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The WTO Consistency of the Buy American Provision and Auto Bailouts[1]

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Executive Summary

1. This memorandum analyzes the WTO consistency of certain measures enacted by Members since the onset of the financial crisis. The United States has implemented a comprehensive economic stimulus package through the American Recovery and Reinvestment Act ("the Recovery Act"), which contains Section 1605 ("the Buy American Provision"). To aid the industries that have been hit particularly hard by the global economic slowdown, several Members have also provided government assistance to their domestic automobile industries. Among them, the scope and impact of the U.S. and French auto bailout plans warrant analysis of their WTO consistency.

2. The memorandum is divided in two parts. Part I provides an analysis of the Buy American Provision, and Part II provides an analysis of the auto bailout packages of the United States and France. Each part will begin by describing the factual background, followed by the legal analysis. Here, a summary conclusion is provided:

3. First, the Buy American Provision appears "as such" consistent with U.S. commitments under the Government Procurement Agreement (GPA). Furthermore, government procurement is probably excluded from Most-Favoured-Nation (MFN) and National Treatment (NT) obligations under the General Agreement on Tariffs and Trade (GATT).

4. In contrast, the Buy American Provision, as implemented by the Interim Rule and the Interim Final Guidance, may indeed be found inconsistent "as applied" with U.S. obligations under the SCM Agreement. The measure could be construed as a prohibited subsidy because it authorizes a "financial contribution" (government purchase of goods) that may often confer a "benefit" upon domestic producers (§ 1605(b)(3) allows for the payment of up to 25 percent above the domestic construction materials' market value), and the resulting "subsidy" appears contingent upon the use of domestic over imported goods.

5. A finding of a prohibited subsidy could theoretically provide the complaining member with a more effective remedy than would be available under the general Dispute Settlement Understanding (DSU) Article 22.4 equivalence standard—namely, the withdrawal of the

subsidy without delay and “appropriate” countermeasures in the event of noncompliance. However, the remedy’s effectiveness may be of limited value by the time litigation (which easily takes two years) is concluded unless the WTO legal bodies were to assume the political risk inherent in authorizing a retrospective remedy in spite of the U.S. government’s contractual obligations.

6. Second, within the auto bailout plans, the bridge loans provided by the U.S. government to GM and Chrysler, and the loans provided by the French government to Renault and Peugeot, are likely to be so-called “actionable subsidies”. As France has removed the condition that companies must maintain their production within French borders in order to receive the loan, the measure has moved further away from being a prohibited subsidy that is contingent on the use of domestic over imported products.

7. Similarly, the scrapping programs, where governments provide vouchers when consumers trade in an old vehicle to replace with a new high fuel economy vehicle, are likely to be actionable subsidies. If the United States adopts a proposed bill to make the scrapping program accord more favorable treatment to vehicles produced domestically, this version of the program is likely to be a prohibited subsidy. Such a measure would also be in violation of the national treatment obligation under GATT Article III:4.

8. Tax credits to consumers who purchase new vehicles, without conditions on production location or fuel economy, are likely to be permissible subsidies because the existence and causality of adverse effects would be more difficult to prove than for other measures. If the U.S. or France auto bailout measures were found to be in violation of WTO obligations, it might be possible to invoke a GATT Article XX(g) defense that the measures are related to the conservation of natural resources, though such a defense would appear unlikely to succeed.

Part I: The Buy American Provision

I. Factual Background

9. The Recovery Act was signed into law by President Obama on February 17, 2009. Section 1605 of the Recovery Act provides in full:

> Sec. 1605. Use of American Iron, Steel, and Manufactured Goods. (a) None of the funds appropriated or otherwise made available by this Act may be used for a project for the construction, alteration, maintenance, or repair of a public building or public work unless all of the iron, steel, and manufactured goods used in the project are produced in the United States.
>
> (b) Subsection (a) shall not apply in any case or category of cases in which the head of the Federal department or agency involved finds that--
>
> (1) applying subsection (a) would be inconsistent with the public interest;
>
> (2) iron, steel, and the relevant manufactured goods are not produced in the United States in sufficient and reasonably available quantities and of a satisfactory quality; or
>
> (3) inclusion of iron, steel, and manufactured goods produced in the United States will increase the cost of the overall project by more than 25 percent.
>
> (c) If the head of a Federal department or agency determines that it is necessary to waive the application of subsection (a) based on a finding under subsection (b), the head of the department or agency shall publish in the Federal Register a detailed written justification as to why the provision is being waived.
>
> (d) This section shall be applied in a manner consistent with United States obligations under international agreements.[2]

10. On March 31, 2009 the Obama administration issued an Interim Rule which amended the Federal Acquisition Regulation in order to implement the Buy American Provision.[3] This Interim Rule affects only federal procurement under the Recovery Act and is open to a period of public comment before finalization, though it is effective immediately.[4] Subsequently, on April 3, the administration issued an Interim Final Guidance for state and local government agencies receiving federal grants appropriated by the Recovery Act.[5]

11. The Interim Rule defines a "public building or public work" as a "building or work, the construction, prosecution, completion, or repair of which . . . is carried on directly by authority of, or with funds of, a Federal agency to serve the interest of the general public regardless of whether title thereof is in a Federal agency."[6] The Interim Final Guidance defines the term as "a public building of, and a public work of, a governmental entity," which

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[2] Pub. L. 111-5 § 1605. Accessed May 3, 2009 at <http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.1.enr:>.

[3] Office of Management and Budget, "Interim Rule with request for comments" (hereinafter "Interim Rule"), *Updated Implementing Guidance for the American Recovery and Reinvestment Act*, 94. Accessed May 3, 2009 at <http://www.whitehouse.gov/omb/assets/memoranda_fy2009/m09-15.pdf>.

[4] *Id*. at 96.

[5] Office of Management and Budget, "Interim Final Guidance for Federal Financial Assistance" (hereinafter "Interim Final Guidance"), *Updated Implementing Guidance for the American Recovery and Reinvestment Act*, 121. Accessed May 3, 2009 at <http://www.whitehouse.gov/omb/assets/memoranda_fy2009/m09-15.pdf>.

[6] Interim Rule, *supra* note 3, at 95.

"may include, without limitation, bridges, dams, plants, highways . . . ."[7]

12. The $787.2 billion Recovery Act consists of both tax cuts and government spending on a wide variety of "targeted priority investments."[8] Relevant "public buildings or public works" may include projects as varied as, for example, $16.5 billion "to modernize federal and other public infrastructure with investments that lead to long term energy cost savings," $17.7 billion "for transit and rail to reduce traffic congestion and gas consumption," $7.2 billion "to expand broadband internet access so businesses in rural and other underserved areas can link up to the global economy," and $4 billion "for building repair and modernization" of public housing, not to mention billions more in discrete construction and renovation projects.[9]

13. Both the Interim Rule and the Interim Final Guidance limit "manufactured goods," in the context of the Buy American Provision, to a "good brought to the construction site for incorporation into the building or work."[10] The Interim Rule lays out relatively lenient rules of origin—requiring only that "domestic construction material" be "mined or produced," or "manufactured" in the U.S.—and further specifies that "[t]here is no requirement with regard to the origin of components or subcomponents in other manufactured construction material, as long as the manufacture of the construction material occurs in the United States."[11] However, the Interim Final Guidance—while containing the same language regarding components and subcomponents—requires that domestic iron, steel, and manufactured goods be "substantially transformed in the United States."[12]

14. Finally, the Interim Rule states, "The restrictions of section 1605 . . . do not apply to Recovery Act designated country construction material."[13] The exempted "Recovery Act designated countries" are broadly defined as any WTO "Government Procurement Agreement country," "Free Trade Agreement country," or "least developed country," all of which are

[7] Interim Final Guidance, *supra* note 5, at 144.
[8] United State House of Representatives Committee on Appropriations, *Summary: American Recovery and Reinvestment Conference Agreement*, February 13, 2009.
[9] *Id*.
[10] Interim Final Guidance, *supra* note 5, at 143; *See also* Interim Rule, *supra* note 3, at 99.
[11] Interim Rule, *supra* note 3, at 97.
[12] Interim Final Guidance, *supra* note 5, at 150.
[13] Interim Rule, *supra* note 3, at 102.

individually listed.[14] Meanwhile, the Interim Final Guidance exempts WTO GPA countries, FTA countries, and US-EC Exchange of Letters countries, but makes no mention of least developed countries.[15] However, such requirements apply only to state and sub-federal agencies that are bound by the relevant international agreements and "shall only apply to projects with an estimated value of $7,443,000 or more"—i.e. the 5 million SDR threshold under the U.S. GPA annexes—"and projects that are not specifically excluded from the application of those agreements."[16]

II. Assessment of the WTO consistency of the Buy American Provision

15. The discussion that follows analyses the WTO consistency of the Buy American Provision of the Recovery Act in relation to the GPA, the GATT, and the SCM Agreement.

16. WTO members not exempted from the Buy American Provision under the terms of the Interim Rule and the Interim Final Guidance will probably be unable to challenge the measure "as such" due to the executive discretion granted by the statute. As the Appellate Body has explained, "where discretionary authority is vested in the executive branch of a WTO Member, it cannot be assumed that the WTO Member will fail to implement its obligations under the *WTO Agreement* in good faith," and therefore the measure cannot be challenged "as such."[17] The Buy American Provision arguably provides three layers of executive discretion: the public interest exception at paragraph (b)(1), the so-called "saving clause" at paragraph (d), and the congressional conference report clarification that "Section 1605(d) is not intended to repeal by implication the President's authority under Title III of the Trade Agreements Act of

[14] According to the Interim Rule, "Recovery Act designated country means any of the following countries":
(1) A World Trade Organization Government Procurement Agreement (WTO GPA) country (Aruba, Austria, Belgium, Bulgaria, Canada, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hong Kong, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea (Republic of), Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Singapore, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, or United Kingdom);
(2) A Free Trade Agreement country (FTA)(Australia, Bahrain, Canada, Chile, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Mexico, Morocco, Nicaragua, Oman, Peru, or Singapore); or
(3) A least developed country (Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Djibouti, East Timor, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea- Bissau, Haiti, Kiribati, Laos, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Tanzania, Togo, Tuvalu, Uganda, Vanuatu, Yemen, or Zambia). *Id*. at 101.

[15] Interim Final Guidance, *supra* note 5, at 138-39.

[16] *Id*. at 138.

[17] Appellate Body Report, *United States – Section 211 Omnibus Appropriations Act of 1998*, para. 259.

