

THE PROBLEM OF SUBSIDIES AS A MEANS OF PROTECTIONISM: LESSONS FROM THE WTO *EC — AIRCRAFT* CASE

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*In this article, I examine the problem of subsidies in international trade. In this regard, I consider that a possible purpose of international regulation of subsidies is to fight protectionist subsidies, as opposed to subsidies used for other goals. With this purpose in mind, I then consider whether the Agreement on Subsidies and Countervailing Measures ('SCM Agreement')¹ can be said to reflect this purpose. I also discuss whether the interpretations of the SCM Agreement in the *EC — Aircraft*² dispute provide any insights on this issue. The dispute involved alleged subsidies to the aircraft maker Airbus by the European Union and certain member state governments, and has been one of the highest profile and most commercially significant disputes in the history of the WTO. The issues in the case were extensively argued by two of the leading WTO members, and thus its findings on these issues are particularly significant. Reviewing the *EC — Aircraft* Panel and Appellate Body findings on a number of specific legal issues, I conclude that a case can be made that the SCM Agreement and the *EC — Aircraft* dispute reflect an underlying purpose of the SCM Agreement of fighting protectionism.*

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¹ *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1A ('*Agreement on Subsidies and Countervailing Measures*') ('*SCM Agreement*').

² Panel Report, *European Communities and Certain Member States — Measures Affecting Trade in Large Civil Aircraft*, WTO Doc WT/DS316/R (30 June 2010, adopted 1 June 2011) ('*EC — Aircraft*'); Appellate Body Report, *EC — Aircraft*, WTO Doc WT/DS316/AB/R, AB-2010-1 (18 May 2011, adopted 1 June 2011).

I INTRODUCTION

The WTO disputes between the United States and the European Union on subsidies to their respective aircraft manufacturers, Boeing and Airbus, are some of the most high profile and commercially significant disputes in the history of the WTO. They deal with a number of important legal interpretations of the WTO's *Agreement on Subsidies and Countervailing Measures* ('*SCM Agreement*'). The *SCM Agreement* has risen in importance in recent years due, in part, to the very large subsidies and bailouts resulting from the 2008 financial crisis. Government actions of this kind have prompted accusations that these subsidies violate trade rules³ and calls to revise the *SCM Agreement* so as to allow such subsidies.⁴ The Airbus–Boeing dispute arose many years before the crisis (and, in fact, some aspects of it go all the way back to the General Agreement on Tariffs and Trade⁵ days), so it has no direct relationship with the recent developments. Nevertheless, the legal decisions in these cases have the potential to shape the WTO's subsidy rules in several areas, and thus have an impact on the recent financial crisis-related subsidies specifically, and on international subsidies regulation more generally. With the *SCM Agreement* currently in the limelight, and WTO panels and the Appellate Body undertaking interpretations that have important systemic implications, questions about the fundamental basis of subsidies regulation arise: why are there disciplines on subsidies, and what goals should the international regulation of subsidies pursue?

In this article, I look at international subsidies regulation and the *EC — Aircraft* case⁶ through the lens of one of the possible purposes of subsidies disciplines: fighting protectionism. I first discuss the issue of how subsidies, which can be used for many reasons, cause problems in the area of trade policy. In this context, I briefly examine the origins of governmental attempts to regulate subsidies as a way to rein in 'indirect protectionism' at the economic conferences held by the League of Nations in the 1920s and 1930s (these talks provide a rich source of thinking about subsidies regulation, and I come back to them in other parts of this article). Next, I examine the final product of the Uruguay Round subsidies talks, the *SCM Agreement*, which provides the main international subsidies rules of today, and which could be seen as targeting 'protectionist' measures. I then turn to an important recent paper on the subject by Professor Alan Sykes, who questions the desirability of international subsidies regulation

³ See, eg, Global Subsidies Initiative, *Will Government Bailouts Lead to Trade Wars?* (5 March 2009) <<http://www.globalsubsidies.org/en/subsidy-watch/analysis/will-government-bailouts-lead-trade-wars>>; James Bacchus, *After the Bailout, Tariffs?* (19 December 2008) *Forbes* <http://www.forbes.com/2008/12/19/trade-tariffs-autos-oped-cx_jb_1219bacchus.html>.

⁴ See, eg, Julia Qin, 'Rethinking WTO Subsidy Rules: Should the SCM have an Escape Clause?' on WorldTradeLaw.net, *International Economic Law and Policy Blog* (25 December 2008) <<http://worldtradelaw.typepad.com/ielpblog/2008/12/rethinking-wto-subsidy-rules-should-the-scm-have-an-escape-clause.html>>; Global Subsidies Initiative, above n 2.

⁵ As established by *General Agreement on Tariffs and Trade*, opened for signature ('*GATT 1947*'). *GATT 1947* obligations are now incorporated into the *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1A ('*General Agreement on Tariffs and Trade 1994*') ('*GATT*').

⁶ Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R; Appellate Body Report, *EC — Aircraft*, WTO Doc WT/DS316/AB/R, AB-2010-1.

and the idea of ‘protectionism’ as the relevant basis for regulating subsidies.⁷ Finally, I explore the findings of the WTO panel⁸ and Appellate Body⁹ in the *EC — Aircraft* case, which deal with subsidies given to Airbus.¹⁰ These reports provide important guidance on a number of key *SCM Agreement* interpretive issues, and help illuminate its scope. In examining the reports, I focus on certain findings that could support the idea of protectionism as the basis for international disciplines on subsidies.

II THE PROBLEM WITH SUBSIDIES (IF THERE IS ONE): SUBSIDIES REGULATION AS A WAY TO FIGHT PROTECTIONISM

One of the fundamental issues with international subsidies regulation is trying to distinguish between ‘good’ and ‘bad’ subsidies. The problem was recognised in the earliest days of attempts at subsidies regulation. Discussions of the issue of subsidies during the League of Nations economic conferences in the 1920s and 1930s illustrate the difficulty of this issue. At a 1933 conference, the German delegation explained the distinction as being between ‘natural’ and ‘artificial and unnatural’ measures:

The Sub-Commission must, therefore, exclude from its deliberations all measures which without directly affecting the interests of other countries, sub-serve the *natural* reconstruction of the national economic system, and should only consider measures of support which give to production an *artificial and unnatural* advantage at the expense of foreign competitors.¹¹

The US delegate later questioned whether this approach offered a workable solution to the problem of distinguishing good and bad subsidies:

Reference has been made to ‘uneconomic subsidies’. I feel certain that very considerable differences of opinion might arise with regard to the interpretation of any resolution or covenant condemning uneconomic subsidies. It is my recollection that the Chairman defined such subsidies as a form of ‘unnatural assistance’. Even though we take the definition as something more concise than the term defined, I think that there might still be considerable divergence of views as to the meaning of any prohibition or condemnation of unnatural assistance.¹²

In this section, I suggest that ‘protectionism’ may be a useful concept in developing a distinction between good and bad subsidies. In doing so, I describe briefly the relationship between subsidies and protectionism, and how subsidies can be used for protectionist purposes in ways that cause trade conflict.

⁷ Alan Sykes, ‘The Questionable Case for Subsidies Regulation: A Comparative Perspective’ (2010) 2 *Journal of Legal Analysis* 473.

⁸ Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R.

⁹ Appellate Body Report, *EC — Aircraft*, WTO Doc WT/DS316/AB/R, AB-2010-1.

¹⁰ The panel report in the case related to subsidies given to Boeing was circulated on 31 March 2011: Panel Report, *United States — Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, WTO Doc WT/DS353/R (31 March 2011). The Appellate Body report has not been circulated at the time of this article.

¹¹ League of Nations, *Monetary and Economic Conference: Reports Approved by the Conference on July 27th 1933, and Resolutions Adopted by the Bureau and the Executive Committee*, Doc C.435.M.220. (17 July 1933) 34 (emphasis in original).

¹² *Ibid* 39.

Subsidies have been defined broadly as '[a] payment by a government to a firm or household that provides or consumes a commodity'.¹³ Subsidies can be used for many purposes, many of which do not raise concerns related to trade policy. For example, a government might give direct financial assistance to poor people to help them purchase food or housing. It is difficult to imagine how such actions would generate trade friction. However, there are other types of subsidies that do lead to conflict. To take the example of the *EC — Aircraft* case, if there are two competing aircraft makers, operating in different countries, and the government of the country in which each company is based gives the domestic company some kind of aid, this aid could be seen as a way to favour the domestic over the foreign producer. It is these kinds of actions that make subsidies an important problem in trade policy.

