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LOOKING BACK INTO THE FUTURE: THE LEGAL STANDARD OF PROHIBITED SUBSIDIES IN SCM AGREEMENT THROUGH WTO CASE LAW, AHEAD OF REFORMS

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The recent developments within the European Union (EU) with regards to foreign subsidies and the regional developments on fuel subsidies, have fuelled further the discussions on reforming the subsidization rules in the World Trade Organization (WTO). One aspect of the reform process is the categories of subsidies considered to be prohibited under the Agreement on Subsidies and Countervailing Measures (SCM), currently covering only export and local content subsidies. Hence, looking ahead this reform process, the purpose of the present paper is to analyse the legal standard of prohibited subsidies as provided for in Article 3.1 SCM, and specifically the term 'contingent' used in provisions 3.1 (a) and 3.1 (b). The analysis primarily focuses on the interpretation and application adopted by the WTO adjudicating bodies. The plurality of WTO case laws provides us a wide canvas on which accurate conclusions can be drawn on the scope of Article 3.1 SCM and the types of governmental interventions covered. At this point, an attempt is made to provide a more consistent interpretation of the term 'contingent' having in mind the customary rule of interpretation as well as the economic rationale of the existing rules. This identification mainly seeks to assemble the different pieces found in the WTO jurisprudence and the legal theory and reformulate the legal standard, proving a necessary comprehensive understanding of the rules, ahead of the reform process.

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I. INTRODUCTION

The notion of prohibited subsidies under the SCM was always controversial amongst lawyers, economists, policymakers and negotiators alike.[1] The fact that certain subsidies are *per se* prohibited without examining the possible negative or positive effects, has never been met without opposition.[2] It is no wonder that first reform proposals on prohibited subsidies started within ten years of the subsidies disciplines, despite the fact that the rules on prohibited subsidies did not apply to many WTO Members for the first eight years due to the flexibilities provided under

[1] Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 14.
[2] *See* Robert Howse, *Making the WTO (Not So) Great Again: The Case Against Responding to the Trump Trade Agenda Through Reform of WTO Rules on Subsidies and State Enterprises,* 23 J. INT'L ECON. L. 371, 378 (2020) [hereinafter Howse]; Alan O Sykes, *The Questionable Case for Subsidies Regulation: A Comparative Perspective*, 2 J. LEGAL ANALYSIS 473 (2010) [hereinafter Sykes]; Alan O Sykes, *The Limited Economic Case for Subsidies Regulation*, INTERNATIONAL CENTRE FOR TRADE AND SUSTAINABLE DEVELOPMENT [ICTSD] & WORLD ECONOMIC FORUM [WEF] (2015) [hereinafter ICTSD & WEF]; Kyle Bagwell & Robert W Staiger, *Will International Rules on Subsidies Disrupt the World Trading System?*, 96 AM. ECON. REV. 877 (2006).

Article 27 SCM to the developing countries.[3]

Before examining the reform proposals, the first part of the paper examines the jurisprudence of the WTO adjudicating bodies with regards to prohibited subsidies and in particular the concept of 'contingency' which is central to the operation of the provisions of the SCM on prohibited subsidies. It examines how the term has been interpreted and applied in different contexts, with due regard to the economic rationale of the prohibition of export and local content subsidies. The goal is to identify the status-quo on the basis of which the reform proposals are made. Then, the paper provides an overview of the reform proposals and treaty-making trends in free trade agreements (FTAs). Finally, the paper proposes a reformulated understanding of the legal standard of contingency through an interpretative process that takes into account more carefully the rationale of the SCM disciplines and the structure of the WTO Agreement. This reformulation purports to provide a better footing for any future proposal, by incorporating the notion of 'distortion' and discrimination in the operation of the standard of contingency in Article 3.1 SCM.

II. THE STANDARD OF CONTINGENCY UNDER ARTICLE 3.1 SCM IN LIGHT OF THE STEPS TAKEN BY THE WTO ADJUDICATORS

The SCM classifies measures that fall under Article 1.1 SCM as 'subsidies' in three distinct categories. Following the textbook example of 'traffic light' classification, first come the 'red light' prohibited subsidies, provided under Part II of SCM, then come the 'yellow light' actionable subsidies, covered under Part III of SCM and finally come the 'green light' non-actionable subsidies, disciplined under Part IV of SCM.[4] The first two types are regarded as 'unfair' trade practice prohibited under the SCM Agreement; thus, giving the right to a member state to bring a case to the Dispute Settlement System of the WTO. The Appellate Body (AB) in *EC — Large Civil Aircraft* has affirmed that there is a fine line between prohibited and actionable subsidies which shall not be blurred.[5]

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[3] For overview of reform proposals, see Siqi Li & Xinquan Tu, *Reforming WTO Subsidy Rules: Past Experiences and Prospects*, 54 J. WORLD TRADE 853 (2020) [hereinafter Li & Tu].

[4] PETER VAN DEN BOSSCHE & WERNER ZDOUC, THE LAW AND POLICY OF THE WORLD TRADE ORGANIZATION: TEXT, CASES AND MATERIALS 1508-1509 (2017) [hereinafter BOSSCHE & ZDOUC]; MITSUO MATSUSHITA ET AL., THE WORLD TRADE ORGANIZATION: LAW, PRACTICE, AND POLICY 299 (3rd ed., 2015) [hereinafter MATSUSHITA].

[5] Appellate Body Report, *European Communities and Certain Member States — Measures Affecting Trade in Large Civil Aircraft,* ¶ 1054, WTO Doc. WT/DS316/AB/R (adopted June 1, 2011) [hereinafter *EC — Civil Aircraft* (AB)]; DOMINIC COPPENS, WTO DISCIPLINES ON SUBSIDIES AND COUNTERVAILING MEASURES: BALANCING POLICY SPACE AND LEGAL CONSTRAINTS 44 (2014) [hereinafter COPPENS]; WOLFGANG MULLER, WTO AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES: A COMMENTARY 104 (2017) [hereinafter MULLER].

Part II of SCM prohibits subsidies granted upon a conditional relationship with either export performance or local content, while Part III does not discipline the granting of a subsidy itself but rather, the use of a subsidy causing adverse effects.[6] Part II, dealing with prohibited subsidies, in Article 3.1 SCM, prohibits subsidies 'contingent' upon exportation or the use of domestic goods over imported ones. The standard of 'contingency' constitutes the heart of the legal test of Article 3.1, setting out the nature of the prohibited relationship between the granting of the subsidy and the exportation or usage of domestic goods.

Under Part III of SCM, subsidies can be disciplined when they are causally linked with a negative market phenomenon, the 'adverse effects'.[7] According to Article 5(c) SCM, adverse effects exist either where injury to the domestic industry has occurred, nullification or impairment of benefits for the WTO members has taken place, or serious prejudice has been caused to the interest of the Members. The legal and evidentiary standard of causality under the three different types of adverse effects is the same according to WTO jurisprudence.[8] So far, no significant discrepancies have been identified in the application of the causality standard in the different instances of adverse effects;[9] hence, occurrences and factual elements in a dispute over 'injurious' subsidized imports may be used as interpretive or factual guidance in a dispute over subsidies causing 'serious prejudice'.

In contrast, the standard of 'contingency', which is situated in the middle of a prohibited subsidy examination, seems to have troubled the jurisprudence so far, as - no matter the declarations - the actual dictums create tensions on the alleged homogenous single legal standard of Article 3 SCM. What is more, we can notice an everlasting misconception in the analysis of the various measures and especially the tools used to evince the standard of prohibited subsidies. Hence, an overview of the jurisprudence is required in order to highlight the misconceptions and misapplications.

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[6] COPPENS, *supra* note 5, at 115; MULLER, *supra* note 5, at 261; *EC — Civil Aircraft* (AB), *supra* note 5; Appellate Body Report, *United States — Continued Dumping and Subsidy Offset Act of 2000*, ¶ 7.1222, WTO Doc. WT/DS217/AB/R (adopted Jan. 27, 2003).

[7] MATSUSHITA, *supra* note 4, at 337.

[8] Appellate Body Report, *United States — Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan,* ¶ 7.75, WTO Doc. WT/DS244/AB/R (adopted Jan. 9, 2004); Appellate Body Report*, United States — Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, ¶ 912, WTO Doc. WT/DS353/AB/R (adopted Mar. 23, 2012); *EC — Civil Aircraft* (AB), *supra* note 5, ¶ 1107.

[9] JAMES J NEDUMPARA, INJURY AND CAUSATION IN TRADE REMEDY LAW: A STUDY OF WTO LAW AND COUNTRY PRACTICES 54 (1st ed., 2016).

A. Introduction to Article 3.1 SCM

> 3.1 . . . the following subsidies, within the meaning of Article 1, shall be prohibited:
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> (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 I;
>
> (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods."
>
> Footnote 4: "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.

Article 3.1 SCM prohibits subsidies that are contingent upon export performance or upon the use of domestic over imported goods, or measures covered by the Illustrative List in Annex I, which illustrates several examples of *per se* prohibited export subsidies.[10] Under the first track, a complainant State needs to demonstrate first, that a subsidy exists under Article 1.1 SCM and afterwards, that it is contingent upon exportation/the use of domestic over imported goods, as depicted under Article 3.1 SCM.[11] These two types of subsidies have been deemed to cause *ipso facto* trade-distortive effects during the Uruguay Round and thus, it was decided that the SCM shall prohibit the mere granting of those subsidies, notwithstanding their actual effects.[12] This goes in accordance with the objective of the SCM which is, "to establish disciplines for subsidies that distort international trade".[13] Therefore, the disciplines set out in Article 3.1 SCM should be in accordance with the aforementioned objective. Emphasis has been given on the word 'contingent', as it

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[10] Panel Report, *Brazil — Export Financing Programme for Aircraft — Recourse by Canada to Article 215 of the DSU (as modified by Appellate Body Report WT/DS46/AB/RW),* ¶ 6.31, WTO Doc. WT/DS46/RW (adopted Aug. 4, 2000) [hereinafter *Brazil — Aircraft* (Panel)]; COPPENS, *supra* note 5, at 118.