1976" (granting the President authority to "waive, in whole or in part . . . the application of any law, regulation, procedure, or practice regarding Government procurement" under certain conditions).[18]

17. A second preliminary issue is whether any "as applied" challenge launched after the commencement of Recovery Act procurement could yield a satisfactory remedy, beyond bringing to light the underlying violation. As a practical matter, claims based on the GPA or the GATT would not attain a satisfactory remedy to the extent that the discriminatory procurement will already have concluded by the end of litigation. Therefore, an SCM claim may be more promising, since a finding of a prohibited subsidy must result in the recommendation that the Member "withdraw" the subsidy—a term that was interpreted by at least one panel to include so-called "retrospective" remedies—accompanied by the more severe "appropriate" standard of retaliation in the event of noncompliance.[19]

A. The Buy American Provision appears consistent with the GPA

18. As explained above, the Interim Rule explicitly exempts all WTO GPA parties—as well as FTA countries and least developed countries—from the Buy American Provision as applied to federal procurement.[20] The Interim Final Guidance, meanwhile, exempts GPA and FTA parties only to the extent that the sub-federal entities are bound by international agreements (in the case of the GPA, only thirty-seven U.S. states are bound under U.S. Annex 2), and only where the project is above a threshold of 5 million SDRs.[21]

19. It might be argued that the relevant threshold for the procurement of "construction material"—defined as a "good brought to the construction site for incorporation into the building or work"—should be "355,000 SDRs for supplies and services" under GPA Annex 2,

[18] Conference Report to accompany H.R.1. Accessed May 3, 2009 at <http://thomas.loc.gov>; 19 U.S.C. § 2511 (2007).
[19] Panel Report, *Australia – Automotive Leather II (Article 21.5 – United States)*, para 6.27.
[20] Although the Interim Rule initially refers to an exception for "construction contracts with an estimated acquisition value of $7,443,000 or more"—citing Subpart 25.4 of the Federal Acquisition Regulations, which is generally applicable to procurement covered by trade agreements—it goes on to specifically state that section 1605 does "not apply to Recovery Act designated country construction material," apparently providing a blanket exemption for such countries at the federal level. Interim Rule, *supra* note 3, at 98, 102.
[21] United States Annex 2, Appendix 1, *Government Procurement Agreement*; Interim Final Guidance, *supra* note 5, at 138.

in addition to a flat "5 million SDRs for construction."[22] Presumably, however, if a single construction material—albeit steel or iron—entails a cost as high as 355,000 SDRs, the costs of the construction services and other construction materials would typically surpass 5 million SDRs, though this need not always be the case.

20. In the sole GPA dispute on record, *Korea – Government Procurement*, the Panel concluded that the agency responsible for the construction of an airport was not covered by Korea's GPA commitments.[23] Here, the U.S. would cite *Korea – Government Procurement* in arguing that certain governmental entities are clearly not bound under the commitments detailed in its GPA annexes. There appears to be no GPA violation where, under the Interim Final Guidance, sub-central government entities not covered under U.S. GPA Annex 2 will be legally required to buy American construction materials insofar as they are not bound under an FTA and no exception is invoked.

21. In sum, it appears that the Buy American Provision of the Recovery Act, as implemented by the Interim Rule and the Interim Final Guidance, is essentially consistent with U.S. obligations under the plurilateral GPA, since GPA parties are explicitly carved out from the Buy American Provision. The Recovery Act thereby subjects some non-GPA parties—most notably China, India, and Brazil, which are neither LDCs nor FTA partners with the U.S.—to the Buy American Provision in a manner consistent with the GPA itself since, clearly, non-GPA parties cannot claim violations of the GPA.[24] The sole object of complaint for GPA parties seems to be at the sub-central government level, and only if the Interim Final Guidance were to apply the Buy American Provision to a project with a total cost estimated at under 5 million SDRs where the construction materials were estimated at over 355,000 SDRs.

B. The Buy American Provision appears consistent with the GATT

[22] United States Annex 2, Appendix 1, *Government Procurement Agreement.*
[23] Panel Report, *Korea –Government Procurement*, para 7.83.
[24] Also of note—but beyond the scope of the present analysis—is Section 604 of the Recovery Act, requiring that "funds appropriated or otherwise available to the Department of Homeland Security may not be used for the procurement of" a number of enumerated textile-related goods, including uniforms. Pub. L. 111-5 § 604. Accessed May 3, 2009 at <http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.1.enr:>. Although U.S. Annex 1 to the GPA covers DHS generally, it excepts two DHS sub-agencies: the Transportation Security Administration and the U.S. Coast Guard. United States Annex 1, Appendix 1, *Government Procurement Agreement.*

22. The Buy American Provision at first blush appears inconsistent with basic GATT principles because it constitutes a regulation providing for discriminatory treatment both amongst WTO Members (counter to MFN) and between domestic and imported goods (counter to NT). The GPA makes no explicit attempt to alter the parties' GATT commitments. Furthermore, it would seem that the GPA could not be invoked as *lex specialis* vis-à-vis non-parties to the GPA to exclude in any way the application of the multilateral agreements of GATT 1994—especially in light of the Appellate Body's willingness to apply the SCM Agreement simultaneously with the more specific Agreement on Agriculture in *U.S. – Upland Cotton*, where the complainant and respondent were parties to both agreements.[25]

23. If the Buy American Provision can be construed as falling within the scope of GATT Article III:4 requiring NT under domestic regulations, then it will also be covered by Article I:1 on MFN, and the measure would be found inconsistent with the GATT—probably under both articles. However, even if the Buy American Provision is interpreted as being excluded from Article III under the III:8(a) exception, an argument could still be made that Article I:1 MFN should apply to procurement.

(1) GATT Article III:8(a) excepts government procurement as regulated by the Buy American Provision from the reach of Article III:4 National Treatment

24. GATT Article III:4 provides in relevant part:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution, or use.

25. By the very nature of government procurement, the construction materials imported from, for example, China, under serious consideration for procurement can be considered to be "like products," as compared to U.S.-made construction materials, especially considering that the Appellate Body has concluded that "the scope of 'like' in Article III:4 is broader than the scope of 'like' in Article III:2, first sentence."[26] A measure such as the Buy American

[25] Appellate Body Report, *U.S. – Upland Cotton*, paras. 570-71.
[26] Appellate Body Report, *EC – Asbestos*, para. 99.

Provision that explicitly prevents the "purchase" of a like product from certain Members not parties to the GPA is clearly in violation of the NT requirement articulated in Article III:4.

26. However, Article III:8 excepts government procurement (as well as certain production subsidies) from the provisions of Article III under certain conditions. Article III:8(a) states:

> The provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by government agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.

27. Though there is, as yet, no precedent to provide guidance in interpreting this provision, textually there appear to be three distinct elements necessary for a procurement measure to escape the reach of Article III: 1) the procurement must be made "by government agencies," 2) the relevant products must be "purchased for governmental purposes," and 3) the relevant products must not be purchased "with a view to commercial resale or with a view to use in the production of goods for commercial sale."[27]

28. Clearly, the Buy American Provision fulfills the third element. It might be argued that the measure fails to fulfill the first element under a theory that the procurement is made not by the government, but by the contractor. An unadopted GATT panel report, *United States – Procurement of a Sonar Mapping System*, in considering the application of the GPA to a prior Buy American measure, indicated that the following factors were relevant in deciding whether procurement was made "by the entities subject to this Agreement" under the former GPA I:1(a): "payment by government, governmental use of or benefit from the product, government possession and government control over the obtaining of the product."[28] The GATT Panel ultimately concluded:

> in the light of the Government's payment for, ownership and use of the sonar mapping system and given the extent of its control over the obtaining of the system, the acquisition of the sonar mapping system was government procurement within the

[27] *Cf.* Nafta Panel Report "ADF Group Inc. v. United States," (finding that even assuming the U.S. had violated the Article 1102 National Treatment requirement concerning investors, Article 1108(7)(a) "renders inapplicable the provisions of, inter alia, Article 1102 in case of procurement by a Party.") NAFTA Article 1108(7)(a) does not contain the second and third elements of GATT Article III:8(a). Article 1108(7) provides: "Articles 1102 [requiring NT for investors], 1103 [requiring MFN for investors] and 1107 do not apply to: (a) procurement by a Party or a state enterprise; or (b) subsidies or grants provided by a Party or state enterprise . . . ."

[28] "United States – Procurement of a Sonar Mapping System," GPR.DS1/R, dated 23 April 1992 (unadopted), para. 4.7.

meaning of Article I:1(a), first sentence, and not "private" procurement outside the Agreement as proposed in the alternative by the European Community.[29]

29. Were such an analysis to be undertaken in the context of GATT Article III:8(a), it appears that this Buy American Provision would similarly be judged to govern “procurement by government agencies,” albeit through the intermediary of a contractor. Here, the government pays for, uses, and controls the obtaining of the construction materials.

29. The final necessary element if the Buy American Provision is to escape the reach of GATT Article III queries whether the relevant products procured by government agencies using funds appropriated by the Recovery Act are “purchased for governmental purposes.” WTO precedent provides little guidance relating to the interpretation of “governmental purposes.” It might be contended that this second element should be read in light of the subsequent language requiring that the products not be procured “with a view to commercial resale.” On the other hand, one might argue that the drafters intended to distinguish between, for example, a vehicle procured for end use by the government and the construction materials to be transformed into a public building where the end user is the society at large.[30] However, this distinction is ultimately unpersuasive, since the construction of “public buildings and public works” is certainly a central purpose of government.

30. In sum, GATT Article III:8(A) seems to exclude the Buy American Provision from the scope of Article III:4, because 1) Recovery Act procurement is made “by government agencies,” 2) the relevant products appear to be “purchased for governmental purposes,” and 3) the relevant products are not purchased “with a view to commercial resale or with a view to use in the production of goods for commercial sale.”

(2) GATT Article I:1 MFN will probably be found not to extend to a procurement regulation exempted from Article III:4 by III:8(a)

31. GATT Article I:1, “General Most-Favoured Nation Treatment,” provides:

With respect to customs duties and charges of any kind imposed on or in

[29] *Id.*, para 4.13.

[30] Perhaps in support of this theory, the negotiating Sub-Committee considered that the exception that would become III:8(a) would exclude from the scope of Article III “laws, regulations and requirements governing purchases effected for governmental *use* where resale was only incidental.” (emphasis added)

> connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, *and with respect to all matters referred to in paragraphs 2 and 4 of Article III*, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties. (emphasis added)

32. If Article I:1 were construed to extend to the Buy American Provision, the measure would surely be deemed inconsistent with MFN because it grants preferred treatment to GPA parties' like products vis-à-vis those originating from Members not parties to the GPA. The decisive issue, then, is whether Article I:1, covering "all matters referred to in paragraphs 2 and 4 of Article III," includes within its scope the Buy American Provision. As stated above, if the measure is construed as not excluded from Article III under Article III:8(a), then it would almost certainly be considered a violation of Article III:4, and therefore necessarily within the scope of Article I:1. A closer question is whether the Buy American Provision could still be construed as falling within the scope of I:1 even after being interpreted as excepted from Article III by III:8(a).