Traditionally, tariffs and quotas were the main instruments for protecting domestic producers. By the early 1900s, though, subsidies had begun to play a greater role. In part, this may have been due to the restrictions countries had imposed on themselves through trade agreements that limited the use of tariffs and quotas. With less flexibility to use these measures, governments turned to subsidies and other means, recognising that they can be just as effective in achieving the goals of protectionism. Economists Paul Samuelson and William Nordhaus provide the following hypothetical example: 'if Switzerland desires to maintain its watch industry, it may provide [subsidies in the form of] low-interest (or subsidized) loans to watch manufacturers'.¹⁴

At the same time, it must be acknowledged that subsidies work very differently from tariffs and quotas. According to Samuelson and Nordhaus, '[s]ubsidies ... are more visible and can be debated openly; they do not raise all prices, but only those of the subsidized goods or workers; and they are subject to periodic review by legislatures'.¹⁵ While tariffs and quotas raise prices for consumers, subsidies may actually lower them, depending on how they are structured and used. In addition, tariffs and quotas are paid for by consumers, often in a way that is hidden. By contrast, subsidies are paid for very visibly by taxpayers, which should provide a natural constraint.

In practice, however, the proliferation of subsidies over the years might indicate that such constraints are not all that great. Although there are differences, to a large extent the various measures — tariffs, quotas and subsidies — can be, and are, used for the same purposes. The essence of the problem is that while subsidies may be used for other purposes, they can quite easily be used as a form of protectionism. As Professor Donald Regan puts it, in the context of discussing the regulation of state protectionism under the US dormant commerce clause:

A carefully calibrated subsidy that was passed on to consumers in a relatively competitive market could achieve a substantial redirection of business to local

¹³ Paul A Samuelson and William D Nordhaus, *Economics* (McGraw-Hill, 13th ed, 1989) 982.

¹⁴ *Ibid* 926.

¹⁵ *Ibid*. In *GATT* negotiations, the US made a similar point: 'The United States Delegation felt that subsidies were preferable to import restrictions or tariffs. Subsidies kept prices down and demand up. They were expansionist rather than contractionist measures.' *Preparatory Committee of the International Conference on Trade and Employment*, UN ESCOR, 2nd Comm, 6th mtg, UN Doc E/PC/T/C.II/37 (1 November 1946) 8.

producers at very little cost. The state might get so much market distortion for its subsidy dollar that the expense of providing this benefit to locals would not be an effective constraint.¹⁶

At this point, it is worth explaining what is meant by protectionism. Samuelson and Nordhaus describe it as '[a]ny policy adopted by a nation to protect domestic industries against competition from imports'.¹⁷ This is a broad definition, encompassing any measure that favours domestic producers over foreign producers in the domestic market, but with implications for competition in foreign markets as well. As suggested with the Swiss watch example noted above, subsidies can play this role quite well. This concern was recognised early on in the multilateral discussion of subsidies. During the League of Nations economic conferences in the 1920s and 1930s, governments of the major trading nations talked about the possibility of a 'tariff truce', under which they would, through trade agreements, agree to lower tariffs.¹⁸ However, in this context, they recognised that 'indirect protectionism' of various kinds could undermine the benefit of these tariff cuts. For example, a government might cut tariffs but then take other actions which make sales of the product in question more difficult. One such action was subsidies to competing domestic producers. In this regard, a 1927 report from a World Economic Conference stated the following in the context of discussing 'indirect means of protecting national trade':

The fact that subsidies are in certain circumstances held to interfere less with the liberty of trading than Customs tariffs does not make it any the less necessary to lay stress on the hidden dangers inherent in this means of encouraging production and exportation. The greater the number of countries which have recourse to this practice, the more difficult will it be for other countries to refrain from following their example. Thus the attempt to restore foreign trade to normal conditions meets with a real obstacle in the shape of subsidies.¹⁹

The concerns expressed by the report reflect the fact that at their core, subsidies can act as protectionism by giving financial assistance to domestic producers while not giving this same assistance to competing foreign producers. All else being equal, the domestic producer will, as a result of the subsidies, be better off than its competitors. In addition to the simple fact that aid is received by domestic producers, but not foreign ones, subsidies can also be tied to various conditions (such as export contingency and domestic content requirements) that provide additional elements that favour domestic producers.

A related point is the difference between subsidies to *consumers* and subsidies to *producers*.²⁰ Taking the example of subsidies for more fuel-efficient vehicles, such as electric cars, one way to offer subsidies for such vehicles is to subsidise the *producers* of the cars. For example, money could be given directly to the

¹⁶ Donald H Regan, 'The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause' (1986) 84 *Michigan Law Review* 1091, 1196.

¹⁷ Samuelson and Nordhaus, above n 13, 980.

¹⁸ Economic, Financial and Transit Department, League of Nations, *Commercial Policy in the Interwar Period: International Proposals and National Policies* (1942) 53, 62.

¹⁹ League of Nations, *Report and Proceedings of the World Economic Conference: Held at Geneva, May 4th to 23rd, 1927*, Doc C.356.M.129. (December 1927) 44.

²⁰ Recall the definition of 'subsidy' quoted above, which includes both subsidies to producers and to consumers: Samuelson and Nordhaus, above n 13 and accompanying text.

companies that make the cars, in order to encourage them to make more of them. Although in theory this money could be given to any and all producers, in practice it tends to go to domestically-owned producers. Thus, it favours domestic over foreign producers as competitors in the industry. By contrast, an alternative approach would be to subsidise *consumers* of such vehicles. For example, a government could offer a tax credit to consumers who buy these cars. Because the latter approach does not distinguish between producers, it is much less likely to discriminate among domestic and foreign producers (it might have a de facto effect, if more domestic producers make such vehicles than foreign producers, but on its face the measure is neutral). Thus, it may be that a good way to discourage subsidies that act as protectionism is to use international rules to push governments to subsidise consumption rather than production. I will return to this issue later.

I have so far discussed protectionism in the abstract. In addressing the issue of subsidies as a form of protectionism, a key point is how to separate good (non-protectionist) and bad (protectionist) subsidies. In the next section, I examine how *GATT*/WTO rules do this (if, in fact, that is what they do, a point which is open to debate).

III INTERNATIONAL SUBSIDIES REGULATION THROUGH THE *SCM AGREEMENT*

The countries involved in the discussion of subsidies during the various League of Nations economic conferences noted above could not in the end reach agreement on how to regulate subsidies. Later, the *GATT 1947* made some progress on subsidies regulation, with limited rules on certain kinds of products. *GATT* art XVI provided some constraints, and *GATT* rules allowed for countervailing duties to be taken by governments against foreign subsidies.²¹ Also, the non-violation remedy was available for such measures.²² Ultimately, though, *GATT* rules on subsidies left many holes. When it came to considering subsidies as a form of ‘protectionism’, for example, the *GATT* art III:8(b) exemption carved out an important form of subsidies (payments to domestic producers) from the national treatment obligations.²³ In other words, the core anti-protectionism rule of *GATT 1947* did not apply to certain subsidies. Most likely, the governments recognised that even if in theory using subsidies as a form of protectionism was bad, in practice it would be going too far to impose a prohibition on these commonly used measures.

While at the time of the *GATT 1947* conferences governments did not have the will to regulate subsidies as protectionism, arguably the current subsidies rules, as set out in the *SCM Agreement*, do a reasonably good job of identifying protectionism and reining in protectionist subsidies. In this section, I examine the current rules.

²¹ *GATT* arts XVI, VI.

²² *Ibid* art XXIII:1(b).

²³ *Ibid* art III:8(b). The French delegate to the 1948 UN *Conference on Trade and Employment* explained that this provision had been added ‘because it was felt that if subsidies were paid on domestic and not on imported products, it might be construed that Members were not applying the “national treatment” rule’: United Nations Conference on Trade and Employment, *Reports of Working Party 3 (Article 18) and Working Party 4 (Article 19)*, 3rd Comm, Sub-Comm A, 33rd mtg, UN Doc E/CONF.2/C.3/A/W.49 (10 February 1948) 2.

The definition of subsidies set out in art 1 of the *SCM Agreement* establishes the elements of a subsidy. There must be a ‘financial contribution’ or income/price support that confers a ‘benefit’. The main types of financial contribution are: direct or potential direct transfers of funds; foregone revenue; government provision of goods/services; and purchases of goods. These are fairly broad categories of government actions, but they are limited somewhat by the ‘benefit’ requirement. For example, if a government loans money to a company, that is a ‘financial contribution’. However, if the loan is on market terms, there is no ‘benefit’. The subsidy definition does not try to distinguish between good and bad subsidies. Instead, it simply sets out the boundaries of which government measures are covered by the *SCM Agreement*.

Other *SCM Agreement* provisions, however, act as a filter, and attempt to identify certain bad subsidies. The *SCM Agreement* rules created three categories of subsidies. First, there is the category of *prohibited* subsidies, under which there is a per se prohibition of subsidies with certain characteristics.²⁴ Second, there is the category of *actionable* subsidies, under which the effects of ‘specific’ subsidies are examined.²⁵ And third, there was (the provisions have expired) the category of *non-actionable* subsidies, under which subsidies for certain purposes were permitted.²⁶ I will examine each category in turn. There is nothing explicit in the *SCM Agreement* explaining what makes a subsidy bad. But as we will see, a case could be made that the subsidies being targeted by the rules are those that discriminate against foreign competitors, that is, protectionist subsidies.

