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Interpreting the 'Removal' Obligation in Article 7.8 of the WTO SCM Agreement

Abhimanyu George Jain*

ABSTRACT: *The meaning of the phrase 'remove the adverse effects' as used in Art. 7.8 of the WTO Subsidies and Countervailing Measures Agreement (SCM Agreement) is unclear; it has been explored neither in the jurisprudence of the DSM, nor in academic literature. There are three fundamental principles underlying the interpretation of the SCM agreement – avoidance of economic analyses, proscription of retrospective remedies and interpretation of 'withdrawal' in Art. 4.7 as prospective cessation. Based on these fundamental interpretive principles, there are several possible meanings of the removal obligation, including equivalent subsidisation, price controls and quantitative restrictions. In the absence of decisive reasons to prefer one over the other, the removal obligation should be construed as a result rather than process obligation. This analytical inquiry demonstrates the problems engendered and perpetuated by the avoidance of economic analyses in interpretation of the SCM Agreement.*

1. INTRODUCTION

The goal of this paper is to interpret the phrase 'remove the adverse effects' as it is used in Art. 7.8 of the Subsidies and Countervailing Measures Agreement (SCM agreement).[1]

The SCM agreement divides subsidies into three categories. The first category refers to export subsidies which are prohibited under the SCM agreement.[2] The second category refers to actionable subsidies which are allowed so long as they do not cause adverse effects to other member states.[3] The third category refers to non-actionable subsidies which are permissible subject to certain conditions.[4] Arguably, this third category is no longer recognised under the SCM agreement, following the lapse of Part IV (Arts. 8 and 9) of the SCM pursuant to Art.

* Legal Advisor, Norton Rose Fulbright LLP, London; LL.M, Georgetown University Law Centre, 2013; B.A., LL.B (Hons.), National Law School of India University. The author may be contacted at abhimanyugeorgejain@gmail.com. The author would like to thank Professor Richard Diamond for his invaluable guidance and support. Any errors remain the sole responsibility of the author.

[1] Agreement on Subsidies and Countervailing Measures, 15 April 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 14 (hereinafter the SCM Agreement).

[2] *Ibid*, at Part II.

[3] SCM Agreement, *supra* note 1, at Part III.

[4] SCM Agreement, *supra* note 1, at Part IV.

31.[5] Nevertheless, this three-tiered understanding of subsidies is a commonly accepted statement of the organisational scheme of the SCM agreement. For the purposes of this paper, reference shall continue to be made to the provisions of Arts. 8 and 9 notwithstanding their lapse, as these provisions potentially provide contextual insights into the meaning of Art. 7.8.

The SCM agreement provides four responses to proscribed subsidies. Prohibited export subsidies are required to be withdrawn.[6] Actionable subsidies are subject to disjunctive obligations of withdrawal, or removal of the adverse effects of the subsidy.[7] Non-actionable subsidies, when they cause adverse effects, are subject to a requirement to modify the subsidy when they cause adverse effects.[8] These three responses are activated through recourse to the institutional aspects of the WTO system, i.e. through recourse to the Dispute Settlement Understanding (DSU).[9] A fourth response is also available under the SCM agreement – countervailing duties (CVDs), which can be determined and imposed unilaterally subject to certain checks.[10]

The meaning of the removal obligation under Art. 7.8, relating to actionable subsidies, has surprisingly managed to evade elucidation till now. This paper aims to understand the contents of that obligation. In the context of the on-going dispute between the U.S.A. and the E.U. regarding subsidies for Airbus and Boeing and means and ways of negating the effects of those subsidies, the subject of this paper is of tremendous importance. Section 2 sets out three fundamental principles which inform the interpretation and application of the SCM agreement. Section 3 examines the removal obligation and suggests possible interpretations. Section 4 concludes.

One of the principles which will be discussed in Section 2 is the marginalisation of economic analyses in the interpretation and application of the SCM Agreement. This deviation from economic principles has been the subject of tremendous criticism because of the difficulties it creates in consistent and effective interpretation of the SCM Agreement.[11] Indeed, the inquiry that forms the subject of this paper has also been hampered significantly on this account. In an attempt to emphasise the perils of deviation from economics and add one more voice to the already weighty criticism of the SCM Agreement on that account, a conscious effort has been made at every stage of this paper to highlight the problems arising from the shunning of economic analyses.

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[5] Art. 31 provides for application of Arts. 6.1, 8 and 9 for a period of five years with the possibility of extended application. But such extension has not been agreed upon. World Trade Organisation, WTO Analytical Index: Guide to WTO Law and Practice 1186, para. 582 (3rd ed., 2012).
[6] SCM Agreement, *supra* note 1, at Art. 4.7.
[7] SCM Agreement, *supra* note 1, at Art. 7.8.
[8] SCM Agreement, *supra* note 1, at Art. 9.4..
[9] Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organisation, Annex 2, 1869 U.N.T.S. 401 (hereinafter DSU).
[10] SCM Agreement, *supra* note 1, at Part V.
[11] *Infra* notes 16-32 and accompanying text.

2. Fundamental Principles Underlying the SCM Agreement

This section will explore some fundamental principles which are essential to understanding the SCM agreement, and to the arguments advanced in subsequent sections of this paper. There are three such principles. First, economic analysis has a limited role to play in understanding and interpreting the SCM agreement. Second, the SCM agreement, and the WTO agreements generally, do not provide for retrospective remedies. Third, withdrawal of subsidies under Arts. 4.7 and 7.8 of the SCM agreement refers to prospective cessation of subsidy payments.

2.1. The Limited Role of Economic Analysis

Intuitively, subsidies are desirable at home and undesirable abroad. At home, they allow governments to channel resources and investment towards industries that are deemed desirable by strategic and political calculations of national interest. Abroad, they constitute unfair competition to displace imports. This self-interest based argument is, however, unconvincing in international trade negotiations. ‘Chinese domestic subsidies harm U.S. industries’ is not a valid argument on which US efforts to reduce Chinese subsidies can be based. Mutual restraint to promote a level playing field is a more convincing argument in this context; mutual proscription of subsidies equally benefits both states and equally ties the hands of both states. Even then, however, mutual restraint may be too high a cost for a state to be willing to bear. It is entirely plausible that a government associates higher value with its abilities to use subsidies as an economic tool at home than with its ability to secure a level playing field for its imports to another country. This argument is even less convincing when applied in the context of inequality between states. Mutual restraint is a successful argument between China and the US – two roughly equal economies, but not between two wildly unequal economies like the US and Benin.

The primary argument against subsidies, and the argument which underlies the international consensus around the proscription of subsidies through the WTO and the SCM agreement, is an economic argument. It is not an argument based in the interests of single countries or groups of countries. Economists assure us that subsidies induce distortions in the efficient allocations of resources that free markets are otherwise able to engineer.[12] This is, of course, true only in the limited case of perfectly competitive, open economies free of distortions.[13] At both the national and international levels, the use of subsidies compromises net welfare through the diversion of resources to less efficient uses.[14] The use of subsidies notwithstanding these efficiency repercussions represents a political problem highlighted by

[12] E.g., Paul R. Krugman and Maurice Obstfeld, *International Economics: Theory & Policy* (2006), at 98-102; Alan V. Deardorff and Robert M. Stern, ‘Current Issues in Trade Policy: an Overview’, in Robert M. Stern (ed.), U.S. Trade Policies in a Changing World Economy (MIT Press1987), at 15.

