SUBSIDIES IN THE CONTEXT OF CHINA'S WTO ACCESSION

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"What's New on Subsidies?"

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I. Introduction

In an overall review of "what's new on subsidies," the treatment of subsidies in the negotiations over China's proposed WTO accession is an important topic. Subsidies have figured prominently in Chinese industrial policy and could be increasingly problematic as China's share of world trade grows. Moreover, decisions made in connection with China's accession could profoundly affect the future direction of the WTO subsidies regime.

Two questions merit consideration. First, what has been agreed so far in the accession talks with China? Second, what is the nature of the WTO subsidies regime which China will be joining?

II. Subsidies in the Negotiations With China

President Clinton's August 1999 "Steel Action Program," at item 8, contained the following pledge:

> *As part of WTO accession negotiations, the Administration will seek strong adherence by acceding governments to WTO subsidies disciplines, including the elimination of export subsidies and import substitution subsidies that are normally prohibited under WTO rules.*

This pledge responded to general unease on the part of U.S. industries regarding the efficacy of WTO subsidy rules, and more immediately to reports that China was insisting on "developing country" status for purposes of the Agreement on Subsidies and Countervailing Measures ("ASCM") which would qualify it for substantial derogations from the ASCM's various subsidy disciplines. (The U.S. steel industry's interest in this issue sharpened in March 2000 when China -- already the world's leading steel-producing country -- announced $6 billion in new subsidies to prepare its domestic steel industry to face international competition.)

There were reasons to expect, therefore, that the U.S. Government would vigorously oppose developing country status for China and would treat the subsidy issue -- or at least the applicability of the ASCM Article 3 prohibitions -- as a high-priority item to be resolved during bilateral U.S.-China negotiations, before the United States would announce its support for accession and move forward on Permanent Normal Trade Relations ("PNTR"). The U.S.-China bilateral accord announced in November 1999, however, contains very few details on subsidies. Most subsidies issues, including the applicability of the special rules for developing countries in ASCM Article 27, are not addressed in the U.S.-China Agreement.

A. What Is Not Known

Many of the most important questions regarding China's subsidies commitments remain open. Export subsidies are perhaps the most important example. If China is

permitted to benefit from Article 27, it will not be immediately subject to the Article 3.1(a) prohibition. There are some indications that China may have dropped its request for delayed application of this prohibition, as, for example, Chinese officials stated at a March 2000 Working Party meeting in Geneva that China had already eliminated all export subsidies. Further, draft protocol language circulated in June 2000 by the WTO Secretariat (identified as "emanating from" the EU-China bilateral agreement announced in May 2000) states that "[i]n accordance with Article 3.1(a) of the [ASCM] China shall eliminate all export subsidies by accession, including fiscal or other financial measures referred to in Article 1 contingent upon export performance."[1]

Additional questions include which, if any, of the other special Article 27 rules for developing countries will be applicable to China, such as: (1) provisions limiting the types of adverse trade effects that can be addressed through WTO dispute settlement; (2) a special *de minimis* standard in CVD investigations; and (3) non-actionability for certain subsidies that are part of a privatization program. Likewise unclear is whether China will be able to invoke the special rules in ASCM Article 29 for economies in the process of transformation into a market economy.

B. What is Known

What is known is that, pursuant to protocol provisions accepted by China during the bilateral negotiations, the United States and other WTO Members will be able, as a U.S. Government press release put it, to "take account of China's unique characteristics" when doing benchmark and specificity analysis in future anti-subsidy proceedings.

With respect to specificity, the U.S.-China Agreement provides:

> *For purposes of applying Article 1.2 and Article 2 of the Agreement on Subsidies and Countervailing Measures, … subsidies provided to state-owned enterprises will be viewed as specific if, inter alia, state-owned enterprises are the predominant recipients of such subsidies or state-owned enterprises receive disproportionately large amounts of such subsidies.*

This means that China cannot excuse an otherwise-actionable subsidy simply by showing that the subsidy is available throughout the state-owned portion of its economy.

With respect to benchmarking, the U.S.-China Agreement provides:

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[1] On the other hand, according to a draft of the working party report published in July 2000, the Chinese delegation recently confirmed that China *does* expect to "avail itself of the derogations and special provisions made available to developing country members of the WTO." Draft Working Party Report at ¶8, reproduced in *Inside US Trade* (July 28, 2000). The draft indicates that other participants in the working party discussions are opposing China's request. As of late July, Chinese officials reportedly were still insisting that China be allowed to benefit from at least some of these special ASCM provisions. "China Resists EU Demands for Strong Industrial Subsidies Disciplines," *Inside US Trade* (August 4, 2000).