A *Prohibited Subsidies*

There are two types of subsidies covered in the ‘prohibited subsidies’ category in the *SCM Agreement*: export subsidies and domestic content subsidies.²⁷ Under art 3.1(a), export subsidies are subsidies that are ‘contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance’.²⁸ This standard has been elaborated in a number of cases, including *EC — Aircraft*, and I will look at it in more detail below. Briefly, export subsidies inherently favour domestic goods that are exported over competing foreign goods in export markets. By their very nature, they give an advantage to the domestic goods by discriminating in favour of domestic goods as compared to goods made by foreign competitors. With a production subsidy, it is not clear that a foreign competitor even exists, as it is possible that the products are only sold in the domestic market. By contrast, with an export subsidy, it is almost certain that the subsidy is designed to assist the domestic producer against its competitors in foreign markets.

The distinction between export subsidies and production subsidies was recognised early on in the subsidies debate, with parties taking different views.

²⁴ *SCM Agreement* pt II.

²⁵ *Ibid* pt III.

²⁶ *Ibid* pt IV.

²⁷ *Ibid* pt II.

²⁸ *Ibid* art 3.1(a) (citations omitted).

In this regard, at the 1933 League Conference, the French delegation took the view that

a distinction must be drawn between bounties and subsidies for *production* on the one hand and bounties and subsidies for *export* on the other. The former might be justified by the need of obviating the dangerous social consequences which the disappearance or stoppage of particular industries or undertakings might bring about. In so far as they affected the national economy only, they could not properly form the subject of international agreements.²⁹

During the *GATT* negotiations, after the US delegate suggested that production subsidies should generally be permitted, whereas export subsidies should generally be prohibited. An opposing view was suggested by the Australian delegate:

The great objection to subsidies for primary products was that they had the effect of stimulating production, thus glutting the world market. Australia did not mind what form of support was given to the producers, as long as it had not an adverse effect on the world market. Many difficulties were due to subsidies being given by importing countries. He could see no validity to the distinction between production and export subsidies, as both gave price support, and the incidence could be the same in both cases.³⁰

The Brazilian delegate, reflecting Australia's views, likewise stated that:

It was difficult for countries largely dependent on export trade to draw a line between export subsidies and production subsidies. Subsidies could create great difficulties for the smaller country, which would not be able to stand the competition of larger countries, especially from a financial point of view. It was for this reason that Brazil was strongly opposed to the granting of any kind of subsidies.³¹

In support of the Australian and Brazilian views, it is clear that export subsidies and producer subsidies can be used for the same purposes. As an illustration, if an export subsidy was being provided, but by virtue of a WTO ruling the government was required to withdraw the subsidy, it could simply provide the same amount without the export contingency, with no clear change in impact on the domestic and foreign producers. On the other hand, export subsidies encourage export, whereas production subsidies do not necessarily have this effect, and hence the impact on trade is clearer with export subsidies. Thus, there seems to be an overlap between the two; they are neither identical nor completely distinct.

The second category of prohibited subsidies is domestic content subsidies. Like export subsidies, which in a sense involve discrimination that is tied to a subsidy, these subsidies also discriminate by their nature. Under art 3.1(b) of the *SCM Agreement*, domestic content subsidies are defined as subsidies that are 'contingent, whether solely or as one of several other conditions, upon the use of

²⁹ League of Nations, *Monetary and Economic Conference: Reports Approved by the Conference on July 27th, 1933, and Resolutions Adopted by the Bureau and the Executive Committee*, Doc C.435.M.220. (27 July 1933) 34 (emphasis in original).

³⁰ *Preparatory Committee of the International Conference on Trade and Employment*, UN ESCOR, 2nd Comm, 6th mtg, UN Doc E/PC/T/C.II/37 (1 November 1946) 7-8.

³¹ *Ibid* 9.

domestic over imported goods'. To some extent, this provision overlaps with the general national treatment requirement of *GATT* art III:4, as certain kinds of local content requirements could violate both provisions. As with export subsidies, by their nature these subsidies give an advantage to domestic goods as compared to a foreign competitor, this time in the home market.

Both of these provisions apply a per se prohibition on certain subsidies that discriminate against foreign products. No other evidence is needed. After examining the terms of the subsidy measure and/or its operation, if the art 3.1 provisions are satisfied, there is a violation.³² Under art 2.3, the 'specificity' requirement discussed below is deemed to have been met for prohibited subsidies.³³ This is perhaps based on the view that with prohibited subsidies, you do not need specificity, because the design, structure, and architecture of the measures show the existence of intent/effect. I will return to the role of intent and effect later.

B *Actionable Subsidies*

A second category of subsidies are 'actionable' subsidies.³⁴ Pursuant to pt III of the *SCM Agreement*, subsidies that are 'specific' may be challenged if they cause 'adverse effects', which can be:

- (a) injury to the domestic industry of another Member;
- (b) nullification or impairment of benefits accruing directly or indirectly to other Members under *GATT 1994* in particular the benefits of concessions bound under Article II of *GATT 1994*;
- (c) serious prejudice to the interests of another Member.³⁵

All of these 'effects' are forms of economic harm. I will not go into much detail here, but to take an example, art 6.3(a) provides that serious prejudice may arise where 'the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member'.³⁶

But this economic harm is not sufficient to find a violation. As noted, the subsidies at issue must also be 'specific'. Article 2 sets out in detail what this means. Article 2.1(a) establishes the simplest case, involving explicit limits of the subsidy to certain enterprises: 'Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.'³⁷ Article 2.1(b) then describes a situation where there is no specificity:

Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided

³² *SCM Agreement* art 3.1.

³³ *Ibid* art 2.3.

³⁴ *Ibid* pt III.

³⁵ *Ibid* art 5 (citations omitted).

³⁶ *Ibid* art 6.3(a).

³⁷ *Ibid* art 2.1(a).

that the eligibility is automatic and that such criteria and conditions are strictly adhered to.³⁸

Finally, art 2.1(c) provides for a more general test that can establish de facto specificity:

If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.³⁹

Taking these various aspects of the specificity standard all together, it seems that specificity means the singling out of certain companies/industries. The question is: why does such a standard exist? One answer is that singling out companies/industries in this way could be taken as an indication that the intent of the measure is to favour those companies/industries. As for the 'adverse effects', as noted, this term entails economic harm. The combined presence of both elements suggests the favouring of domestic companies/industries at the expense of foreign competitors was the purpose of the measure and had that effect. Thus, arguably, these elements together serve to identify protectionism. Unlike prohibited subsidies, these subsidies are not protectionist by nature. However, on a case-by-case basis, subsidies will be evaluated to see if the required elements are met.

C *Non-Actionable Subsidies*

A final category is subsidies used for specific purposes which make them 'non-actionable'.⁴⁰ These provisions expired five years after the *SCM Agreement* came into force.⁴¹ Under these provisions, even if these subsidies were 'specific' and caused 'adverse effects', they would nevertheless be permitted. Under art 8.2, three specific purposes are set out: certain research and development activity; financial assistance to poor regions; and certain environmental protection programs.⁴² These purposes are very narrow and targeted. There are no broad exemptions like those in *GATT* art XX. Nevertheless, the existence of an exemption for non-protectionist purposes does fit within a framework of thinking about the *SCM Agreement* as targeting only protectionist measures and excluding non-protectionist ones.

D *Conclusions on Existing SCM Agreement Rules*

As noted, the *SCM Agreement* does not explicitly say that it targets discrimination or protectionism. However, when examining the terms of the *SCM Agreement*, it is plausible to say that these are the principles upon which

³⁸ Ibid art 2.1(b) (citations omitted).

³⁹ Ibid art 2.1(c) (citations omitted).

⁴⁰ Ibid pt IV.

⁴¹ Ibid art 31.

⁴² Ibid art 8.2.

the rules were based, at least to some extent. Arguably, the existing rules do a reasonably good job of identifying protectionism, regardless of whether this is what the drafters had in mind.

IV RETHINKING SUBSIDIES REGULATION: THE SYKES CRITIQUE

The League of Nations talks considered subsidies to represent a form of indirect protectionism.⁴³ Can today's subsidies regulation reasonably be thought of as a way to restrict protectionism? In a recent article in the *Journal of Legal Analysis*, Professor Alan Sykes analyses the regulation of subsidies under US, EU and WTO law, and calls into question the idea that subsidies should be regulated. He suggests that perhaps the laissez-faire approach under the US federal system is preferable. He also seems sceptical of the idea that subsidies regulation can be seen as a way to fight protectionism. In this section, I examine some of the key aspects of Sykes' rationale for his conclusions.