[13] E.g., Avinash Dixit, ‘International Trade Policy for Oligopolistic Industries’, *The Economic Journal*, 1984, 94-Supplement: Conference Papers, pp.1-16, at 1; Jagdish Bhagwati and V.K. Ramaswami, ‘Domestic Distortions, Tariffs and the Theory of Optimum Subsidy’, *Journal of Political Economy*, 1963, 71: 44-50, at 44, 45.

[14] Alan O. Sykes, ‘The Economics of WTO Rules on Subsidies and Countervailing Measures’, *University of Chicago Law & Economics, Olin Working Paper*, 2nd series, June 2003, No. 186 <http://ssrn.com/abstract_id=415 780> at 8.

public choice theory – the relative imbalance of power between the concentrated interests of producers and the diffused interests of consumers. Thus, the SCM agreement and the general proscription of the use of subsidies in international trade is premised in an overall argument regarding the net (global) welfare diminishing effects of subsidies.[15]

This is at odds, however, with the absence of economic analysis in the working of the SCM agreement. The following examples illustrate this.

(a) The interpretation of 'benefit'

This is evident in the interpretation of 'benefit', and consequently, 'subsidy', in Art. 1 of the SCM agreement.[16] The benefit conferred by a subsidy should be measured in terms of its impact on production, i.e., in terms of its effects on the marginal cost of production of the subsidised firm or industry. This approach is not, however, reflected in the SCM agreement. The benefit of a subsidy in the SCM agreement is determined by an increase in the cash flow or wealth of the producer. This interpretation of 'benefit' under Art. 1.2 of the SCM agreement is reflected in the jurisprudence of the DSM. In the privatization cases, the decision of the appellate body (AB) that fair market value sale of subsidised public entities extinguishes the effect of the subsidy can only be justified if subsidies are viewed as an increase in producer wealth rather than a reduction in the marginal cost of production.[17] Fair market value sale accounts for the cash flow increase produced by the subsidy, but ignores the effects that the increased cash flow secured, namely a reduction in the cost of production and increased efficiency of production.[18]

Thus, 'benefit' has been interpreted in financial rather than economic terms, i.e., to say, the effect of the subsidy (the benefit it confers) is perceived as an increase in cash flow to the

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[15] John H. Jackson, *The World Trading System: Law and Policy of International Economic Relation* (2nd ed., MIT Press, 1997), at 282; Richard Diamond, 'Economic Foundations of Countervailing Duty Law', *Virginia Journal of International Law*, 1989, 29(4): 767-812, at 780.

[16] E.g., Charles J. Goetz *et al*, 'The Meaning of "Subsidy" and "Injury" in the Countervailing Duty Law', *International Review of Law and Economics*, 1986, 6(1): 17-32, at 19-25; Richard Diamond, 'A Search for Economic and Financial Principles in the Administration of United States Countervailing Duty Law', *Law and Policy in International Business*, 1990, 21(4): 507-608, at 537-42; Gene M. Grossman and Petros C. Mavroidis, 'United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom: Here Today, Gone Tomorrow? Privatization and the Injury Caused by Non-Recurring Subsidies, in Henrik Horn and Petros C. Mavroidis (eds.), *The WTO Case Law of 2001: The American Law Institute Reporters' Studies* (Cambridge: Cambridge University Press, 2003), at 20-22; Warren F. Schwartz, 'Countervailing Duty Law for the 1990s: a New Look at the Law and Economics of Subsidies', *Law and Policy in International Business*, 1990, 21(4): 503-506, at 504. All of these authors argue for the consideration of the benefit conferred by a subsidy in terms of effect on marginal cost of production, instead of the current position, which examines cost of the subsidy.

[17] *United States – Imposition Of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom,* Appellate Body Report, WT/DS138/AB/R, 10 May 2000, para. 68; *United States – Countervailing Measures Concerning Certain Products from the European Community*, Appellate Body Report, WT/DS212/AB/R, 9 December 2003, para. 103; *Canada – Measures Affecting the Export of Civilian Aircraft*, Appellate Body Report, WT/DS70/AB/R, 2 August 1999, para. 157.

[18] Mavroidis and Grossman 2003, *supra* note 16, at 34; Gene M. Grossman and Petros C. Mavroidis, 'United States – Countervailing Measures Concerning Certain Products from the European Communities: Recurring Misunderstanding of Non-Recurring Subsidies', in Henrik Horn and Petros C. Mavroidis (eds.), *The WTO Case Law of 2002: The American Law Institute Reporters' Studies* (Cambridge: Cambridge University Press, 2005), at 8-10; Richard Diamond, 'Privatization and The Definition of Subsidy: A Critical Study of Appellate Body Texturalism', *Journal of International Economic Law*, 2008, 11(3): 649-678, at 654-6.

recipient or a quantum of cost to the government (financial), rather than as a decline in marginal cost of production (economic).

By foregoing economic analysis in interpreting 'benefit', the SCM agreement fails to provide an accurate typology of subsidies. Beyond the superficial categorisation which forms the organising principle of the SCM agreement, all subsidies are the same. A 'simple' subsidy of the nature of a fixed sum per unit of agricultural produce is the same as a subsidy to an industrial manufacturer to build a new, more efficient plant. A lump sum subsidy is the same as a subsidy paid in instalments over a period of time subject to production-based prerequisites.

These distinctions are important because they lead to differences in the effects of subsidies. A simple agricultural subsidy of the sort discussed here will not lead to a reduction in marginal cost of production. A subsidy for construction of a more efficient plant will lead to reduction in marginal cost of production. The conflation of these two types of subsidies within the term 'subsidy' as used in the SCM Agreement is a result of the interpretation of 'benefit' in financial and not economic terms. Thus, an evident problem arising from the disuse of economic analyses is the unnecessary broadening of the term 'subsidy' to include government programs which have none of the negative effects which underlie the proscription of subsidies.

(b) Provisions relating to CVDs

The absence of economic analysis is apparent in the SCM agreement's provisions relating to CVDs. First, the permissibility of CVDs under the SCM Agreement is a glaring example. CVDs are recognised as economically undesirable on account of their distortive effects.[19] From the perspective of the importing country, subsidised exports enhance net (national) welfare.[20] Thus, the permissibility of CVDs is at odds with the disdain for the economic distortions that frame the argument against subsidies, as is their use by importing nations.

Second, the methodology of the SCM agreement for determining the presence of adverse effects in the case of actionable subsidies reinforces this conclusion. The injury test reflected in Art. 15 of the SCM agreement is premised solely on the displacement of domestic sale by subsidised exports.[21] A causal relationship between the subsidy and the negative impact on domestic producers is not required. A similar standard is invoked for determining the existence of nullification or impairment.[22] Causal analysis is required in the case of serious prejudice under Art. 6.1, but that provision has lapsed,[23] leaving the determination of

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[19] Alan O. Sykes, 'Second-best Countervailing Duty Policy: a Critique of the Entitlement Approach', *Law and Policy in International Business*, 1990, 21(4): 699-722, at 704; Michael J. Trebilcock, 'Is the Game worth the Candle? Comments on 'A Search for Economic and Financial Principles in the Administration of U.S. Countervailing Duty Law', *Law and Policy in International Business*, 1990, 21(4): 723-738, at 728.