33. This issue has been examined at some length by the *EC – Vessels* Panel in the context of a discriminatory EC subsidy interpreted to be excluded from Article III by the III:8(b) exception for subsidies. There, the Panel chose to focus on the meaning of the term "matters" in the Article I:1 language applying MFN to "all matters referred to in paragraphs 2 and 4 of Article III." The Panel first noted that "[i]n light of this use of the word 'matters' to refer to provisions containing legal obligations, we consider that among the various dictionary definitions, 'subject' and 'substance' are particularly pertinent . . . ."[31] The Panel then reasoned that by "the ordinary meaning of the terms used in their context . . . the phrase 'matters referred to in...' in Article I:1 refers to the subject matter of those provisions in terms of their substantive legal content."[32] Having established such a narrow interpretation of the relevant clause in Article I:1, the Panel concluded that the subsidy was "not a measure falling within the scope of the subject matter of Article I:1…"[33]

[31] Panel Report, *EC – Vessels*, para. 7.83.
[32] *Id.*
[33] *Id.*, para. 7.90.

34. It could be argued that an analysis of the clause "all matters referred to in paragraphs 2 and 4 of Article III" which focused on the words "all" and "referred to"—as opposed to the potentially ambiguous term "matter"—would yield a different interpretation of the ordinary meaning of the treaty language in the context of Article I:1. "Refer" means in this sense, "to direct attention usually by clear and specific mention."[34] Under this line of argument, "all matters referred to by paragraphs 2 and 4 of Article III" consist of "all" the "subjects" specifically mentioned in those paragraphs—in this case, "all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution, or use." Notably, the Article I:1 language refers to all matters *referred to by*—as opposed to all matters *covered by*—paragraphs 2 and 4 of Article III.

35. Although this interpretation may indeed be the most natural reading of the treaty text, future panels will most likely follow the lead of *EC – Vessels* in order to avoid a conflict with the drafters' intent as reflected in the *travaux preparatoire*, as well as in subsequent negotiating history. Under Vienna Convention on the Law of Treaties (VCLT) Article 32, a panel need only find preliminary ambiguity after applying the Article 31 "General rule of interpretation" in order to proceed to examine "the preparatory work of the treaty and the circumstances of its conclusion."[35]

36. During the Geneva Session of the ITO Preparatory Committee in 1947, the U.S. explained its proposal to introduce the language, "with respect to all matters referred to . . .":

> The changes proposed in line 8 of paragraph 1 are designed to extend the grant of most–favoured-nation treatment to all matters dealt with in Article 15 (except governmental operations under paragraph 5 of Article 15) regardless of whether national treatment is provided for in respect of such matters.[36]

37. The *EC – Vessels* Panel interpreted this explanation as follows:

> The statement thus makes it clear that the proposed drafting change would apply the MFN clause to "all matters referred to in paragraphs 1,2,3 and 4 of Article 15" but not to "governmental operations under paragraph 5 of Article 15". At the time the United States made this proposal, paragraph 5 of Article 15, which eventually became paragraph 8 of Article 18 of the Havana Charter and of Article III of the GATT, provided that the national treatment obligations would not apply to government

[34] *Merriam-Webster Dictionary*. Accessed May 3, 2009 at < http://www.merriam-webster.com/dictionary/refer>.
[35] Article 32: Supplementary means of interpretation, *Vienna Convention on the Law of Treaties* (1969).
[36] United Nations Economic and Social Council, Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, E/PC/T/W/146 (30 May 1947).

procurement.[37]

38. The *EC – Vessels* Panel further noted that "in a discussion on draft Article 18.8(a) of the Havana Charter corresponding to Article III:8(a), it was observed at a meeting in February 1948 that:

> '...the Sub-Committee had considered that the language of paragraph 8 would except from the scope of Article 18 [national treatment] <u>and hence from Article</u> 16 [MFN treatment], laws, regulations and requirements governing purchases effected for governmental purposes where resale was only incidental...'."[38]

39. Finally, the mere existence of the GPA—and the fact that it includes its own MFN provision—is at least evidence of the GPA parties' strong belief that Article I:1 excluded regulations concerning government procurement from its scope.[39]

40. In sum, a reasonable textual argument can be made that GATT Article I:1 encompasses a measure such as the Buy American Provision even if that measure is excluded by Article III:8(a) from violation of Article III:4. However, a WTO panel would probably be loath to reject the logic of *EC – Vessels*, especially given the clarity of the drafters' intentions as revealed in the *travaux preparatoire*.

C. The Buy America Provision as applied could constitute a prohibited subsidy under the SCM Agreement, but a satisfactory remedy may prove elusive

41. If it is possible to locate within the Buy American Provision a subsidy as defined by Article 1 of the SCM Agreement, then such a subsidy is prohibited to the extent that it is contingent upon the use of domestic over imported goods under Article 3. Under Article 4, a Member must "withdraw" the prohibited subsidy "without delay" and will face "appropriate countermeasures" if it fails to comply.[40]

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[37] Panel Report, *EC – Vessels*, para. 7.85.

[38] Panel Report, *EC – Vessels* para. 7.86, citing United Nations Conference on Trade and Employment, Third Committee: Commercial Policy, Summary Record of the Forty-First Meeting, E/CONF.2/C.3/SR.41 (23 February 1948), p. 3. (Emphasis added).

[39] Though potentially persuasive, this interpretation by some, but not all, of the GATT parties probably does not rise to the level of a "subsequent agreement between the parties regarding the interpretation of the treaty" or "subsequent practice in the application of the treaty . . . ." Article 31: General Rule of Interpretation, *Vienna Convention on the Law of Treaties* (1969).

[40] Articles 4.7 and 4.10, *Subsidies and Countervailing Measures Agreement*.

(1) The Buy American Provision appears to be a subsidy under Article 1

42. SCM Article 1 on the "Definition of a Subsidy" provides in full:

> 1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:
> (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as 'government'), i.e. where:
>
> (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
>
> (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
>
> (iii) a government provides goods or services other than general infrastructure, or purchases goods;
>
> (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) or (ii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;
>
> or
>
> (a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994;
>
> and
>
> (b) a benefit is thereby conferred.
>
> 1.2 A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2.

43. The Appellate Body in *Canada – Aircraft* provided a clear interpretation of the dual elements that constitute SCM Article 1.1:

> The definition of "subsidy" in Article 1.1 has two discrete elements: "a financial contribution by a government or any public body" and "a benefit is thereby conferred". The first element of this definition is concerned with whether the *government* made a "financial contribution", as that term is defined in Article 1.1(a). The focus of the first element is on the action of the government in making the "financial contribution". That being so, it seems to us logical that the second element in Article 1.1 is concerned with the "benefit… conferred" on the *recipient* by that governmental action.[41]

44. SCM Article 2.3 states, "Any subsidy falling under the provision of Article 3 [i.e. a prohibited subsidy] shall be deemed to be specific," thereby fulfilling the requirement of Article 1.2.

(i) There is a "financial contribution"

45. Article 1.1(a)(1)(iii) states simply that a financial contribution exists where "a government provides goods or services other than general infrastructure, *or purchases goods*" (emphasis added).[42] SCM Article 14(d)—though in the context of the calculation of a "benefit" for the purpose of imposing countervailing duties—informs the meaning of 1.1(a)(1)(iii)'s reference to where "a government . . . purchases goods": "[T]he provision of goods or services or *purchase of goods by a government shall not be considered as conferring a benefit unless* the provision is made for less than adequate remuneration, or *the purchase is made for more than adequate remuneration*" (emphasis added). Reading SCM Article 1.1(a)(1)(iii) in the context of SCM Article 14(d), it is unequivocally clear that there is a financial contribution where "a government . . . purchases goods"—regardless of whether that purchase "is made for more than adequate remuneration," which must be considered separately in analyzing whether a "benefit" is conferred under Article 1.1(b) (see below).[43]

46. A related issue is whether Article 1.1(a)(1)(iii)'s carve-out for "general infrastructure" provision exempts what would otherwise be a procurement-related financial contribution. Article 1.1(a)(1)(iii) provides that a financial contribution exists where "a government provides goods or services *other than general infrastructure*, or purchases goods" (emphasis added).

47. At first blush, the carve-out may appear to apply to situations such as the Recovery Act in which the government provides general infrastructure—i.e. public buildings and public works. However, the financial contribution here is not the contribution of a public building or public work per se, but rather the government purchase of goods. Furthermore, the carve-out may not even apply to the "purchases" clause. Arguably, the "general infrastructure" exception applies only to the preceding language covering government provision of "goods or services," for example, education to the general public. Here, the challenge refers to an

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[41] Appellate Body Report, *Canada – Aircraft*, para. 156.
[42] The lone WTO dispute involving Article 1.1(a)(1)(iii), *U.S. – Softwood Lumber IV*, dealt only with the separate issue of whether the Canadian Government, by conferring the right to harvest timber, "provides" a "good" to domestic lumber companies. Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 76.
[43] *See* Appellate Body Report, *Brazil – Aircraft*, para. 157.

earlier, different relationship: not the government providing goods or services to the public, but the government making a financial contribution to companies in the process of providing infrastructure to the public.

48. Under an alternative theory, meanwhile, the requisite "financial contribution" would be construed as the "direct transfer of funds" from the federal government to state and local governments under SCM Article 1.1(a)(1)(i). SCM Article 1 does not explicitly require that the government's financial contribution be directed toward a private entity. As Professor Charnovitz has recently pointed out, "there is no WTO case law yet on whether subsidies from one government to another are immune from SCM disciplines."[44] Under this theory, the federal grants to state and local governments for Recovery Act projects themselves constitute a "direct transfer of funds (e.g. grants . . .)."[45]

49. In summary, there appears to be a financial contribution under SCM Article 1.1—most clearly under 1.1(a)(1)(iii) where the government "purchases goods," but alternatively under an inter-governmental transfer under a 1.1(a)(1)(i) theory.

(ii) As applied, the Buy American Provision may often confer a "benefit"

50. Under SCM Article 1.1(b), the second element necessary to complete the definition of a subsidy is that "a benefit is thereby conferred." As the Appellate Body explained in *Canada – Aircraft*, "the second element in Article 1.1 is concerned with the 'benefit… conferred' on the *recipient* by that governmental action."[46] The Appellate Body proceeded with an explication of Article 1.1(b):

> We also believe that the word "benefit", as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because

[44] Steve Charnovitz, "Resist US Protectionism: The Top Trade Priority for the G20." Accessed May 3, 2009 at <http://www.globaleconomicgovernance.org/blog/2009/03/resist-us-protectionism-the-top-trade-priority-for-the-g20/>.

[45] Under this somewhat radical theory, transfers of funds from the treasury to any government agency could be construed as a subsidy, assuming that the benefit benchmark is set at zero funding. The limiting principle for SCM purposes would be specificity to an industry or enterprise—which, presumably, would rarely be found with such financial contributions. But where, as here, the subsidy is prohibited, that subsidy shall automatically be deemed specific under SCM Article 2.3.

[46] Appellate Body Report, *Canada – Aircraft*, para. 156.

