WORLD TRADE ORGANIZATION

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FURTHER PROPOSAL ON SERIOUS PREJUDICE[1]

Paper from Brazil

The following communication, dated 20 April 2006, is being circulated at the request of the Delegation of Brazil.

The submitting delegation has requested that this paper, which was submitted to the Rules Negotiating Group as an informal document (JOB(06)/94), also be circulated as a formal document.

I. INTRODUCTION

1. This communication addresses the "serious prejudice" provisions of Article 6 of the WTO *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"). This proposal is complementary to Brazil's previous submission on the issue (TN/RL/GEN/81) and refers to some aspects not addressed in Canada's proposal (TN/RL/GEN/14).

II. PROPOSED AMENDMENTS

A. REINSTATEMENT AND REVISION OF ARTICLE 6.1

2. Brazil wishes to reaffirm its support to the reinstatement of Article 6.1 of the SCM Agreement, provided that footnotes 15 and 16 relating to civil aircraft be deleted. In any case, a reinstated Article 6.1 will require improvements and clarifications.[2]

3. Without undermining the proposals contained in document TN/RL/GEN/81 or the provisions of the Article 6.3 (d) of the SCM Agreement, Brazil is of the view that in agricultural subsidies the provisions of Article 6.1 should be applicable exclusively to those Members with a relevant international role, whose agricultural subsidies are most likely to cause trade-distorting effects. In that sense, in order to circumscribe the presumption of serious prejudice to agricultural subsidies that have a greater potential to have distortive effects, Brazil suggests a new footnote in the caput of the Article 6.1:

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[1] Brazil reserves its rights to offer additional thoughts and submit further proposals on the matter.

[2] In this regard, Brazil takes note of the proposal by the United States (TN/RL/GEN/94) to possibly reinstate Article 6.1 as an expansion of the prohibited subsidies category (Article 3 of the SCM Agreement). Concerning the approach proposed by the United States in footnote 4 of its proposal, Brazil believes that the expansion of the category of prohibited subsidies will be undermined if any sort of "Peace Clause" is introduced for agricultural subsidies, be it in the Agreement on Agriculture (AoA) or in the SCM Agreement. As the US - Upland Cotton Panel made it clear, agricultural subsidies must be treated as actionable subsidies under the SCM Agreement. Additionally, the AoA has no specific provisions to deal with the impact of trade-distorting domestic subsidies on the market. In the light of the very trade-distorting nature of agricultural subsidies, any improvement in subsidies disciplines must also be oriented to reduce the adverse effects of agricultural subsidies on the international market and on the decision-making process of farmers.

Article 6
Serious Prejudice

6.1. Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of [1]:

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[1] In the case of a particular primary agricultural product or commodity, the provisions of this article shall apply only if the average world export market share that the subsidizing Member had during the previous period of three years is higher than 2%.

4. With regard to the suggestion contained in document TN/RL/GEN/81 that paragraph 4 of Annex IV, including its footnote, be transposed as a new Article 6.1(e), Brazil wishes to further clarify that the calculation of the benefit in start-up situations has also to be done according to the provisions of Annex IV. The refined new paragraph 6.1(e) would now read:

(e) the overall rate of subsidization exceeding 15 percent of the total funds invested[1, 2], where the recipient is in a start-up situation.[3]

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[1] For purposes of this paragraph, a start-up period will not extend beyond the first year of production.
[2] The total ad valorem subsidization shall be calculated in accordance with the provisions of Annex IV.
[3] Start-up situations include instances where financial commitments for product development or construction of facilities to manufacture products benefiting from the subsidy have been made, even though production has not begun.

5. Additionally, notwithstanding the provisions of Article XVI of the GATT 1994, Article 6.1 of the ASCM should have a specific provision dealing with direct payments based on price support schemes. Brazil proposes the introduction of a new sub-paragraph (f) in Article 6.1. The suggested provision would read:

(f) direct payments based on price support schemes.