First, Sykes criticises the inconsistency of the existing rules. In this regard, he discusses 'import substitution' subsidies as follows:

Recall that *GATT* Article III(8)(b) exempts 'the payment of subsidies exclusively to domestic producers' from the national treatment obligation. Accordingly, a *GATT* panel held in *Italian Discrimination against Imported Agricultural Machinery* that a low interest loan program available to *purchasers* of certain Italian-made farm machinery was a violation of Article III. A closely related principle was later enshrined in the WTO *SCM Agreement*, which places import substitution subsidies — 'subsidies contingent ... upon the use of domestic over imported goods' — into the category of prohibited subsidies.

The blanket prohibition on import substitution subsidies seems odd. Imagine a subsidy to a domestic purchaser of an Italian tractor equal to 500 euros, a subsidy that is clearly illegal. Now imagine instead a subsidy to the Italian tractor manufacturer of 500 euros per tractor sold. If the manufacturer does not export (or if the subsidy to the manufacturer is limited to units sold domestically), the economic effects of the two subsidies are identical. The producer subsidy shifts the supply curve inward, while the purchaser subsidy shifts the demand curve outward by a comparable amount. The effect on the equilibrium number of sales by the manufacturer, and thus the effect on foreign manufacturers seeking to sell tractors in Italy, will be the same. It thus seems peculiar for the law to condemn the purchaser subsidy but potentially to allow the producer subsidy.⁴⁴

Sykes' example is designed to show that it does not make sense to prohibit local content subsidies when regular producer subsidies are not covered, as the two have the same effect. One conclusion to draw is that perhaps neither should be prohibited. Another reaction to this inconsistency, though, is that both kinds of subsidies should be covered, although in slightly different ways due to their different natures. Import substitution subsidies represent a clear case of discrimination in favour of domestic over imported goods. Subjecting import substitution subsidies to the strong disciplines that apply to prohibited subsidies seems appropriate, as the discriminatory effect and intent are clear with these kinds of subsidies. As a result, we can ban them *per se*. By contrast, with other

⁴³ League of Nations, *Report and Proceedings of the World Economic Conference: Held at Geneva, May 4th to 23rd, 1927*, Doc C.356.M.129. (December 1927) 44.

⁴⁴ Sykes, above n 7, 518 (emphasis in original) (citations omitted).

kinds of producer subsidies under the *SCM Agreement* rules, we need to use an effects test to determine whether there is a violation. In essence, under the existing rules, import substitution subsidies are banned because they are inherently protectionist. If it can be shown that producer subsidies are inherently protectionist, then arguably they should also be banned entirely. If, however, they are only considered protectionist in particular circumstances, the rules should be tailored to those circumstances, which, arguably, is what the 'adverse effects' rules do.

This raises the question of how to identify protectionism. Earlier in his article, Sykes recognises the objective of 'free trade' as a possible purpose of the WTO.⁴⁵ He is sceptical, though, noting the following:

A different perspective on the role of subsidies regulation arises if the goal of interjurisdictional cooperation is the attainment of free trade, and not merely enhanced market access. This assumption is quite implausible with respect to the WTO, which has never had the objective of eliminating all trade barriers, much less all government policies that might be deemed inefficient. ...

Although the rationale for general disciplines on subsidies is different under the assumption that free trade is the objective, its implications for appropriate legal rules are much the same. The challenge for the legal system is to identify subsidies that are protectionist, and to discipline protectionist subsidies while leaving governments free to use subsidies for other purposes. General subsidies disciplines become suspect if they are poorly suited to this task.⁴⁶

Later, he goes into more detail on this issue:

an important question remains: is the subsidy one that ought to be condemned? Following the discussion in Section 4.2, this question comes down in substantial part to the question of whether the subsidy is protectionist or not. Thus, consider the legal rules that are used to identify unacceptable government subsidies, and how well they map to the goal of identifying protection.⁴⁷

In this regard, Sykes considers both the specificity test⁴⁸ and the idea of injury as a test,⁴⁹ but deems each of them to be inadequate for the task of identifying protectionism.

He may be right that these tests *on their own* are not sufficient to identify protectionism. However, combining the two might lead to a different conclusion. If you can show both specificity *and* injury, perhaps that demonstrates a protectionist intent/effect. Both of the factors provide some indication that a subsidy was intended to favour domestic producers over foreign producers. On their own, each might not be enough. But if both are present, perhaps we can say with some degree of certainty that the measure is protectionist.

Turning to export subsidies, in his examination of the *SCM Agreement's* *per se* prohibition on export subsidies, Sykes calls them a 'mixed bag'.⁵⁰ He says

⁴⁵ Ibid 498.

⁴⁶ Ibid 498–9.

⁴⁷ Ibid 511.

⁴⁸ Ibid 511–15.

⁴⁹ Ibid 515–16. He also considers marginal cost, but his reasons for rejecting this as a test appear strong and I do not address them here.

they can be a positive response to foreign trade barriers that have artificially lowered the volume of trade.⁵¹ On the other hand, he notes that they are only a second best solution, and that they may threaten negotiated market access.⁵² On this basis, he is sceptical of a blanket prohibition on such subsidies.⁵³

It is worth noting, however, that export subsidies inherently favour domestically-produced exported goods over competing foreign goods when they are sold in export markets. By their very nature, they discriminate in favour of domestic goods through the advantage they provide. Thus, we can look at the basic characteristics of export subsidies and conclude that they are protectionist. The same goes for import substitution subsidies.

So is Sykes' critique convincing? Should we be regulating subsidies at all? Ultimately, this may depend on one's view of how easy it is to identify 'good' and 'bad' subsidies, and whether the rules, as currently set up or under some theoretical approach, inappropriately deter the use of 'good' subsidies. Sykes is sceptical of the ability to regulate this area effectively. While I have suggested that the existing rules may be seen as restricting 'bad' subsidies while allowing 'good' subsidies (on the basis of whether they are protectionist), I do not attempt to provide a full answer to these points in this article. However, the reader can think about the issue in the context of the various subsidies under consideration in *EC — Aircraft* by considering the following questions: can these subsidies be deemed protectionist, and should these kinds of subsidies be constrained under international rules?

We will now look at how the rules were applied in *EC — Aircraft*. I begin with a brief overview of the dispute in Part V. This dispute has been both lengthy (it has been six years from the time of the consultations request to the circulation of the Appellate Body report) and complex (in terms of both legal and factual issues), necessitating a fairly short treatment here. I then focus on three issues that could indicate that identifying protectionism played a role in the Panel and Appellate Body rulings.

V THE WTO *EC — AIRCRAFT* PANEL AND APPELLATE BODY REPORTS ON SUBSIDIES TO AIRBUS

US claims in the *EC — Aircraft* dispute concerned alleged subsidies by the EU and certain member states to the aircraft industry, in particular to the various Airbus companies. As noted by the Panel, the US complaint

alleges more than 300 separate instances of subsidization, over a period of almost forty years, by the European Communities and four of its member states, France, Germany, Spain and the United Kingdom, with respect to large civil aircraft ('LCA') developed, produced and sold by the company known today as Airbus SAS.⁵⁴

⁵⁰ Ibid 517.

⁵¹ Ibid 516.

⁵² Ibid 516–17.

⁵³ Ibid 517–18.

⁵⁴ Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [7.1] (citations omitted).

The Panel grouped these measures into five general categories,⁵⁵ as follows:

- ‘Launch Aid’/Member State Financing (‘LA/MSF’): The provision by France, Germany, Spain and the UK of financing for large civil aircraft design and development to the Airbus companies. This financing is alleged to provide benefits to the recipient companies, such as below-market interest rates and a repayment obligation that arises only upon successful sales.
- Design and Development Financing Loans: The provision by the European Communities and the member states, through the European Investment Bank (‘EIB’), to the Airbus companies of financing for large civil aircraft design, development, and other purposes.
- Infrastructure and Related Grants: The provision by the European Communities and the member states of financial contributions to develop, expand, and upgrade facilities and other infrastructure for the Airbus companies.
- Corporate Restructuring Measures (Debt Forgiveness, Equity and Grants): The assumption and forgiveness by the European Communities and the member states of debt resulting from Launch Aid and other financing for large civil aircraft development and production and the provision by the European Communities and the member states of equity infusions and grants, including through government-owned and government-controlled banks.
- Research and Development: The provision by the European Communities and the member states of financial contributions for aeronautics-related research, development, and demonstration undertaken by Airbus, whether alone or with others, or in any other way to the benefit of Airbus.

As explained by the Panel, the products at issue in the dispute are large civil aircraft (‘LCA’), as distinguished from smaller (regional) aircraft and military aircraft.⁵⁶ LCA are generally large (weighing over 15 000 kilograms) ‘tube and wing’ aircraft, with turbofan engines carried under low-set wings, designed for subsonic flight. LCA are designed for transporting 100 or more passengers and/or a proportionate amount of cargo.