> the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market.[47]

Thus, the Appellate Body in *Canada – Aircraft* has made it exceedingly clear that there is a "benefit . . . conferred" where "the 'financial contribution' makes the recipient 'better off' than it would otherwise have been" and that the "appropriate basis" for such a comparison is "the marketplace."

51. Applying Article 1.1(b) to the Buy American Provision, then, it is necessary to compare whether the recipients of the "financial contribution" are "better off" than they would otherwise be in the absence of the contribution. Under the primary theory of the case (in which the "financial contribution" is the government purchase of goods), the recipients of the benefits are the domestic producers where they sell their construction materials for up to 25 percent more than the world price under § 1605(b)(3) of the Recovery Act. As the Appellate Body has endorsed Article 14 as "relevant context in interpreting Article 1.1(b)," it is appropriate to consider here Article 14(d) stating: [48]

> [T]he provision of goods or services or purchase of goods by a government shall not be considered as conferring a benefit unless the provision is made for less than adequate remuneration, or the purchase is made for more than adequate remuneration. The adequacy of remuneration shall be determined in relation to prevailing market conditions for the good or service in question in the country of provision or purchase (including price, quality, availability, marketability, transportation and other conditions of purchase or sale).

52. To the extent that this standard is applicable to the determination of whether a benefit is conferred under Article 1.1(b), § 1605(b)(3)'s 25 percent mark-up threshold at least *allows for* "more than adequate remuneration" for domestic construction materials "in the country of provision or purchase." Presumably, this Article 14(d) benefit standard is highly relevant to the 1.1(b) determination, since the Appellate Body decided in *Canada – Aircraft* not only that Article 14 is relevant context for Article 1.1(b), but also that the "appropriate basis" for a

[47] *Id.*, para. 157; The Appellate Body then considered SCM Article 1.1(b) in the light of SCM Article 14: "Article 14, which we have said is relevant context in interpreting Article 1.1(b), supports our view that the marketplace is an appropriate basis for comparison. The guidelines set forth in Article 14 relate to equity investments, loans, loan guarantees, the provision of goods or services by a government, and the purchase of goods by a government. A 'benefit' arises under each of the guidelines if the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market." *Id.*, para. 158.
[48] *Id.*

1.1(b) comparison is "the marketplace"—precisely the standard against which the factors listed in Article 14(d) are designed to measure the "adequacy of remuneration."[49]

53. The Interim Rule provides a window into exactly how a benefit may be conferred upon domestic producers in the form of remuneration up to 25 percent above the market value for construction materials. Under the Interim Rule's new § 25.605 of the Foreign Acquisition Regulation, entitled "Evaluating offers of foreign construction material," the contracting officer is directed in paragraph (a)(1) to "use an evaluation factor of 25 percent, applied to the total offered price of the contract, if foreign iron, steel, or other manufactured goods are incorporated in the offer as construction material based on an exception for unreasonable cost requested by the offeror."[50] The Interim Rule makes explicit:

> The clauses are unique in that, for Recovery Act-funded construction projects, the 25 percent price adjustment factor for non-U.S. iron, steel, and other foreign manufactured construction material excepted from the section 1605 requirement on the basis of unreasonable cost is applied to the entire price of the project, not only to the cost of the foreign materials. The 6 percent adjustment for the Buy American Act is retained and applied to the cost of foreign unmanufactured goods . . . .[51]

54. Section 25.605 goes on to illustrate: "Total evaluated price = offered price + (.25 x offered price, if (a)(1) applies) + (.06 x cost of foreign unmanufactured construction materials if (a)(2) applies).[52] By this formula—although discretion is retained by the contracting officer to "determine that an exception applies because the cost of certain domestic construction material is unreasonable"—the contracting officer is explicitly prohibited from accepting an offer including foreign construction materials unless the entire project offer is over 25 percent cheaper than an offer including only domestic construction materials: "If two or more offers are equal in price, the contracting officer must give preference to an offer that does not include foreign construction material excepted at the request of the offeror on the basis of unreasonable cost."[53]

55. In the context of the Interim Rule, then, the Buy American Provision has the potential to benefit domestic producers in two distinct ways. First, inefficient domestic producers

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[49] *Id*., paras. 157-8.
[50] Interim Rule, *supra* note 3, at 98.
[51] *Id*. at 96.
[52] *Id*. at 98; *See also* Interim Final Guidance, *supra* note 5, at 140.
[53] Interim Rule, *supra* note 3, at 98.

(relative to the world price in the domestic market) may win contracts that they otherwise would not be able to secure. Though these companies' profit margins would not necessarily be higher than the market would provide foreign competitors, the fact that domestic firms will win contracts at above-world market prices allows them to secure otherwise unattainable market share and profits. Again, the analogous 14(d) benefit standard concerns itself only with the "prevailing market conditions for the good or service in question." On the other hand, it might be asked whether such inefficient domestic producers exist in the first place, since theoretically they will have been driven out of business. However, pre-existing barriers to trade may have allowed such firms to survive (for example, in the steel industry), or new inefficient firms could emerge under the protection of the Buy American Provision.

56. In a second scenario, efficient domestic producers could be able to reap a higher profit than would otherwise be accorded by the market—but only if they are able to charge a higher price for their goods and are not underbid by domestic competitors. Theoretically, this would only occur where a domestic firm has great market power.

57. Upon reflection, it appears that—assuming perfect competition and efficiency on the world market—U.S. producers would simply charge normal market prices and hence receive no benefit. Under this scenario, even when domestic producers win contracts due to the application of the Buy American Provision, they will have bid the same world price as their non-GPA party competitors. But whether such assumptions hold for U.S. markets is a factual matter, to be evidenced by the application of the Buy American Provision. Therefore, the Article 1.1(b) analysis of whether there is a benefit conferred appears to provide yet another reason why a challenge to the measure must be "as applied," as opposed to "as such"—in addition to the discretionary safeguards in the statutory language, described above.[54] On the other hand, it might also be argued that the mere existence of the 25 percent cushion operates as a benefit in itself that the market does not provide on its own—perhaps providing certainty or credit-worthiness to domestic firms.

58. Meanwhile, under Professor Charnovitz's novel inter-governmental theory, there is no

[54] *See e.g.* Panel Report, *Korea –Vessels*, para. 7.121 (applying "the traditional mandatory / discretionary approach" in determining whether the measure as such conferred a benefit and finding that the EC failed to established that the measure *required* "the provision of [advance payment refund guarantees] on terms more favourable than Korean

need to rely on § 1605(b)(3)'s establishment of the 25 percent threshold. Rather, it could be argued that the state and local governments receiving federal grants can be said to benefit simply because they receive cash (for the purpose of implementing Recovery Act projects) that they otherwise would not have. However, there is a persuasive counterargument: no market exists between governments, and without a market benchmark, it seems impossible to identify a proper counterfactual to be used in measuring a benefit.[55] On the other hand, one could argue that the benchmark for a grant will always be the absence of a grant, and the limiting principle for government transfers vis-à-vis the SCM Agreement is simply specificity.

59. In summary, under a textual analysis of Article 1 of the SCM Agreement, subsidies may often be provided by the application of the Buy American Provision. The "financial contribution" exists most obviously under Article 1.1(a)(1)(iii) where the government purchases goods, and a "benefit" will be conferred on domestic producers where the government overpays for goods up to the 25 percent threshold permitted under § 1605(b)(3).

(2) Where the Buy American Provision as applied produces a subsidy, that subsidy is probably prohibited under Article 3

60. Within Part II of the SCM Agreement concerning "Prohibited Subsidies," Article 3 provides in relevant part:

> 3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited: . . . (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.
> 3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.

61. Applying Article 3 to the Buy American Provision, where the measure authorizes a subsidy within the meaning of Article 1 (a financial contribution conferring a benefit), such a subsidy would initially appear clearly contingent upon the use of domestic over imported goods. However, the subsidy itself is not the Buy American Provision as a whole, but rather the benefit conferred—in this case, the portion of the price paid above the market price. The

shipyards could obtain on the market."); *see also* Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft* (rejecting Brazil's "as such" challenge but finding various benefits conferred "as applied.")

issue, then, appears to be whether this markup (i.e. the "subsidy") is itself "contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods."

62. It might be argued that the issue thus formulated leads the inquiry to whether the domestic construction materials themselves must contain domestic inputs in order to receive the subsidy. As mentioned previously, both the Interim Rule and the Interim Final Guidance explicitly state that "[t]here is no requirement with regard to the origin of components or subcomponents in other manufactured construction material, as long as the manufacture of the construction material occurs in the United States."[56] However, the Interim Rule does state that "[p]roduction in the United States of the iron or steel used as construction material requires that all manufacturing processes must take place in the United States, except metallurgical processes involving refinement of steel additives," while the Interim Final Guidance requires that domestic iron, steel, and manufactured goods be "substantially transformed in the United States"—both of which may *de facto* make the subsidy contingent upon the use of domestic over imported goods.[57]

63. On the other hand, one could still argue that the markup "subsidy" is contingent upon the use of domestic over imported goods by the terms of the Buy American Provision itself:

> None of the funds appropriated or otherwise made available by this Act may be used for a project for the construction, alteration, maintenance, or repair of a public building or public work unless all of the iron, steel, and manufactured goods used in the project are produced in the United States.[58]

Since "none of the funds" under the Recovery Act may be used where the Buy American Provision is applied "unless all of the iron, steel, and manufactured goods used in the project are produced in the United States," the subsidy too—clearly within the scope of "the funds"—is contingent upon the use of domestic over imported goods.

64. Therefore, the subsidies resulting from the Buy American Provision may often be *de facto* contingent on the use of domestic over imported goods, if not contingent upon the use of

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[55] For example, does New Orleans or Louisiana receiving funds after Hurricane Katrina constitute the conferral of a benefit? Should we compare such transfers of funds to what the state or local government would have received without the storm or compare to what is "normal" to get in case of a major hurricane?
[56] Interim Rule, *supra* note 3, at 97; Interim Final Guidance, *supra* note 5, at 136.
[57] Interim Rule, *supra* note 3, at 97; Interim Final Guidance, *supra* note 5, at 150.

domestic over imported goods by the terms of the Provision itself.

(3) The obligation to "withdraw" a prohibited subsidy has been applied retrospectively and (separately) in spite of contractual obligations

65. In the context of government procurement, the critical issue with respect to remedies under an "as applied" SCM Agreement claim is whether a finding of a subsidy (e.g. government purchase of goods conferring a benefit on domestic producers) that is prohibited (contingent on the use of domestic products) will lead to a satisfactory remedy before the procurement process has run its course—and if not, whether the measure's WTO-consistency is then moot.

