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Negotiating Group on Rules

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BENEFIT PASS-THROUGH

Paper from Canada

The following communication, dated 16 November 2005, is being circulated at the request of the Delegation of Canada.

The submitting delegation has requested that this paper, which was submitted to the Rules Negotiating Group as an informal document (JOB(05)/289), also be circulated as a formal document.

Members will recall that, at the June 2004 session of the Negotiating Group, Canada presented a paper on "Benefit Pass-Through" (circulated as document JOB(04)/55). Having had the benefit of Members' views, Canada is submitting this revised version of its original paper. In this regard, and given the comments of various Members with respect to the Annex proposed in that paper, Canada has significantly streamlined its text proposal and eliminated the Annex altogether. Canada believes its revised proposal represents an important codification of GATT/WTO jurisprudence (given that benefit pass-through is the vehicle by which subsidies are bestowed indirectly within the meaning of Article VI:3 of the GATT 1994), and improvement to the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement).

I. ISSUE

1. It is well-established in GATT/WTO jurisprudence that, where the recipient of a financial contribution and the alleged recipient of the resulting benefit are different entities, the investigating authority of a Member cannot presume a benefit pass-through, but rather, must examine whether, and to what extent, the benefit of the financial contribution has actually been passed through from the entity that was the initial recipient of the financial contribution to the entity that produces the product at issue.[1]

[1] In the *US – Canadian Pork* GATT panel report (adopted on 11 July 1991), the panel held that, because swine producers and pork producers were separate industries operating at arms length, the US Department of Commerce was required to examine whether and to what extent the subsidies bestowed on the upstream producers benefited the downstream producers. In a somewhat different (i.e. pre-privatization subsidy) context, the WTO panel in *US – Lead and Bismuth II* (WT/DS/138/R) stated (at fn. 69) that: "A 'financial contribution' does not have to be bestowed directly on a company in order to confer a 'benefit' on that company. For example, one company may be found to 'benefit' from a 'financial contribution' conferred on another company." The Appellate Body report (WT/DS138/AB/R, adopted on 7 June 2000) however went on to clarify that a pre-privatization subsidy cannot be deemed to confer a benefit to a successor company. The Appellate Body in United States – Final Countervailing Duty Determination with respect to Certain Softwood from Canada (WT/DS257/AB/R of 17 February 2004) also reaffirmed the findings in US – Canadian Pork explaining, at paragraph 143, that:

2. The current SCM Agreement does not, however, afford any direct guidance on this matter. In the absence of explicit guidance to conduct pass-through analyses, there is greater scope for the authorities of a Member to apply countervailing measures on the basis of a perfunctory or *pro forma* analysis. It would therefore be useful to include guidelines in the SCM Agreement to assist both investigating authorities in the conduct of pass-through analyses and dispute settlement panels in the consideration of such issues.

III. PROPOSED TEXT AMENDMENTS

3. It is proposed that a new footnote be added to current Article 1.1(b) of the SCM Agreement that takes account of existing GATT/WTO jurisprudence that the pass-through of the benefit of a financial contribution from one entity to an unrelated entity cannot be presumed, but rather, must be demonstrated. For greater clarity, and internal coherence, the demonstration of pass-through should be linked to current Article 14 of the SCM Agreement, i.e.:

> Where there is evidence suggesting that a financial contribution, within the meaning of that term in Article 1.1(a)(1), is received by one entity and a benefit, within the meaning of that term in Article 1.1(b), is conferred thereby to an unrelated entity so as to constitute the bestowal of an indirect subsidy, the Member concerned shall determine whether, and to what extent, the benefit of the financial contribution was actually passed through from the former to the latter in accordance with the provisions of Article 14 of this Agreement applied *mutatis mutandis*. A pass-through analysis shall be conducted in a transparent manner and a finding that all or part of the benefit of a subsidy has been passed through to another entity shall be adequately explained. For greater clarity, the requirement to demonstrate that the benefit of a financial contribution has passed from one entity through to another is limited to transactions within the territory of the Member in which the subsidy was bestowed.

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The above does not purport to be an exhaustive enumeration of issues relating to pass-through and Canada reserves its right to offer additional thoughts on the matter.

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> [F]or a potentially countervailable subsidy to exist, there must be a financial contribution by the government that confers a benefit to a *recipient*. Where a subsidy is conferred on input products, and the countervailing duty is imposed on processed products, the initial recipient of the subsidy and the producer of the eventually countervailed product, may not be the same. In such a case, there is a *direct recipient* of the benefit—the producer of the *input* product. When the input is subsequently processed, the producer of the *processed product* is an *indirect recipient* of the benefit—provided it can be established that the benefit flowing from the input subsidy is passed through, at least in part, to the processed product. Where the input producers and producers of the processed products operate at *arm's length*, the pass-through of input subsidy benefits from the direct recipients to the indirect recipients downstream cannot simply be presumed; it must be established by the investigating authority. In the absence of such analysis, it cannot be shown that the essential elements of the subsidy definition in Article 1 are present in respect of the *processed product*. In turn, the right to impose a countervailing duty on the processed product for the purpose of offsetting an input subsidy, would not have been established in accordance with Article VI:3 of the GATT 1994, and, consequently, would also not have been in accordance with Articles 10 and 32.1 of the SCM Agreement. (Emphasis in original)