[11] Panel Report, *United States — Conditional Tax Incentives for Large Civil Aircraft (as modified by Appellate Body Report WT/DS487/AB/R),* ¶ 7.196, WTO Doc. WT/DS487/R/Add.1 (adopted Sep. 22, 2017).

[12] BOSSCHE AND ZDOUC, *supra* note 4, at 1550.

[13] Panel Report, *Brazil — Export Financing Programme for Aircraft (as modified by Appellate Body Report WT/DS46/AB/R),* ¶ 7.26, WTO Doc. WT/DS46/R (adopted Aug. 2, 1999).

constitutes the very heart of the legal standard according to the AB in *Canada — Aircraft*.[14] This suggests that the required strength of the tie between the subsidies and export performance (or the usage of domestic goods) should abide by the rationale behind this prohibition, i.e., distortive trade effects, which, however has been largely missing from WTO jurisprudence.

The interpretation and the application of the standard of 'contingency' have evolved ever since the early WTO jurisprudence mainly in three phases: the pre-*EC — Large Civil Aircraft* jurisprudence, the *EC — Large Civil Aircraft* dictum and the post *EC — Large Civil Aircraft*. The paper follows this three-phase approach in order to examine whether the standard of contingency has reached a specific conclusion and whether this conclusion has been consistently applied.

B. Early WTO Jurisprudence

Early WTO jurisprudence mainly analysed export subsidies. Local content subsidies were not examined as much since most of the measures were challenged cumulatively under Article III:4 General Agreement on Tariffs and Trade (GATT) as a violation of national treatment. Panels and the AB have examined Article III:4 GATT claims before Article 3.1(b) SCM claims since the standard in Article III:4 GATT is broader than Article 3.1(b) SCM.[15] For instance, the AB Report in *Brazil — Taxation* clarified that the standard under Article 3.1 SCM is more demanding.[16] Hence, the standard of 'contingency' is not satisfied when "the measure at issue alters the conditions of competition to the detriment of the imported products by providing an incentive to use domestic goods", which is the relevant standard under Article III:4 GATT.[17]

The AB in *Canada — Autos* found that the same standard of conditionality applies between Article 3.1(a) and 3.1(b),[18] and between *de facto* and *de jure* contingency, while

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[14] Appellate Body Report, *Canada — Measures Affecting the Export of Civilian Aircraft,* ¶ 171, WTO Doc. WT/DS70/AB/R (adopted Aug. 20, 1999) [hereinafter *Canada — Aircraft* (AB)].
[15] In case of successful examination, the Panels and the Appellate Body exercise juridical economy, see Douglas Nelson & Laura Puccio, *Nihil Novi Sub Sole: The Need for Rethinking WTO and Green Subsidies in Light of United States – Renewable Energy,* 20 WORLD TRADE REV. 491, 495 (2021) [hereinafter Nelson & Puccio].
[16] Appellate Body Report, *Brazil — Certain Measures Concerning Taxation and Charges,* ¶ 5.254, WTO Doc. WT/DS472/AB/R/Add.1, WT/DS497/AB/R/Add.1 (adopted Jan. 11, 2019) [hereinafter *Brazil — Taxation* (AB)].
[17] *Id.*
[18] Appellate Body Report, *Canada — Certain Measures Affecting the Automotive Industry*, ¶ 123, WTO Doc. WT/DS139/AB/R, WT/DS142/AB/R (adopted May 31, 2000) [hereinafter *Canada — Autos*]; Panel Report*, United States — Subsidies on Upland Cotton (as modified by*

differing in the employment of evidence.[19] A finding of *de jure* contingency should be demonstrated based on the wording of relevant laws, regulations or generally, legal instruments while that of *de facto* contingency requires an examination of the total configuration of the facts surrounding and constituting the granting of the subsidy, without considering any fact as decisive.[20]

The term 'contingent' has been interpreted as introducing a relationship of conditionality/dependence between the granting of the subsidy and the export performance,[21] while footnote 4 SCM uses the term 'tied to' that introduces a concept of a close relationship which has been considered synonymous to the word 'contingent'.[22] The Panel in *Australia — Leather* interpreted the term 'tied to' so as to encompass a "limit or restriction on … conditions."[23] However, WTO jurisprudence has not defined what exact type of conditionality is required in order to breach Article 3.1 SCM. Thus, it is not clear whether exports are required to be a necessary condition for the granting of the subsidy, or being a sufficient condition is enough. The Panel in *Canada — Aircraft* may have inclined towards a 'necessary' conditionality with the use of a 'but for' test.[24]

However, this tool was rejected by the AB. It remarked that the text of the treaty itself does not introduce such an analysis; thence, the Panel cannot invent its own standard.[25] Yet, the AB in *Canada — Autos* commented that, "as the import duty exemption is simply not available to a manufacturer unless it exports motor vehicles, the import duty exemption is clearly conditional upon exportation".[26] Thus, an observation of 'but for' situation (even though not *expressive verbis*) was made by the AB. Thence, early jurisprudence did not define the required strength of conditionality.

Indeed, this conclusion is exemplified by a different application of the standard in

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Appellate Body Report WT/DS267/AB/R), ¶ 7.1081, WTO Doc. WT/DS267/R, Add.1 to Add.3 and Corr.1 (adopted Mar. 21, 2005).

[19] *Canada — Aircraft* (AB), *supra* note 14, ¶ 167.

[20] *Id.*; MARC BÉNITAH, THE WTO LAW OF SUBSIDIES: A COMPREHENSIVE APPROACH 67-68 (2019) [hereinafter BÉNITAH].

[21] *Canada — Aircraft* (AB), *supra* note 14, ¶ 166.

[22] *Canada — Aircraft* (AB), *supra* note 14, ¶ 171; PETROS C MAVROIDIS, THE REGULATION OF INTERNATIONAL TRADE 271 (2016).

[23] Panel Report, *Australia — Subsidies Provided to Producers and Exporters of Automotive Leather*, ¶ 9.55, WTO Doc. WT/DS126/R (adopted May 25, 1999) [hereinafter *Australia — Leather*].

[24] Panel Report, *Canada — Measures Affecting the Export of Civilian Aircraft (upheld by Appellate Body Report WT/DS70/AB/R)*, ¶¶ 9.332, 9.339, WTO Doc. WT/DS70/R (adopted Aug. 20, 1999) [hereinafter *Canada — Aircraft* (Panel)].

[25] *Canada — Aircraft* (AB), *supra* note 14, ¶ 171, n. 102.

[26] *Canada — Autos*, *supra* note 18, ¶ 104.4.

Canada — Autos and in *Canada — Aircraft*. The analysis of the Panel (as approved by the AB) in the Aircraft case, sheds light on a variety of different factual factors (a total of eighteen different factors); yet, still reached a conclusion without using a necessary conditional relationship (i.e., the subsidy being a *conditio sine qua non* for the granting of the subsidy). Rather, the standard of contingency was reached by finding that the export potentiality of the Canadian aerospace and defence sector could most significantly materialize the goals of the TPC Program.[27] The lack of any kind of 'necessity' is evident.

Moving on, the Panel in *Australia — Leather* applied the standard in a manner similar to *Canada — Autos*, since it found that the thirty million dollar grant (given in three instalments) gifted to Howe by the Australian government was export contingent, as the company in order to reach the sales targets set under each instalment should continue and even increase its export sales, since the domestic market was too small and the company was pushed towards the export markets.[28] In this case, we see that the conditionality is rather a necessary one, as in fact Howe could not have reached the targets set by the subsidy in order to gain each instalment without its export sales.

On the same trail, the Compliance Panel (as reaffirmed by the AB) in *US — FSC* found that the Extraterritorial Income Exclusion (ETI) Act of 2000 provided tax breaks only when domestic good were exported; thus export constituted a necessary precondition for the receipt of the subsidy.[29] Hence, the necessary conditionality was upheld by WTO jurisprudence, which was again endorsed by the AB in *US — Cotton Subsidies*.[30] The standard of contingency in Article 3.1 SCM was satisfied on the grounds that payments under the Farm Security and Rural Investment (FSRI) Act of 2002 were issued to exporters only after successfully demonstrating actual exportation.

Therefore, even though the AB ruled against using a necessary conditionality test (but for), the actual application of the term seems to have ignored this interpretative restriction. As an excuse for the rather vagueness of the interpretation or

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[27] *Canada — Aircraft* (Panel), *supra* note 24, ¶ 9.340.

[28] *Australia — Leather*, *supra* note 23, ¶ 9.58, 9.67.

[29] Appellate Body Report, *United States — Tax Treatment for 'Foreign Sales Corporations' — Recourse to Article 215 of the DSU by the European Communities*, ¶¶ 119, 120, WTO Doc. WT/DS108/AB/RW (adopted Jan. 14, 2002); Panel Report, *United States — Tax Treatment for 'Foreign Sales Corporations' — Recourse to Article 215 of the DSU by the European Communities (as modified by Appellate Body Report WT/DS108/AB/RW)*, ¶¶ 8.58, 8.60, 8.72, WTO Doc. WT/DS108/RW (adopted Jan. 29, 2002).

[30] Appellate Body Report, *United States — Subsidies on Upland Cotton*, ¶ 582, WTO Doc. WT/DS267/AB/R (adopted Mar. 21, 2005).

inconsistency in the application, we could say that it was found not necessary to examine whether necessary or sufficient conditionality is required. Rather, the adjudicating bodies chose to simply find evidence or hints that connote a close tie revealing 'dependence' between exports/domestic goods and the granting of the subsidy.[31] It goes without saying that a 'but for' observation, as in *Canada — Autos*, points decisively towards a close tie. On these grounds, a general conditional relationship may suffice, as in *Canada — Aircraft*; yet, in most cases the analysis focused on a much closer relationship.