In proceedings under Parts II, III and V of the SCM Agreement, when addressing subsidies described in Articles 14(a) [equity infusion], 14(b) [loan], 14(c) [loan guarantee] and 14(d) [provision or purchase of goods and services], relevant provisions of the SCM Agreement shall apply; however, if there are special difficulties in that application, the importing WTO Member may then use methodologies for identifying and measuring the subsidy benefit which take into account the possibility that prevailing terms and conditions in China may not always be available as appropriate benchmarks. In applying such methodologies, where practicable, the importing WTO Member should adjust such prevailing terms and conditions before considering the use of terms and conditions prevailing outside China.

A careful reader will spot some unanswered questions here as well. The specificity provision clearly has ASCM-wide applicability -- it applies "for purposes of applying Article 1.2 and Article 2," which are the ASCM's basic definitional provisions. As for the benchmarking provision, it applies by its terms "in proceedings under Parts II [prohibited subsidies], III [actionable subsidies] and V [countervailing duties] of the SCM Agreement." However, the wording of the remainder of the provision suggests a focus limited to CVD cases, a reading consistent with the initial U.S. Government press releases. Perhaps the best that can be said on that point is that some further clarification is needed during the multilateral discussions which remain to be completed concerning the protocol.

Meanwhile, what is the value of these bilaterally-agreed provisions in the CVD context? That depends on when, and under what terms, the United States elects to apply its CVD law to China.

C. Georgetown Steel

Currently, the United States does not apply its CVD law to non-market economies ("NMEs") like China, as a result of Georgetown Steel Corp. v. United States, 801 F.2d 1308 (Fed. Cir. 1986). That situation must change in order for the benchmarking and specificity rules accepted by China to have any impact in CVD cases. The question then becomes, how high a barrier does Georgetown Steel present to the use of CVD law on imports from China? Three readings of the decision are possible.

Narrow view: The narrow reading of Georgetown Steel focuses on the procedural posture of the case as presented to the CAFC. Under this view, the court simply held that Commerce's decision not to countervail rested upon a permissible interpretation of the statute.[2] Thus, in this view, Commerce is free to reverse its interpretation with adequate explanation and, benefiting from Chevron deference, could expect to prevail in any ensuing court appeal. In such an appeal, Commerce could argue that the new definition

[2] The opinion's concluding paragraph states: "We cannot say that the Administration's conclusion that the benefits … provided for the export of potash to the United States were not bounties or grants under section 303 was unreasonable, not in accordance with law or an abuse of discretion." 801 F.2d at 1318.

of a subsidy installed in the law in 1994 plainly reaches subsidies bestowed by NME governments. (How do we know this? Because it is the same definition as the basic definition in Articles 1 and 2 of the ASCM, and that definition obviously applies to China as evidenced by the very fact that China's ASCM obligations are now the subject of active negotiation, including by the U.S. Government. If China were incapable of providing a "benefit," there would be nothing to negotiate.)

Broad view: Under the broad, and probably the most widely-held, view of Georgetown Steel, the Federal Circuit held as a matter of law that the CVD law does not and cannot reach bounties bestowed by NME governments. This view is supported by the very expansive language used by the court in announcing its decision. Under this interpretation, legislative action would be needed in order to enable countervailing duties to be imposed on products from NMEs. This would make the bilaterally-agreed provisions useless, for quite a while at least.

Functional view: An intermediate functional view of Georgetown Steel is also possible. This view focuses on the *reasons* animating the agency and court decisions not to countervail. One rationale articulated at the time was that NME subsidies could not be countervailed because they could not be measured -- that is, because benchmarking is too difficult in a state-controlled economy where prices have no real economic meaning. Some subsidies, however, are easier than others to benchmark -- for example, a per unit export subsidy. This may point the way for at least a partial departure from the flat prohibition on NME CVD cases. To be sure, Commerce's analysis suggests that even such seemingly obvious and easily measurable subsidies are unreachable, since in a centrally-planned economy they typically come with many conditions attached (such as maintaining employment levels, supplying inputs to industrial consumers at non-market prices, etc). This argument will remind CVD aficionados of the concept of subsidy "offsets." Perhaps, as a way of easing out of the Georgetown Steel framework, Commerce could develop a methodology under which it will consider in NME CVD cases a range of potential offsets broader than the narrowly drafted list of offsets currently in the CVD statute (limited to application fees and the like).

