B DEFINING SUBSIDIES

At the origins of the GATT, little attention was given to the trade impact of subsidies. However, contracting parties soon appreciated the need to deal with subsidies in order to secure the value of their agreed tariff concessions. A country can undermine its market access commitments by providing subsidies to import-competing industries. In addition, subsidies given to competing exporters in third countries can divert trade away from a country that had relied on negotiated market access to another market. These concerns led to the development of more stringent disciplines on subsidies than those initially provided for under the GATT (1947). A major step was the negotiation of the plurilateral "Subsidies Code" during the Tokyo Round and, thereafter, of the WTO Agreement on Subsidies and Countervailing Measures (SCM) and the Agreement on Agriculture (AoA).[1]

In much of this Report the term "subsidies" refers to the concept of subsidies used in the WTO Agreement. Yet, the Report inevitably has to deal with other definitions of subsidies, in particular when it comes to the description of national or international data on subsidies or of national policies with respect to subsidies. This Report therefore starts with a discussion of the different concepts and definitions of subsidies used in the literature. Particular attention will be paid to those definitions relevant to the rest of the study, such as the definition of subsidies used in the System of National Accounts and the concept of producer subsidy equivalent (PSE) frequently used in OECD statistics. This Section ends with a short discussion of the WTO definition of subsidies under the SCM Agreement in the light of the concepts and alternative subsidy definitions introduced previously.

1. THE DEFINITION OF SUBSIDIES: CONCEPTUAL ISSUES

Although the term "subsidy" is widely used in economics, it is rarely defined. Often it is used as an antonym to a tax, i.e. a government transfer of money to an entity in the private sector. This seems, for instance, to be the case in the Oxford Online Dictionary[2] where a subsidy is defined as: "a sum of money granted from public funds to help an industry or business keep the price of a commodity or service low".[3] But many would argue that tax concessions are also a form of subsidization. Indeed, for the relevant recipients it may not make much difference whether they are made better off by receiving money or through the reduction of their tax bill. Both forms of "assistance" also represent financial transfers by the government. Border protection, e.g. tariffs, on the other hand does not result in any such financial transfer from the government, and instead results in fiscal revenue. Yet it could be argued that the imposition of a tariff represents a form of subsidization for the import-competing sectors that are thereby protected from foreign competition. To define subsidies in terms of government transfers or fiscal expenditure is thus not necessarily complete.

An alternative approach is to consider that a "subsidy" arises any time a government programme benefits private actors. The main difficulty with this approach is that recipients of, for instance, a cash transfer or a tax concession, are not necessarily the ultimate beneficiaries of the policy. For example, housing allowances, such as the German "Eigenheimzulage", consist in transfers or tax concessions to consumers who build a house. In their ultimate effect, however, they are not unlike direct payments to construction companies. Similarly, the main beneficiaries of subsidized intermediate goods may not be the recipients of the subsidies, but rather downstream firms utilizing these products as inputs in their own production. Such indirect effects may or may not be intended by the government. The more specifically designed a programme, the more likely it is that the intended beneficiary (objective) and the actual beneficiary (effect) coincide. But it is not necessarily

1 The development of subsidy disciplines under the GATS has been left for the built-in negotiations that commenced in 2000 and currently forms part of the ongoing trade negotiations under the Doha Development Agenda.

2 Panels and the Appellate Body commonly rely on the Oxford English Dictionary to define the ordinary meaning of words used in the Agreement. See, for instance, *Canada–Dairy*, Appellate Body Report: paras. 104, 107 and 108, for the definition by the Oxford English Dictionary of the word "payment" (appearing in AoA Article 9.1(c)) as "the remuneration of a person with money or its equivalent". The Appellate Body noted further that a "payment" which did not take the form of money was commonly referred to as a "payment in kind" and that the ordinary meaning of the word "payments" in Article 9.1(c) was consistent with the dictionary meaning of the word.