This constituted the perceived standard before the AB in *EC — Large Civil Aircraft*, as evinced by the dictum of the Panel in the same case. It found that the typical example of de facto contingency exists when subsidies are granted subject to the existence of a performance obligation which is achieved only through export sales.[32]

C. The Milestone: Appellate Body Report, EC- Large Civil Aircraft

The AB in *EC — Large Civil Aircraft* confronted the vagueness of the previous jurisprudence due to the factual peculiarities of the case. If the AB followed the previous jurisprudence, the measures at issue, namely the LA/MSF, had a clear-cut tie with the anticipated export performance of Airbus. More specifically, each LA/MSF loan given by the EC had a repayment requirement through per-aircraft levy. Interesting enough, the Large Civil Aircraft market, the relevant market for Airbus and the recipient of the LA measures, is characterised by infrequent sales (hence, there is a close connection between construction of an aircraft and specific order/sales) and by globalised demand and duopolised supply; thus, Airbus is fully export oriented.[33] These, though, were not indicative of export contingency according to the AB. This is not because there was no strong tie between the exports and the granting of the subsidies but rather due to the fact that this tie did not illustrate the necessary distortive quality in order to be considered prohibited.

The AB explained that a *de facto* prohibited export subsidy may be evinced by examining whether "the granting of the subsidy [was] geared to induce the promotion of future export performance by the recipient".[34] This 'inducement test'

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[31] *Canada — Aircraft* (AB), *supra* note 14, ¶¶ 171, 174.

[32] Panel Report, *European Communities and Certain Member States — Measures Affecting Trade in Large Civil Aircraft (as modified by Appellate Body Report WT/DS316/AB/R)*, ¶ 7.644, WTO Doc. WT/DS316/R (adopted June 1, 2011).

[33] *EC — Large Civil Aircraft* (AB), *supra* note 5, ¶¶ 1065–1080; Michael Hahn and Kirtikumar Mehta, *It's a Bird, It's a Plane: Some Remarks on the Airbus Appellate Body Report (EC and Certain Member States — Large Civil Aircraft, WT/DS316/AB/R),* 12 WORLD TRADE REV. 139 (2013); Jeffrey Kienstra, *Cleared For Landing: Airbus, Boeing, and the WTO Dispute over Subsidies to Large Civil Aircraft*, 32 NW. J. INT'L L. & BUS. 569 (2012) [hereinafter Kienstra].

[34] *EC — Large Civil Aircraft* (AB), *supra* note 5, ¶ 1044.

examines whether the granting of the subsidy incentivizes exportation in abnormal market conditions.[35] This incentive should derive from a total configuration of the facts, such as the design or structure of the measure, the modalities of operation and any other relevant factual circumstance.[36]

So, an inducement of export in abnormal market conditions should be found in order to clearly establish how the prohibited subsidy was anticipated to alter the market decisions and the normal market course of the recipient.

In addition, if relevant evidence is present, it could involve a comparison between the ratio of 'anticipated' export and domestic sales of the subsidised product and the ratio of such sales in the absence of the subsidy. The latter export/domestic sales ratio could either be derived from historical sales by the recipient or from the sales of a hypothetical profit-maximising firm in the absence of the subsidy. [37] An export subsidy is present if the 'anticipated' export/domestic sales ratio is higher than the one derived from historical/hypothetical sales.

The 'export inducement test' was later clarified by the Panel in the compliance proceedings of the same case which considered that the export inducement test has three prerequisites. First, the inducement of a recipient. Second, the inducement consists of discrimination in favour of export sales at the expense of domestic sales. Third, this inducement is contrary to the market forces of supply and demand.[38] The Panel further clarified the application of the inducement test as well as the Ratio Analysis. In its examination, it reiterated that the Ratio Analysis is a relevant, yet not definitive, consideration in the Export Inducement Test, as the total configuration of the facts necessitates the examination of all relevant factors as well as the subsidy itself, while none of those factors is conclusive by itself. Still, the Ratio Analysis retains its probative value when it is possible to isolate "the impact of export-contingent aspects of that subsidy on. . . sales behaviors", as the AB had emphasised by the phrase "all other[s] being equal".[39]

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[35] BOSSCHE AND ZDOUC, *supra* note 4, at 1554; *EC — Civil Aircraft* (AB), *supra* note 5, ¶ 1045. The AB stated that, "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."

[36] *EC — Large Civil Aircraft* (AB), *supra* note 5, ¶ 1046; BÉNITAH, *supra* note 20, at 68.

[37] *EC — Large Civil Aircraft* (AB), *supra* note 5, ¶ 1047; MATSUSHITA, *supra* note 4, at 333.

[38] Panel Report, *European Communities and Certain Member States — Measures Affecting Trade in Large Civil Aircraft — Recourse to Article 215 of the DSU by the United States (as modified by Appellate Body Report WT/DS316/AB/RW)*, ¶ 6.689, WTO Doc. WT/DS316/RW/Add.1 (adopted Dec. 2, 2019).

[39] *Id.* ¶¶ 6.685-6.703.

As a final note, the AB manifestly changed the examination of export contingency (and as a result of local content) by introducing this qualitative examination, the inducement of the unfavourable market condition. It clarified that this examination stems from the need to distinguish between prohibited and actionable subsidies, as the *effet utile* interpretive principle mandates. Indeed, the mere fact that a subsidy may increase the export performance of a recipient or if it is used exclusively for export sales should not create a breach of Part II of SCM. Such instances are regulated by Part III - actionable subsidies.[40] Rather, prohibited subsidies should include an inherently distortive quality. For this reason, the evidence "must be assessed on the basis of the information available to the granting authority at the time the subsidy is granted", not on the effect-based information that comes later as in the causality analysis of Part III.[41]

D. The Post EC-Aircraft Jurisprudence

After *EC — Large Civil Aircraft,* the *US — Tax Incentives* case dealt with Article 3.1(b) SCM and the local content provisions in the Sitting Provisions in the Business & Occupation tax rates applicable to the aerospace sector in the state of Washington. The AB made several distinguishable clarifications.

First, the distinction between *de jure* and *de facto* is of minor relevance, as they constitute a continuum which should be examined holistically with a need to compartmentalize the process.[42] The demonstration of a conditional link, a "requirement" as the AB put it, is a common process in both instances; thus, reaffirming emphatically that a common standard exists.

Moving on, the AB analysed how a mere production subsidy does not meet the standard of prohibited local content in a manner that reminded of the dictum of the AB in *EC — Large Civil Aircraft* –

> We note in this respect that such subsidies can ordinarily be expected to increase the supply of the subsidized domestic goods in the relevant market, thereby increasing the use of these goods downstream and adversely

[40] *EC — Large Civil Aircraft* (AB), *supra* note 5, ¶¶ 1054,1056.
[41] *Id.* ¶ 1049.
[42] Appellate Body Report, *United States — Conditional Tax Incentives for Large Civil Aircraft*, ¶ 5.13, WTO Doc. WT/DS487/AB/R/Add.1 (adopted Sep. 22, 2017) [hereinafter *US — Tax Incentives*].

> affecting imports, without necessarily requiring the use of domestic over imported goods as a condition for granting the subsidy.[43]

However, the AB considered the inducement test as inappropriate for the conclusion of *de facto* local content contingency. Indeed, the AB clarified that the inducement test relates only to the examination of export subsidies as it is based on the wording of Article 3.1(a) SCM and footnote 4.[44] Further, it considered that the inducement test would not provide any evidence on whether there is a local content requirement in the granting of a subsidy.[45] It reminded that the standard of contingency is not met by using an effect-based analysis, as in the case of actionable subsidies, since Article 3.1 SCM does not regulate such instances. The AB reiterated that the examination should focus on "design, structure, modalities of operation, and the relevant factual circumstances", and not the effects.[46]

The AB recalled that a but for examination may be a permissible tool in the context of the prohibited subsidies; yet, it should be used cautiously in instances with limited evidence.[47] In that case, it examined the exercise of discretion by the Washington Department of Revenue in order to examine the relationship between the granting of the subsidy and the local content condition. The Report finally admitted that conditionality for the receival of a subsidy is not generally unusual. However, in that instance it was not clear how the Washington Department of Revenue would exercise its discretionary powers and how the possibility of losing a subsidy, under the conditions set, would evince a local content conditional requirement.[48]

On the same footing, the AB in *EC — Aircraft (21.5)* in its examination of Article 3.1(b) SCM further clarified that Article 3.1(b) does indeed address discriminatory conduct; yet the focus of the legal standard of contingency is to capture instances of a local content requirement, not to address any measure that may result in

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[43] *Id.* ¶ 5.15; *EC — Civil Aircraft* (AB), *supra* note 5, ¶ 1045. The AB stated "[w]e do not suggest that the standard is met merely because the granting of the subsidy is designed to increase a recipient's production, even if the increased production is exported in whole."

[44] Footnote 4 of the SCM considers that an *de facto export subsidy* may be established if the grating is "tied to actual or anticipated exportation or export earnings".

[45] *US — Tax Incentives*, *supra* note 42, ¶¶ 5.17-5.18. The AB stated that "a test based on an examination of whether a given measure is "geared to induce" the use of domestic products over imports does not answer the question of whether the measure requires the recipient to use domestic over imported goods as a condition for receiving the subsidy."

[46] *Id.* ¶ 5.48.

[47] *Id.* ¶ 5.77; BÉNITAH, *supra* note 20, at 438-439.