[20] Paul Krugman once famously quipped that the best response in such a situation would be to 'send a thank-you note to the embassy'. Andrew T. Guzman and Alan O. Sykes (eds.), *Research Handbook in International Economic Law* (Edward Elgar Publishing, 2007), at 107.

[21] *Infra* notes 66-69 and accompanying text.

[22] *Infra* notes 70-71 and accompanying text.

[23] *Supra* note 5 and accompanying text.

serious prejudice to be determined by Art. 6.3 alone, which, once again, invokes a market displacement test.[24]

Third, the very quantification of the effect of the subsidy for the purposes of calculating the amount of CVDs demonstrates an aversion to economic analysis. Under Art. 14 of the SCM agreement, the benefit of a government loan or guarantee on concessional terms is measured by the difference between the market interest rate or charge and the government interest rate or charge.[25] Art. 19.4 of the SCM agreement, echoing Art. VI:3 of the GATT,[26] provides that the amount of the CVD cannot exceed the quantum of the subsidy. These provisions effectively endorse the financial interpretation of 'benefit' and ignore its economic effects. This approach is evident not just in the WTO rules relating to CVDs, but also in domestic legal regimes relating to CVDs.[27] Thus, even in the determination and imposition of CVDs, the benefit conferred by the subsidy is determined by reference to the increase in producers' cash flow, and consequently, the CVD serves not to negate the economic effects of the subsidy, but its financial effects.

(c) Assumed undesirability of subsidies

The SCM agreement ignores the very real possibility that subsidies are not distorting the market process, but are, in fact, correcting existing distortions.[28] It is possible that subsidies succeed in ensuring accurate valuation of social resources which could not otherwise be achieved through market forces. For instance, subsidies for research and development bridge a temporary commercial viability gap to ensure the production of socially valuable goods.[29] Similarly, agricultural subsidies may be used to ensure a minimum level of domestic agricultural independence, or to give effect to a social preference for a certain portion of the population to be engaged in the agricultural sector.[30] Another example is subsidies for infant export industries, not to promote or increase exports, but to account for costs incurred in the negation of entry barriers in the importing market (e.g., market research), which will then have spill-over effects for the entire industry.[31] All of these subsidies are potentially circumscribed by the SCM Agreement.[32] The SCM agreement undertakes a very superficial

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24 *Infra* notes 72-73 and accompanying text.
25 SCM Agreement, *supra* note 1, at Arts. 14(a) and 14(b).
26 General Agreement on Tariffs and Trade, 30 October 1947, 61 Stat. A-11, 55 U.N.T.S. 194 (hereinafter GATT).
27 See, e.g., Richard Diamond, 'Economic Foundations of Countervailing Duty Law', 1988-1989, *Virginia Journal of International Law*, 29: 767-812, for an economics-based critique of U.S. CVD law; *see also* Diamond 1990, *supra* note 16.
28 Warren F. Schwartz and Eugene W. Harper, 'The Regulation of Subsidies affecting International Trade', *Michigan Law Review*, 1972, 70: 831-858, at 834.
29 *Ibid.*, at 844-5.
30 *Ibid.*, at 845-7.
31 *Ibid.*, at 847.
32 With regard to subsidies for research and development, see, *supra* note 5 and accompanying text. Subsidies for research and development would ordinarily be afforded some protection under Part IV of the SCM Agreement, but with the lapse of Part IV in accordance with Art. 31 of the SCM Agreement, that protection has been removed, and there is no longer a special regime for non-actionable subsidies. With regard to subsidies for agriculture, see, Karen Halverson Cross, 'King Cotton, Developing Countries and the "Peace Clause": the WTO's US Cotton Subsidies Decision', *Journal of International Economic Law*, 2006, 9(1): 149-195. Agreement on Agriculture art. 13, 15 April 1994, Marrakesh Agreement Establishing the World Trade Organisation, Annex 1A, 1867 U.N.T.S. 410, referred to as the 'peace clause', protected agriculture-related measures from WTO scrutiny, but that clause expired in 2003, and thereafter agriculture-related trade measures are no longer protected. See, e.g., *United States –*

categorisation of subsidies into export, actionable and non-actionable. This categorisation fails to account for the possibility of subsidies which are necessary to correct market distortions because it shuns the economic analysis of the nature and effects of subsidies which would reveal these insights. In the process it prevents the use of legitimate and desirable subsidies.

How can the economic rationale for the SCM agreement and the financial orientation of its provisions be reconciled? A more convincing view of the SCM agreement is that the role of economic analysis is restricted to justifying an international proscription of subsidies. In the actual application of the rules of the SCM agreement, economic analysis has been replaced by political considerations. The purpose of the SCM agreement is not to negate the economic effects of subsidies – an exercise that would demand a rigorous and admittedly difficult economic analysis. Its purpose is to dis-incentivize the use of subsidies (deemed undesirable on the basis of economic analysis) by contracting states by providing remedies chosen for their political appeal rather than economic efficacy. The SCM agreement thus reflects an over-simplification of the economic argument against subsidies in cases of beneficial impact on marginal cost of production, to a rudimentary 'subsidies are bad'. This over-simplification is essentially a political exercise – a blanket proscription of subsidies regardless of actual economic effect based on accountability to concentrated domestic lobbies.

An economically-oriented subsidies regime would assess subsidies in terms of their economic effects or benefit. Only if subsidies are in fact producing an economic impact in terms of reduction of marginal cost of production would they be subject to the SCM Agreement's regime, and even then, only if they could be shown to be creating rather than correcting distortions. Further, this economic analysis would ideally spill over into the regime of remedies for subsidies.

Admittedly these economic analyses are far from easy.[33] Nonetheless, there must be a greater effort to incorporate economic analysis in the interpretation of the SCM Agreement, if only to ensure that the economic rationale of the SCM Agreement is satisfied and it is given effect to.

In conclusion, economic analysis of the effects of subsidies and the negation of those effects is not an integral part of the rules of the SCM agreement. Economic analysis, insofar as it is invoked, is relevant only in an ancillary fashion to justify the existence of the SCM agreement, and within the SCM agreement in a very limited capacity to determine causality between subsidies and market displacement.

2.2. The Proscription of Retrospectivity

Retrospective remedies are generally prohibited under the WTO as well as the SCM Agreement.[34] Art. 19.1 of the DSU of the WTO provides in case of a positive finding of

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Subsidies on Upland Cotton, Appellate Body Report, WT/DS267/AB/R, 3 March 2005. With regard to infant export industry subsidies, these would be *prima facie* prohibited under Part II of the SCM Agreement.

[33] Trebilcock, *supra* note 19, at 726.

[34] Gavin Goh and Andreas R. Ziegler, 'Retrospective Remedies in the WTO after Automotive Leather', *Journal of International Economic Law*, 2003, 6(3): 545-564, at 552.

inconsistency with the WTO agreements, the panel or AB shall: *'recommend that the Member concerned bring the measure into conformity with that agreement.'* This indicates a prospective remedy only. Under Art. 3.7, the first objective of the DSM is to secure *'the withdrawal of the measures concerned.*' In the *Trondheim* case under the GATT, the panel held: '[retrospective application] *had not been within customary practice in dispute settlement under the GATT system*.'[35] Arbitral awards relating to compensation and retaliation under Art. 22, DSU, for instance, in *EC – Hormones*,[36] *EC – Bananas*,[37] *US – FSC*,[38] etc., have held that available remedies are restricted to prospective application.

