WORLD TRADE ORGANIZATION

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BENEFIT PASS-THROUGH

Communication from Canada

The following communication, dated 21 May 2004, 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(04)/55), also be circulated as a formal document.

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 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 to the other entity.[1]

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[1] In the *United States – Pork* 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 Department of Commerce should have examined 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 panel in US – Lead and Bismuth II (WT/DS/138/R) stated 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 panel in *United States – Preliminary Determination with respect to Certain Softwood Lumber from Canada* (WT/DS236/R, adopted on 1 November 2002) held that:

> An authority may not assume that a subsidy provided to producers of the 'upstream' input product automatically benefits unrelated producers of downstream products, especially if there is evidence on the record of arms-length transactions between the two. Rather, we consider that in such circumstances the investigating authority should examine whether and to what extent the subsidies bestowed on the upstream producers benefited the downstream producers.

Most recently, the panel in *United States – Final Countervailing Duty Determination with respect to Certain Softwood Lumber from Canada* (WT/DS257/R of 29 August 2003) reaffirmed the finding in United States – Pork, i.e:

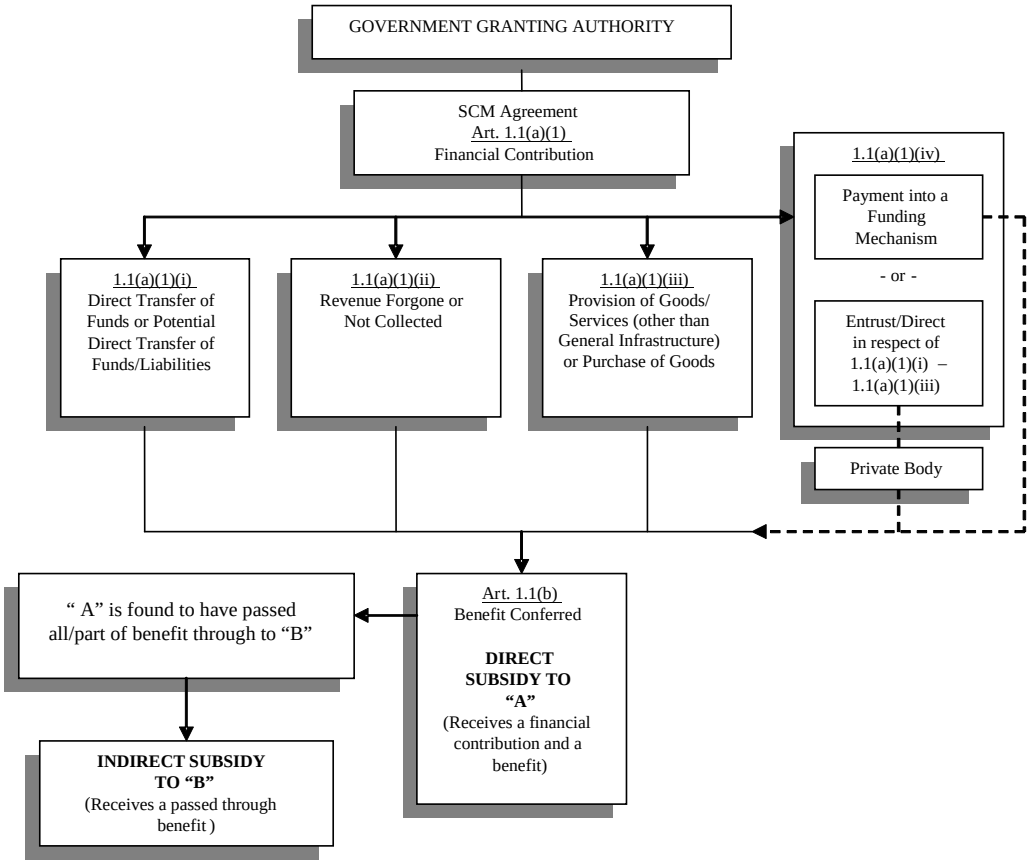
> Our analysis is consistent with the findings of the 1990 GATT Panel on *US – Canadian Pork*…That panel found, as we do, that investigating authorities had the affirmative obligation to make a determination of subsidization in respect of a product, and could not simply assume such subsidization where the subsidies were bestowed in respect of a product (the input product) that was different from the product subject to countervailing duty, and where the input producers were unrelated to the producers of that subject merchandise.