66. As an initial matter, it should be noted that SCM Article 4, regarding "Remedies" for prohibited subsidies, provides accelerated dispute settlement procedures whenever a Member "has reason to believe that a prohibited subsidy is being granted or maintained by another Member" under Article 4.1. These expedited procedures include, for example, consultations entered into "as quickly as possible" under Article 4.3 (as opposed to within 30 days under the DSU), immediate establishment of a panel after 30 days under 4.4 (as opposed to a request after 60 days and the establishment of a panel at DSB following that at which the request first appears on the DSB's agenda under the DSU), and a firm 90-day deadline for the submission of the panel report under 4.6 (as opposed to the DSU's 6 months with the possibility of extension). Furthermore, the term "without delay" in Article 4.7 has been interpreted in *Brazil – Aircraft*—in light of "the circumstances of the case"—as requiring that "Brazil shall withdraw its subsidy within 90 days."[59]

67. SCM Article 4.7 provides in full:

> If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time period within which the measure must be withdrawn.

In applying Article 4.7 to the Buy American Provision, the critical issue is how to interpret the

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[58] Pub. L. 111-5 § 1605(a). Accessed May 3, 2009 at <http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.1.enr:>.
[59] Appellate Body Report, *Brazil – Aircraft*, para. 190 (citing the Panel Report approvingly).

meaning of the term "withdraw."

68. A satisfactory remedy should be available to the extent that an "as applied" challenge under Article 4's expedited procedures leads to a favorable ruling that can be enforced before the conclusion of Recovery Act procurement. However, assuming that the Buy American Provision is not brought into conformity with the SCM Agreement before the conclusion of Recovery Act procurement, the first key issue is whether any "retrospective" remedy is available under Article 4.7, considering that the Buy American Provision is a one-time measure. In the absence of a retrospective remedy, in the event that the procurement policy has run its course, a complainant will find itself in the same predicament lamented by the U.S. in the GATT-era *Trondheim* dispute:

> [B]ecause benefits accruing under the [GPA] were primarily in respect of events (the opportunity to bid), rather than in respect of trade flows . . . standard panel recommendations requiring an offending Party to bring its rules and practices into conformity would, in many cases, not by themselves constitute a sufficient remedy and would not provide a sufficient deterrent effect.[60]

69. The Article 21.5 Panel in *Australia – Automotive Leather II* did "not find meaningful the distinction proposed by the parties between repayment of 'prospective' and 'retrospective' portions of past subsidies in the context of Article 4.7 of the SCM Agreement."[61] The *Australia – Leather* Panel preferred to take a purely textual approach, finding an ordinary meaning of "withdraw" that:

> does not suggest that "withdraw the subsidy" necessarily requires only some prospective action. To the contrary, it suggests that the ordinary meaning of "withdraw the subsidy" may encompass "taking away" or "removing" the financial contribution found to give rise to a prohibited subsidy. Consequently, an interpretation of "withdraw the subsidy" that encompasses *repayment* of the prohibited subsidy seems a straightforward reading of the text of the provision.[62]

70. Even the complainant U.S. objected to the Panel's disregard of the WTO's conventional limitation on retrospective remedies, but the decision was not appealed because a settlement

[60] GATT Panel Report, *Norway – Procurement of Toll Collection Equipment for the City of Trondheim*, para. 4.22.
[61] Panel Report, *Australia –Automotive Leather II (Article 21.5 – United States)*, para 6.22.
[62] *Id.*, para. 6.27 (emphasis added); The Panel went on to argue: "An interpretation of Article 4.7 of the SCM Agreement which would allow exclusively 'prospective' action would make the recommendation to 'withdraw the

was reached between the parties.[63] Although the Panel's reasoning is rarely mentioned at the WTO today, *Australia – Leather II* may still be relevant as apparently the only SCM dispute in which a prohibited subsidy was found to exist in a one-time measure (as opposed to a continuing program) so that "repayment" of the subsidy would be the only effective remedy.

71. In subsequent disputes, the WTO has been more conservative in its reading of the term "withdraw" in Article 4.7, perhaps in response to Members' concerns. Although the Appellate Body in *Brazil - Aircraft (21.5)* agreed that "withdrawal" of a subsidy "refers to the 'removal' or 'taking away' of that subsidy," it concluded only that "to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to 'withdraw' prohibited export subsidies"—making no mention of repayment of the prohibited subsidy.[64] The Article 21.5 Panel in *U.S. – Upland Cotton*—on the basis that complainant Brazil denied seeking a retroactive remedy—asserted that it "need not decide whether the obligation to 'withdraw the subsidy' pursuant to a panel recommendation adopted under Article 4.7 of the SCM Agreement imposes an obligation on a Member to 'remove' or 'take away', *retrospectively*, individual subsidies that were provided in the past."[65]

72. Applying the term "withdraw" from SCM Article 4.7 to the Buy American Provision, the question is whether the prohibited subsidies can be withdrawn retrospectively. The Appellate Body has yet to rule squarely on this issue, and it appears that Members have been hesitant to request a retrospective remedy. However, where, as here, there is a one-time measure constituting a prohibited subsidy, *Australia – Automotive Leather II* signaled that a retrospective remedy is possible as the only effective remedy.

73. *Brazil – Aircraft* and *U.S. – Upland Cotton* are also relevant here because of their treatment of a separate but related issue: whether the subsidizing Member's existing contractual obligations except it from the obligation to "withdraw" the prohibited subsidy. The Appellate Body in *Brazil – Aircraft (21.5 – Canada)* did "not consider that any private contractual obligations, which Brazil may have under its domestic law, are relevant to the

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subsidy' under Article 4.7 indistinguishable from the recommendation to 'bring the measure into conformity' under Article 19.1 of the DSU, thus rendering Article 4.7 redundant. *Id.*, para 6.31.

[63] *Id.*, para 6.20.

[64] Appellate Body Report, Brazil – Aircraft (Article 21.5 - Canada), para. 45.

[65] Panel Report, *U.S. – Upland Cotton (21.5 - Brazil)*, para. 14.38. *Australia – Automotive Leather II* was not cited in the Panel Report.

issue of whether the DSB's recommendation to 'withdraw' the prohibited export subsidies permits the continued issuance of NTN-I bonds under letters of commitment issued before" the date set by the Panel for the withdrawal of the subsidies.[66]

74. However, the Article 21.5 Panel in *U.S. – Upland Cotton* clarified, "the relevant question is not whether the United States, after the end of the implementation period, makes *any* 'payment' in a general sense under programmes that were found, in the original proceeding, to constitute prohibited export subsidies, pursuant to prior commitments," but rather "whether the United States continues or continued, after the end of the implementation period, to provide export subsidies."[67]

75. Regarding the U.S. government's obligations under Recovery Act procurement contracts, it should first be noted that the Appellate Body, the Article 22.6 arbitrators, and Brazil itself in *Brazil – Aircraft* all echoed VCLT Article 27: "A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty." Even by the logic of the *U.S – Upland Cotton* Panel, it would seem that all payments that constitute prohibited subsidies in themselves must at least be discontinued following the implementation period. Theoretically, in the context of the Buy American Provision, all payments for domestic construction materials above their market value represent prohibited subsidies. Therefore, a panel could conceivably find that this margin must be denied domestic producers—or perhaps even repaid—regardless of domestic contracts.

76. In sum, an effective remedy to withdraw the Buy American Provision would entail not only a retrospective remedy, but also the abrogation of domestic contracts—a hitherto unseen combination in either *Australia – Automotive Leather II* or *Brazil – Aircraft*. In addition, a panel seeking to provide a retrospective remedy in response to the Buy American Provision would be challenged by U.S. federal-state distinctions and might conclude that abrogating contracts at the state level would be unreasonable.[68] The odds that a WTO panel would make

[66] Appellate Body Report, *Brazil – Aircraft (Article 21.5)*, para. 46; The Article 22.6 arbitrators agreed: "We do not consider the arguments based on Brazil's contractual obligations to be compelling. Obligations under internal law are no justification for not performing international obligations." *Brazil – Aircraft (Article 22.6)*, para 3.65 (citing VCLT Art. 27).

[67] Panel Report, *U.S. – Upland Cotton (21.5 – Brazil)*, para. 14.32.

[68] Article XXIV:14 of the *Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994* provides in relevant part: "When the Dispute Settlement Body has ruled that a provision of GATT 1994 has

four politically-risky findings in a single high-profile dispute—construing a procurement measure as a subsidy despite the existence of the GPA, recommending a retrospective remedy, suggesting that contracts may have to be abrogated, and extending its reach to the state level—seem very low indeed. However, a finding of a prohibited subsidy in itself may be censure enough, and the U.S. could always opt to settle. Finally, in the event that the DSB would require that the U.S. retroactively "withdraw" its prohibited subsidies, it would face the more severe "appropriate countermeasures" if it failed to comply.[69]

III. Conclusion

77. The statutory language of the Buy American Provision "as such" appears consistent with U.S. commitments under the GPA, and government procurement is probably excluded from MFN and NT obligations under the GATT. However, a WTO panel engaged in a purely legalistic analysis of the measure "as applied," (that is, with reference to specific government tenders) may find the U.S. in violation of the SCM Agreement. The measure can be construed as a prohibited subsidy under the SCM Agreement because it appears to authorize a "financial contribution" (government purchase of goods under 1.1(a)(1)(iii)) conferring a "benefit" upon domestic producers (to the extent that the government provides more than adequate remuneration as measured against the construction materials' market value), and the resulting "subsidy" is arguably contingent upon the use of domestic over imported goods. A finding of a prohibited subsidy could theoretically provide the complaining member with a more effective remedy than would otherwise be available under DSU 22.4—namely, the withdrawal of the subsidy without delay and "appropriate" countermeasures in the event of noncompliance. However, the remedy's effectiveness may be of limited value by the time litigation is concluded unless WTO legal bodies assume the political risk of authorizing a retrospective remedy in spite of the U.S. government's contractual obligations at the federal and sub-federal levels.

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not been observed, the responsible Member shall take such reasonable measures as may be available to it to ensure its observance."

Part II: Auto Bailouts

I. Factual Background

A. United States

(1) Bailout Loans for GM and Chrysler

78. The Auto Industry Financing and Restructuring Act (H.R. 7321) was introduced on December 10, 2008. This bill provides for $17.4 billion in aid to automakers, $13.4 billion for GM and $4 billion for Chrysler. The funds originate from the Troubled Assets Relief Program (TARP) funds appropriated for Section 136 of the Energy Independence and Security Act. Aid is provided in the form of a bridge loan and must be paid back within 7 years, with 5 percent interest over the first 5 years and 9 percent interest over the last 2 years.

79. G.M and Chrysler have almost exhausted the combined $17.4 billion in federal aid they have received since December. G.M. has asked for up to $16.6 billion more, and Chrysler has requested another $5 billion.

80. Section 6 of the bill mandates each auto company to provide its restructuring plan by March 31, 2009. The government received the companies' restructuring submissions on February 17, 2009, which the Auto Task Force evaluated. On March 31, President Obama determined that "neither goes far enough to warrant the substantial new investments that these companies are requesting." As an ultimatum, GM was given 60 days to avert bankruptcy by working closely with the government to produce an adequate restructuring plan. Chrysler was given one month to develop a merger agreement with Fiat, after which the president promised another $6 billion in aid for the merger to succeed.