This general proscription of retrospective application has been justified on account of the difficulties associated with domestic application of retrospective decisions. Often the retrospective rectification of a domestic action inconsistent with the WTO agreements may require the expropriation of seizure of property now legally vested in the hands of private persons.[39] This may well be constitutionally or otherwise impermissible and result in a situation in which the member state concerned is forced to continue in a state of violation of WTO rules indefinitely.

Though there have been instances in which retrospective application of remedies has been required, these instances may be explained as aberrations on the basis of the justification discussed above. Specifically, in the *New Zealand –Electrical Transformers*[40] and the *India – Patent Protection*[41] cases retrospective remedies were ordered. These and other cases involving retrospective remedies, however, could be remedied simply through governmental action, without implicating the vested rights of the private citizens of the country.[42] All of these cases involved derogations from government obligations to foreign producers, for instance, improper imposition of CVDs or anti-dumping duties (ADDs) on foreign imports, or failure to maintain a record of foreign patent applications. It was thus possible to protect the rights of foreign producers simply through governmental action without implicating the vested rights of private individuals within the state. This may be an important qualification of the proscription of retrospective remedies in the WTO.

In the context of remedies for subsidies in particular, retrospective application has been expressly rejected. The panel in the *Australia – Automotive Leather II* case held that the requirement of withdrawal under Art. 4.7 mandated repayment of the amount of subsidy

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35 *Norway – Restrictions on Imports of certain Textile Products*, Report of the Panel, L/4959, 24 March 1980, paras. 4.17, 4.26, GATT B.I.S.D. (27th Supp.) at 119 (1980) (hereinafter Trondheim case); Peter Mavroidis, 'Government Procurement Agreement – the Trondheim Case: the Remedies Issue', Aussenwirtschaf – *The Swiss Review of International Economic Relations*, 1993, 48: 77-94.

36 *European Communities – Measures Concerning Meat and Meat Products (Hormones)*, WTO Arbitrator's Report, WT/DS26/ARB, 29 May 1998, paras. 38, 41.

37 *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Panel Report, WT/DS27/RW/ECU, 12 April 1999, para. 6.49.

38 *United States – Tax Treatment for 'Foreign Sales Corporations'*, WTO Arbitrator's Report, WT/DS108/ARB, 30 August 2002, para. 5.41.

39 Goh and Ziegler, *supra* note 34, at 556.

40 *New Zealand – Import of Electrical Transformers from Finland*, Report of the Panel, L/5814, 19 June 1985, para. 4.11, GATT B.I.S.D. (32nd Supp.) at 55 (1985).

41 *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, Panel Report, WT/DS50/R, 5 September 1997, para. 5.66.

42 Goh and Ziegler, *supra* note 34, at 557.

already paid, arguing that to fail to do so would render the obligation under Art. 4.7 of the SCM agreement indistinguishable from the obligation under Art. 19.1, DSU.[43] The panel further argued that to restrict the Art. 4.7 remedy to prospective application risked rendering the remedy superfluous in cases of subsidies involving one time payments.[44] The comprehensive criticism that this decision has met with has conclusively established the strictly prospective application of the withdrawal obligation under Art. 4.7.

At the meeting at which the adoption of the panel report in this case was discussed, the decision was criticised by several members.[45] Australia,[46] USA,[47] Canada,[48] Brazil,[49] EC,[50] Japan,[51] Hong Kong,[52] and Malaysia[53] all criticised the decision. Interestingly, neither party argued for or against retrospective remedies. In fact, both the US and Australia, the principal parties in the dispute, as well as the EC, which submitted arguments as an interested party, argued that Art. 4.7 only encompassed a prospective remedy. Subsequent decisions, including *Brazil – Aircraft*,[54] *Canada – Aircraft*,[55] *United States – FSC*,[56] etc., have toed this temporal line, consistently holding that the Art. 4.7 remedy is purely prospective in nature.

Similarly, in the case of CVDs, Art. 20.1, SCM agreement expressly prevents the retrospective application of CVDs.

In conclusion, there is a very strong presumption against retrospective application of WTO remedies, especially within the SCM agreement.

2.3. Interpretation of the Withdrawal Obligation under Art. 4.7

'Withdraw' under Art. 4.7 of the SCM agreement has repeatedly been interpreted in a restrictive manner to only require prospective cessation of the subsidy payments.[57] Efforts to introduce a retrospective aspect to this remedy have failed,[58] notwithstanding the desirability

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[43] *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States*, Panel Report, WT/DS126/RW and Corr.1, 21 January 2000, paras. 6.39-41.
[44] *Ibid.*, at paras. 6.25, 6.35-8.
[45] Meeting of the Dispute Settlement Body, 11 February 2000, WT/DSB/M/75.
[46] *Ibid.*, at 5-7.
[47] *Ibid.*, at 5.
[48] *Ibid.*, at 7-8.
[49] *Ibid.*, at 8.
[50] *Ibid.*, at 9.
[51] *Ibid.*, at 8.
[52] *Ibid.*, at 8-9.
[53] *Ibid.*, at 9.
[54] Brazil – Aircraft – Art. 21.5 Appellate Body Report, *infra* note 57.
[55] Canada – Aircraft – Art. 21.5 Panel Report, *supra* note 57, *infra* note 57.
[56] US – FSC – Second Reference to Art. 21.5 – Appellate Body Report, *supra* note 57, *infra* note 57.
[57] E.g., *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, Appellate Body Report, WT/DS46/AB/RW, 21 July 2000, para. 45,; *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, Panel Report, WT/DS70/RW, 9 May 2000, paras. 5.47-8, 5.63; *United States – Tax Treatment for 'Foreign Sales Corporations' – Second Recourse to Article 21.5 of the DSU by the European Communities*, Appellate Body Report, WT/DS108/AB/RW2, 13 February 2006, para. 83; *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, Appellate Body Report, WT/DS316/AB/R, May 18, 2011, para. 754; *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, Panel Report, WT/DS316/R, 30 June 2010, para. 7.282,; *United States – Subsidies on Upland Cotton – Recourse to Article 21.5 of the DSU by Brazil*, Appellate Body Report, WT/DS267/AB/RW, 2 June 2008, para. 238.
[58] *Supra* notes 43-44 and accompanying text.

of such an interpretation.[59] Further, no distinction seems to be drawn on the basis of the nature of a subsidy. A simple agricultural subsidy is treated on par with a subsidy to a company manufacturing aircraft. It seems to make no difference that the former will have no economic effect, while the latter may well be responsible for the existence of the company, and prospective cessation of payments will never succeed in eliminating the ‘benefit’ (economic) conferred by the subsidy.

Clearly this interpretation of ‘withdraw’ is related to the manner of interpretation of ‘benefit’. If the benefit of a subsidy is purely financial, that benefit is withdrawn, to a great extent, by cessation of subsidy payments. Conceptualising ‘benefit’ in economic terms would require acknowledgement that the decrease in marginal cost of production induced by a subsidy cannot be eliminated merely by prospective cessation, and would lead to a different interpretation of ‘withdraw’.