In terms of companies in the industry, LCA are presently produced only by Boeing (a US company) and Airbus (a European company), which both sell a range of LCA models worldwide. Both companies engage in continued development of LCA, which requires significant up-front investments over a period of 3–5 years before any revenues are obtained.

As noted, the focus of this dispute was alleged subsidies to Airbus. As the Panel explained:

Prior to 2001, no single legal entity produced the family of Airbus LCA ... Airbus LCA was produced by a consortium of French, German, Spanish and (from 1979)

⁵⁵ *Ibid.*

⁵⁶ *Ibid* [2.1].

United Kingdom aerospace companies (the Airbus partners), operating in a form of partnership arrangement through the French entity, Airbus GIE. ... In 2000, the Airbus partners consolidated their LCA-related activities under EADS [the European Aeronautic Defence and Space Company EADS NV]. This consolidation involved each of the French, German and Spanish Airbus partners placing their Airbus-related design, engineering, manufacturing and production assets and activities ... into legal entities that would become wholly owned subsidiaries of the newly formed EADS, in return for shares in EADS representing the agreed values of the Airbus partners' corresponding contributions. In 2001, EADS and [Airbus' British partner] BAE Systems placed their Airbus-related assets and operations and their membership rights in Airbus GIE under the common control of a newly-created holding company, Airbus SAS. Finally, in 2006, EADS purchased BAE Systems' 20 percent interest in Airbus SAS, and Airbus SAS became a wholly-owned subsidiary of EADS.⁵⁷

Broadly speaking there were two categories of claims: (1) export subsidies and (2) 'adverse effects'. With regard to export subsidies, the US claimed that the challenged LA/MSF measures are prohibited export subsidies within the meaning of *SCM Agreement* art 3.1(a).⁵⁸ In addition, the US claimed that *each* of the challenged measures is a specific subsidy within the meaning of *SCM Agreement* arts 1 and 2, and that the European Communities and the four member states, through the use of these subsidies, caused adverse effects to US interests under the *SCM Agreement*.⁵⁹ The adverse effects claims involved allegations of both 'injury' under art 5(a) and serious prejudice under arts 5(c) and 6.3.⁶⁰

The Panel ruled on these claims as follows. In addressing the adverse effects claims, the Panel considered each measure under the relevant *SCM Agreement* provisions. The *SCM Agreement* only applies to 'specific subsidies', so the initial issues to consider were: (1) is there a subsidy; and (2), if so, is it 'specific'?

With regard to whether there is a subsidy, under *SCM Agreement* art 1.1 there are two elements: is there a 'financial contribution', and, if so, does that financial contribution confer a benefit? With regard to 'financial contribution', the focus here was on issues of *direct and potential direct transfers of funds* under art 1.1(a)(1)(i) and *provision of goods and services* 'other than general infrastructure' under art 1.1(a)(1)(iii).⁶¹ As to 'benefit', the Panel considered whether the measures provided the financial contribution on terms that are more favourable than those available on the market.⁶²

In addition, the Panel examined whether the subsidies at issue were 'specific', in the sense of going to 'an enterprise or industry or group of enterprises or industries'.⁶³ Here, the Panel focused on *de jure* specificity under art 2.1(a),⁶⁴ *de facto* specificity under art 2.1(c)⁶⁵ and regional specificity under art 2.2.⁶⁶

⁵⁷ Ibid [7.183] (citations omitted); see also Appellate Body Report, *EC — Aircraft*, WTO Doc WT/DS316/AB/R, AB-2010-1, [582].

⁵⁸ Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [3.1(a)].

⁵⁹ Ibid [3.1(b)]; Appellate Body Report, *EC — Aircraft*, WTO Doc WT/DS316/AB/R, AB-2010-1, [2]–[4].

⁶⁰ Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [3.1(b)].

⁶¹ *SCM Agreement* arts 1.1(a)(1)(i), (iii).

⁶² See, eg, Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [7.1353].

⁶³ *SCM Agreement* art 2.1; see, eg, *ibid* [7.919].

For those subsidies which were found to be specific (the only category for which none of the challenged measures were found to constitute specific subsidies was the EIB loans),⁶⁷ the Panel considered whether adverse effects had been shown under arts 5 and 6.⁶⁸ In this regard, the following issues were considered under art 6, which involves allegations of serious prejudice:⁶⁹

- Article 6.3(a) — Displacement in EC Market;
- Article 6.3(a) — Impedance in EC Market;
- Article 6.3(b) — Displacement in Third Country Market;
- Article 6.3(b) — Impedance in Third Country Market;
- Article 6.3(c) — Price Undercutting;
- Article 6.3(c) — Price Depression;
- Article 6.3(c) — Price Suppression; and
- Article 6.3(c) — Lost Sales.

The Panel considered separately the issues of: (1) whether serious prejudice exists; and (2) whether serious prejudice has been caused by the subsidies. Ultimately, the Panel found that the subsidies caused the following types of serious prejudice: displacement in the EC market; displacement in third country markets; and lost sales.⁷⁰ As part of an additional ‘adverse effects’ claim, the Panel rejected the claims under art 5(a) related to injury and threat of injury.⁷¹

With regard to export subsidies, the Panel found that some instances of LA/MSF constituted export subsidies, whereas others did not.⁷² In reaching this conclusion, the Panel set out what it considered to be the correct interpretation of the *de facto* export contingency legal standard. In this regard, it said that:

a subsidy may be found to be contingent *in fact* upon *anticipated* export performance, and therefore prohibited under Article 3.1(a), when there is evidence demonstrating the existence of three distinct elements: (i) the granting of a subsidy; (ii) that is tied to; (iii) anticipated exportation or export earnings.⁷³

The Panel noted that:

At the heart of this legal standard is the second element, which reflects the notion of contingency set out in Article 3.1(a). The meaning of ‘contingent’ in Article

⁶⁴ *SCM Agreement* art 2.1(a); see, eg, Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [7.1097].

⁶⁵ *SCM Agreement* art 2.1(c); see, eg, Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [7.1579]–[7.1580].

⁶⁶ *SCM Agreement* art 2.2; see, eg, Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [7.1223]–[7.1242].

⁶⁷ See Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [7.931], [7.935].

⁶⁸ *SCM Agreement* arts 5, 6; see *ibid* [7.1729]–[7.2186].

⁶⁹ *SCM Agreement* art 6; see Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [7.1729]–[7.2028].

⁷⁰ Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [7.2025].

⁷¹ *Ibid* [7.2186].

⁷² *Ibid* [7.689].

⁷³ *Ibid* [7.648] (emphasis in original).

3.1(a) is ‘conditional’ or ‘dependent for its existence upon’. Thus, in order to qualify as a prohibited export subsidy, the grant of the subsidy must be *conditional* or *dependent upon* actual or anticipated export performance.⁷⁴

In this regard, the Panel explained that under this standard, ‘a subsidy must be granted *because* of actual or anticipated export performance.’⁷⁵

The EU filed a notice of appeal alleging various errors in relation to the Panel’s findings of violation, as well as on some systemic issues.⁷⁶ In addition, the US filed a notice of other appeal alleging errors related to certain claims that had been rejected.⁷⁷

On appeal, the Appellate Body reversed some of the Panel’s findings, and upheld others. In some instances, where it reversed the Panel’s findings, it was able to complete the legal analysis and make a finding of its own. In others, it was not. Briefly, its specific findings were as follows.

In terms of the adverse effects issues, the Appellate Body modified and reversed several of the Panel’s findings. However, it upheld the broad thrust of the findings that a large number of the EU subsidies at issue, including LA/MSF, had caused adverse effects, in the form of ‘serious prejudice’ to US interests.⁷⁸ In particular, this serious prejudice was the ‘displacement’ and ‘lost sales’ experienced by Boeing in various markets.⁷⁹

With regard to the issue of export subsidies, the Appellate Body reversed the Panel’s legal interpretation. Rather than focusing on whether a subsidy is granted *because of* actual or anticipated export performance, the Appellate Body said the standard should involve looking at whether the subsidy creates an incentive to export as compared to selling domestically:

Where the evidence shows, all other things being equal, that the granting of the subsidy provides an incentive to skew anticipated sales towards exports, in comparison with the historical performance of the recipient or the hypothetical performance of a profit-maximizing firm in the absence of the subsidy, this would be an indication that the granting of the subsidy is in fact tied to anticipated exportation within the meaning of Article 3.1(a) and footnote 4 of the *SCM Agreement*.⁸⁰

Having reversed the legal interpretation, the Appellate Body was unable to complete the analysis to determine whether any of the LA/MSF subsidies at issue constituted an export subsidy.⁸¹ As a result, the legal status of these

⁷⁴ Ibid (emphasis in original) (citations omitted).

⁷⁵ Ibid (emphasis in original).

⁷⁶ *Revision to the Notification of an Appeal by the European Union under Article 16.4 and Article 17 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), and under Rule 20(1) of the Working Procedures for Appellate Review*, WTO Doc WT/DS316/12/Rev.1 (17 August 2010).