B. PROPOSED AMENDMENTS TO ARTICLE 6.3

6. Regarding, Article 6.3 (d) of the SCM Agreement, Brazil proposes that the expression *"world market share"* be replaced by the expression *"world export market share"*. Thus, the provision would refer to a Member's share of the world market for exports. In the United States – Upland Cotton dispute, the Panel found that the provision, as currently stated, refers to "the share of the world market supplied by the subsidizing Member", which includes both domestic and export markets.

7. Brazil understands that Article 6.3 should be adapted, as suggested, in order to more accurately cover the trade-distorting effects of agricultural subsidies in the world market. The *world export market share* is important not only to identify serious prejudice, but also to measure the adverse effects caused by the subsidies in the international market. In the absence of the subsidies, the subsidizing Member would not be able to maintain or increase its market share. Brazil maintains that the adverse effects caused by subsidies are not only related to the increase of the market share of the subsidizing Member, but also to its maintenance.

8. In that sense, Brazil believes that the present text of Article 6.3(d) does not fully addresses situations where the subsidizing country is able to sustain its market share due to the effect of subsidies. In order to precisely observe the effects of the subsidies in the world export market, the capacity to sustain market share should also be analyzed. Therefore, Brazil proposes the introduction of a new sub-paragraph (e) in Article 6.3. The suggested provisions would thus read:

Article 6
Serious Prejudice

6.3 Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:

(…)

(d) the effect of the subsidy is an increase in the world <u>export</u> market share of the subsidizing Member in a particular subsidized primary product or commodity[17] as compared to the average share it had during the previous period of three years and this increase follow a consistent trend over a period when subsidies have been granted.

(e) the effect of the subsidy is to sustain the world export market share of the subsidizing Member in a particular subsidized primary product or commodity at levels that would not be possible in the absence of the subsidy.

C. PROPOSED AMENDMENTS TO ANNEX IV

9. Firstly, in order to clarify that the provisions of Annex IV are to be used only for the purpose of calculating the total *ad valorem* subsidization under Article 6.1(a), Brazil proposes to clarify the title of Annex IV.

10. Secondly, considering the difficulties identified by the Informal Group of Experts (IGE) created to examine matters related to Annex IV (G/SCM/W/415/Rev.2), with regard to the calculation of the government costs of funds (paragraphs 17 to 27 of the said document), Brazil suggests to replace the concept of "cost to the government" approach of paragraph 1 of the said Annex with the concept of "benefit to the recipient", according to the concept of "benefit" of Article 1.1(b) of the SCM Agreement. Moreover, Brazil suggests further improvements in the Annex, based on recommendations of the IGE.

11. Lastly, Brazil proposes that the expression "tied to the production or sale of a given product" in paragraph 3 be replaced by the expression "tied to the production, sale, price or other specific characteristic of a given product".

12. Annex IV, as amended by these suggestions, would thus read[3]:

[3] The deletion of paragraph 4 within Annex IV has already been suggested by Brazil in document TN/RL/GEN/81.

ANNEX IV

CALCULATION OF THE TOTAL AD VALOREM SUBSIDIZATION FOR THE PURPOSE OF ~~(~~PARAGRAPH 1(a) OF ARTICLE 6~~)~~ [62]

1. Any calculation of the amount of a subsidy for the purpose of paragraph 1(a) of Article 6 shall be done in terms of the ~~cost to the granting government~~ benefit to the recipient, according to Article 1.1(b). The ad valorem subsidization of a product shall be calculated on a firm-specific basis[62bis]*. Individual firms with less than 5 per cent subsidization would not be subject to a presumption of causing serious prejudice.*

2. Except as provided in paragraphs 3 through 5, in determining whether the overall ~~rate~~ amount of subsidization exceeds 5 per cent of the value of the product, the value of the product shall be calculated as the total value of the recipient firm's[63] *sales in the most recent full accounting year ~~12-month period,~~ for which sales data is available, preceding the period in which the subsidy is granted.*[64]

2.1 The recipient firm's sales should be the recipient's sales during the most recent accounting year preceding the period to which the relevant portion of the subsidy was allocated. The provision of this sub-paragraph applies also to paragraph 3.