An obvious problem with this interpretation of ‘withdraw’ is that it incentivises countries to structure subsidies as one time payments so that even if they are challenged, the immunity of past payments ensures the toothless-ness of the withdrawal obligation.[60] The net effect is the prioritisation of unilateral remedies in the form of CVDs which are less desirable, first, because they are distortion enhancing, and second, they are unilateral measures in an arguably rules-based multilateral system.

In addition to making it easier to circumvent the withdrawal obligation, this interpretation also reduces its effectiveness. In the case of subsidies which merely provide financial benefits (only increase in cash flow with no decrease in marginal cost of production) the current interpretation of the withdrawal obligation merely amounts to prospective cessation of a financial benefit. It does not amount to recovery of any financial benefit that may have been conferred in the past. In other words, the increased liquidity or cash flow may stop henceforth, but in the past it was of some use to the producer(s) and this past utility and any advantage it may or may not have conferred remains untouched by this interpretation of withdrawal.

In the case of subsidies which provide economic benefit (reduction in marginal cost of production), the current interpretation of the withdrawal obligation amounts to cessation of compounding of an economic benefit that has been given. Prospective cessation of subsidy payments will not eliminate the economic benefit that has been derived by the previous subsidy payments. Those payments have already induced a reduction in marginal cost of production (the economic benefit) which is being allowed to remain in existence. The only effect of withdrawal of the subsidy is that the economic benefit conferred is not being further compounded. In simple terms, while the withdrawal of the subsidy will prevent further reductions in the marginal cost of production, reductions in the marginal cost of production produced by previous subsidy payments continue to remain in effect, continuing to provide a

[59] Peter C. Mavroidis, ‘Remedies in the WTO: between a Rock and a Hard Place’, European Journal of International Law, 2000, 11(4):763-813, at 790, arguing that the retrospective application of remedies is both in conformity with public international law and desirable from the perspective of ensuring efficacy of and compliance with the WTO agreements.

[60] *Supra* note 43; Mavroidis, *supra* note 59.

relative advantage over non-subsidised producers. This is particularly true in situations in which the subsidy is responsible for the existence of the subsidised firm or industry in the first place, for example, the aircraft subsidies discussed in the *EC – LCA* and *Brazil – Civil Aircraft* cases.[61] In these cases in particular, the ineffectiveness of this interpretation of the withdrawal obligation is starkly visible.

Thus, the current interpretation of the withdrawal obligation amounts at best to cessation of a financial benefit and at worst cessation of compounding of an economic benefit. In either case, the immunity of prior payments ensures that some benefit – financial or economic – remains on the table for the producers.

These questions have no satisfactory answer, for it is fairly clear that, notwithstanding the scope for circumvention and limited effectiveness, the current interpretation of the withdrawal obligation is not only deeply entrenched, but also meets with the approval of member states. Thus, these questions must be preserved as criticisms of the current interpretation of this obligation, rooted in a failure to use economic analyses.

In conclusion, this section has discussed three important principles to be kept in mind while attempting to interpret the provisions of the SCM agreement. The first is that economic analysis and concepts are at best an ancillary element of the SCM agreement's rules. The second is that there is a very strong presumption against retrospective application of the remedies under the SCM agreement. The third is that to withdraw a subsidy is to prospectively cease making subsidy payments; that this amounts either to a discontinuation of an financial benefit, or a cessation of compounding of an economic benefit, and is, therefore, severely inadequate to counter the effects of subsidies.

3. INTERPRETING 'REMOVE'

This section will examine the meaning of the obligation to remove adverse effects in light of the previous two sections which have outlined basic principles underlying the SCM agreement, and the accepted interpretation of the withdrawal obligation under the SCM agreement.

It must be noted at the outset that there is absolutely no authority to guide the interpretation of the removal obligation. There is no DSM jurisprudence, or any mention in the *travaux* of the SCM agreement. Thus, this section will undertake a first principles analysis of the meaning of this obligation. This section is divided into three sub-sections. Sub-section 3.1 examines the text and context of Art. 7.8 to introduce the removal obligation. Sub-section 3.2 introduces five conceptually possible meanings for the obligation. Sub-section 3.3 analyses these possible meanings and determine the most accurate interpretation.

3.1. Art. 7.8 and the Removal Obligation

The removal obligation is located in Art. 7.8 of the SCM agreement.

[61] *Supra* note 57.

Art. 7.8 provides,

> Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy.

The literal meaning of ‘remove’ is to take away or off or to put out.[62] It is normally used in the sense of detaching or dissociating the thing being removed from the thing from which it is being removed. An examination of Art. 7.8 makes it clear that Art. 7.8 provides the DSU-based remedy in the case of actionable subsidies, as does Art. 4.7 in the case of prohibited subsidies. Art. 7.8 provides for two disjunctive remedies – withdrawal, which means the same as it does in Art. 4.7, and removal. While the obligation of withdrawal applies to the subsidy itself, the obligation of removal attaches to the adverse effects of the subsidy. Thus the removal obligation requires the detachment of the adverse effects of the subsidy from the subsidy itself. The subsidy may or may not be touched at all.

The concept of ‘adverse effects’ finds elaboration in Art. 5 and includes injury,[63] nullification or impairment of benefits under GATT 1994, especially under Art. II,[64] and serious prejudice.[65]

Injury is defined in Art. 5 in the same way as it is in Part V of the SCM agreement which deals with CVDs.[66] Within Part V, injury is defined in Art. 15. All references to injury in the SCM agreement are references to injury as defined in this provision and this provision includes material injury or threat thereof to a domestic industry, or material retardation of the establishment of an industry.[67] The SCM agreement uses ‘injury’ in place of ‘material injury’ as employed in GATT,[68] and this clarification as to the equivalence of ‘injury’ and ‘material injury’ avoids a perplexing rift between the GATT and the SCM agreement. The definition of injury in Art. 15 is essentially one of market displacement.[69] It is satisfied if it can be demonstrated that the increased importation of subsidised goods had reduced prices in the domestic market and adversely affected domestic producers.

The nullification and impairment requirement refers primarily to benefits arising from the tariff bindings under Art. II of GATT 1994. It refers primarily to legitimate expectations of market access derived from negotiations concerning tariff concessions.[70] The test for the existence of nullification or impairment has been held to require demonstration of a

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[62] The American Heritage Dictionary of the English Language1527 (3rd ed., 1992).
[63] SCM Agreement, *supra* note 1, at Art. 5(a).
[64] *Ibid.,* at Art. 5(b).
[65] *Ibid.,* at Art. 5(c).
[66] *Ibid.,* at footnote 11.
[67] *Ibid.,* at footnote 45.
[68] GATT, *supra* note 26, at Art. VI:6.
[69] E.g., SCM Agreement, *supra* note 1, at Art. 15(1) requires consideration of the volume of foreign imports, impact of those imports on prices for like goods in the domestic market, and the consequent impact on domestic producers.
[70] *European Communities – Measures Affecting Asbestos and Products Containing Asbestos*, Panel Report, WT/DS135/R, 18 Sep 2000, para. 8.285; 1 World Trade Organisation, WTO Analytical Index: Guide to WTO Law and Practice 342-3, para. 974-7 (3rd ed., 2012) (hereinafter 1 WTO Analytical Index).

correlation between the impugned measure and the upsetting of the competitive relationship between the domestic and imported products.[71] In effect, a non-violation based challenge to a subsidy can be raised based on the demonstration of a correlation between the subsidy and market distortion defeating legitimate expectations based on negotiated tariff bindings. This is basically a test of market displacement.