81. These new loans would be tied to environmental conditions. According to Sec. 6, for the restructuring plan to be approved, it must result in, *inter alia*:

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[69] *See*, *e.g.*, Thomas Sebastian, *World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness*, 48 Harv. Int'l L.J. 337 (2007) (comparing SCM Article 4 "appropriate

(2) the ability--
(A) to comply with applicable fuel efficiency and emissions requirements;
(B) to commence domestic manufacturing of advanced technology vehicles, as described in section 136 of the Energy Independence and Security Act of 2007 (Public Law 110-140; 42 U.S.C. 17013); and
(C) to produce new and existing products and capacity, as described in section 14.

82. In addition, the U.S. government provided capital and loans to the financial arms of the auto companies in order for them to help finance consumers' purchases of vehicles. These funds also came out of TARP and became available under the Emergency Economic Stabilization Act of 2008. These are separate from the auto subsidies of $17.4 billion and $4 billion allocated to GM and Chrysler, respectively.

83. On December 29, 2008, the U.S. Treasury announced that it would purchase $5 billion in senior preferred equity with an 8 percent dividend from GMAC LLC. Additionally, the U.S. Treasury agreed to lend up to $1 billion to GM so that it could support GMAC's reorganization as a bank holding company. Thus, GMAC, as a bank holding company eligible for federal money, received a total of $6 billion in aid from the government. GMAC subsequently loosened its tight lending standards, which had made it more difficult for would-be car buyers to get loans.

84. On January 16, 2009, the U.S. Treasury announced a $1.5 billion five-year loan to a special purpose entity created by Chrysler Financial to finance retail automotive purchases. The firm will pay the one-month Libor rate, plus 1% in the first year of the five-year loan, and Libor plus 1.5% in the subsequent years. This is a more attractive rate that Chrysler Financial would have been able to find in private markets. In contrast to GMAC, which received a direct capital injection, Chrysler Financial is receiving only a loan. Less than an hour after the bailout was announced, Chrysler offered buyers 0% interest rates on loans to buy select Chrysler, Dodge and Jeep vehicles.

(2) Scrapping program ("Cash for Clunkers")

85. The United States does not yet have a scrapping program in effect. One proposal for such a program, the Accelerated Retirement of Inefficient Vehicles Act of 2009 (H.R. 520),

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countermeasures" to the DSU 22.4 equivalence standard).

was introduced on January 14, 2009. This bill aims to accelerate motor fuel savings nationwide and provide incentives to owners of fuel-inefficient automobiles to replace such automobiles with fuel-efficient automobiles ones.

86. Owners of eligible vehicles would receive a redeemable voucher for the purchase of a new or used fuel-efficient automobile. Cars that have a fuel-economy rating of less than 18 miles per gallon are deemed to be high fuel consumption automobiles.[70] The car traded in would then be taken apart for scrap. A fuel-efficient automobile is one that has a fuel-economy rating that exceeds the Corporate Average Fuel Economy (CAFE) target for that class by at least 25 percent and meets or exceeds federal emissions standards.[71] Owners can also receive vouchers for public transit fare credits in the equivalent dollar amount. This program would last from 2009 to 2012.

87. This version of a "Cash for Clunkers" program does not mandate that the voucher must be spent on domestically produced cars. However, President Obama indicated in a March 30 speech that he might be considering a plan that would promote the sale of domestic vehicles:

> Several members of Congress have proposed an even more ambitious incentive program to increase car sales while modernizing our auto fleet. And such fleet modernization programs, which provide a generous credit to consumers who turn in old, less fuel-efficient cars and purchase cleaner cars, have been successful in boosting auto sales in a number of European countries. I want to work with Congress to identify parts of the Recovery Act that could be trimmed to fund such a program, and make it retroactive starting today.

88. While President Obama did not clarify whether he was referring to the bills that specifically encourage the purchase of cars assembled in the United States, the possibility certainly looms. The Consumer Assistance to Recycle and Save Act of 2009 (H.R. 1550) was introduced on March 17, 2009. Under this bill, U.S. consumers would receive a cash voucher to purchase a new fuel efficient automobile that has been assembled only in North America, but not elsewhere. Among them, the most favorable terms are given for purchases of cars manufactured in the United States, when compared to fellow NAFTA members. For example, the redemption value of the voucher if used towards the purchase of a new automobile is $5000 for a passenger automobile assembled in the United States with a minimum fuel

[70] These cars must have been registered for at least the past 120 days and be in drivable condition.
[71] These cars must also have an MSRP of less than $45,000 and a model year 2004 or later.

economy of 30 mpg, but only $4000 for a passenger automobile assembled in Canada or Mexico with the same fuel economy.

(3) Tax credits

89. Thus, the United States does not yet have a scrapping program similar to France and other European countries. So far, the U.S. government has sought to spur purchases of new vehicles by providing tax credits. The Recovery Act signed into law on February 17, 2009 includes § 1008, Additional Deduction for State Sales Tax and Excise Tax on the Purchase of Certain Motor Vehicles. Section 1008 provides a tax benefit for new cars and light trucks purchased between the day the bill becomes law and December 31, 2009. There are limitations based on vehicle price ($49,500) and the taxpayer's adjusted gross income ($125,000, or in the case of a joint return, $250,000). There is no condition that the car must be made in the United States for it to be a qualified motor vehicle under this measure.

B. France

90. The EU has not embarked on a Europe-wide response to help the automobile industry. EU member states have announced their own individual plans for state aid, and the EU's Commissioner for Competition must ensure that these state-level plans do not violate EU competition rules. The state that has caused EU officials the most concern with its auto industry assistance plans is France.[72]

(1) Bailout loans

91. On February 9, 2009, the French government revealed an auto bailout package that would provide €6 billion to Renault SA and PSA Peugeot-Citroën, and offer an additional €500 million in loans to other automobile companies with operations in France. The government will give Renault and Peugeot each a loan of €3 billion, to be paid back in five years at a 6 percent interest rate.

[72] "EU to Rule on Legality of European Auto Bailout Packages", HIS Global Insight, 26 February 2009, http://www.globalinsight.com/SDA/SDADetail16083.htm.

92. Previously, the French government had stated that the auto companies would be eligible for these loans on the condition that they keep their manufacturing plants within French borders, give preference to French suppliers, and maintain their level of employment in France. This had sparked debate over whether the French auto bailout violates WTO or EC law. Following this announcement, there were several negotiations between the EC and France regarding its compliance with EC competition law.

93. On February 28, 2009, the French government communicated to the EC that it had withdrawn from the loan any conditions regarding the location of their production or a preference for French suppliers.[73] The Commissioner for Competition stated that she was satisfied with the guarantees set out by the French government that it would not have measures that go against the principles of the internal market.

94. France is providing loans to the financial arms of the auto companies as well. The French government said it would double the amount to €2 billion each for the financing arms of Renault and Peugeot in order to make it easier for consumers to get car loans from those companies.

(2) Scrapping program

95. In December, the French government initiated a plan to give €1,000 to consumers who scrap cars that are more than 10 years old and replace them with new models. Germany and Italy also have passed such incentives as part of their stimulus plans. There are no conditions that favor domestic products. The government believes this move will remove the less fuel-efficient vehicles from the road and that safety and environmental standards will be raised overall. This program has already stimulated car sales since the beginning of 2009.

II. Assessment of bailout packages under the SCM Agreement

96. To find a violation under the SCM Agreement, it must be first determined that the measure constitutes a subsidy. SCM Article 1 provides the definition of a subsidy, laying out

three criteria that must be met: 1) existence of a financial contribution by a government or public body, 2) benefit conferred, and 3) enterprise or industry specificity.

(1) Bridge loans to auto companies are a subsidy

97. *There is a financial contribution by a government or public body.* SCM 1.1(a)(1)(i) provides that a government practice involving a direct transfer of funds such as grants and loans is a financial contribution by a government or public body. The U.S. government has already provided $17.4 billion of low-interest bridge loans to prevent the two companies from going bankrupt, and the companies may receive more federal aid depending on government approval of their restructuring plans. The French government is providing low-interest loans of €3 billion each to Renault SA and PSA Peugeot-Citroën. It has offered €500 million in loans to other automobile companies with operations in France.

98. *There is a benefit conferred.* The benefit conferred is the difference between the government interest rate and the commercial market interest rate for the loan.[74] Section 11(b) of the auto bailout bill sets the interest rate at 5 percent for the first five years and 9 percent afterwards. If GM were to seek a loan on the commercial market, the interest rate would be based on the yield of its bonds. This was 143 percent on December 19, 2008 for bonds due May 2009.[75] If the terms are better than what is available on the market, the companies have been granted an advantage that they would not enjoy under normal market conditions. The French government, meanwhile, will give Renault and Peugeot each a loan of €3 billion, to be paid back in five years at a 6 percent interest rate. The interest rate of 6 percent is lower than the 10 to 12 percent interest rates the companies would receive in normal credit markets.

99. *The subsidy is specific to the auto companies.* SCM 2.1(a) provides that a subsidy shall be specific where the granting authority explicitly limits access to a subsidy to certain enterprises. The U.S. auto industry had sole access to the bridge loans provided by the Auto Industry Financing and Restructuring Act, the purpose of which is to "immediately provide

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[73] Letter to Mrs Neelie Kroes, Commissioner for Competition, from Mr Luc Chatel, Secretary of State for Industry, on 28 February, Brussels, State Aid Weekly E-News from the Directorate-General of Competition in the EC, http://ec.europa.eu/competition/state_aid/newsletter/06032009.pdf.
[74] Panel Report, *Canada-Aircraft*, para 9.96.
[75] Claire Brunel and Gary Clyde Hufbauer, "Money for the Auto Industry: Consistent with WTO Rules?" Peterson Institute for International Economics, February 2009.

authority and facilities to restore liquidity and stability to the *domestic automobile industry* in the United States." Under § 4(a) of the Act, the bridge loans or lines of credit are provided "to each automobile manufacturer that submitted a plan to the Congress on December 2, 2008 ('eligible automobile manufacturer'), and has submitted a request for such loan or commitment". Among the Big Three, Ford did not apply for the loans, leaving GM and Chrysler as the recipients. The French government has provided €3 billion in loans to its domestic auto companies, Renault and Peugeot, and smaller amounts of loans to other auto companies manufacturing in France. As the loans were reserved only for the auto industry—namely the national brands Renault and Peugeot—there is enterprise or industry specificity. Therefore, the government has limited access to automobile companies with operations in France, giving priority to its national brands.

(2) Loans to the financial arms of the auto companies are a subsidy

100. *There is a financial contribution by a government or public body.* SCM 1.1(a)(1)(i) provides that a government practice involving a direct transfer of funds such as loans or equity infusion is a financial contribution by a government or public body. The U.S. Treasury purchased $5 billion in senior preferred equity with an 8 percent dividend from GMAC LLC, the financial arm of GM. The U.S. government also gave $1.5 billion in loans to Chrysler Financial. The French government provided €2 billion in loans to the financing arms of Renault and Peugeot-Citroën. Here again, there is a financial contribution by the government to the auto companies.

