

**EXPANDING THE PROHIBITED "RED LIGHT" SUBSIDY CATEGORY
DRAFT TEXT**

Proposal from the United States

The following communication, dated 1 June 2007, is being circulated at the request of the Delegation of the United States.

Pursuant to the US proposal (TN/RL/GEN/94, 16 January 2006) discussed at the February 2006 meeting of the Rules Negotiating Group, this submission consists of proposed revised text for Article 3 and Article 25 of the Agreement on Subsidies and Countervailing Measures (Subsidies Agreement). This submission is made without prejudice to subsidies rules developed in the agriculture negotiations. In light of the ongoing agriculture negotiations, the proposed new disciplines discussed in this paper are not intended to apply to the agricultural sector.

The proposed text essentially moves all but one of the former "dark amber" subsidies of the now-lapsed Article 6.1 to an expanded prohibited category under a new Article 3.2. In response to the comments from other Members on the United States' January 2006 paper and comments on the proposals to reinstate the "dark amber" category, we have not included subsidies over five per cent *ad valorem* in the new, expanded category of prohibited subsidies. In addition to the former dark amber subsidies, the United States is also proposing that additional types of subsidies, representing the most extreme forms of government economic intervention be included in an expanded prohibited category. These additional subsidy types include: loans to uncreditworthy companies; the provision of equity capital in a manner inconsistent with the usual investment practice of private investors; and other forms of financing that a company would be unlikely to receive from commercial sources. The first two of these subsidy types require guidance as to how the financial health of a company should be evaluated. Proposed guidance in this regard is provided in footnotes seven and eight. The United States recognizes that these footnotes raise complex issues worthy of discussion.

There are two other significant provisions in the proposed text that were not foreshadowed in the approach outlined in the United States' January 2006 paper. The first is a requirement that the product that benefits from the new class of prohibited subsidies be exported or competes with imports (see Article 3.2). Secondly, if the subsidizing Member can demonstrate that the subsidy provided does not have a positive effect on the capacity and sales of the subsidy benefit recipient, the prohibition will not apply (see Article 3.3). The cumulative effect of these two provisions is to ensure that subsidies that have no trade-distorting effect will not be subject to the new prohibition. These provisions were added in response to Members' comments on the United States' January 2006 paper.

The proposed notification requirement, described in the United States' January 2006 paper, of providing information with respect to the adverse effects of a government equity investment has also

been eliminated in response to comments received. The remainder of the draft text follows the original proposal in a relatively straightforward manner.

The United States welcomes further discussion of its proposal to expand the prohibited category of subsidies and, in particular, how the proposed text might be improved. In anticipation of such suggestions, the text found below does not necessarily represent the final position of the United States.

Article 2: Specificity

2.3 Any subsidy falling under the provisions of ~~Article 3~~ paragraph 1 of Article 3 shall be deemed to be specific.

Article 3: Prohibition

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

- (a) subsidies contingent, in law or in fact¹, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;²
- (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

3.2 Except as provided in the Agreement on Agriculture, and provided that such subsidies are specific, and the subsidized product is exported or competes with imports, the following subsidies within the meaning of Article 1 above, shall be prohibited^{3, 4}:

- (a) the direct transfer of funds to cover operating losses sustained by an enterprise or industry;
- (b) forgiveness of debt⁵, i.e., forgiveness of government-held loans or other instruments of indebtedness, and grants to cover repayment of government-held loans or other instruments of indebtedness;
- (c) loans and other instruments of indebtedness provided directly to enterprises that are uncreditworthy^{6,7};

¹ 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 accorded to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

² Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

³ It is understood that a Member may take measures for prudential reasons pursuant to laws and regulations of general application, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Such measures shall not be used as a means of avoiding a Member's obligations under this Agreement. Where a panel considers a dispute involving a measure taken for prudential reasons, panel members shall have expertise with respect to such measures.