[48] *US — Tax Incentives*, *supra* note 42, ¶ 5.73; Kienstra, *supra* note 33, at 17-18.

discriminatory effects.[49] Still, it clarified that the phrasing of Article 3.1(b) SCM does inherently entail a discriminatory import substitution. However, this should not be equated with an effect-based approach as we would in Part III of SCM.[50]

The dictum in *US — Tax Incentives* was upheld by the AB in *Brazil — Taxation*, by approving the Panel's perception that a subsidy is "prohibited under Article 3.1(b) of the SCM Agreement, if the use of domestic goods is required or necessary in order to receive the subsidy".[51] The AB examined the Basic Production Processes (PPBs), which comprised of a number of sequential production steps that should be followed by a company in order to benefit from the tax incentive scheme.[52] Among else, it concluded that the scheme does not meet the standard of *de jure* contingency since the wording or the necessary implications of PPBs are not more than "a collection of production steps" which are "likely to result in the use of domestic components and subassemblies".[53]

III. THE CONTEMPORARY STANDARD OF CONTINGENCY

Having introduced an array of different cases, the interim conclusion made is that there is no precise standard of contingency. The first few cases can be considered consistent, yet inconclusive. The interpretation provided to the term as a "conditional relationship between the granting of the subsidy and the export performance/import substitution" cannot be deemed as a definitive interpretation of the term especially since a conditional relationship may encompass various different forms. For example, if we use the general definition of a conditional relation we would get "a logical relation between propositions p and q of the form 'if p, then q; if p is true then q cannot be false'".[54] It is evident that such a generic definition is not adequate and unfortunately such an inference may be derived from the interpretation followed.

Early jurisprudence, until the AB Report in *EC — Large Civil Aircraft*, never revealed what type of conditionality had in mind, whether it was a sufficient conditionality or

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[49] Appellate Body Report, *European Communities and Certain Member States — Measures Affecting Trade in Large Civil Aircraft — Recourse to Article 215 of the DSU by the United States*, ¶ 5.72, WTO Doc. WT/DS316/AB/RW/Add.1 (adopted May 28, 2018).

[50] *EC — Large Civil Aircraft* (AB), *supra* note 5, ¶ 5.70.

[51] *Brazil — Taxation* (AB), *supra* note 16, ¶ 5.259.

[52] *Id.* ¶ 5.283.

[53] *Id.* ¶ 5.284.

[54] Andrew Brennan, *Necessary and Sufficient Conditions*, *in* THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N Zalta ed., Summer 2017, Metaphysics Research Lab, Stanford University 2017), https://plato.stanford.edu/archives/sum2017/entries/necessary-sufficient/.

a necessary one. The note we had was the scolding of the AB to the Panel in *Canada — Aircraft* as the later employed the but for test with a necessary relation in mind. This scolding may not directly hint the type of conditionality required as the but for is a counterfactual that illustrates a causal relationship not a conditional one.[55] What is more, the AB was simply searching a close 'tie' which does not require a specific type of condition. Still, the lack of a qualitative or quantitative guide in search of the standard of this close tie still renders the interpretation inconclusive.

Then, the AB in *EC — Aircraft* took a different turn, by introducing the inducement test. The notion of conditionality was abandoned in search of this close 'tie' of inducement of export performance. This interpretation envisaged a qualitative notion of distortion which gave depth to the standard of conditionality; yet its introduction was hasty as it lacked a very important step.

Before analysing this step, we note that the lack of this step was recognised by the *US — Tax Incentives* where it was recognised that the whole inducement test is not applicable on Article 3.1(b) SCM as it was relevant only in the context of Article 3.1(a) - footnote 4 and more specifically in case of contingency upon anticipated export performance.[56] The AB pointed out that the inducement test had nothing to add in the examination of conditionality in Article 3.1(b) SCM.

The reason why the examination of prohibited contingency has turned into a series of - to be frank - confusing events is the methodological overstep that the AB made in *EC — Large Civil Aircraft*. The examination of a conditional relationship does not lead directly to an examination of inducement. Inducement is in no way included in the notion of contingency. Rather, it should have introduced a final interpretation in the notion of contingency by introducing in its analysis a qualitative standard which is on the same footing with the inducement test. The latter should be considered as a simple test that applies the general common standard of contingency. As the AB in *EC — Aircraft* clarified, the test is the factual equivalent of *de jure* conditionality examination; thus, it is not a standard but a mere applicable test.[57]

In other words, there is a need for finding this common legal standard of contingency*,* one that fits into both export and local content subsidies (both *de facto* and *de jure*), which constitutes the intermediary between the 'preliminary' notion of conditionality and the various applicable tests such as the inducement test. Based on this interpretation and the relevant context of specific subsidy, i.e., anticipated

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[55] William Starr, *Counterfactuals, in* THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N Zalta ed., Fall 2019, Metaphysics Research Lab, Stanford University 2019), https://plato.stanford.edu/archives/fall2019/entries/counterfactuals/.

[56] *US — Tax Incentives*, *supra* note 42, ¶¶ 5.17-5.18.

[57] *EC — Large Civil Aircraft* (AB), *supra* note 5, ¶ 1044.

exportation or *de facto* import substitution, we shall apply the different tests such as the inducement or a counterfactual analysis.

With this in mind, the different tests applied or rejected by the AB may indeed guide us towards finding this common standard since throughout the case law, the rulings seem more cohesive in light of a much more terminal standard.

IV. REFORM ATTEMPTS AND TRENDS IN FREE TRADE AGREEMENTS

Amidst this confusion, WTO Members have sought to increase or amend the rules of the SCM on prohibited subsidies.[58] EU submitted in 2006 proposals for amendments in the SCM Agreement,[59] followed by the US in 2007,[60] which did not generate enough support.[61] These proposals mostly aimed at extending the scope of prohibited subsidies, such as the prohibition of subsidies having a similarly distortive impact as import substitution or export subsidies or subsidies breaching the national treatment principle. Australia and Canada proposed adding clarification on the evidentiary requirements of *de facto* export subsidies.[62] Lastly, many developing countries such as India, Egypt, Venezuela and Cuba mainly focused on reinvigorating Part IV of SCM (non-actionable subsidies, such as environmental or subsidies aiming at legitimate policy goals). [63]

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[58] For overview of proposals, see Li & Tu, *supra* note 3.

[59] Negotiating Group on Rules, World Trade Organisation, Subsidies: Submission of the European Communities, TN/RL/GEN/135M (Apr. 24, 2006).

[60] Negotiating Group on Rules, World Trade Organisation, Expanding the Prohibited "Red Light" Subsidies Category Draft Text: Proposal from the United States, TN/RL/GEN146 (June 5, 2007).

[61] Gary N Horlick & Peggy A Clarke, *WTO Subsidies Discipline During and After the Crisis, in International Law in Financial Regulation and Monetary Affairs*, *in* INTERNATIONAL LAW IN FINANCIAL REGULATION AND MONETARY AFFAIRS 316 (Thomas Cottier et al. eds., 2012).

[62] Negotiating Group on Rules, World Trade Organisation, Comments and Views from Australia on Canada's Submission on Improved Rules under the Agreement on Subsidies and Countervailing Measures (Document TN/RL/W/112), TN/RL/W/135 (June 6, 2003); Negotiating Group on Rules, World Trade Organisation, Futher Contribution to the Discussion of the Negotiating Group on Rules on the Agreement on Subsidies and Countervailing Duty Measures, TN/RL/W/139 (July 18, 2003); Negotiating Group on Rules, World Trade Organisation, Improved Disciplines Under the Agreement on Subsidies and Countervailing Measures and the Anti-dumping Agreement: Communication from Canada, TN/RL/W/1 (Apr. 15, 2002).

[63] *See*, *e.g.*, Negotiating Group on Rules, World Trade Organisation, Intervention by India on the Proposal by the EC Captioned WTO Negotiations Concerning the WTO Agreement on Subsidies and Countervailing Measures (TN/RL/W/30), TN/RL/W/40 (Dec., 2002); Negotiating Group on Rules, World Trade Organisation, Improved Rules under the Agreement on Subsidies and Countervailing Measures – Non-actionable Subsidies: Proposal by Venezuela and Cuba, TN/RL/W/41/Rev.1 (Mar. 10, 2003); Negotiating Group on Rules,

The 2019 Joint Trilateral Statement between US, EU and Japan reiterated the need to introduce new rules on industrial subsidies.[64] In the 2020 Joint Statement the parties provided the following examples of prohibited subsidies that should be covered by Article 3.1 SCM:

> a. unlimited guarantees;
>
> b. subsidies to an insolvent or ailing enterprise in the absence of a credible restructuring plan;
>
> c. subsidies to enterprises unable to obtain long-term financing or investment from independent commercial sources operating in sectors or industries in overcapacity;
>
> d. certain direct forgiveness of debt.[65]

The proposal further identifies certain subsidies considered to be harmful that justify a reversal of the burden of proof so that the granting Member has to prove the lack of serious negative trade or capacity effects. Hence, these subsidies are rebuttably presumed to be prohibited absent contrary evidence. The examples provided are: "excessively large subsidies; subsidies that prop up uncompetitive firms and prevent their exit from the market; subsidies creating massive manufacturing capacity, without private commercial participation; and, subsidies that lower input prices domestically in comparison to [the] prices of the same goods when destined for export."

Within this context, the European Commission issued in 2021 a proposed Regulation on Foreign Subsidies distorting the internal market.[66] The Commission sought to address the regulatory gap within the WTO with regards to foreign

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World Trade Organisation, Preliminary Answers of Cuba and Venezuela to the Questions Provided by Egypt Regarding Document TN/RL/W/41, TN/RL/W/ 108 (May 13, 2003).

[64] Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union (Paris) (May 23, 2019); Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union (Washington, D.C.) (Jan. 14, 2020); Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union (Buenos Aires) (Dec. 12, 2017); U.S.-EU Summit Statement: Towards a Renewed Transatlantic Partnership (Brussels) (Jun. 15, 2021).

