REGULATORY AND TRADE DEVELOPMENTS

BRAZIL-CANADA AIRCRAFT SUBSIDIES DISPUTE: THE DEFINITION OF EXPORT SUBSIDIES AND REMEDIES

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The recent WTO Appellate Body decisions in the dispute between Brazil and Canada over one another's alleged subsidization of regional and commuter aircraft exports sheds some interesting light on two areas of the law of subsidies.[1] First, the decisions flesh out some of the developing law on what sort of subsidies are prohibited, and in particular, what export subsidies are prohibited. Second, and in concert with at least two other recent WTO decisions,[2] the dispute and these decisions exemplify some interesting approaches in remedies, both those negotiated between the parties and those imposed by the WTO.

Impact on Prohibited Export Subsidies

Under the Agreement on Subsidies and Countervailing Measures, a product of the Uruguay Round negotiations, there are three types of subsidies: actionable, non-actionable, and prohibited subsidies. Non-actionable subsidies include general subsidies such as education and infrastructure spending, and several specifically enumerated subsidies (none of which are relevant to the Brazil-Canada dispute).[3] Actionable subsidies fall in the middle range of permissibility. These are specific forms of government assistance to firms or industries, which may be contrary to the SCM Agreement if they (a) cause injury to another country's industry; (b) impair benefits accruing to another country under the GATT; or (c) cause serious prejudice to the interests of another country.[4] The third category of subsidies are prohibited outright, and fall on the most objectionable point of the continuum. These are of two types. First, subsidies contingent on the use of domestic inputs; and second, subsidies contingent, in law or in fact, on export performance.[5] It was this last, most egregious, type of subsidy that both the Canadian and Brazilian programs were alleged to constitute.

The Appellate Body's decision on the Canadian programme provides some elaboration of the meaning of "benefit" in determining whether any subsidy exists at all. Under Article 1.1 of the SCM Agreement, a subsidy exists where a government makes a financial contribution and a benefit is thereby conferred. Canada argued that whether or not a benefit existed should be found by examining the cost to government of the financial contribution. The Appellate Body rejected this proposal, and made clear that a "benefit" would be defined by looking to the effect of the financial contribution on the subsidized industry.[6]

A second important aspect of the Appellate Body's ruling is its discussion of what constitutes export contingency in fact, under Article 3.1 of the SCM Agreement, the provision that prohibits export contingent subsidies. This *de facto* export contingency is prohibited because of the obvious interest of governments in disguising any explicit export orientation that their industrial aid programmes may

have. Explicit, *de jure* export contingent subsidies are easily located and are, along with *de facto* export contingent subsidies, prohibited *per se*. Canada argued, among other things, that it was inappropriate for the Panel to find, based merely on the fact that the Technology Partnerships Canada programme used anticipated exportation as a "consideration" in granting assistance, that the program was *de facto* contingent on export. The Appellate Body agreed that no single factor could generally be determinative in identifying *de facto* export contingency. It found, however, that the Panel had quite appropriately relied on TPC's "consideration" of anticipated export among a variety of factors in concluding that TPC and Canada Account were, in point of fact, subsidy programs contingent on export.

Accordingly, it set out a three-part test for determining whether, as a factual matter, a program was contingent on export. First, was a subsidy granted; second, were there actual or anticipated export earnings in the subsidized industry; and third, was the subsidy "tied to" such earnings. The structure of the relationship makes clear that mere export orientation of an industry, together with a subsidy, cannot establish a prohibited subsidy's existence. The "tied-to" component requires a thorough factual analysis of the program's relationship with exportation.[7]

Finally, the Appellate Body's decision on the Brazil "PROEX" program raised the interesting question whether the Illustrative List of types of prohibited export subsidies annexed to the SCM Agreement could afford parties an "affirmative defence" to the charge of prohibited subsidies if they could show their programme did not fall within the illustrated category. While the Appellate Body declined to formally rule on the question, it did make clear that, under item (k) of the List,[8] it was the terms of the OECD Arrangement establishing guidelines for export credits that would determine whether a member had conferred a "material advantage" on an industry (and thus violated item (k)), whether or not a party subscribed to the Arrangement.[9]

Impact on Remedies for Prohibited Export Subsidies

A significant finding in the Brazil case concerned Brazil's claim that its PROEX program was intended to "match" the alleged subsidization by Canada of its regional aircraft industry. Again, Brazil framed this claim as part of its "affirmative defence" under item (k) of the Illustrative List. The Appellate Body rejected the claim for several reasons, foremost among them the fact that many of the alleged Canadian subsidies were not in the field of export credit terms—while PROEX was a unified program exclusively in that field. A retaliatory "match" in the field of export credit terms, it held, cannot be used to redress subsidies operating in different fields, such as direct subsidies tending to reduce the product's basic price. As well, the fact that PROEX applied a single, across-the-board discount of 3.8 basis points regardless of the transaction or purchaser in question removed much of the plausibility from Brazil's claim that the programme was designed to respond to a single member's rather complex structure of subsidization.[10]

The recent decision of the WTO Arbitration Panel on the question of Canada's remedy against Brazil is also quite novel. In the first place, the Arbitration Panel rejected the possibility of allowing retaliatory tariffs based on the damage to Canadian industry, instead measuring the appropriate response in terms of the value to Embraer (PROEX's prime beneficiary) of the subsidy itself.[11] Nullification- and impairment-based remedies are calculated by reference to the amount of damage done to the complainant country's industry, and the terms are used, respectively, where the damage completely or partially destroys that industry. The