Serious prejudice is a parallel form of the injury test, except that it applies in the case of adverse effects on the exports of a third country into a second country because of subsidised exports from a first country.[72] In other words, the adverse effects referred to here are not those on domestic producers in the importing market, but instead on competing exporters from a third country. Serious prejudice is also premised on the existence of market displacement, but in addition to the demonstration of market displacement by subsidised exports, the serious prejudice test, unlike the injury test, actually requires a causation analysis between the subsidy and the adverse effect or displacement.[73]

It is now clear what is to be done (removal), to what (adverse effects) and from what (subsidy). It is still unclear how removal might be achieved.

A useful resource for resolving the question of how might be other uses of the various forms of the verb 'to remove' in the SCM agreement. There are five other references to removal in the SCM agreement.

Art. 7.9, which allows countermeasures in case neither withdrawal nor removal is effected within six months;

Art. 9.4, which allows modification of subsidies in order to remove adverse effects in the context of non-actionable subsidies;

Art. 18.1(b), referring to price increases by the exporting producers which are adequate to remove the injury to the domestic industry;

Art. 19.2, referring to the quantum of the CVD imposed which is adequate to remove the injury to the domestic industry;

Art. 21.2, referring to the removal of the duty;

Arts. 7.9 and 21.2 provide no insights as they use the term in the same sense as Art. 7.8 and in a completely different sense respectively. Art. 19.2 refers to a right of the injured member, and is thus of limited utility for elucidating the duty of the contravening state. Arts. 9.4 and 18.1(b), however, illustrate possible modes of achieving the goal of removal – modification of the subsidy and increase of prices.

The objects and purposes of the SCM agreement provide no further insight. The determination of the objects and purposes of a treaty in the absence of specific preambular

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71 *Japan – Measures Affecting Consumer Photographic Film and Paper*, Panel Report, WT/DS44/R, 31 March 1998, para.10.83-88; 1 WTO Analytical Index, *supra* note 70, at 346-7, para. 986-8.

72 SCM Agreement, *supra* note 1, at Art. 6.3.

73 *United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, Appellate Body Report, WT/DS353/AB/R, 23 March 2012, para. 984.

text can only ever be conducted at a high level of generality,[74] and the mere understanding that the removal obligation should be interpreted in a manner that deters subsidies is not spectacularly useful.

Thus, the ordinary, contextual and teleological meanings of the text in question provide no startling insights or conclusive clarity as to the meaning of the removal obligation. A final source of information is the *travaux* for the SCM agreement, but as has been mentioned, there is no discussion in those documents of the substantive content of this obligations.

The results of the inquiry undertaken in this part may be summarised as follows:

(i) The removal obligation is distinct from the withdrawal obligation.

(ii) The removal obligation attaches to the effects of the subsidy rather than the subsidy itself, and the effects referred to are adverse effects.

(iii) Modification and price increases are possible interpretations of removal as derived from other uses of the term 'remove' in the SCM agreement.

3.2. Five Conceptually Possible Meanings

This part will examine from first principles what possible meanings might be attached to the removal of adverse effects.

Five such meanings are possible. These suggested meanings represent potential conceptual responses to the effects of a subsidy. They are not filtered on the basis of the difference between withdrawal and removal, or even on the basis of the information gleaned from the discussion in the previous part of this section. As such they represent an unrestricted set of solutions; the actual interpretation of removal may involve one or more of these solutions, but the idea is that the interpretation should be constructed using elements of this unrestricted set alone.

The first is prospective cessation of subsidy payments. This would be similar to the current interpretation of 'withdraw'. The second is retrospective cessation of subsidy payments, i.e. the subsidised entity would be required to repay the previously received subsidy payments. The interpretation of 'withdraw' suggested by the panel in the *Australia – Automotive Leather II* case involved both this meaning as well as the previous one.

The third is equivalent subsidization for firms of the injured country, i.e. payment of an equivalent subsidy to adversely affected producers in other countries. The fourth is negation of the effects of the subsidy, through for instance, quantitative restrictions on sales, or fixed limits on prices. The fifth is a modification of the subsidy programme to remove the adverse effects. In effect it is likely modification would be achieved by recourse to equivalent subsidisation or negation or both, but it is suggested as a discrete element in this unrestricted set of solutions to include any other possible means of modification that might not be captured within equivalent subsidisation or negation of the effects of the subsidy.

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[74] *United States – Laws, Regulations and Methodology for Calculating Dumping Margins ("Zeroing"),* Panel Report, WT/DS294/R, 9 May 2006, footnote 292.

Removal of adverse effects may require elimination of subsidy payments, either in the past, or in the present payments, or in the future, of one or more of these. These possibilities are captured by the first two interpretations suggested above – prospective and retrospective cessation. Alternatively, the removal obligation may allow keeping the subsidy in place but changing it in some way. These possibilities are captured by the last three possibilities – equivalent subsidisation, negation of effects and modification in some other way. Thus, these five possible interpretations are suggested as a universal set of interpretations because they encompass all conceptually possible interpretations. Each of them shall now be separately considered.

(a) Cessation – prospective and/or retrospective

The first two options may be rejected at the outset. First, they impact the subsidy and not its adverse effects, violating the plain text requirement of Art. 7.8. Second, prospective cessation is the currently accepted meaning of the withdrawal obligation. Art. 7.8 presents withdrawal and removal as disjunctive obligations. To interpret them identically would again be contrary to the plain text interpretation of Art. 7.8. Third, retrospective cessation is implausible given the strength of the presumption against retrospectivity within the WTO.

(b) Equivalent subsidization for foreign producers

Equivalent subsidisation raises a number of concerns. First, from the perspective of negating or reversing the economic distortions produced by subsidies, this is a completely undesirable solution. It will only increase the number of subsidies, magnifying the economic distortions produced.

Second, it is likely that there will be several countries and industries adversely affected by the impugned subsidy, and it is likely that the subsidizing country will be required to provide equivalent subsidization to affected industries in all member countries. This has the effect of making this interpretation improbable on account of the expense involved as well as exponentially magnifying its efficiency distorting effects if undertaken. Third, it is entirely possible that equivalent subsidization may not be acceptable from the perspective of the affected country or countries. It would not be unreasonable for those countries to refuse to admit the creation of efficiency distortions in their economies to support the political objectives of another country.

Fourth, is it possible for countries to simply pay their way out of breaches of WTO rules as equivalent subsidisation seems to amount to? The GATT seems to permit this.[75] Art. 22 of the DSU recognises the possibility of suspension of concessions and/or compensation as valid remedies for breaches of the provisions of the WTO texts. But the text of Art. 22,[76] and the jurisprudence of the DSM has made it very clear that implementation of the DSB's

[75] Compare Goh and Ziegler, *supra* note 34, at 559, advocating sparing use of this possibility, with Marco Bronckers and Naboth van den Boek, 'Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement', *Journal of International Economic Law*, 2005, 8(1): 101-126, arguing for recognition of the possibility of financial compensation as a remedy for violation of the WTO agreements.