3 This definition assumes that subsidies received are "passed through", i.e. have an effect on sales price. This assumption may not always hold, and pass-through may be a matter of degree, as it is conceivable that at least part of a subsidy is put to entirely different uses.

easy to design well targeted programs. The literature provides numerous examples of subsidy programmes that have unintended side effects. Adams (2000), for instance, examines the possibility that owing to improper targeting of inferior goods in the case of food subsidies to assist the poor, part may be leaked to high-income people, where they free up funds for other uses. Devarajan and Swaroop (1998) illustrate how official development assistance (ODA), even though targeted at a specific project, may indirectly finance other activities in cases where the government would have implemented the relevant project anyway and ODA has the effect of releasing government resources that can be spent elsewhere.

Another drawback of defining subsidies purely in terms of "benefits" is that such a definition should in principle take into account the other side of the ledger – the numerous government programmes that impose costs on those same "actors", either in the form of taxes or regulations that pose a burden on private activity.[4] Many governmental services, such as road infrastructure, are tax-financed by users, in this case through such levies as excise duties on cars and road tolls. The provision of road infrastructure should thus not be seen as a subsidy in its entirety, but it may contain an element of subsidization that is in most cases difficult to measure. Some subsidy programs even appear to be designed in order to counterbalance distortions created through other government interventions. In many countries, for instance, savings beneath a certain threshold are exempt from taxes. Such tax concessions serve in part to redress the discrimination of saving *vis-à-vis* consumption, which may explain why the German Government in its periodic subsidy reports excludes such tax exemptions from its subsidy calculation.[5]

The previous paragraphs illustrate some of the difficulties in defining the concept of subsidies. Although there appears to be agreement that subsidization involves the government and results in benefits for somebody, approaches differ when it comes to the details. Indeed, the relevant literature is full of references to the difficulties of defining the term "subsidy", as reflected in the frequently quoted statement by Hendrik S. Houthakker: "My own starting point was also an attempt to define subsidies. But in the course of doing so, I came to the conclusion that the concept of a subsidy is just too elusive".[6] What Houthakker wrote several decades ago still holds today. Rather than trying to pin down one specific definition of subsidies, this Section therefore discusses a range of characteristics of subsidy definitions used in the literature or in policy documents and analyses how different subsidy definitions make reference to these characteristics.

Depending on the context, a large number of government programmes may be considered subsidies. For simplicity, these programmes can be grouped into at least three categories: firstly, the government may transfer funds to producers or consumers, resulting in direct or potential budgetary expenditure, or use its power to instruct private entities to make a transfer. Direct transfers, like re-training grants or child allowances, would fall into this category. An example of potential expenditure is the provision of loan guarantees.[7] The latter may or may not lead to actual disbursements, but even if they do not, an official guarantee artificially lowers default risks of potential buyers and stimulates consumption that otherwise would not take place. If a government instructs a private bank to provide loans at preferential interest rates to certain private entities, this would not result in government expenditure. Yet this can be considered to be a government transfer as it would not have taken place without the intervention of the government and as it has the same effect as if the government itself had provided the loan at preferential rates.

Secondly, the government may provide goods or services at no cost or below market price, such as university education, public transport or food stamps. Such transfers also involve expenses for the government, with the difference being that beneficiaries receive in-kind contributions as opposed to funds they can freely dispose of.[8]

4 Sykes (2003).

5 Boss and Rosenschon (2002).

6 See quote in Steenblik (2003) p.4.

7 See, for instance, Freinkman et al. (2003).

8 Also the public provision of goods or services, e.g. electricity, can have intended or unintended indirect effects. It can, for instance, affect competition in industries that use the relevant goods or services as an input, as it affects producers differently depending on how intensively they use the input.