[65] Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union (Washington, D.C.) (Jan. 14, 2020).

[66] Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, COM (2021) 223 final (EC).

subsidies. Article 4 of the Proposal introduces a list of subsidies that are most likely to distort the internal market, which is identical to the list of the Joint Statement. A key difference, here, is the institutional setting since the EU Proposed Regulation will be applied within an anti-trust setting where positive and negative impacts of the subsidy will be accessed while, on the contrary, the WTO setting does not presently have the administrative and inquisitorial/fact-finding capacity for such an extensive analysis.[67] The Regulation was formally adopted at the end of 2022 and entered into force in 2023.[68]

Further, the practice of WTO Members at the regional level does not provide significant evidence of any particular trail. Indeed, the vast majority of FTAs simply reiterate the disciplines provided in the SCM Agreement.[69] In EU FTAs, we note a tendency to introduce additional categories of prohibited subsidies that mostly correspond to the proposals of the EU at the WTO. For instance, the EU-Singapore FTA prohibits specific subsidies granted whereby a government/public body covers debts and/or liabilities of an enterprise without any limitation; and subsidies granted to insolvent or ailing enterprises without a credible restructuring plan.[70]

An interesting feature, though, that appears in the EU-Singapore FTA and other EU FTAs[71] is the rebuttable presumption of trade distortiveness of prohibited subsidies.[72] Article 11.7(2) of the EU-Singapore FTA provides that subsidies listed as prohibited will not be considered prohibited when the subsidizing party demonstrates that the subsidy under examination does not affect trade of the other party, nor will be likely to do so. This constitutes the most innovative development

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[67] *See id.* arts. 3 and 5; *see also* Howse, *supra* note 2, at 382; Marios Tokas, *Playing the Game: The EU's Proposed Regulation on Foreign Subsidies,* 56 J. WORLD TRADE (2022).

[68] Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market 23.12.2022 (COM (2021) 223 final) 1.

[69] Luca Rubini, *Subsidies*, *in* HANDBOOK OF DEEP TRADE AGREEMENTS 452-453 (Nadia Rocha et al. eds., 2020).

[70] Free trade Agreement between the European Union and the Republic of Singapore, art. 11.4, Nov. 14, 2019, 2019 O.J. (L 294) 3 (EC).

[71] *See*, *e.g.*, Economic Partnership Agreement between the European Union and Japan, art. 12.7, Apr. 18, 2018, COM/2018/192 final-2018/0091/NLE; *Compare* Free trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part, art. 11.11, May 14, 2011, 2011 O.J. (L 127) 6 (EC), *with* Free Trade Agreement between the European Union and the Socialist Republic of Vietnam, art. 10.5(10), June 12, 2020, 2020 O.J. (L 186) 3 (EC), *and* EU-New Zealand Free Trade Agreement, ch. 16, art. X.7, June 30, 2022.

[72] Leonardo S Borlini and Claudio Dordi, *Deepening International Systems of Subsidy Control: The (Different) Legal Regimes of Subsidies in the EU Bilateral Preferential Trade Agreements*, 23 COLUM. J. EUR. L. 551, 572-573 (2017).

regarding prohibited subsidies as it seems to slightly move away from the very formative prohibition towards a more 'effects-based' approach. Still, this development has not been mirrored by other international actors, even United Kingdom (UK), mostly due to the drafting and regulatory technique followed that mirrors the particularities of the EU State Aid law.[73] Further, a few preferential trade agreements (PTAs) explicitly recognise the need for cooperation to achieve a multilateral solution on export subsidies and domestic support.[74]

In sum, the various reform attempts within the WTO system do not provide additional clarity on how Article 3.1 SCM should operate. It seems that mostly WTO Members are interested in adding more transactions into the list of *ipso facto* prohibited subsidies, as a matter of procedural convenience, not analytical economic rationale. This is reiterated by the developments in the Trilateral Initiative and the Foreign Subsidies Regulation, which provide examples of subsidies, but do not clarify which exact market conditions are to be primarily scrutinized through subsidies regulation.[75] These developments contradict the academic proposals that propose the addition of certain types of subsidies, such as fossil fuels or resource depleting subsidies, due to the apparent negative externalities or other negative effects of such subsidies.[76]

Overall, the reform proposals demonstrate, among else, that there is a significant lack of understanding on the existing rules under the SCM since Members are unwilling to build upon the language of the Agreement and simply introduce new items on the list of prohibited subsidies, similarly to Annex I SCM. For this reason, the present paper moves on to a lengthy interpretive exercise in order to clarify the

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[73] Only the EU-UK Trade and Cooperation Agreement has similar clauses. The EUK adopted such an option in its newly adopted Subsidy Control Act (Subsidy Control Act 2022 c.23, UK Public General Acts).

[74] Panama-El Salvador Free Trade Agreement, art. 706, Apr. 11, 2003; Chile-Central America Free Trade Agreement, art. 7.02, Feb. 15, 2008. Focusing on agricultural goods, United States-Australia Free Trade Agreement, ch. 3, art. 3.1, Jan. 1, 2005; Thailand-Australia Free Trade Agreement, art. 208, Jan 1, 2005; Canada-Costa Rica Free Trade Agreement, art. III.12, III.13, Nov. 1, 2002; United States-Chile Free Trade Agreement, art. 3.16, Jan. 1, 2004; Chile-Mexico Free Trade Agreement, art. 3.13, Aug. 1, 1999.

[75] There are some multilateral discussions with regards to subsidies that lead to overcapacity but the concerns were not developed in the aforementioned instruments. Committee on Subsidies and Countervailing Measures, The Contribution of the WTO to the G20 Call for Action to Address Certain Measures Contributing to Overcapacity, G/SCM/W/569; Committee on Subsidies and Countervailing Measures, Role of Subsidies in Creating Overcapacity and Options for Addressing this Issue in the Agreement on Subsidies and Countervailing Measures, G/ SCM/W/572/Rev.1.

[76] Gary Horlick & Peggy A Clarke, *Rethinking Subsidy Disciplines for the Future: Policy Options for Reform*, 20 J. INT'L. ECON. L. 673, 682-686 (2017).

precise content of Article 3.1 SCM, and in particular whether a legal standard or test can be reached that complies with the balance struck during the Uruguay Round, incorporates concerns of economic theory, and takes due regard of the text and the context of the SCM.

V. TOWARDS A NEW STANDARD OF PROHIBITED SUBSIDIES

The analysis starts from the beginning, the customary rules for interpretation, as enshrined in the Vienna Convention of the Law of Treaties (VCLT).[77] Article 31.1 VCLT introduces the main interpretative tools, i.e., the ordinary meaning, the context and the object and purpose.[78] The AB has previously introduced the ordinary meaning of the term 'contingency'; yet, this dictionary definition cannot be considered in clinical isolation from the rest of the tools identified in Article 31 VCLT. All the different useful interpretative 'innuendos' of this holistic exercise enshrined in Article 31 VCLT, are to be examined.[79]

A. Interpreting the Standard from Scratch

The AB in *Canada — Aircraft* (21.5) duly noted that the granting of a subsidy is not, in and of itself, prohibited under the SCM Agreement nor does granting a 'subsidy', without more, constitute an inconsistency with that Agreement.[80] The universe of subsidies is vast and not all subsidies are inconsistent with SCM, but only those that specifically fall under Article 3.1 of SCM.[81] This means that the AB preferred a rather narrow interpretation of the legal standard of contingency, as this would be in agreement with the object and purpose of the SCM Agreement. The Panel in *Brazil — Aircraft* found that "the object and purpose of the SCM Agreement is to impose multilateral disciplines on subsidies which distort international trade. It is for this reason that the SCM Agreement prohibits two categories of subsidies — subsidies

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[77] Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, art. 3.2, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, 1869 U.N.T.S. 401.

[78] Vienna Convention on the Law of Treaties, art. 31.1, May 23, 1969, 1155 U.N.T.S. 331; For the purposes of the present analysis, the remaining 3 paragraphs (i.e., 31.2, 31.3 and 31.4) shall not be examined as they cannot provide interpretative guidance in the present case as neither a special meaning can be found (31.4), nor additional text - outside of the WTO single undertaking - for 31.2, nor subsequent agreements/practices or applicable relevant rules for 31.3.

[79] ISABELLE VAN DAMME, TREATY INTERPRETATION BY THE WTO APPELLATE BODY 106 (2009).

[80] Appellate Body Report, *Canada — Measures Affecting the Export of Civilian Aircraft — Recourse by Brazil to Article 21.5 of the DSU*, ¶ 47, WTO Doc. WT/DS70/AB/RW (adopted July 21, 2000).

[81] *Id.*

contingent upon exportation and upon the use of domestic over imported goods — that are specifically designed to affect trade".[82]

Therefore, the initial-dictionary-definition of 'contingency' which according to the AB is "conditional/dependent for its existence", should be construed narrowly so as to capture only those subsidies that are 'tied to' exports or usage of domestic goods and more importantly are designed to distort trade. This is similar to the test introduced in some EU FTAs, as examined previously, that allow the subsidizing party to demonstrate lack of trade distortion (or lack such capacity).

Thus, when examining the necessary tie of conditionality, we should keep in mind the probability/capability to distort trade. For this reason, it is not pertinent to the analysis of conditionality whether exports are officially declared a sufficient or necessary condition - especially since the text of the treaty does not provide any hint - rather any such instance of sufficient or necessary conditionality remains relevant to the analysis, as proof of a 'tied to' relation. [83]

To put it differently, we shall examine whether the granting of the subsidy has a close conditional connection, which may very well be derived from a finding of necessary or sufficient conditionality, with e.g., exports, in a way that can distort international trade. In this regard, the AB in *US — Aircraft* noted that "subsidies contingent on export modify the incentives faced by a domestic producer, and reward discrimination in favour of production for export markets over the domestic market"[84] (emphasis supplied).