[76] Arts. 22.1 and 22.9 make it very clear that the use of compensation is a fall-back option if compliance is not possible.

recommendations is preferable to countermeasures or compensations, that countermeasures or compensation are only available in the case of failure to implement the DSB’s recommendations, and that countermeasures and compensation are exceptional remedies available only for a limited period of time.[77] Notwithstanding this preference, however, this seems permissible. A greater problem is that compensation is understood in the WTO system as trade concessions rather than as financial compensation.[78]

A strong argument may be made for its recognition.[79] This would also be in keeping with the idea of ‘efficient breach’, i.e. permitting states to continue policies which violate WTO rules if they are so convinced of the value of those policies that they are willing to pay for that breach. Most importantly, however, even if such equivalent subsidisation were not *strictu sensu* in conformity with the WTO rules, there would be no country that would complain, because the affected countries would be the ones whose industries were receiving the foreign subsidies.

Fifth, the question remains how the amount of the subsidy for the purposes of equivalent subsidisation is to be determined. Two possibilities exist: financial and economic. Equivalent financial subsidisation would replicate the increase in the producers’ cash flows in the affected industries and countries. Equivalent economic subsidisation would replicate the economic effect, i.e. the beneficial impact on the production cost. These two options correlate to the actual and preferred interpretations of ‘benefit’ discussed above.

Equivalent financial subsidisation would seem to be more in keeping with the financial orientation of the SCM agreement. However, this will almost certainly lead to differing effects. Merely paying producers in the affected country the same amount that has been paid to producers in the subsidizing country will not achieve the same effects due to the inevitable presence of structural differences in the economies. This will perpetuate and multiply the original distortion induced by the subsidy.

Further, the economic conception of equivalent subsidisation better gives effect to the text and objects of the SCM agreement. Art. 7.8 requires the removal of the adverse effects of the subsidy. These adverse effects are defined in terms of market displacement. Therefore, there is a requirement for the compensation proffered to be capable of reversing the market displacement that has taken place. This can only be achieved by measuring the impact of the subsidy on the production costs in the subsidizing country and designing a payment or subsidy programme that achieves the same effects in the affected country.

Equivalent financial subsidisation is thus an easier interpretation of the obligation from the perspective of the subsidising country and equivalent economic subsidisation is a preferable interpretation from the perspective of the affected countries. However, as discussed, in light of the previous interpretation of the SCM agreement, equivalent financial

77 *United States – Subsidies on Upland Cotton – Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WTO Arbitrator’s Report, WT/DS267/ARB/1, 31 August 2009, paras. 3.39, 3.46,

78 Bronckers and van den Boek, *supra* note 75, at 102.

79 *Ibid.*

subsidisation seems to satisfy the obligation. However, Art. 22 of the DSU which also discusses the procedure for imposition of countermeasures and determination of compensation, and which will therefore serve as guidance for the determination of equivalent subsidization as removal under Art. 7.8, stipulates that compensation is voluntary,[80] and to be determined by negotiation between the parties.[81] It is thus possible for the affected country to press for the determination of the amount of equivalent subsidization in accordance with the ideal of replicating the economic effect of the subsidy payments and not just their financial effects.

(c) Negation of the effects of the subsidy

This may conceptually take two forms. Either the quantity of subsidized sales or exports may be reduced, or the price of subsidized sales or exports may be increased.

In the case of quantitative restrictions, beneficiaries of the subsidy would agree to control their sales and exports to maintain prior market shares. A major limitation to the application of such a policy is Art. XI of the GATT. That provision expressly prohibits the use of quantitative restrictions.[82] Art. XI evinces a systemic preference for trade restrictive measures to be framed in the forms of tariffs, rather than non-tariff barriers, premised on the understanding that non-tariff barriers have greater trade distorting effects, and their administration is tougher and less transparent.[83] However, the applicability of Art. XI in this context is far from certain. Given that the country affected by the quantitative restriction is also the country affected by the subsidies, no country would have the standing to allege a violation of the rules of the WTO.

A major problem with the use of quantitative restrictions is that its invocation of static market shares to determine permissible sales of subsidized goods perpetuates inefficiencies over and above those associated simply with the use of quantitative restrictions.

Price increases may be voluntary or involuntary. A voluntary price increase would reflect an agreement by the subsidized firms or industry to increase prices to offset the benefits of the subsidy. An involuntary price increase would take the form of a government levy to negate the benefits of the subsidy and may be considered as analogous to a CVD, except imposed by the subsidizing government.

As was the case with equivalent subsidisation, the per unit price increase may be calculated with regard to the financial effect of the subsidy (the amount of the subsidy divided by the quantity produced), or with regard to its economic effect (based on the new marginal cost of production after incorporating the economic effect of the subsidy). However, as with

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80 DSU, *supra* note 9, at Art. 22.1.

81 *Ibid.*

82 See, e.g., *EEC – Quantitative Restrictions against Imports of Certain Products from Hong Kong*, Report of the Panel, L/5511, 1 July 1983, GATT B.I.S.D. (30th Supp.) at 129 (1983), paras. 15, 17, 19; *Japan – Measures on Imports of Leather*, Report of the Panel, L/5623, 2, March 1984, GATT B.I.S.D. (31st Supp.), para. 21, at 94; *Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, Panel Report, WT/DS155/R, 19 December 2000, para. 11.28; *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, Panel Report, WT/DS58/R, 15 May 1998, para. 7.17; *Japan – Trade in Semi-Conductors*, Report of the Panel, L/6309, 24 March 1988, GATT B.I.S.D. (35th Supp.), paras. 105-109, at 116.

83 Jackson, *supra* note 15, at 153.

equivalent subsidisation, the former is the more plausible interpretation given the financial orientation of the SCM agreement. Again, as with equivalent subsidisation, this would be subject to negotiation between the parties.

Unlike equivalent subsidisation, which had the potential to be completely ineffective if a financially identical subsidy was incapable of replicating the economic effects in light of structural differences, a financially determined price increase will probably be more effective. Any price increase will reduce quantity, and will go some way towards removing the adverse effect of market displacement.

(d) Modification of the subsidy

Modification is another avenue that seems to be in the contemplation of the SCM agreement itself, in Art. 9.4. It is far from clear, however, what such modification would entail, and how it could be achieved. Thus, modification of the subsidy is not a feasible interpretation of the removal obligation.

Modification would be undertaken with a view to remove the adverse effects of the subsidy, i.e. to remove the market displacement occasioned by the benefit conferred by the subsidy on producers. Thus, the focus of modification efforts would be on the benefit conferred by the subsidy. However, the benefit of the subsidy has been interpreted in purely financial terms, ignoring its economic aspects. Benefit to the producer exists, and consequently, a subsidy exists, when there is an increase in the cash flow of the producer. This is a binary characterisation of the subsidy. Either there is an increase in cash flow, or there isn’t. Either there is benefit, or there isn’t. Modification as a class of actions in this context is a null set. If the conceptual understanding of subsidies and their benefit allowed for consideration of their economic effects, it might still have been possible to consider the possibility of modification. In that scenario, the subsidy might have been amenable to restructuring so that it served the political interest behind its creation, without decreasing marginal costs of production. However, that analysis is not feasible under a financial understanding of subsidies and their benefits and effects.

Thus, modification is not a feasible interpretation for the removal obligation.

3.3. Determining the Correct Interpretation of Art. 7.8

The previous part of Section 3 identified three possible interpretations of the removal obligation: equivalent subsidization of affected industries, quantitative restrictions and price controls. Each of these was premised on a financial rather than economic understanding of the effects of subsidies, and each suffered from patent defects.