⁷⁷ *Notification of an Other Appeal by the United States under Article 16.4 and Article 17 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), and under Rule 23(1) of the Working Procedures for Appellate Review*, WTO Doc WT/DS316/13 (20 August 2010).

⁷⁸ Appellate Body Report, *EC — Aircraft*, WTO Doc WT/DS316/AB/R, AB-2010-1, [1412].

⁷⁹ Ibid.

⁸⁰ Ibid [1047]; see generally ibid [1040]–[1055].

⁸¹ Ibid [1085]–[1101].

subsidies is uncertain. There is simply no finding on whether any such measures are export subsidies, and such a finding could only be made if a new proceeding were brought.

In addition to these findings, the Panel and Appellate Body also considered a number of important issues of systemic interest, including the following: the proper consideration of the ‘subsidized product’ and the product markets;⁸² the issue of ‘extinguishing’ subsidies through sale of the subsidised company;⁸³ the role of non-WTO legal instruments in interpreting WTO rules;⁸⁴ the consideration of subsidies from many years in the past;⁸⁵ and the appropriate method of appealing issues involving application of the law to the facts.⁸⁶

VI PROTECTIONISM AS THE UNDERLYING FOCUS IN THE *EC — AIRCRAFT* DISPUTE

In this section, I examine three aspects of the Panel and Appellate Body reasoning in *EC — Aircraft* that could be taken as an indication that the core concern in the dispute was protectionism. I do not mean to argue that this reasoning shows conclusively that this panel and the Appellate Body see limiting protectionism as the main goal of the *SCM Agreement*. Rather, I make the more modest claim that the reasoning is consistent with fighting protectionism as an objective, and provides some support for the theory that protectionism is the core of what the *SCM Agreement* is about.

A *Export Subsidies*

Export subsidies are governed by *SCM Agreement* art 3.1(a), which states:

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I⁸⁷

Footnote 4 provides additional detail on contingency ‘in fact’:

This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.⁸⁸

Despite some guidance in previous cases, prior to the *EC — Aircraft* case, there was still a good deal of uncertainty as to the scope of the export contingency ‘in fact’ standard. In addressing this issue, the Panel seems to have

⁸² Ibid [409]–[427].

⁸³ Ibid [718]–[736].

⁸⁴ Ibid [841]–[845].

⁸⁵ Ibid [650]–[690].

⁸⁶ Ibid [1313]–[1316].

⁸⁷ *SCM Agreement* art 3.1 (citations omitted).

⁸⁸ Ibid n 4.

relied on the intent of the measure as the focus of the export contingency standard. In this regard, the Panel said:

Correctly interpreted, the legal standard set out in footnote 4 indicates that a subsidy may be found to be contingent *in fact* upon *anticipated* export performance, and therefore prohibited under Article 3.1(a), when there is evidence demonstrating the existence of three distinct elements: (i) the granting of a subsidy; (ii) that is tied to; (iii) anticipated exportation or export earnings. At the heart of this legal standard is the second element, which reflects the notion of contingency set out in Article 3.1(a). The meaning of ‘contingent’ in Article 3.1(a) is ‘conditional’ or ‘dependent for its existence upon’. Thus, in order to qualify as a prohibited export subsidy, the grant of the subsidy must be *conditional* or *dependent upon* actual or anticipated export performance; or as we have put it above, a subsidy must be granted *because* of actual or anticipated export performance.⁸⁹

Arguably, the reference to the subsidy being granted ‘because of’ export performance refers to the reason for or the motivation behind the subsidy. This is made clearer in this later statement by the Panel:

In our view, a government’s motivation for granting a particular subsidy, to the extent it can be established from the evidence and arguments presented by the parties in dispute, will be highly relevant when evaluating whether a subsidy has been granted contingent in fact upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement*.⁹⁰

On appeal, the Appellate Body reversed the Panel’s interpretation and developed its own approach. With regard to intent, the Appellate Body was critical of the Panel’s reliance on ‘subjective motivations’, although overall the Appellate Body’s discussion of the use of intent seems to accept that it will play a role.⁹¹ In this regard, the Appellate Body explained that

[t]he standard for determining whether the granting of a subsidy is ‘in fact tied to ... anticipated exportation’ is an objective standard, to be established on the basis of the total configuration of facts constituting and surrounding the granting of the subsidy, including the design, structure, and modalities of operation of the measure granting the subsidy.⁹²

That is,

the conditional relationship between the granting of the subsidy and export performance must be objectively observable on the basis of such evidence in order for the subsidy to be geared to induce the promotion of future export performance by the recipient.⁹³

⁸⁹ Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [7.648] (emphasis in original) (citations omitted). See also at [7.644]: ‘we are saying that the required contingency may be demonstrated where the subsidy was granted *because* the granting authority anticipated export performance’. The various findings on specific Airbus subsidies can be found at [7.679]–[7.688].

⁹⁰ *Ibid* [7.675].

⁹¹ Appellate Body Report, *EC — Aircraft*, WTO Doc WT/DS316/AB/R, AB-2010-1, [1050]–[1051].

⁹² *Ibid* [1050].

⁹³ *Ibid*.

Thus, it considered that the standard is ‘not satisfied by the subjective motivation of the granting government to promote the future export performance of the recipient’.⁹⁴ Noting that, in past cases, the Appellate Body and panels have ‘cautioned against undue reliance on the intent of a government behind a measure to determine the WTO-consistency of that measure’,⁹⁵ and recalling its past statement in *US — Offset Act*⁹⁶ that “‘the intent, stated or otherwise, of the legislators is not conclusive” as to whether a measure is consistent with the covered agreement’,⁹⁷ the Appellate Body said that this

same understanding applies in the context of a determination on export contingency, where the requisite conditionality between the subsidy and anticipated exportation under Article 3.1(a) and footnote 4 of the *SCM Agreement* must be established on the basis of objective evidence, rather than subjective intent.⁹⁸

It added, however, that

while the standard for *de facto* export contingency cannot be satisfied by the subjective motivation of the granting government, objectively reviewable expressions of a government’s policy objectives for granting a subsidy may ... constitute relevant evidence in an inquiry into whether a subsidy is geared to induce the promotion of future export performance by the recipient.⁹⁹

In this regard, the Appellate Body made it clear that ‘the standard does not require a panel to ascertain a government’s reasons(s) for granting a subsidy’.¹⁰⁰ Instead, the issue must be determined ‘by assessing *the subsidy itself*, in the light of the relevant factual circumstances, rather than by reference to the granting authority’s reasons for the measure’.¹⁰¹ However, it cautioned that this does not mean ‘that evidence regarding the policy reasons of a subsidy is necessarily excluded from the inquiry into whether a subsidy is geared to induce the promotion of future export performance by the recipient’.¹⁰²

Thus, while the Appellate Body questioned the use of intent as applied by the Panel, it nevertheless seems to have left open some role for it. While ‘subjective’ intent may play only a limited role, ‘objective’ intent may be quite relevant.

Of greater importance, though, was the Appellate Body’s discussion of the legal standard for determining when export contingency ‘in fact’ exists. In this regard, the Appellate Body said that ‘the factual equivalent of such conditionality can be established by recourse to the following test: is the granting of the subsidy

⁹⁴ Ibid [1064].

⁹⁵ Ibid [1050].

⁹⁶ Appellate Body Report, *United States — Continued Dumping and Subsidy Offset Act of 2000*, WTO Doc WT/DS217/AB/R, WT/DS234/AB/R, AB-2002-7 (16 January 2003) (*‘US — Offset Act’*).

⁹⁷ Appellate Body Report, *EC — Aircraft*, WTO Doc WT/DS316/AB/R, AB-2010-1, [1050] (emphasis in original) (citations omitted).

⁹⁸ Ibid.

⁹⁹ Ibid (emphasis in original).

¹⁰⁰ Ibid [1051].

¹⁰¹ Ibid (emphasis in original).