101. *There is a benefit conferred.* GMAC received a direct capital injection through the equity infusion. Chrysler Financial must pay back the loans in five years, paying the one-month Libor rate plus 1% in the first year, and Libor plus 1.5% in the subsequent years. This is a better rate that what it could have obtained in private markets. This federal aid puts GM and Chrysler in a better position in the marketplace because it allows them to offer cheaper loans to consumers purchasing their cars. Since receiving the aid, GM has loosened its lending conditions, and Chrysler has offered 0% interest rates on loans for purchasing its vehicles, spurring sales which would not have been possible if the government had not granted the aid. The French loan was also intended to allow Renault and Peugeot-Citroën to

help consumers receive loans to purchase their cars. This places the recipient in a better position than the recipient otherwise would have been in the marketplace, which the Panel in *US – Upland Cotton* found to be a conferred benefit.[76]

102. *The subsidy is specific to the auto industry.* The aid was provided to the financial arms of the two auto companies, without the government establishing criteria or conditions for eligibility for, and the amount of, a subsidy. Therefore, the subsidies are specific.

(3) Scrapping programs ("Cash for Clunkers") are a subsidy

103. *There is a financial contribution by the government or public body.* The government provides vouchers redeemable for cash value when a consumer turns in an old vehicle and purchases a newer fuel-efficient one. There is a direct transfer of funds from the government to the dealers who are able to sell the new vehicle as a result of the voucher program.

104. *There is a benefit conferred.* Auto companies will be able to sell more vehicles with the scrapping program than before, so they are in a better position than it they would otherwise have been in the marketplace.[77]

105. *The subsidy is specific.* The scrapping program applies to the automobile industry, so the access to the vouchers is explicitly limited to certain enterprises. There are no criteria or conditions governing the eligibility for the vouchers.

(4) Tax credits to consumers are a subsidy

106. *There is a financial contribution by the government or public body.* By providing a tax credits to consumers for the purchase of a new vehicle, a financial contribution by the government or public body exists as specified in SCM1.1(a)(1)(ii): government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits). The Panel in *U.S. – FSC* stated that the determination of whether revenue is "otherwise due" must involve a comparison between the fiscal treatment being provided by a Member in a particular

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[76] Panel Report, *US-Cotton*, para 7.111.
[77] *Ibid*.

situation and the tax regime otherwise applied by that Member, and concluded that the term "otherwise due" refers to the situation that would prevail "but for" the measures in question.[78] But for this measure, the government would have been collecting taxes on purchases of vehicles, and as they were foregoing this revenue in order to aid the auto producers, there is a financial contribution by the government.

107. *There is a benefit conferred.* The tax credit confers a benefit to the auto companies which sell a vehicle which would not otherwise have been sold. In *U.S. – FSC*, the panel observed the "benefit" that results from the FSC measure in that Foreign Sales Corporations (FSCs) and their parent companies "need not pay certain taxes that would otherwise be due."[79] Whether the tax credit is applied on the consumers end, in real economic terms the burden of an excise tax is distributed between consumers and producers, so the tax credit also confers a benefit to the producers end.

108. *The subsidy is specific.* The tax credit is limited to the automobile industry, and any auto company is eligible for this subsidy.

A. Prohibited subsidies

109. SCM Article 3.1 states that subsidies that are contingent upon (a) export performance or (b) the use of domestic goods are prohibited in the WTO. A subsidy found to fall under Article 3 would be in clear violation of WTO rules. As a prohibited subsidy is automatically deemed to have specificity, a prohibited subsidy would not have to demonstrate specificity as laid out in SCM Article 2 for it to be a WTO violation.

(1) French bridge loans are not a prohibited subsidy, as the conditions were withdrawn

110. Neither the U.S. nor French governments' loans to its domestic auto companies are contingent upon export performance or the use of domestic over imported goods. The U.S. government has provided $17.4 billion to GM and Chrysler to avert bankruptcy, while

[78] Panel Report, *U.S. – FSC*, paras. 7.41-102 (Subsequently, the Appellate Body softened the "but for" test, clarifying that it may not be necessarily so in all cases).

additional loans are contingent upon the approval of their restructuring plans, which must include a viable plan for moving towards producing more fuel-efficient cars. For Chrysler, another $6 billion of loans is contingent upon the success of a merger agreement with Fiat.

111. The French government had, at first, made the loans to Renault and Peugeot contingent upon their guarantees of retaining production facilities and employees in France. Whether this would make the French measure a prohibited subsidy was unclear. It could have been argued that keeping the manufacturing plants within French borders is essentially promoting the use of domestic goods over imported goods by the manufacturing plants, as companies in France are more likely to use domestic inputs than if they were located elsewhere, making the subsidies "contingent" upon the use of domestic over imported goods. Also, by keeping the manufacturing plants inside France, the cars sold outside of France would become exports and would prevent France from having to import cars made from Renault and Peugeot plants outside of its borders. Thus, by making the loan contingent on production at a domestic location, it could have been argued that the loan was contingent on increasing net exports.

112. However, such conditions would have first been a clear violation of EC competition rules, which allow for freedom of movement of capital and persons. Thus, the EC initiated several talks with France since the notification of such a plan, and compelled the French government to withdraw the conditions and to provide a guarantee that it would adhere to principles of the internal market in giving loans to the auto companies. By doing so, France has removed doubt of its measure falling under an SCM Article 3 prohibited subsidy.

(2) U.S. scrapping program may be a prohibited subsidy if the proposed bill is passed

113. Since last December, the French measure has been providing €1,000 to consumers who scrap cars more than 10 years old and replace them with newer fuel-efficient models. There is no provision in the measure that favors domestic over imported cars.

114. The United States does not yet have a similar measure in place, but is considering several proposals. One version in the House will provide vouchers only to purchasers of

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[79] Panel Report, *U.S.-FSC*, para. 7.103

vehicles produced in North America. The value of the vouchers depends on a combination of two factors: the location of production and the fuel economy of the vehicle. SCM Article 3.1(b) provides that "subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods" shall be prohibited. Therefore, should the United States adopt this bill for its Cash for Clunkers program, the measure is likely to be a prohibited subsidy: the subsidy is not provided when buying cars imported from outside of North America. In two segments, only cars assembled in the United States would receive the subsidy: work trucks and passenger automobiles with a minimum highway label fuel economy value between 27 and 29 mpg. As these factors make the scrapping program contingent on the use of domestic over imported goods, this version of the program would likely constitute a prohibited subsidy.

B. Actionable subsidies

115. Measures that are subsidies under the definition of SCM Article 1 are permitted so long as they are not prohibited and they do not cause adverse effects to the interests of other Members. In the case of a subsidy that causes adverse effects under SCM Article 5, the measure is an actionable subsidy which another Member can challenge at the WTO. Such adverse effects may be:

(a) injury to the domestic industry of another Member
(b) nullification or impairment of benefits accruing directly or indirectly to other Members under 1994, in particular benefits of concessions bound under Article II
(c) serious prejudice to the interests of another Member.

116. *Injury to domestic industry:* This term is used in the same sense as it is used in Part V of the SCM Agreement. Article 15.1 provides that a determination of injury shall be based on positive evidence and involve an examination of (a) the volume of subsidized imports and the effect of the subsidized imports on prices in the domestic market for like products and (b) the subsequent impact of these imports on the domestic producers of such products.

117. Article 15.7 provides the factors of consideration to make a determination of a *threat* of material injury. The change in circumstances which would create a situation in which the subsidy would cause injury must be *clearly foreseen and imminent*. Factors to be considered include the following:

(i) nature of subsidy and the trade effects likely to arise therefrom;
(ii) a significant *rate of increase* of subsidized imports into the domestic market indicating the likelihood of substantially increased importation,
(iii) sufficient freely disposable, or an imminent, substantial increase in, *capacity of the exporter* indicating the likelihood of substantially increased subsidized exports to the importing Member's market, taking into account the availability of other export markets to absorb any additional exports;
(iv) whether imports are entering at prices that will have a significant *depressing or suppressing effect on domestic prices* and would likely increase demand for further imports; and
(v) inventories of the product being investigated.

118. Material injury to a domestic industry or threat thereof may not only make the subsidy actionable at the WTO, but it gives the right to countries importing the subsidized cars from the United States or France to impose countervailing duties on those cars. The investigation can be initiated quickly and no WTO authorization is required to impose the duties. The countervailing duties should be imposed in accordance with Part V of the SCM Agreement. If another Member were to impose countervailing duties on U.S. of French cars, they could be subject to challenge before the WTO under a theory that injury to the Member's domestic industry does not exist or that there is no causal link between the subsidized auto imports and the alleged injury.

119. *Serious prejudice to interests of another Member*: This term is used in the same sense as it is used in GATT XVI:1, and includes the *threat* of serious prejudice. SCM Article 6.1, which provides specific cases deeming the existence of serious prejudice, has lapsed after five years of the date of entry into force of the WTO Agreement (i.e., as of January 1, 2000). Paragraph 2 of Article 6 is linked to paragraph 1 so it has also lapsed, in effect shifting the burden of proof on the complainant to show that any of the effects in SCM Article 6.3 does exist, in order to demonstrate serious prejudice.[80]

(a) *displacing or impeding imports of a like product* of another Member into market of subsidizing member
(b) *displacing or impeding exports of like product* of another Member from third country market;
(c) significant price undercutting/suppression/depression/lost sales of like product in

[80] In *Korea-Vessels*, the Panel said that the situations listed in SCM Article 6.3 (a)-(d) in themselves constitute serious prejudice. The Panel recalled this decision in *U.S.-Upland Cotton*, concluding that a finding under SCM Article 6.3 is sufficient basis for finding that there has been serious prejudice within the meaning of SCM Article 5(c).

another Member’s market
(d) *increase in world market share* of subsidizer of specificically subsidized primary product or commodity (compared to previous 3 years and increase follows a consistent trend over a period when subsidies have been granted)

120. SCM Article 8 provided the criteria for a non-actionable subsidy, but this provision lapsed five years after the date of entry into force of the WTO Agreement (January 1, 2000).

(1) The bridge loans may be an actionable subsidy because they cause a threat of serious prejudice to the interests of another Member or threat of injury to the domestic industry of another Member

121. If it can be demonstrated that the loans cause serious prejudice or a threat thereof to the interests of another Member or a threat of injury to the domestic industry of another Member, then it would be deemed that the United States and France have caused adverse effects to the interests of another Member, making the loans an actionable subsidy under the SCM Agreement.