Equivalent subsidization would have to be undertaken with regard to affected industries in all WTO member states. It would thus be very expensive. Further, the idea of responding to the trade distorting effects of a subsidy with the magnification of that distortion seems counter-intuitive. Moreover, the restriction of the equivalent subsidization to repeating the financial effects of the original subsidy will probably result in differing results. Finally, there is a high probability that affected states will be reluctant to accept the perpetuation of efficiency distortions in their economies for the sake of achievement of the subsidizing country's political objectives. However, equivalent subsidisation does cater to the important idea of allowing efficient breach.

Quantitative restrictions are impermissible under the GATT, though questions regarding their permissibility are unlikely to be raised given the absence of countries negatively affected by their use in this instance. Nonetheless, the efficiency distortion which underlies their proscription in Art. XI of the GATT, as well as the efficiency distortion associated with their invocation of static market shares, remains a continuing problem with their use.

Price controls probably suffer from the least defects in that they will probably be more effective than the other two methods, though complete efficacy is not guaranteed.

The next question is how to choose from amongst these three options. The text – from literal, contextual and teleological perspectives – and *travaux* provide no guidance. Price controls find mention in the chapter of the SCM agreement which deals with CVDs, but the difference in context of the two mentions of removal make it doubtful that any contextual support for the price controls interpretation of removal can be derived. At best the reference in Art. 18(1)(b) may be adduced as evidence that price controls are not *ab initio* irreconcilable with the SCM agreement.

Equivalent subsidization represents the least desirable interpretation because of the many defects that it suffers from. By the same token, price controls represent the most desirable, relatively rather than objectively, interpretation. The greatest accusation that can be laid at the doorstep of price controls relates to efficacy. Limited effectiveness does not seem to be a disqualification under the SCM agreement as evidenced by the approach adopted regarding the withdrawal requirement, or that taken up in the privatization cases. Quantitative restrictions fall in between the other two interpretations. Further, price controls are preferable over the other two alternative interpretations by a significant margin because both quantitative restrictions and equivalent subsidization are clearly antithetical to the free trade, minimum market distortion approach that underlies the WTO and its agreements.

Notwithstanding the presence of a relatively clear hierarchy between these three interpretations, none of them should be discarded. The removal obligation under Art. 7.8 should be construed as a result obligation rather than as a process obligation, i.e., the obligation is discharged once the adverse effects are removed, irrespective of how the removal is achieved. The concept of result obligations is not alien to the jurisprudence of the WTO. For instance, the causation analysis required by Art. 6 for the determination of serious prejudice has been interpreted in a manner that allows states to choose the methodology for the analysis.[84] Under this construction of Art. 7.8, states could discharge their removal obligation through any one of the three methods discussed above, or even some other

[84] E.g. *US – Upland Cotton*, Appellate Body Report, *supra* note 32, at para. 427:

> Article 6.3(c) does not set forth any specific methodology for determining whether the particular economic effect (e.g. significant price suppression) is "the effect of a subsidy", and there may well be different ways to make this determination.

interpretation subject to the good faith obligation of *pacta sunt servanda*.[85] It is probable, however, that for the reasons mentioned above, price controls will be preferred by states.

This construction of the removal obligation in Art. 7.8 has two advantages. First, it avoids the much maligned practice of judicial legislation to fill in blanks in the WTO texts.[86] In the absence of any decisive argument for or against a particular interpretation, it is impossible to choose one of the interpretations.

Second, it has the benefit of leaving the door open for potential efforts to negate the economic effects of subsidies rather than just their financial benefits. Such an interpretation of the removal obligation is by no means required under the SCM agreement, but by virtue of being distinctly more onerous and effective than the actual interpretation, it would certainly not be undesirable.

In concluding this section, it has been suggested that the removal obligation be construed as requiring a particular result rather than mandating a particular procedure, and therefore, that member states be free to choose from amongst these potential interpretations, and also be free to choose to tackle the economic rather than the financial benefits of subsidies.

4. CONCLUSION

This paper has made significant inroads towards the conclusive determination of the removal obligation. It has suggested that the removal obligation be interpreted as requiring the achievement of a specific result – removing the adverse effects of the subsidy from the subsidy, leaving the subsidy itself in place – and leaving the modalities of achieving that goal to the member states, subject to the requirement of good faith. Three possible interpretations have been suggested – equivalent subsidization, quantitative restrictions and price controls. Additionally, a hope has been expressed that leaving the option of economic negation of the effects of the subsidy (rather than the financial negation associated with the other three interpretations) will result in its eventual adoption.

In concluding, two subjects remain for discussion. The first is the obvious need for clarification of the meanings of the withdrawal and removal obligations. The withdrawal obligation possesses a definite, finite meaning, but that interpretation has been shown to be clearly lacking. The removal obligation has been construed as a result obligation because of the impossibility of choosing between three possible interpretations. There is a critical need for expansion of the meanings of these concepts.

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85 E.g. *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, Appellate Body Report, WT/DS379/AB/R, 25 March 2011, para. 326,

86 Goh and Ziegler, *supra* note 34, at 562 for a strong criticism of the decision in Australia Leather Art. 21.5 Arbitration Report, *supra* note 43 on this basis.

To some extent this need has been reflected in the Doha Development Round negotiations. Both the US[87] and Australia[88] have proposed clarifications to the meanings of these obligations. Australia, in particular, has proposed clarification of the temporal application of the withdrawal obligation, i.e. if and to what extent it can apply retrospectively.[89] Hopefully, these proposals will be successful.

The second is the yawning gap between the economic underpinning of the SCM agreement and its financial orientation. This paper assumed as one of its premises the shunning of economic analyses in the interpretation and application of the SCM agreement, reflected in the understanding of the benefit that defines subsidies, in the permissibility and use of CVDs, in the one size fits all approach to subsidies and in the prospective interpretation of the withdrawal obligation. However, at every stage of this paper, it has been very clear that there are two very distinct choices regarding the understanding of subsidies, their effects and the benefits they confer – financial and economic. At every stage it has been equally clear that the financial option is the one which is preferred while simultaneously being the worse choice.

In discussing the interpretation of the withdrawal obligation it became clear that the financial understanding of withdrawal was leading to diminished efficacy. In considering the three possible remedies that remain on the table as possible interpretations of the removal obligation, it was emphasized that their application in light of an economic understanding of subsidies and their effects would be more effective, but that a financial oriented application was more likely. Modification of subsidies as a possible interpretation of the removal obligation was found to be impossible in the context of a financial understanding of subsidies.

This paper has thus served to highlight the complexities wrought by the shunning of economic analyses in the interpretation and application of the SCM agreement.

[87] 'ASCM Reform Proposals tabled in DDA Rules Negotiating Group, TN/RL/W/78 (U.S.A.)', *in* John R. Magnus, 'World Trade Organisation Subsidy Discipline: is this the "Retrenchment Round"?', *Jounal of World Trade*, 2004, 38(6): 985-1047, at 1009.

[88] 'ASCM Reform Proposals tabled in DDA Rules Negotiating Group, TN/RL/W/139 (Australia)', *ibid.,* at 1006.

[89] 'ASCM Reform Proposals tabled in DDA Rules Negotiating Group, TN/RL/W/85 (Australia)', *in* Magnus, *supra* note 87, at 1007.