⁴ It is understood that this Agreement only applies to subsidies affecting trade in goods, and therefore, the only subsidies prohibited under this provision are those made to a goods-producing enterprise.

⁵ Actions taken pursuant to generally applicable bankruptcy laws or regulations or other insolvency proceedings shall not be prohibited under Article 3.2.

- (d) provision of equity capital where the investment decision is inconsistent with the usual investment practice (including for the provision of risk capital) of private investors in the territory of that Member;⁸ and
- (e) other financing (i.e., "royalty-based" or "sales-contingent" financing or other similar financing) to an enterprise or project that otherwise would be unlikely to receive such financing from commercial sources.

3.3 The subsidies in paragraph 3.2 shall not be prohibited if the subsidizing Member demonstrates that the subsidies have not had a positive effect on the capacity and sales of the subsidy benefit recipient.

3.4 The following are not prohibited under paragraph 3.2:

- (a) subsidies provided pursuant to small business programs;⁹
- (b) subsidies to public utilities (e.g., publicly-owned enterprises that supply electricity and water); and
- (c) subsidies necessary to ensure the provision of arms, ammunition or war materiel indispensable for national security or national defence purposes.

~~3.2~~ 3.5 Members shall not grant nor maintain subsidies referred to in paragraphs 1 or 2.

Article 25: Notifications

25.x Members shall notify the Committee of the following information regarding ownership of an enterprise by a government or public body:

⁶ In limited circumstances, the analysis under paragraphs 3.2(c), 3.2(d) and 3.2(e) may more appropriately focus on a particular investment project of an enterprise rather than the enterprise as a whole, for example, where the financing is provided for large investment projects for new products, processes, or capacity (e.g., a plant expansion or a new model or product line).

⁷ In examining whether an enterprise or project is uncreditworthy, the following factors, among others, shall be considered: (1) the receipt by the enterprise of comparable, commercial, long-term (i.e., longer than one year) loans; (2) the present and past financial health of the enterprise, as reflected in financial indicators calculated from the enterprise's financial statements and accounts; (3) the enterprise's recent past and present ability to meet its costs and fixed financial obligations with its cash flow; (4) evidence of the enterprise's future financial position, such as market studies, country and industry economic forecasts, and project and loan appraisals prepared prior to the agreement between the lender and the enterprise on the terms of the loan; and (5) the value of any collateral or guarantee provided on commercial terms to secure the loan.

⁸ In examining whether a government's provision of equity capital meets these conditions, the following factors, among others, shall be considered: (1) the price paid by private investors for the same (or similar form of) newly issued shares in the recipient enterprise where such private investor share purchases are significant and concurrent with those of the government; (2) objective analyses of the future financial prospects of the recipient enterprise or project as indicated by, *inter alia*, market studies, economic forecasts, and project or loan appraisals prepared prior to the government-provided equity infusion; (3) current and past indicators of the recipient enterprise's financial health calculated from the enterprise's financial statements and accounts adjusted, as appropriate, to conform to generally accepted accounting principles (GAAP), preferably the GAAP in the territory of the Member; (4) the enterprise's rates of return on equity in the three years prior to the government equity infusion; and (5) equity investment in the enterprise by private investors.

⁹ A "small business" is an enterprise with fewer than X employees.

- (a) with respect to the provision of equity capital by any government or public body: the date and terms of the transaction; and an explanation of the consistency of the investment with the usual practice of private investors in the territory of that Member;
- (b) with respect to any government majority-owned, as well as government-controlled enterprises¹⁰: the percentage of direct and indirect ownership that the government or any public body holds in the enterprise and the terms and conditions of any financial contribution by any government or public body to the government majority-owned or controlled enterprise, excluding non-specific instances in which government revenue that was otherwise due was foregone or not collected.

Members shall submit these notifications biannually not later than 30 June.

¹⁰ This notification requirement does not apply to a publicly-owned utility or financial institution.