Thirdly, regulatory policies may be seen as subsidies, if they create transfers from one group to another. Border protection, for example, allows for price discrimination and pooling of revenues to producers that are implicitly financed by domestic consumers (Schluep and De Gorter, 2000).[9] In this context, Cadot et al. (2004) point out that regulatory instruments can circumvent forms of direct subsidization, leading to the same effects but at higher welfare costs. The authors demonstrate that preferential rules of origin amount to export subsidies for intermediate goods industries in the preference-providing country. This category of transfers caused but not paid for by the government may also comprise implicit subsidies arising from the failure by governments to internalize externalities, such as air pollution by industry, or rents associated with untaxed exploitation by private parties of publicly-owned or managed resources.[10]

2. THE DEFINITION OF SUBSIDIES IN NATIONAL AND INTERNATIONAL DATA SOURCES

Most definitions of subsidies in statistical sources or national legislation are rather explicit on whether they include or not each of the three subsidy categories distinguished above. But within these categories, an impressive range of different instruments are available to governments to grant subsidies. Many subsidy definitions would not embrace all of the possible instruments within one category because they define the term subsidy also along other lines. Indeed, subsidy definitions tend to make reference to one of the following characteristics of government interventions in order to confine the concept of subsidies: the recipients of subsidies, the form of subsidies, their objectives and their effect. Using the example of the banking sector, Box 1 gives a flavour of the variety of instruments that can be used within one particular sector.

Box 1: Possible subsidy instruments in the banking sector

Category 1:

Direct money transfers to certain banks:

In both, industrialized and developing countries, restructuring aid has frequently been given to banks during the process of privatization. More generally, governments intervene to rescue private banks that are in trouble, thus avoiding bank closure or the sale of assets to new investors. The "systemic risk" related to bank closure is most of the time given as an argument for public intervention. This type of intervention often takes the form of direct financial transfers to the establishment in trouble.

Institutional guarantees to certain banks:

Governments may provide guarantees to certain financial institutions, thus ensuring that the government steps in if the institution defaults on a loan. Such guarantees allow beneficiary banks to obtain better ratings from credit-rating agencies and as a result the banks can make considerable savings on the cost of refinancing. Institutional guarantees were, for instance, provided by the German Government for certain local and regional banks that were expected to serve small and medium enterprises (SME), a market segment that may be underserved by financial markets without government intervention.

9 Border protection has budgetary impacts and some may therefore consider it to be a form of subsidization that falls into the first category. In contrast to the other forms of subsidies within category one, however, subsidization through border protection results in an increase in government revenue and not in a decrease in revenue or an additional outlay.

10 See Steenblik (2003) for a discussion of this issue.

Loan guarantees:

State guarantees to banks for loans to companies are frequently used as a form of public intervention to support companies in difficulty. The advantage of state guarantees over direct subsidies is that they avoid immediate commitments from the public budget. In the case of state guarantees for bank loans to companies, the state becomes a lender of last resort and is obliged to pay the guarantee if the borrower is not able to pay a debt. While it is generally accepted that such state guarantees may contain an element of assistance to the borrower, there is no agreement as to whether thy also involve assistance to the lending bank itself.

Equity injections to avoid bankruptcy:

Governments are often minority or majority shareholders in banks and governments have frequently assisted such banks through equity injections in times of financial difficulties. It has been argued that such assistance results in subsidization if it is provided under terms and conditions that a private investor would not find acceptable acting under normal market conditions.[1]

Category 2:

State-owned banks:

In the past, banking services were often provided by state-owned banks and this is still the case in numerous countries, particularly in the developing world. Public ownership of banks has, for instance, been justified on the grounds of the "systemic risk" that bank activities can involve. The presence of information asymmetries in financial markets, with respect to the credit worthiness of potential clients, has also been used as an argument in favour of public supply of financial services.

Category 3:

Specific prudential regulation for certain establishments: the example of microfinance institutions (MFI):

Micro-credit schemes have proliferated in many developing countries as a surrogate to standard financial services and in response to the low penetration of traditional bank accounts. One of the major functions of MFIs is to provide borrowing opportunities to poor households and small firms which would otherwise not have access to credit. These borrowers can then invest the new resources for productive use and increase their revenues in the short to medium term. Microfinance institutions often act in a different regulatory environment than other financial institutions. If they face any prudential regulation at all, it is often less restrictive and thus less costly, thereby counterbalancing the fact that MFIs are only active in a small and not very profitable market segment.

1 See, for instance, the definition of the "market economy investor test" as used by the European Commission and described in Bourgeois (2001).