The bottom line: Under any view of Georgetown Steel, the fact that Congress passed a new CVD statute, with a new definition of "subsidy" after the Uruguay Round, calls into question the continued vitality of the decision, based as it is on pre-Uruguay Round law. Thus, some change can be envisioned. However, there are likely to be some political constraints on that change. One challenge facing those who attempt to chart a new course will be to devise an approach that does not raise the specter of wholesale countervailability of government aid provided in Russia.

III. The WTO Subsidy Regime

On the eve of China's accession, the WTO anti-subsidy regime which China proposes to join is in a state of flux. Two recent developments, discussed by other presenters this evening, illustrate the uncertainties.

A. The *UK Bar* Decision

It remains to be seen what is left of subsidy disciplines, as a practical matter, after the Appellate Body decision in *United States -- Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/5 ("*UK Bar*"). In *UK Bar*, the Appellate Body upheld a panel's decision that, on the precise facts presented, a change in ownership at "fair market value" extinguished billions of dollars in prior subsidies to the entity being sold.

This was a grossly unjust and poorly-reasoned decision on numerous levels, but the key thing to keep in mind here is that the Appellate Body was interpreting Article 1 which is the basic definitional provision of the ASCM. The decision means that changes in ownership can erase prior subsidies in all contexts, not just in the CVD context. Applied broadly (which would be a tragic mistake), such a rule would comprehensively gut the existing negotiated disciplines on domestic subsidies. It would also create a road map for aspiring subsidizers: a government could use massive amounts of money to create and expand production which would not have existed under market conditions, and then by privatizing escape discipline.

Turning back to China, I will conclude with a simple question and confess that I do not know the answer: what happens if China subsidizes, then privatizes?[3]

B. Serious Prejudice and the Developing Countries

The green light (Articles 8 and 9) and dark amber (Article 6.1) provisions of the ASCM expired after an initial 5-year trial period at year-end 1999. Article 6.1 defined "dark amber" subsidies -- subsidies rebuttably presumed to cause "serious prejudice," so that a complaining WTO Member need not prove trade damages in order to obtain a favorable panel decision. This category included subsidies to cover operating losses, direct forgiveness of debt, and subsidies exceeding 5% *ad valorem* when measured on a cost-to-government basis.

The expiration of Article 6.1 raises an important question about the continued possibility of bringing any "serious prejudice" case against a developing country, inasmuch as Article 27.9 specifies that the only "serious prejudice" cases available against developing countries are those based on subsidies of the type described in Article 6.1. It is conceivable that a developing country might argue that, with Article 6.1's expiry, the prohibition on these "serious prejudice" cases is now absolute. The counter-argument, of course, is that Article 27.9 cross-references the types of subsidies mentioned in Article 6.1, not Article 6.1 itself, so that a case based on those types of subsidies would still be valid.

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[3] It was reported on June 30, 2000 that the issues raised by China as "sensitive" in the latest round of working party discussions "relate to privatization subsidies, and subsidies to state trading enterprises." "China WTO Working Party Work Load Raises Doubt on 2000 Accession," *Inside US Trade*, June 30, 2000, at 1, 2.

This "serious prejudice" question applies to all developing countries, but the resolution of the interplay between Articles 27.9 and 6.1 in China's protocol of accession could affect the broader answer in unpredictable ways. For instance, if China explicitly agrees that it is subject to "serious prejudice" cases, then that might be said to imply that developing countries are no longer subject to such cases absent such an explicit agreement. A preferable formula would have China simply commit not to invoke any of the special rules in Articles 27.7, 27.8 and 27.9.[4]

IV. Conclusion

China's accession process has moved a long way toward completion -- including a vote for PNTR in the House of Representatives -- without answers emerging to some of the important questions regarding subsidies. These questions will have to be resolved during what remains of the accession process. Moreover, China is nearing accession at a time when the WTO subsidies regime itself is undergoing potentially profound changes. Resolution of the issues mentioned above will affect WTO Members' ability to discipline and respond to subsidies for years to come.

[4] *See* "China Resists EU Demands for Strong Industrial Subsidies Disciplines," *Inside US Trade* (August 4, 2000).