We focus, thus, mainly on the rationale of banning export and local content subsidies, rather than examining in detail conditional structuring, especially since the AB has already equated the term 'contingent' with the term 'tied to'. Therefore, before moving on with the context, we shall briefly demonstrate the rationale of prohibited subsidies.

B. The Economic Rationale of Prohibition

The rationale behind the prohibition of export and import substitution subsidies is

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[82] Panel Report, *Brazil — Export Financing Programme for Aircraft (as modified by Appellate Body Report WT/DS46/AB/R)*, ¶ 7.26, WTO Doc. WT/DS46/R (adopted Apr. 14, 1999); *Brazil — Aircraft*, *supra* note 10, at ¶ 7.26.

[83] This is reaffirmed by the text of Article 3.1(a) SCM which explains that subsidies may be contingent "whether solely or as one of several other conditions", to export performance or local content.

[84] Appellate Body Report, *United States — Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, ¶¶ 1251-1253, WTO Doc. WT/DS353/AB/R (adopted Mar. 23, 2012).

overly debated. To be more accurate, this strict prohibition of such subsidies, especially of export contingent, seems to be an exorbitant rule, especially since the negative impacts of those subsidies can be regulated under Part III SCM, as actionable subsidies. Still, the fact that such a prohibition exists requires the examination of its object and purpose considering the relevant economic justification, in order to further understand this qualitative feature introduced by the AB in *EC — Aircraft*.

First, it is predominantly believed that export and local content subsidies are responsible among else, for harming international competition in two-fold measure.[85] First, prohibited subsidies may partition markets and breach market access expectations by allowing Members to create an incentive for companies to export, whilst avoiding that domestic price are driven down. Thus, prohibited subsides frustrate the basic objective of the WTO Agreements, to promote fair international trade, by directly distorting trade since their effect mimics tariffs, especially towards domestic input. Second, they reduce or negatively affect the competitive position of a foreigner either domestically or internationally since prohibited subsidies provide incentives to infiltrate a foreign market or by raising barriers through local content requirements.[86] Yet, it seems that the negotiators were mainly concerned about protecting their own market, not so much about the global welfare.[87]

What is more, the prohibition of local content subsidies has its roots in Article III GATT, as the AB in *Canada — Autos* clarified.[88] Indeed, as the delegation of US stated during the Uruguay Round, local content subsidies "are as effective as any tariff in protecting domestic input supplying industries and distorting the flow of resources internationally".[89] While on the other hand, prohibition of export subsidies scrutinize the so-called 'beggar-thy-neighbour' policy which envisages

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[85] LUCA RUBINI, THE DEFINITION OF SUBSIDY AND STATE AID 401-402 (2009).

[86] Luca Rubini, *"The Wide and the Narrow Gate": Benchmarking in the SCM Agreement after the Canada–Renewable Energy/FIT Ruling*, 14 WORLD TRADE REV. 211, 65 (2015).

[87] James Flett, *From Political Pre-Occupation to Legitimate Rule against Market Partitioning: Export Subsidies in WTO Law after the Appellate Body Ruling in the Airbus Case*, GLOBAL TRADE & CUSTOMS J. 50, 50-51 (2012) [hereinafter Flett].

[88] *Canada — Autos*, *supra* note 18, ¶ 140.

[89] Group of Negotiations on Goods and Negotiating Group on Subsidies and Countervailing Measures, *Multilateral Trade Negotiations the Uruguay Round*, GATT Doc. MTN.GNG/NG10/W/29 (Nov. 22, 1989). Many arguments exist that the prohibition of Art. 3.1(b) SCM is especially flawed since it prohibits purchaser subsidies and not production subsidies even if they have the same local content condition. For the purposes of this analysis, we shall not elaborate on this issue as it does not affect the interpretation of the term 'contingent' rather the term 'use' or 'product' which should be interpreted in light of the object and purpose of SCM and specifically the context of 3.1(b).

practices of state that try to boost their export performance by pillaging the performance of the neighbours.[90]

In all, both instances of prohibition may exist as a safeguard to prevent a Prisoners' Dilemma situation where all exporting or importing states are forced to subsidise in order to reduce the possible reduction in their national payoffs by either the raging bull exports of the subsidised state that knock at their doorstep or by the decreased export capability as its exports are cold-shouldered by the local-content-subsidy reinforced foreign market.[91]

The aversion towards such practices creates not only huge subsidies spending but also huge market stagnation by nullifying the forces of supply and demand in the global market, an instance that par excellence combats the holy grail of WTO's liberalization, the exploitation of comparative advantages.[92] This needs to avoid the partition of the market, a feature inherent to the operation of prohibited subsidies that should be accessed in the legal standard of contingency by excluding subsidies that merely have a positive effect on the export potentiality or a benefit to the domestic market/producers.[93]

The outcome of this brief analysis on the justification of the prohibition of Article 3.1 SCM is that we should examine the rule on conditionality on basis of the qualitative link, which includes, among else, the rationale between exports/local content and the granting of the subsidy.

Here, the US-China Policy Working Group has proposed that the red lines in governmental intervention (in general, not only subsidies) are drawn across polices causing significant distortions in global markets and entailing global economic losses, such as the beggar-thy-neighbour policies. [94] For our purposes, this entails that Article 3.1 SCM should focus more on substance than on form.[95] Thence, the legal standard of contingency here should entail a substantive analysis, even if

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[90] COPPENS, *supra* note 5, at 10.

[91] Kyle Bagwell and Robert W Staiger, *Strategic Export Subsidies and Reciprocal Trade Agreements: The Natural Monopoly Case*, 9 JAPAN & WORLD ECON. 491, 492 (1997).

[92] *See* Kevin Kennedy, *GATT 1994*, *in* THE WORLD TRADE ORGANIZATION: LEGAL, ECONOMIC AND POLITICAL ANALYSIS (Patrick FJ Macrory et al. eds., 2005); Mordechai E Kreinin & Michael G Plummer, *Economic Principles of International Trade*, *in* THE WORLD TRADE ORGANIZATION: LEGAL, ECONOMIC AND POLITICAL ANALYSIS (Patrick FJ Macrory et al. eds., 2005); BÉNITAH, *supra* note 20, at 63-64 .

[93] Flett, *supra* note 85, at 57; WOLFGANG MULLER, WTO AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES: A COMMENTARY 207 (2017).

[94] Howse, *supra* note 2, at 381.

[95] Sykes, *supra* note 2.

without actual negative trade effects.

C. The Legal Standard in its Context

At this point, we examine the standard of conditionality not only in relation to Article 3.1 SCM in specific and the SCM Agreement in general, but also the WTO Agreement as a system; hence, examining not only the immediate but also the broader context.[96] At this point, we are mindful that Article XVI:4 GATT does not offer interpretative guidance despite its reference to export subsidies.[97]

At the outset, we notice that the SCM Agreement lacks a clear non-discrimination obligation but for the application of countervailing duties. Indeed, one of the cornerstones of the WTO rules-based systems seems to be missing from the determination of a prohibited subsidy. The specificity test in Article 2 SCM seems to capture to a certain extent the principle of non-discrimination at least to the enterprise and industry level.[98] In this regard, Article 2.3 SCM deems prohibited subsidies as *ipso facto* specific. We could infer here that the notion of discrimination is inherent to the operation of prohibited subsidies.

Alternatively, Article 2 SCM does not introduce the notion of discrimination but rather illustrates that the drafters - at least - thought that a targeted subsidy is inherently more distortive and should be subdued to further scrutiny.[99] Thus, this targeting exercise under Article 2 SCM, should be reflected in the analysis of Article 3.1 SCM since prohibited subsidies entail an *ipso facto* distortive conditional relation.

In this sense, the AB in *Canada — Aircraft* considered the obligatory sales display of the applicants to the Technology Partnership Canada (TPC). The applicants were required to make a clear distinction between domestic and export sales during the granting process; and second, that the grantor, reviewed these track records and attached considerable importance to the export proportion. Absent such a clear distinction, the TPC employees were ordered under the Interim Reference Binder,

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[96] Appellate Report Body, *European Communities — Customs Classification of Frozen Boneless Chicken Cuts*, ¶ 163, WTO Doc. WT/DS269/AB/R, WT/DS286/AB/R/Corr.1 (adopted Sep. 12, 2005).

[97] According to the Appellate Body in *US — FSC*, Art. XVI:4 GATT does not refer to export subsidies in the same sense as the SCM Agreement. Appellate Body Report, *United States — Tax Treatment for 'Foreign Sales Corporations'*, ¶ 117, WTO Doc. WT/DS108/AB/R (adopted Mar. 20, 2000).

[98] *See*, *e.g.*, Art. 2.1 (a) SCM "[w]here 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" (emphasis supplied).

[99] ICTSD & WEF, *supra* note 2, at 4; BOSSCHE AND ZDOUC, *supra* note 4, at 1540.

to reject the project.[100] Therefore, the AB has examined such an inherent discriminatory treatment, or to be more accurate a privileged/more favourable position.

This result is also reaffirmed by WTO jurisprudence of *de jure* contingency, as in the measures examined in *US — FSC* and *Canada — Autos*, exports expressly opened the road for funding; hence, establishing a privileged position for exports over other sales or activities. In addition, in *Canada — Autos*, the Panel found that the standard of conditionality was met because producers could benefit further from the tax exemption when focusing on exports even while decreasing production. Therefore, focus on export was the only economically viable option for the producers, as, all things being equal, a manufacturer would benefit more from export orientation.[101]

The examination of privileged (i.e., more favourable) status is closely related to the 'dictum' of the AB in *EC — Aircraft* and the inducement test. The privileged positions that exports receive, gives an incentive to producers to alter the ratio between their export and domestic sale, in a way that under normal market circumstances, absent the subsidy, they would not.