¹⁰² Ibid.

geared to induce the promotion of future export performance by the recipient?’¹⁰³ It considered that the standard would be met

when the subsidy is granted so as to provide an incentive to the recipient to export in a way that is not simply reflective of the conditions of supply and demand in the domestic and export markets undistorted by the granting of the subsidy.¹⁰⁴

It said that where relevant evidence exists,

the assessment could be based on a comparison between, on the one hand, the ratio of *anticipated* export and domestic sales of the subsidized product that would come about in consequence of the granting of the subsidy, and, on the other hand, the situation in the absence of the subsidy.¹⁰⁵

In this regard, the Appellate Body noted that ‘[t]he situation in the absence of the subsidy may be understood on the basis of historical sales of the same product by the recipient in the domestic and export markets before the subsidy was granted’¹⁰⁶ and that,

[i]n the event that there are no historical data untainted by the subsidy, or the subsidized product is a new product for which no historical data exists, the comparison could be made with the performance that a profit-maximizing firm would hypothetically be expected to achieve in the export and domestic markets in the absence of the subsidy.¹⁰⁷

It concluded:

Where the evidence shows, all other things being equal, that the granting of the subsidy provides an incentive to skew anticipated sales towards exports, in comparison with the historical performance of the recipient or the hypothetical performance of a profit-maximizing firm in the absence of the subsidy, this would be an indication that the granting of the subsidy is in fact tied to anticipated exportation within the meaning of Article 3.1(a) and footnote 4 of the *SCM Agreement*.¹⁰⁸

The key to the standard, then, is the ‘incentives’ created by the subsidy. One way to look at the relationship between subsidies and export is to ask whether the subsidies encourage companies to export, in the sense of providing an incentive to export rather than sell domestically. Putting this in *GATT* art III:4 terms, perhaps this could be thought of as the ‘conditions of competition’ as between exports and domestic sales.¹⁰⁹ By favouring export sales through a subsidy, the subsidy encourages producers to export instead of sell domestically.

The importance of the Appellate Body’s findings can be understood by looking at an alternative approach, which can perhaps be seen in the US arguments in this case. In the US’ view, it might be enough to prove export

¹⁰³ Ibid [1044].

¹⁰⁴ Ibid [1102].

¹⁰⁵ Ibid [1047] (emphasis in original).

¹⁰⁶ Ibid.

¹⁰⁷ Ibid.

¹⁰⁸ Ibid.

¹⁰⁹ The Appellate Body has talked about ‘incentives’ in the art III:4 context as well. See, eg, Appellate Body Report, *China — Measures Affecting Imports of Automobile Parts*, WTO Doc WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R, AB-2008-10 (15 December 2008, adopted 12 January 2009) [195]–[196].

contingency if the subsidy encourages more exports, even if it applies equally to domestic sales and encourages them as well.¹¹⁰ In other words, if you have a subsidy that will, by its nature, result in more exports, that is enough to demonstrate export contingency. In the situation described by the US under the facts of *EC — Aircraft*, the contracts required a certain level of sales, one that can only be met if there are export sales. In the US' view, this is enough to show export contingency, *even if domestic sales increase as well*. Such a standard is broader than that adopted by the Appellate Body, in the sense that more subsidies would have been found to be export subsidies.

The rejection of the US' view, and the Appellate Body's adoption of the 'incentive to export' standard, could be taken to show that the Appellate Body's emphasis is on *discrimination as between export and domestic sales*. Arguably, the reason for such an approach is as follows. All producer subsidies can increase export sales. More production means more sales, both at home and abroad. But subsidies that offer an incentive to export cause a shift away from domestic sales towards export sales. This incentive is likely to cause a surge in exports, and thus is more likely to cause harm to foreign competitors than a normal producer subsidy would. In fact, it is almost certain to do so, whereas producer subsidies may or may not, depending on various circumstances. Thus, the favouritism shown to domestic products is particularly egregious with export subsidies, in terms of its probable impact, as there is a clear intent to affect trade in a way that gives an advantage to domestic producers. Under the Appellate Body's export subsidy standard, it is only where export sales are favoured over domestic sales, and domestic products that are being exported are given such a clear and significant advantage over foreign products, that a violation will be found. By contrast, incidental effects on exports that certain subsidies might have are not, in the absence of this favouritism, enough to find a violation under the export subsidy provisions (of course, they may still be considered under the adverse effects provisions, where, subject to further evidence being presented, they may be found in violation).

This view can perhaps be seen in the Appellate Body's general statement related to 'in law' contingency that:

it is clear that a subsidy that is neutral on its face, or by necessary implication, and does not differentiate between a recipient's exports and domestic sales cannot be found to be contingent, in law, on export performance within the meaning of Article 3.1(a) of the *SCM Agreement*.¹¹¹

The talk of 'neutrality' and 'differentiation' as between export and domestic sales clearly indicates the idea of discrimination between the two. Arguably, the counterpart standard developed for 'in fact' export subsidies — based on the 'incentive to export' — is designed to focus on the same issue: whether the subsidies favour export over domestic sales, that is, whether they discriminate in favour of domestic products. In this regard, the Panel seemed to favour intent as the crucial element, whereas the Appellate Body took a more balanced approach of looking at the intent and the effect on conditions of competition as between

¹¹⁰ Appellate Body Report, *EC — Aircraft*, WTO Doc WT/DS316/AB/R, AB-2010-1, [487]–[488].

¹¹¹ *Ibid* [1056].

exports and domestic products. Under either standard, though, the discrimination in favour of export sales means that domestic products sold abroad will be particularly likely to cause harm to competing foreign products.

B *Specificity*

The scope of coverage of the *SCM Agreement* is limited to subsidies that are 'specific'. In this regard, art 2.1 provides in relevant part:

2.1 In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this *Agreement* as 'certain enterprises') within the jurisdiction of the granting authority, the following principles shall apply:

(a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.

(b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.

(c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy. In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation.¹¹²

As the Appellate Body recently explained:

Article 2.1(a) establishes that a subsidy is specific if the granting authority, or the legislation pursuant to which the granting authority operates, *explicitly* limits access to that subsidy to eligible enterprises or industries. Article 2.1(b) in turn sets out that specificity 'shall not exist' if the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions governing the eligibility for, and the amount of, the subsidy, provided that eligibility is automatic, that such criteria or conditions are strictly adhered to, and that they are clearly spelled out in an official document so as to be capable of verification. These provisions thus set out indicators as to whether the conduct or instruments of the granting authority discriminate or not: Article 2.1(a) describes limitations on eligibility that favour certain enterprises, whereas Article 2.1(b) describes criteria or conditions that guard against selective eligibility. Finally, Article 2.1(c) sets out that, notwithstanding any appearance of non-specificity resulting from the principles laid down in subparagraphs (a) and (b), other factors

¹¹² *SCM Agreement* art 2.1 (citations omitted).

may be considered if there are reasons to believe that a subsidy may, in fact, be specific in a particular case.¹¹³

At its core, the specificity requirement attempts to identify situations where a subsidy favours particular domestic entities, that is, by singling them out or targeting them to the exclusion of others. Taken together with the ‘adverse effects’ on imported products that are to be demonstrated under art 5, it could be argued that these provisions are another way to show that subsidies will be found in violation when they discriminate against foreign products.¹¹⁴ To illustrate this point, I take the example of certain subsidy measures designed to support Airbus through improvements to infrastructure.

The US argued that ‘the main runway at Bremen airport was extended by German authorities in 1988–89 to accommodate transport flights for Airbus wings manufactured in Bremen’.¹¹⁵ In this regard, the US contended that: (1) ‘the extension of the Bremen airport runway and the provision of the runway to Airbus for its exclusive use, including the implementation of noise reduction measures, constitutes the provision of goods and services other than general infrastructure within Article 1.1(a)(1)(iii)’;¹¹⁶ (2) it ‘confers a benefit on Airbus’ under art 1.1(b); and (3) it is ‘specific’ under art 2.¹¹⁷

The Panel explained the factual background as follows:

According to the European Communities, German authorities require a safety margin at either end of commercial runways, consisting of a 300 meter area free of all obstacles. In Bremen, the implementation of this requirement had resulted in the shortening of the usable length of the runway. In May 1988, an extension of the runway by 300 meters at either end was authorized. Consequently, in 1989–90, the runway was extended from its existing length of 2034 meters to 2634 meters. At the same time, noise reduction measures were put in place. It is undisputed that, with the exception of emergencies, only 2034 meters of the runway’s length is available for general aviation use. Regular use of the entire length of the runway, including the 600 meters of extension, is permitted only for flights transporting Airbus wings from Bremen.

The cost of the runway extension and noise reduction measures was borne by the City of Bremen. The United States asserts that Bremen paid DM 40 million to extend the runway and a further DM 10 million for noise reduction measures.¹¹⁸

After finding that this measure constitutes a subsidy, the Panel considered whether it is specific. It concluded:

As Airbus is the only company entitled to regular use of the extended runway, and in view of the fact that the extension was undertaken by the Bremen authorities explicitly to fulfil Airbus’ needs in transporting aircraft wings, we find that the

¹¹³ Appellate Body Report, *United States — Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WTO Doc WT/DS379/AB/R, AB-2010-3 (11 March 2011) [367] (emphasis in original) (citations omitted).

¹¹⁴ *SCM Agreement* art 5.

¹¹⁵ Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [7.1098].

¹¹⁶ *Ibid* [7.1102]; *SCM Agreement* art 1.1(a)(1)(iii).

¹¹⁷ Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/R, [7.1098], [7.1102]; *SCM Agreement* arts 1.1(b), 2.