3. Where the subsidy is tied to the production, ~~or~~ sale, price or other specific characteristic of a given product, the value of the product shall be calculated as the total value of the recipient firm's sales of that product in the most recent full accounting year ~~12-month period~~, for which sales data is available, preceding the period in which the subsidy is granted.

3.1 To determine whether a subsidy is "tied" to a particular product, and hence whether the recipient firm's sales should be the recipient's sales of that product alone, instead of to its total sales, a subsidy may be deemed to be tied to a product if its intended use is known to the granting Government, and so acknowledged, prior to or concurrent with the subsidy's bestowal.

3.2 Where a firm receives both tied and untied subsidies, separate ad valorem calculations should be performed for each using the appropriate sales denominators, and that the resulting percentages should be aggregated, to determine the total ad valorem subsidization of the product. Specifically, the ad valorem subsidization percentages from tied and untied subsidies should be calculated using as the recipient firm's sales the recipient firm's sales of the relevant product and the recipient firm's total sales, respectively. The resulting ad valorem percentages then should be added together to determine the aggregate ad valorem subsidization of the product from these subsidies.

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[62] *An understanding among Members should be developed, as necessary, on matters which are not specified in this Annex or which need further clarification for the purposes of paragraph 1(a) of Article 6.*

[62bis] *The ad valorem subsidization of a primary product or commodity shall be calculated on an industry output basis.*

[63] *The recipient firm is a firm in the territory of the subsidizing Member.*

[64] *In the case of tax-related subsidies, the value of the product shall be calculated as the total value of the recipient firm's sales in the fiscal year in which the tax-related measure was earned.*

~~*4. Where the recipient firm is in a start-up situation, serious prejudice shall be deemed to exist if the overall rate of subsidization exceeds 15 per cent of the total funds invested. For purposes of this paragraph, a start-up period will not extend beyond the first year of production.*~~[65] *In the event that a case is brought after the end of a start-up period during which subsidies were received, these subsidies are to be analyzed to determine whether any portion of them is allocable to the period under consideration. If so, these allocated subsidy amounts should be included in the calculation of ad valorem subsidization to determine if the 5 per cent threshold has been reached.*

5. ~~*Where the recipient firm is located in an inflationary economy country, t*~~*The value of the product shall be calculated as the recipient firm's total sales (or sales of the relevant product, if the subsidy is tied) in the preceding calendar year indexed by the rate of inflation experienced in the 12 months preceding the month in which the subsidy is to be given.*

5.1 The determination of which inflation index should be applied to both the numerator and the denominator shall be made on a case-by-case basis, to ensure the selection of the most appropriate index to fit the particular circumstances.

5.2 As an alternative to adjusting the numerator and the denominator for inflation in the country granting the subsidy, both the subsidy amounts and the recipients firm's sales could be converted to a stable currency commonly used in international business transactions, or to a basket of currencies (the Purchasing Power Parity Index or the average for developed countries, for example).

6. In determining the overall rate of subsidization in a given year, subsidies given under different programmes and by different authorities in the territory of a Member shall be aggregated.

7. Subsidies granted prior to the date of entry into force of the WTO Agreement, the benefits of which are allocated to future production, shall be included in the overall rate of subsidization.

8. Subsidies which are non-actionable under relevant provisions of this Agreement shall not be included in the calculation of the amount of a subsidy for the purpose of paragraph 1(a) of Article 6.

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[65] ~~*Start-up situations include instances where financial commitments for product development or construction of facilities to manufacture products benefiting from the subsidy have been made, even though production has not begun.*~~