Yet, the aforementioned analysis should be read in light of the relevant context provided by Article III:4 GATT, which introduces a less demanding standard requiring the incentives introduced by the measure to not alter the competitive conditions to the detriment of imported goods.[102] Consequently, the measure should not provide incentives that are deemed to 'most likely' lead to export/use domestic product by altering the market conditions;[103] rather, the incentive should be similar to an inducement.[104] In other words, when a State introduces an export conditional subsidy and "makes an offer that [s]he [simply] can't refuse" as a rational market actor, then the granting of the subsidy is not a mere incentive as prescribed in the jurisprudence of Article III:4 GATT.

D. The Inherent Balance of the SCM Agreement

Another issue that should be examined is a more systemic one which deals with the capability of a state to pursue national policy objections within the scope of the SCM obligations.

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[100] *Canada — Aircraft* (AB), *supra* note 14, ¶ 178.
[101] Panel Report, *Canada — Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 215 of the DSU (as modified by Appellate Body Report WT/DS70/AB/RW)*, ¶ 10.184, WTO Doc. WT/DS70/RW (adopted Aug. 4, 2000) [hereinafter *Canada — Recourse*].
[102] *Brazil* — Taxation (AB), *supra* note 16, ¶ 5.254.
[103] *Id.* ¶ 5.284.
[104] *EC — Large Civil Aircraft* (AB), *supra* note 5, ¶ 1045.

The current SCM Agreement, as a self-standing agreement, does not have expressive provisions on regulatory space to promote non-trade principles and values, emphasis given that Part IV SCM, on non-actionable subsidies (green or research and development subsidies) is 'out of order'.[105] The immediate answer to the aforementioned problem would be resorting to Article XX GATT. However, it is highly disputed whether the General Exception applies to a violation of the SCM Agreement,[106] and since Member States avoid raising such an issue in an SCM dispute,[107] we shall seek safe harbour in other standards which may include such a policy space.

For example, it has been proposed that causation in actionable subsidies is in fact a necessity test, the same as in Article XX GATT.[108] Should the subsidy be limited to what is necessary in order to promote such a policy consideration or a common good, the standard of causation will, generally speaking, not be fulfilled. In addition, it is no wonder that countervailing duties require a demonstration of 'material' injury.[109]

On this basis, it could be an elegant - in terms of contextual and systemic consistency - addition to the examination of contingency, a qualitative assessment of general policy considerations. It has been proposed after all, that the WTO Agreements are characterised by an inherent balance which may very well include examinations that are identical to the General Exception of the GATT, e.g., Technical Barriers to

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[105] Robert Howse, *Securing Policy Space for Clean Energy under the SCM Agreement: Alternative Approaches*, E15 Expert Group on Clean Energy Technologies and the Trade System (2013); Luca Rubini, *Ain't Wastin' Time No More: Subsidies for Renewable Energy, The SCM Agreement, Policy Space, and Law Reform,* 15 J. INT'L ECON. L. 525 (2012).

[106] *See* Robert Howse, *Climate Mitigation Subsidies and the WTO Legal Framework: A Policy Analysis,* IISD (2010), https://www.iisd.org/system/files/publications/bali_2_copenhagen_subsidies_legal.pdf; Virginia Hildreth, Renewable Energy Subsidies and the GATT, 14 CHI. J. INT'L L. (2014), https://chicagounbound.uchicago.edu/cjil/vol14/iss2/10; Fernando Piérola, *The Availability of a GATT Article XX Defence with Respect to a Non-GATT Claim: Changing the Rules of the Game?*, 5 GLOBAL TRADE & CUSTOMS J. 172 (2010).

[107] *Canada — Certain Measures Affecting the Renewable Energy Generation Sector*, WTO Doc. WT/DS412/19 (adopted May 24, 2013). In this case, only an *amicus curiae* referred to the applicability of Art. XX; Nelson & Puccio, *supra* note 15.

[108] James Flett, *Preserving the Balance between Trade and Non-Trade Interests through a Systematic Interpretation of WTO Subsidies Law*, *in* WHAT SHAPES THE LAW?: REFLECTIONS ON THE HISTORY, LAW, POLITICS AND ECONOMICS OF INTERNATIONAL AND EUROPEAN SUBSIDY DISCIPLINES 96 (Luca Rubini & Jennifer Hawkings eds., 2016).

[109] *Id.*

Trade Agreement.[110] To be clear, we do not submit that the policy space provided is the same for the TBT and the SCM, especially since "the right to regulate" is part of the object and purpose of TBT.[111] Rather, the 'delicate balance struck' in imposing disciplines in the use of subsidies,[112] should provide the regulatory space to introduce subsidies promoting general policy considerations, as long as market distortions are avoided.

Such an assessment should not seem so innovative or ground-breaking as the Panel in *Canada — Aircraft (21.5)* followed a similar inquiry, which was not reversed by the AB. The Compliance Panel in *Canada — Aircraft* drew a distinction between "export performance" on one hand and "general technological or economic benefits" on the other. The latter are the increase in economic growth and the promotion of sustainable development, which in some cases may indeed be derived decisively from exports. The restructured TPC was found to be a technology investment fund established to contribute to the Canadian economic growth and sustainable development which was found not to be export contingent mainly due to the striking out of the original component for targeting projects that operate on an export base.[113] Thus, as far as the fund did not include any unnecessary goal provision or did not operate in any such way, contingency was not found, even if general conditionality on exports existed.

Besides, the AB in *EC — Aircraft* clarified that the government's policy reasons for awarding the subsidy, when objectively reviewed, are pertinent to this analysis.[114] Therefore, the way that governmental policy is infused in the application process, for example, becomes part of this total assessment of conditionality. On these grounds a conditional relationship may exist between exports and the granting of a

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[110] Appellate Body Report, *United States — Measures Affecting the Production and Sale of Clove Cigarettes*, ¶ 96, WTO Doc. WT/DS406/AB/R (adopted Apr. 4, 2012) [hereinafter *US — Clove Cigarettes*]; Appellate Body Report, *Argentina — Measures Relating to Trade in Goods and Services*, ¶ 6.114, WTO Doc. WT/DS453/AB/R/Add.1 (adopted Apr. 4, 2016); Panel Report, *Thailand — Customs and Fiscal Measures on Cigarettes from the Philippines — Recourse to Article 215 of the DSU by the Philippines*, ¶ 7.755, WTO Doc. WT/DS371/RW/Add.1 (adopted Nov. 12, 2018); Panel Report, *Thailand — Customs and Fiscal Measures on Cigarettes from the Philippines — Second Recourse to Article 215 of the DSU by the Philippines*, ¶ 7.265, WTO Doc. WT/DS371/RW2/Add.1 (adopted July 12, 2019).

[111] *US — Clove Cigarettes*, *supra* note 108, ¶ 96.

[112] Appellate Body Report, *United States — Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea*, ¶ 115, WTO Doc. WT/DS296/AB/R (adopted June 27, 2005); Marios Tokas, *Hanging in the Balance: The Prohibition of Protectionism in Article III and XX of the GATT 1994 in Light of the Inherent Balance Theory*, 11 INDIAN J. INT'L ECON. L. 195 (2019).

[113] *Canada — Recourse*, *supra* note 99, ¶ 5.33.

[114] *EC — Civil Aircraft* (AB), *supra* note 5, ¶ 1050.

subsidy; yet, exports may be the incidental repercussion of the promotion of environmentally friendly products.

In this regard, the recent Panel in *Brazil — Taxation* verified this alternate second look on a primitive finding of contingency. In that case, the tax suspensions provided under the PEC and the RECAP programmes by Brazil, included an eligibility requirement of 50% export performance.[115] The Panel recognises that this eligibility requirement "at first sight appears to be clear evidence of export conditionality or dependency". Still, the adjudicating body moved on and examined Brazil's argument that the goal of the programs was credit accumulation, and the operation and eligibility requirements were set so as to verify that the turning point for credit accumulation is in the 45 to 50% range of share of exports in the revenue of Brazilian companies. Despite ruling against Brazil due to lack of evidence, the Panel did clarify that the WTO members are entitled under the WTO rules to pursue reasonable policies such as credit-accumulation and Brazil could demonstrate that the export requirement does not demonstrate export contingency but rather dependence on a reasonable policy, that is credit accumulation.[116]

The EU-UK Trade and Cooperation Agreement (EU-UK TCA) introduces a similar exception to export subsidies prohibition for "short-term credit insurance for non-marketable risks".[117] This applies to instances where there is lack of sufficient private market capacity due to significant deterioration of severing sector rating, corporate sector performance, or significant contraction of private credit insurance capacity.

E. Finding Room for the Inducement Test

As a final note, we should examine the validity of the inducement test, especially in conjunction with other instances of prohibited subsidies. We remind that we have accepted the test as an application of the standard of contingency, rather than a standard itself.

First, it is evident that the dictum of the AB cannot be directly transposed for an inquiry of contingency either upon actual exportation (still *de facto*) or *de jure* export contingency but only upon anticipated exports/export-earnings. This is due to the

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[115] Panel Report, *Brazil — Certain Measures Concerning Taxation and Charges (as modified by Appellate Body Reports WT/DS472/AB/R / WT/DS497/AB/R)*, ¶¶ 2.148-2.170, WTO Doc. WT/DS472/R/Add.1 and Corr.1, WT/DS497/R/Add.1 and Corr.1 (adopted Oct. 4, 2017 and Aug. 30, 2017) .

[116] *Id.* ¶¶ 7.1232-7.1236.