Arbitration Panel discussed the use of such remedies and concluded that they were largely ineffective. In the case at hand, for instance, such a remedy would severely interfere with other Members competing in the same field as the two Members if retaliatory subsidies were allowed.[12] In cases where the nullification or impairment damage is significantly lower than the amount of subsidy, such a remedy will "have no or less inducement effect and the subsidizing country may not withdraw the measure at issue."[13] Secondly, the remedy against Brazil included not only a prohibition against using PROEX in future sales, but required Brazil to cancel PROEX support of purchases for which it had already committed itself. This point has particularly troubled Brazil, who continue to negotiate with Canada to find a way around this.

These two points may be particularly important for future cases. Currently, the WTO and its dispute resolution mechanisms are dominated by the E.U. and the United States. This is in no small part due to the ineffectiveness of remedies for subsidies conferred by either of these two powers when sought by comparatively small countries, and the result is of great significance for the WTO's efficacy as an adjudicator of disputes for all its members. A remedy against the United States, for instance, which allows a small country to impose countervailing duties, or retaliatory subsidies, will generally be completely ineffective. In the case of countervailing duties, the smaller member will most likely only deprive itself of United States trade, if the smaller country's market for U.S. goods is an insignificant part of the entire market for those goods. In the case of retaliatory subsidies, the United States industry is unlikely to be affected at all. Further, remedies calculated on the basis of subsidy expenditure by a large state, rather than by impairment of a small one, makes for easier and more objective calculation of the financial amount of a remedy. Retroactivity stops the subsidies immediately, both reducing their corrosive effect on complainant states' industry and providing further incentives to states not to make such prohibited expenditures in the first place.

An even more significant pronouncement on the same topic came earlier this year in a well-publicized panel ruling in the Australian Automotive Leather case.[14] In that case, a WTO Panel required a manufacturer, the sole recipient of illegal, export-contingent subsidies, to repay these subsidies in full. Although both parties to the action agreed not to contest the ruling, both they (the U.S. and Australia) and Canada and Brazil expressed concerns over the ruling. In addition, the current dispute between the European Union and the U.S. over the large tax breaks accorded to U.S. Foreign Sales Corporations raises many of the same remedial issues.[15] The estimated benefit to U.S. corporations conducting sales outside of the U.S. is around $4 billion (U.S.). Thus far, the E.U. has threatened to impose sanctions on that basis. Although an agreement has been struck to defer a trade war, a WTO decision on the appropriate measures is expected within nine months.[16]

Meanwhile, final resolution of the Brazil-Canada dispute is still pending. The two states have met numerous times to find a compromise solution to Brazil's problems in having to cancel purchases for which it had already committed PROEX support. The solution seems likely to include reductions in Brazilian tariffs on a variety of Canadian goods.[17] If and when the dispute is resolved by diplomacy, and indeed, when the United States-E.U. dispute is concluded, a clearer picture will begin to emerge of the new state of the law on export subsidies.

Notes

[1] *Brazil— Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body (August 2, 1999) (hereinafter, "Brazil Appellate Report"); *Canada— Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body (August 2, 1999) (hereinafter, "Canada Appellate Report").
[2] These are *United States—Tax Treatment of Foreign Sales Corporations*, Report of the Panel (October 8, 1999), and *Australia— Subsidies Provided to Producers and Exporters of Automotive Leather*, Report of the Panel (January 21, 2000). See discussion, *infra*.
[3] Agreement on Subsidies and Countervailing Measures (hereinafter, "SCM Agreement"), Article 8. *See generally* M. Trebilcock and R. Howse, *The Regulation of International Trade* (2d ed.) (London and New York: Routledge, 1999) at 196-7.
[4] SCM Agreement at Article 5.
[5] *Ibid* at Article 3, and in the case of subsidies contingent on export, supplemented by the Illustrative List, an Annex to the SCM Agreement.
[6] Canada Appellate Report at paras. 153-160.
[7] *Ibid.* at paras. 161-178.
[8] Item (k) specifically prohibits, as an illustration of the sort of export subsidies prohibited, measures that are "used to secure a material advantage in the field of export credit terms." Brazil had argued that the measures were not "used to secure" whatever material advantage might have nevertheless accrued.
[9] Brazil Appellate Report at paras. 171-185.
[10] *Ibid.* at para. 185 *et seq*
[11] *Brazil—Export Financing Programme for Aircraft*, Decision by the Arbitrators (August 28, 2000).
[12] *Ibid.* at para. 3.58.
[13] *Ibid.* at para. 3.54.
[14] *Australia—Subsidies Provided to Producers and Exporters of Automotive Leather*, Report of the Panel (January 17, 2000)
[15] "FSC's" were found to constitute illegal export-contingent subsidies by the WTO Panel in *United States—Tax Treatment for "Foreign Sales Corporations,"* Report of the Panel (October 8, 1999); Report of the Appellate Body (February 24, 2000).
[16] A. Croft, "E.U., U.S. stop short of full-scale trade war," *The Globe and Mail*, Oct. 2, 2000, pag e B8.
[17] I. Jack, "No solution to jet subsidy dispute," *National Post*, Sept. 29, 2000 (Financial Post).