¹¹⁸ Panel Report, *EC — Aircraft*, WTO Doc WT/DS316/AB/R, [7.1100]–[7.1101] (citations omitted).

subsidy in question is specific to Airbus within the meaning of Article 2.1(a) of the *SCM Agreement*.¹¹⁹

In a sense, as noted above, this finding that a measure is specific is another way of saying that the measure discriminates. Recall that specificity can be taken to mean the singling out of certain companies/industries, which is an indication that the intent of the measure, in terms of its design, structure and architecture, is to favour those companies/industries.

Later, the Panel considered this measure in conjunction with various other measures, concluding that it caused adverse effects, in particular, serious prejudice.¹²⁰ The serious prejudice finding arguably provides another element of discrimination. The presence of specificity and serious prejudice could mean that favouring domestic companies/industries at the expense of foreign competitors was both the purpose of the measure and had that effect. Thus, arguably, these elements serve to identify protectionism, as they suggest that the subsidy in question discriminates in favour of the company or companies at issue (here, Airbus) against any other competitors (here, Boeing). There is no absolute presumption of discrimination. However, on a case-by-case basis, subsidies will be evaluated to see if the required elements are met and whether discrimination exists.

C *Displacement and Competition in the Marketplace*

One type of serious prejudice is the displacement of sales that would otherwise have been made by companies which are competing with the subsidised products, in either the home country market or a third country market. In this regard, art 6.3(a) provides that serious prejudice may arise where ‘the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member’,¹²¹ and art 6.3(b) says that it may arise where ‘the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market’.¹²² In considering the issue of displacement, the Appellate Body explained:

displacement is a situation where imports or exports of a like product are replaced by the sales of the subsidized product. The mechanism by which displacement operates is, in our view, essentially an economic mechanism, the existence of which is to be assessed by reference to events that occur in the relevant product market. We construe the concept of displacement as relating to, and arising out of, competitive engagement between products in a market. Aggressive pricing of certain products may, for example, lead to displacement of exports or imports in a particular market. This, however, can only be the case if those products compete in the same market. An examination of the competitive relationship between products is therefore required so as to determine whether such products form part of the same market. We conclude therefore that a ‘market’, within the meaning of Articles 6.3(a) and 6.3(b) of the *SCM Agreement*, is a set of products in a particular geographical area that are in actual or potential competition with each

¹¹⁹ Ibid [7.1134].

¹²⁰ Ibid [7.2025].

¹²¹ *SCM Agreement* art 6.3(a).

¹²² Ibid art 6.3(b).

other. An assessment of the competitive relationship between products in the market is required in order to determine whether and to what extent one product may displace another. Thus, while a complaining Member may identify a subsidized product and the like product by reference to footnote 46, the products thereby identified must be analyzed under the discipline of the product market so as to be able to determine whether displacement is occurring. Ordinarily, the subsidized product and the like product will form part of a larger product market. But it may be the case that a complainant chooses to define the subsidized and like products so broadly that it is necessary to analyze these products in different product markets. This will be necessary so as to analyze further the real competitive interactions that are taking place, and thereby determine whether displacement is occurring.¹²³

Under the issue of displacement, as explained by the Appellate Body, the focus of an ‘adverse effects’ claim is on how the domestic company (Airbus) and the foreign company (Boeing) compete in the market. The Appellate Body’s reasoning here can be taken as another illustration of the point that the *SCM Agreement* rules focus on actions that favour domestic products over foreign ones. In this regard, competition in the market is another way of talking about competitive opportunities, which has been the focus of *GATT* art III’s national treatment requirement.¹²⁴ In essence, under the ‘displacement’ element, there must be evidence of competition in the marketplace — which is necessary for discrimination to have any impact — and a competitive loss by the foreign company that has been caused by the subsidies. The loss illustrates the discriminatory impact of the subsidy measure.

VII CONCLUSIONS

Alan Sykes has questioned why we regulate subsidies and whether it is worth doing so. In this article, I have suggested that the reason for such regulation is to fight protectionism, and that without such efforts some of the core WTO obligations would be undermined. In terms of what current WTO subsidies rules actually do, there is a plausible argument that, at least in part, they target protectionist subsidy measures. The rules themselves can be viewed this way, and certain parts of the reasoning in *EC — Aircraft* seem to reinforce this. However, to be clear, the rules do not say this explicitly, and it is uncertain whether the WTO members see them as acting this way.

One major gap in the rules, if in fact they are intended to fight protectionism, is that exceptions for non-protectionist subsidy measures are no longer in force.

¹²³ Appellate Body Report, *EC — Aircraft*, WTO Doc WT/DS316/AB/R, AB-2010-1, [1119] (citations omitted).

¹²⁴ See, eg. GATT Panel Report, *United Kingdom Complaint on Italian Discrimination against Imported Agricultural Machinery*, GATT Doc L/833 (15 July 1958, adopted 23 October 1958) GATT BISD 7S/60, [12]; GATT Panel Report, *United States — Section 337 of the Tariff Act of 1930*, GATT Doc L/6439 (16 January 1989, adopted 7 November 1989) GATT BISD 365/345, [5.11]; Appellate Body Report, *Korea — Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WTO Doc WT/DS161/AB/R, WT/DS169/AB/R, AB-2000-8 (11 December 2000) [135]–[136]; Appellate Body Report, *Thailand — Customs and Fiscal Measures on Cigarettes from the Philippines*, WTO Doc WT/DS371/AB/R, AB-2011-1 (17 June 2011) [134]; Appellate Body Report, *China — Measures Affecting Trade Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WTO Doc WT/DS363/AB/R, AB-2009-3 (21 December 2009) [305].

There previously were limited exceptions in art 8 of the *SCM Agreement*, but these have lapsed. As a result, the current rules may be overbroad, in the sense that they cover subsidy measures that have a legitimate non-protectionist purpose.

One way to address this problem would be to restore the art 8 exceptions, and possibly add new ones as well. A more complicated — but perhaps more comprehensive — way to rectify this situation is through a form of ‘re-integration’ of the *SCM Agreement* subsidies disciplines with *GATT*. As noted, *GATT* art III:8(b) carved out certain producer subsidies from the national treatment rules. In some sense, though, the *SCM Agreement* rules can be seen as replicating the national treatment obligation found in *GATT* art III:4, and thus perhaps the current separation of *GATT* and *SCM Agreement* rules is artificial and should be eliminated. In this regard, I note that it is well-established that art III:4 concerns ‘conditions of competition’.¹²⁵ There are aspects of the *SCM Agreement* that could be said to apply the same concept. For instance, the art 15.3 injury standard in the countervailing duty context also refers to ‘conditions of competition’. More generally, one way to look at the *SCM Agreement* is as an elaboration of the conditions of competition standards. In this regard, the *SCM Agreement* could be said to establish the specific situations under which the ‘conditions of competition’ have been adversely modified by subsidy measures. As described above, the export subsidy and adverse effects standards are both, to some degree, about finding discriminatory intent and effect. Thus, perhaps it could be argued that the *SCM Agreement* effectively acts as the implementation of the art III:4 ‘conditions of competition’ test in the context of subsidies. The *SCM Agreement* may approach the issue somewhat differently, by looking at actual trade volumes in some instances (which art III:4 does not do),¹²⁶ but it nevertheless has a similar objective.

If it is the case that the *SCM Agreement* rules can be seen as an application of *GATT* art III:4, perhaps a better approach than expanding art 8 of the *SCM Agreement* would be to clarify that *GATT* art XX applies to such measures, as it would to measures challenged under art III:4. That would make the subsidy rules’ focus on protectionism more precise, as many measures that could be shown to have a non-protectionist purpose would be exempt by virtue of the art XX exemptions.

As a final point, for those who are concerned about international restrictions on the use of subsidies, and worry that the art XX exception will not provide sufficient flexibility, it should be recalled that subsidies regulation still excludes one category of subsidies almost entirely. Regardless of how *producer* subsidies are treated, subsidies to *consumers* are likely to be consistent with the rules (unless they result in de facto discrimination against foreign producers, or have discriminatory conditions attached). To illustrate this, compare the *SCM Agreement*’s treatment of a subsidy to the *domestic producers* of electric cars

¹²⁵ GATT Panel Report, *United Kingdom Complaint on Italian Discrimination against Imported Agricultural Machinery*, GATT Doc L/833 (15 July 1958, adopted 23 October 1958) GATT BISD 7S/60, [12].

¹²⁶ See, eg, Appellate Body Report, *European Communities — Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, AB-2000-11 (12 March 2001, adopted 5 April 2001) [97]–[98].

with the treatment of a subsidy to *consumers who purchase electric cars of any origin*, referred to above.¹²⁷ The latter is much more likely to be found consistent. Thus, if it turns out that an enhanced focus under WTO rules on rooting out protectionist subsidies proves too intrusive into domestic affairs, even with the art XX exceptions being applied, a switch to subsidising consumption might provide an effective way to achieve non-protectionist goals without violating WTO rules.

¹²⁷ See Part II above.