[117] Trade and Cooperation Agreement between the European Union and the European Atomic Energy Community, of the One Part, and the United Kingdom of Great Britain and Northern Ireland, of the other Part, art. 367.8(a), Dec. 31, 2020, 2020 OJ (L 444) 14 (EC).

fact that first, the adjudicating bodies of the WTO examined in *EC — Aircraft* examined the US's allegation of contingency only upon anticipated export performance and not on actual export performance.[118] Besides, it would lead to ineffective interpretation of footnote 4 SCM to examine an inducement of exports in cases of *de facto* contingency upon actual exports, as we would render the use of the word 'or' without meaning. The SCM captures different distorting practices by making a distinction between actual and anticipated exports. This was also reiterated by the AB as it made a clear distinction between the terms actual and anticipated exports.[119] After all this and mirroring the dictum of the AB in *US — Tax Incentives*, the inducement test would not be able to demonstrate the qualitative standard of contingency in cases of actual exportation. Indeed, the inducement test as used by the AB is tailored to an examination of anticipated exports, anticipated with and without the granting of the subsidy. Such an examination is indeed not suitable to examine a condition upon actual exports subsidy.

Even though the test of *EC — Aircraft* is not *per se* suitable to be directly transposed in other circumstances of export contingency, we draw some useful inferences from its application. As we have seen, the test serves to examine whether a distortive quality exists in the relationship between the granting of the subsidy and the anticipated exportation. In this sense the AB had clarified that export-contingent subsidies will indeed favour a recipient's export sales over its domestic sales.[120] This privileged position of anticipated exportation is the key outcome of the test and the core of the distortive nature of the subsidy at hand. Hence, this privileged position is what the prohibition upon actual exportation serves. After all, when the funding is *de facto* 'limited to' a demonstration of actual exports by the possible recipient, then indeed exportation is induced in abnormal market conditions that are a governmental funding, otherwise unavailable, to incentivize the increase in exports.

Following the trail of privileged positioning of exports, a similar examination not only should but also has taken place in local content subsidies. The AB (and the Panel) in *Canada — Autos*, in the analysis of *de jure* conditionality, made an interesting observation.

In that case, EC and Japan challenged the import duty exemption provided by the Canadian Government to certain motor vehicle manufacturers under the Motor Vehicle Tariff Order (MVTO) 1998 and the Special Remission Orders (SROs).[121] The import duty exemption was available to a manufacturer if, among else, it satisfied the Canadian value added (CVA requirements), that is a minimum amount

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[118] *EC — Civil Aircraft* (AB), *supra* note 5, ¶¶ 1042-1043.
[119] *Id.*
[120] *Id.* ¶ 1053.
[121] *Canada — Autos*, *supra* note 18, ¶¶ 10.203-10.204.

of CVA, and a minimum ratio ('production-to-sales' ratio) with respect to its sales of motor vehicles in Canada. One way to satisfy the aforementioned requirement according to the MVTO 1998 is to use domestic components in the motor vehicles by the manufacturer. The Panel found that Canada's import duty exemption did not satisfy the standard of dependence upon local content, as a manufacturer would be able and more importantly, willing to satisfy the CVA requirement without using domestic goods, but rather using other elements such as direct labour costs, manufacturing overheads, general and administrative expenses and depreciation.[122] Therefore, the Panel considered as crucial the privileged position that domestic goods should have under the CVA scheme (in a similar analysis to the 'inducement' test), in order to demonstrate whether a manufacturer was incentivized to use domestic goods over imported ones.

This conclusion is also reaffirmed by the report of the AB, even though it reversed the Panel's decision (however, due to lack of facts it refrained from reaching a decision) and actually scolded the Panel for not examining the exact level of its CVA requirements and the multiplicity of possibilities for compliance to these requirements. The AB found of high importance how the level of its CVA requirement makes the use of domestic good necessary to reach a high threshold.[123] What we derive from the reversal of the Panel's dictum and the unfinished analysis of the Canadian import duty exemption, is a need to demonstrate an incentive in the form of privileged position of domestic goods in a way that twists the normal market conditions via i.e., high threshold of domestic value added.

An examination of this privileged position supplements and complements the analysis of incentives undertook in sub-section B of paragraph III. A market actor is incentivized (near 'induced') to export/use domestic products, only when the privileged position granted by the measures to the exports/domestic products, is of such character that no rational market actor would be able to withstand the 'temptation'. To an extent, the Panel in *India — Export Related Measures* did examine how important were the financial incentives set forth, for the early fulfilment of the export related conditions for receiving the subsidy.[124]

The adjudicating body could set up an examination similar to sequential gaming in game theory.[125] In other words, the Panels could examine how the different payoffs and strategies of the market players are expected to change due to the suspected conditionality, in order to assess whether indeed a distortive incentive was given that

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[122] *Id.* ¶¶ 10.216, 10.219.
[123] *Id.* ¶¶ 127-128, 130.
[124] Panel Report, *India — Export Related Measures*, ¶ 7.511, WTO Doc. WT/DS541/R/Add.1 (adopted Oct. 31, 2019).
[125] STEVE TADELIS, GAME THEORY: AN INTRODUCTION (2013).

a rational player could not simply ignore. For example, if a subsidy is given on the necessary condition of 80% usage of domestic products; yet the subsidy amounted cannot be considered able to incentivise substantially the possible recipients to alter the preference due to e.g., the low volume of the domestic product; the Panel should not consider it as a prohibited subsidy under Article 3.1(b) SCM.

VI. THE STANDARD AND ITS APPLICATIONS AHEAD OF REFORM

From the totality of WTO jurisprudence, we can deduce that a pattern is followed by the AB in terms of clarifying and applying the standard of conditionality. The pattern is that the standard of contingency requires a demonstration of a conditional relationship which is expected to distort international trade (mainly with a partition of the market), by providing a discriminatory privileged position to exports/domestic goods which cannot be explained by legitimate general policy considerations.

The standard can be met by a plurality of different applicable tests such as the inducement test or the but for test, none of which is the Pavlovian response for finding contingency.[126] For example, we can have a necessary *de jure* conditionality in an instance that does not meet the standard of contingency. In other words, it is possible that under a subsidy scheme a possible beneficiary is required to demonstrate export under the granting process as part of a pure *de jure* eligibility requirement. However, this requirement is defined in a pure procedural manner, such as, "[e]very possible recipient should have demonstrated exports in the last 10 years". Indeed, exports are a necessary condition in this case. However, this does not suffice for a violation of Article 3.1(a) SCM, as this requirement does not present any qualitative distortive feature, such as the capability to partition, even if it does place the exports in a privileged position. Still, the requirement of exports is expressed in such a pure procedural manner that no distortion of the market incentives or conditions is introduced.

Thus, the examination of this continuity (i.e., *de jure* and *de facto*) should examine whether, first, a conditional relationship exists (of any kind) between the granting of the subsidy and export performance/use of domestic goods; second, this relationship places the exports/domestic goods in a substantial privileged (more favourable) position; third, this privileged position is characterized as distortive for international trade; and fourth, this conditional distortive relation is not an incidental 'by-product' of a legitimate policy consideration.

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[126] For classical conditioning (i.e., automatic or unconscious response), see Kendra Cherry, *What Is Classical Conditioning? How It Works, Terms to Know, and Examples*, VERYWELL MIND, https://www.verywellmind.com/classical-conditioning-2794859.

It is not suggested that the Panels should examine a claim strictly in this exact format. Rather, these four different factors should be taken into account via any applicable test the adjudicating bodies deem applicable. For example, the 'inducement test' takes into account the privileged position of export performance and examines the distortive effect of this privileged position, while it should highlight the conditional relationship, which in the *EC — Aircraft* was rather overshadowed by the analysis of incentives, and the examination of general policy considerations that could account for the privileged position of exports.

VII. CONCLUSION

Bringing up rear, the issue of prohibited subsidies has been in the spotlight multiple times for adjudicators and scholars. Notwithstanding the dissenting opinions on the rationale of the prohibitions by scholars, the WTO adjudicating system has consistently considered them as highly distortive for international trade. On this basis, the examination of its core prerequisite, 'contingency', should be made in accordance with this qualitative feature. Thus, the issue of distortive privileged treatment should be dealt with high mindfulness as it is not only the core of the standard but also, it must operate consistently with the distinction between prohibited and actionable subsidies.

In other words, the examination of the distortive character of the granting of the subsidy, as enshrined in the conditional requirement, should not blur with the examination of real effects and causality. The different applicable tests such as the but for, the inducement as well as its relevant ratio analysis, should be used in order to draw the crucial inferences of a distortive instance not the actual trade effects. Therefore, objectively verifiable policy considerations and intentions of the grantors are a part of the analysis. Therefore, adjudicators should be cautious in examining the standard of contingency so as not only putting undue weight on the subjective policy consideration of the grantor but also on the different counterfactual scenarios in terms of inducement or restricted availability.

Article 3.1 SCM prohibits export and local content subsidies as a matter of principle not as a matter of effect. Hence, on this ground the adjudicators should examine their existence and go the distance towards consistent scrutiny of prohibited subsidies.

Such a comprehensive approach paves the way for future discussions within the WTO on reforming subsidy control. A balanced examination that considers the distortive elements of a subsidy, even if presumed for the purposes of prohibited subsidies, and the possible legitimate policy considerations, may bridge the divergent opinion of WTO Members. Export and local content subsidies will not be judged purely based on form but rather based on substance, even if without evidence of

actual negative trade effects. This need for substantive analysis will trigger further conversation on what types of distortions WTO Members are mostly concerned about. This analytical framework will be especially relevant for future discussions on regulating subsidies related to industrial policies, as we have seen industrial subsidies constituting success stories for developing countries and ending up being WTO illegal.[127]

[127] Swati Dhingra and Timothy Meyer, *Leveling the Playing Field: Industrial Policy and Export-Contingent Subsidies in India–Export Related Measures*, 20 WORLD TRADE REV. 606, 620–621 (2021).