The current SCM Agreement does not, however, afford any direct guidance on the conduct of pass-through analyses.

2. In the absence of explicit guidance for the conduct of pass-through analyses, there is greater scope for the authorities of a Member to apply countervailing measures on imports of subject goods on the basis of a perfunctory or *pro forma* pass-through analysis. By the same token, the provision of meaningful guidance for the conduct of such analyses could assist investigating authorities in rooting out certain trade-distorting subsidies that might otherwise go undetected and unaddressed. This document does not purport to be an exhaustive enumeration of issues relating to pass-through; it is simply intended to promote a technical discussion of the matter. In this regard, Canada reserves its right to offer additional thoughts.

II. GENERAL PRINCIPLES

3. The conferral of an indirect subsidy *via* a benefit pass-through can be schematically depicted as follows:



4. Of course, whether or not an upstream recipient of a financial contribution appropriates all or part of the benefit of that contribution or passes it through to a downstream enterprise will depend upon the particular circumstances of each case. It would, however, be useful to include an illustrative

list of relevant factors to consider in the SCM Agreement to guide investigating authorities in the conduct of pass-through analyses and to assist dispute settlement panels in the consideration of such issues.

III. PROPOSED AMENDMENTS

5. It is proposed that a new footnote be added to current Article 1.1(b) of the SCM Agreement that essentially codifies existing GATT/WTO jurisprudence to the effect that pass-through cannot be presumed, but rather, must be demonstrated, i.e:

> "Where the recipient of a financial contribution and the recipient of the resulting benefit operate at arm's length from one another, the investigating authority shall examine whether, and to what extent, the benefit of the financial contribution was passed through from the former to the latter, in accordance with the provisions of Annex VIII."

6. It is also proposed that an Annex VIII be added to the SCM Agreement on "*Guidelines for Benefit Pass-Through Analyses*", which includes the following elements:

(a) *Presumption*: Transactions between entities operating at arms length from one another shall be subject to a rebuttable presumption that the benefit of a financial contribution to one entity has not been passed through, either in whole or in part, to the other.

(b) *Relevant Considerations*: In determining whether the benefit of a financial contribution to one entity has been passed through, either in whole or in part, to another entity, the following factors shall be considered:

- Where the recipient of the government financial contribution provides goods or services to, or purchases goods or services from, an arm's-length entity, whether the provision or purchase is for less than adequate remuneration determined in relation to prevailing market conditions for such goods or services in the country of provision or purchase (including price, quality, availability, marketability, transportation and other conditions of purchase or sale);

- Where the recipient of the government financial contribution provides goods or services to, or purchases goods or services from, an arm's-length entity ostensibly for adequate remuneration, whether there existed a compensatory arrangement or other collateral agreement between the entities (i.e. an agreement between the two entities on matters falling outside the scope of what is normally understood to be "conditions of purchase or sale"), or whether there was an entrustment or direction by the government granting authority to pass the benefit through at the downstream level to the other arm's-length entity; and

- The conditions of competition in the market.[2]

[2] The term "conditions of competition" is already used in Article 15.3 of the SCM Agreement. An analysis of the conditions of competition in the context of a pass-through determination would include an assessment of the intensity of price competition among the upstream players. Among the factors that might be relevant to such an analysis would be the downstream price-elasticity of demand for the upstream input product.

(c) *Non-Attribution Requirement*: The investigating authority shall also consider whether factors other than the pass-through of benefits have affected the price of goods or services and such price effects shall not be attributed to the pass-through of benefits.

7. The above does not purport to be an exhaustive enumeration of relevant factors that would appear in an Annex VIII.

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