122. Without the subsidy, GM and Chrysler would have gone bankrupt, allowing room for foreign auto companies to sell more of their vehicles—and potentially at higher prices—in the U.S. market. In the United States., new GM and Chrysler cars will have to comply with higher fuel-efficiency and CO2 standards in order to receive more aid from the government. France has not attached a condition that Renault and Peugeot will have to produce higher fuel-efficiency cars in order to qualify for the loans. However, the companies have stated that they will use the state aid towards the production of higher fuel-efficiency cars. Foreign firms who export their cars on the U.S. or French market will also have to comply with more stringent environmental standards, but those firms would not have received similar assistance for achieving compliance. Thus, the bridge loans could have the effect of 6.3(a) displacing or impeding the imports of a like product of another Member into the U.S. or French market.

123. Also, the bridge loans could have the effect identified in 6.3(b), displacing or impeding the exports of a like product of another Member from a third country market. Article 6.4 elaborates that the displacement or impeding of exports shall include any case in which it has been demonstrated that there has been a change in relative shares of the market to the

disadvantage of the non-subsidized like product. The appropriately representative period sufficient to demonstrate clear trends of said effect is deemed to be at least one year.

124. GM and Chrysler would have gone bankrupt if not for the bridge loans, so the market share of their cars in third country markets relative to like products exported by another Member would have declined in the absence of the subsidy. As for the French companies, they would not have been in good shape to maintain previous market shares. Renault reported a "disastrous" year in 2008, with sales in Europe down by more than 7% compared to the previous year.[81] In February, Peugeot expected that sales will drop by 20% in Europe in 2009, resulting in further losses and "unprecedented difficulty" in the first half of 2009.[82] Even if the market share of these companies in third markets does not *increase* as a result of the subsidy, the change in relative shares shall be deemed to exist if their market share (b) remains *constant* or (c) *declines at a slower rate* than would have been the case if the companies had not received the government loans.

125. Finally, the loans could cause threat of material injury to the domestic industry of another Member producing automobiles. The factors to consider in determining the existence of such a threat are listed under SCM 15.7—none of which by itself can give decisive guidance, but the totality of which must lead to the conclusion that further subsidized exports are imminent and that, unless protective action is taken, material injury would occur. The loans prevented the bankruptcy of GM and Chrysler, potentially allowing them to restructure themselves to increase competitiveness by producing better fuel-efficient cars. While Renault and Peugeot were not in as dire shape, they also have a change to gain a competitive edge by using the state aid to prepare their companies for an era of more stringent environmental standards. Thus, the loans have resulted in a substantial increase in the capacity of the exporter indicating the likelihood of substantially increased subsidized exports to the importing Member's market under 15.7(iii). After the loans, a car-producing Member such as Korea could see a significant rate of increase of U.S. or French imports under 15.7(ii), which would cause material injury to Korea's own domestic auto industry. Based on these factors, it can be determined that the U.S. and French loans to their domestic auto companies cause a

[81] Javier Espinoza, "Renault Skids Into 2009," Forbes, 12 February 2009, http://www.forbes.com/2009/02/12/renault-earnings-sales-markets-equity-0212_autos_economy_27.html.

threat of material injury to the domestic industry of another Member.

126. For any of these cases to demonstrate adverse effects, the difficulty lies in proving causality. In light of the worldwide economic downturn, it is harder to prove that foreign companies are experiencing adverse effects due to subsidized U.S. and French vehicles, as there is greater uncertainty to predict what the level of sales would have been without the U.S. or French subsidies. Should it be found that the loans are indeed what caused the adverse effects to the interests of other Members, the bridge loans may be an actionable subsidy under the SCM Agreement.

(2) Loans to financing arms may be an actionable subsidy because they seem to cause at least a threat of serious prejudice to the interests of another Member

127. Both the United States and France have provided loans to the financing arms of the domestic auto companies in order to assist them in grant loans for the purchase of their vehicles. If car loans are easier to receive for purchasing a domestic automobile, this government assistance would be decreasing the competitiveness of imports. A consumer in the United States who would have purchased a Japanese vehicle in previous circumstances will now have an incentive to purchase a GM or Chrysler vehicle because it is easier to finance the purchase. Therefore, the effect of the loans to financing arms of auto companies is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member under Article 6.3(a).

(3) The French scrapping program may be an actionable subsidy because it causes a threat of serious prejudice to the interests of another Member

128. France has been providing €1,000 to people who scrap cars that are more than 10 years old and replace them with newer fuel-efficient models. There is no provision in the scrapping program that favors domestic over imported cars. However, the domestic companies are receiving subsidies to produce higher fuel-efficiency vehicles, while other foreign producers competing in the French market are not. By providing an incentive to purchase cars in a

[82] Steve Goldstein, "France backs plan as Peugeot loses $1.4 billion", WSJ MarketWatch, 11 February 2009, http://www.marketwatch.com/news/story/france-backs-plan-peugeot-loses/story.aspx?guid={B874A86A-F7DA-4022-

segment of the market where French companies have an advantage over foreign companies, the effect of the subsidy could be to displace or impede the imports of a like product of another Member in the French market under Article 6.3(a).

(4) U.S. tax credits for vehicle purchases may be an actionable subsidy but it is more difficult to prove adverse effects.

129. Currently, the United States provides tax credits for consumers to purchase new vehicles. There are limitations based on vehicle price and taxpayer's adjusted gross income, but there is no condition that the car must be locally produced or that it must have higher fuel efficiency. For this reason, President Obama had said that he is considering scrapping programs that would provide vouchers favoring the purchase of American-made and environmentally-friendly vehicles. However, as the tax credit program stands now, it will stimulate the purchase of domestic and imported vehicles alike. Therefore, this measure is not a prohibited subsidy under SCM Article 3.

130. The limits put on car price or taxpayer income may produce adverse effects to some Members' imports. The tax credit may provide incentive for a consumer who was considering the purchase for an expensive imported automobile to switch to a car that would qualify for the tax credit. If there is a disproportionate number of imported vehicles compared to domestic vehicles in the price range falling outside of the tax credit program, then the effect of the subsidy could be to displace or impede the imports of a like product of another Member in the U.S. market under 6(a). However, the existence of an adverse effect would be even more difficult to prove than the other measures, due to the additional question of whether one car under the price limit and another car over the price limit can be like products.

III. Assessment of other possible violations and a GATT XX defense

A. U.S. scrapping program can violate national treatment if H.R. 1550 is adopted.

131. If bill H.R. 1550, which favors cars made in North America and in particular the U.S, is adopted as the U.S. scrapping program, this measure may be in violation of GATT III:4 for

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according less favorable treatment to like imported products.

132. The measure at issue is a ‘law, regulation or requirement’ which affects the internal sale, offering for sale, and purchase of automobiles. Domestic high fuel economy automobiles and foreign high fuel economy automobiles, of the same mile-per-gallon in the same segment, are ‘like products’. However, H.R. 1550 only provides vouchers for the purchase of vehicles produced in North America. This provides incentive for consumers to purchase a U.S. vehicle over a like imported vehicle. As this is according less favorable treatment to like imported products, this version of the scrapping program would be in violation of the national treatment obligation under GATT III:4.

133. The carve-out of GATT III:8(b), which provides that GATT Article III shall not prevent payment of subsidies exclusively to domestic producers, would not be applicable in this case because the subsidy is provided to other North American producers as well.

134. The bill would not be a violation of the most-favored-nation principle under GATT I:1 because the WTO Members who are accorded the advantage of being included in the scrapping program are only NAFTA signatories.

B. Where the measures are found to be WTO violations, it may be difficult for the U.S. or France to make a successful GATT XX defense

135. Previously, the SCM Agreement provided under Article 8.2(c) that certain subsidies to promote the adaptation of existing facilities to new environmental requirements would be non-actionable. However, this provision expired on January 1, 2000, giving environmental subsidies the same status as other subsidies.

136. There has been no conclusion yet on whether GATT XX can be applied to all WTO covered agreements. If SCM is an extension of Article VI and XVI of GATT, it could be argued that GATT XX may be invoked as an exception to an SCM violation.

137. Measures to conserve natural resources fall under GATT XX(g). The United States or France would first have to demonstrate that the measure is “related to” the conservation of an

exhaustible natural resource. They could argue that the auto subsidy has the aim of reducing carbon emissions and is, therefore, "related to" the conservation of clean air, an exhaustible natural resource.[83] The environmental objective need not be the primary objective: in *US-Gasoline,* the Appellate Body rejected the criteria of "primarily related to", so that it suffices for the measure to be "related to" the objective under XX(g).

138. It would be difficult for France to demonstrate that the bridge loans were "related to" the environmental objective under XX(g) because they were not explicitly contingent on the use towards developing fuel efficient vehicles. Similarly, the loans that have already been given to GM and Chrysler to prevent bankruptcy were not tied to environmental objectives, although the future loans depend on the production plan for fuel efficient vehicles. The U.S. tax credit does not create a preference for the purchase of more fuel-efficient cars, but it could be argued that new cars tend to be more fuel-efficient than older cars. The U.S. and French scrapping programs, which create clear incentives to purchase vehicles of higher fuel efficiency, are measures most likely to be "related to" the objective of conserving clean air.

139. Once it has been determined that the subsidy is related to the objective of conserving an exhaustible natural resource, the United States or France would have to demonstrate that these measures conform to the Article XX chapeau. To satisfy the chapeau, the measure must not be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or be a disguised restriction on international trade. The subsidies could be said to discriminate against auto imports from countries that have carbon emissions reductions programs that are already equivalent or higher than what the United States is trying to achieve through its auto bailout scheme. The French scrapping program could be a disguised restriction on international trade, for it boosts the sales of the type of vehicles for which the domestic auto companies are receiving a subsidy to produce. The U.S. scrapping program, if in the form proposed under H.R.1550, would more likely be found to be a disguised restriction on international trade because auto imports from outside of North America would not qualify for the voucher at all.

IV. Conclusion

[83] Appellate Body Report, *US-Gasoline.*

140. In sum, the measures in the U.S. and French auto bailout schemes can be construed as subsidies under the SCM Agreement. Currently, no prohibited subsidy has been implemented by either government. France has withdrawn its conditions for the auto companies to keep their production in France in order to receive the loans, and the United States has not yet enacted a scrapping program that favors domestic vehicles over like imported vehicles.

141. The bridge loans provided by the U.S. government to GM and Chrysler, and the loans provided by the French government to Renault and Peugeot, are likely to be actionable subsidies. The French scrapping program is also a subsidy that could arguably have adverse effects. In any case, it would be difficult to demonstrate the existence of adverse effects and the causality between such adverse effects and the subsidies.

142. Tax credits to consumers who purchase new vehicles, without conditions on production location or fuel economy, are likely to permissible subsidies, as the existence and causality of adverse effects are even more difficult to prove. It is yet to be seen whether the United States will adopt a more "ambitious" assistance program to encourage the sales of domestic vehicles, as President Obama suggested. The version of the scrapping program as proposed in the House would likely be a prohibited subsidy.

143. If the United States or France were found to be in violation of WTO obligations with the auto bailout plans, they will argue that they are justified under GATT XX due to the environmental conditions attached to these measures. However, it is unclear whether GATT XX is available to justify SCM violations and, in any event, whether a GATT XX defense would succeed in each case.