different types of evidence to be referred to in the inquiry.
- "A Member must also avoid focusing exclusively or unduly on any single characteristics without affording due consideration to other relevant factors."
- Public body inquiry must have due regard to
  - core characteristics and functions of an entity,
  - the entity's relationship with the government, and
  - legal and economic environment in which the investigated entity operates

(*U.S. – Countervailing Measures (Art.21.5–China)*(AB, DS437) paras.5.95–5.97)

Panel/AB seems to imply a two-tier approach…

- "[I]nvestigating authority examining meaningful control must answer the substantive legal question of whether an entity exercises, possesses, or has been vested with government authority. …[t]his *substantive standard* should not be confused with the *evidentiary standard* required to establish that an entity is a public body within the meaning of the SCM Agreement."



i.e.,

Tier 1

To establish "meaning control" to satisfy evidentiary standard

If positive, then

Tier 2

Substantive legal question of whether an entity exercises, possesses

Yes

Entity in question IS "public body"

No

Entity in question IS NOT "public body"



Not really. In fact, it is unitary

- USDOC considered in establishing "meaningful control"…
  - not only governmental ownership and other formal links,
  - but also general background of governmental intervention in the state sector in question, more specifically, the application of industrial plans, government benefits and protections provided to a government-related entity, and supervision over managerial appointments in the entity
- No need to explicit consider core characteristics of an entity in question

(*U.S. – Countervailing Measures (Art.21.5–China)*(Panel, DS437) paras.7.65–7.72



Implications and analysis

- Panels/AB exclude just a simple and formal government ownership test
  - Never denied U.S. approach to rely mainly on governmental control thorough ownership
- What should U.S. have done?
  - Not to jump into conclusion just looking at majority governmental ownership in entities in question
  - To take into consideration other conditions surrounding an entity in question to confirm governmental control over the entities



Implications and analysis (cont.)

- Comprehensive “meaningful control” test seems satisfactory to meet “governmental authority” without further inquiry
- The “governmental authority” was redundant and unnecessary?
  - AB has never clarified what “exercises, possesses, or is vested governmental authority” really means
  - Never requires a two-tier test
  - Very puzzling, just redundant



Conclusion

- Essence of “public body” standard is in fact “meaningful control” test
- The “meaningful control” test can be a good start point for APEC/WTO discussion regarding redefinition of a “public body”



Chapter 4

IMPROVING TRANSPARENCY



“Dismal” subsidy notification

- “The current rules of the ASCM do not provide for any incentive for WTO Members to properly notify their subsidies. Therefore, the state-of-play of subsidies notifications is dismal. ”

(Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, US and EU, Jan. 14, 2020, para.4)



How “dismal” ?

- Deterioration of level of compliance with notification requirement significantly since 1995
  - Share of Members that notified subsidies decreased from 50% in 1995 to 38% in 2015 (62 members notified out of 162)
- Some Members do not notify sub-central subsidy programs at all or in an inadequate manner
- Poor quality of notifications
  - Attempt to notify subsidy programs clearly outside the scope of the SCM Agreement to create the appearance of transparency without notifying actual industrial subsidies

(Communication from EU, TN/RL/GEN/188, May 30, 2017)



Japan-US-EU proposal (Nov. 1, 2018)

- Encouraging to provide a counter notification
- Encouraging to submit explanation for delay in notification
- Punitive approach: Two-phase sanctions after deadlines for notification
  - One yr. after: no right to nominate its own representatives to chairpersons of WTO bodies, question posed in TPR left unanswered, additional contribution to the WTO budget, etc.
  - Two yrs. after: demoted to "inactive member", restriction on taking floor, etc.
- Technical assistance and capacity building for developing Members

(JOB/GC/204)



Counterproposal from developing members (June 27,2019)

- Criticizing a punitive approach taken in Japan-US-EU proposal
- Emphasizing capacity and resource constraints
  - Developing Members cannot take additional obligations of notification
- Insisting on "inclusiveness" approach
  - extension of time-flames
  - simplified format for notification
  - technical assistance and capacity building as central components

(JOB/GC/218)



Contribution by APEC

- Great discrepancy between developed and developing economies
- APEC embraces economies of a great variety of development level
  - Suitable forum to narrow down the discrepancy


The end of my presentation
Thank you!