Subsidy definitions often distinguish between two categories of recipients: producers and consumers. They also sometimes make explicit reference to the nationality of individuals, i.e. by making a distinction between domestic and foreign recipients.[11] Any given subsidy programme may in addition limit subsidization to certain subgroups within these categories. The more narrowly defined the group of (potential) recipients, the more "specific" a subsidy programme is considered to be. Subsidy programs with a wide range of (potential) recipients, instead, are often referred to as "general" subsidies.

11 Odedokun (2003), for instance, points out that official development assistance (ODA) amounts to subsidization of specific activities in foreign markets leading to distortions, such as the increased consumption or use of certain commodities.

There is a tendency to assume that more "specific" programs are more distortionary, but whether this is the case or not may depend on the programme's objective. Boss and Rosenschon (2002), for instance, argue that in the case of redistributive activities the more narrowly defined the beneficiary group, such as handicapped people, the less transfers, say free public transport, should be seen as subsidies. If on the other hand, resources are redistributed within the public at large, for instance, in order to financially support theatres or hospitals, subsidization should be deemed to exist. Yet, this criterion may be hard to operationalize: targeted support to farmers or coal-miners may principally be socially motivated, but have large distortionary effects on resource allocation in the economy at large. It is more common, therefore, to consider the subsidy content of policies lower the wider the range of beneficiaries, as is explicitly the case in the German Government's Annual Subsidy Report (BMF, 2003) and is, arguably, the case in the WTO definition of subsidies that will be discussed in more detail below.

In particular, within the first category of subsidies defined above, a significant range of different forms of subsidization can be found. The most direct form of subsidization is cash subsidies referring to money transfers from the government to the recipient. Alternatively, governments can provide subsidies through tax concessions. Indeed, when a government provides a tax exemption, credit, deferral or other forms of preferential tax treatment to an individual or group, its budget is affected in much the same way as if it had spent some of its own money. A third form of subsidization consists in the assumption of contingent liabilities. These occur, for instance, when governments give institutional guarantees or loan guarantees with respect to the loans taken by certain institutions in the market place. Both practices reduce the financial cost of carrying out a certain business and thus constitute subsidies. In the case of a loan guarantee, for instance, the borrower need not pay a risk premium commensurate with its actual default risk, but instead obtains the loan at the risk-free interest rate.[12] This results in a subsidy for the borrower, even if the government agency is never requested to step in and repay the loan. Governments can also provide subsidies through procurement policies at administered prices such that a mark-up over free-market prices is afforded to certain producers. Last but not least, subsidies can be provided through equity injections into businesses if this results in maintaining the price of the relevant equities artificially high.

The most widespread, standardized information on "subsidies" is provided in National Accounts Statistics for which country data are available worldwide. National Accounts Statistics (NACC) define subsidies as follows: "Subsidies are current unrequited payments that government units make to enterprises on the basis of the level of their production activities or the quantities or values of the services which they produce, sell or import. They are receivable by resident producers or importers...".[13] This subsidy definition is restricted to the first category of subsidies defined above and only to one specific form of intervention within this category. It only includes direct payments in its definition and thus ignores transfers through tax breaks or soft loans.[14] The definition is also very explicit about the recipients of subsidies. Transfers are only considered to be subsidies if they are given to producers, while transfers made directly to households are considered as social benefits. In addition, recipients of transfers need to be resident in the country whose government is making the transfer, in order for the transfer to be considered a subsidy. Last but not least, it only refers to payments linked to the level of commercial activity and not to "decoupled" payments, such as pure income support. The definition only makes indirect reference to the effect of a subsidy, as subsidies are considered to be "unrequited" payments, i.e. no equivalent contribution is received in return.

In numerous subsidy definitions transfers pursuing certain policy objectives are implicitly or explicitly excluded. It has, for instance, been argued in the subsidy literature that payments for public goods[15] may not be considered subsidies and most definitions limit the use of the term "subsidy" to transfers to firms, including producer

12 See also Box 1.

13 United Nations, 1993 System of National Accounts, chapter VII, D.3: para. 7.72. See http://unstats.un.org/unsd/sna1993/tocLev8.asp?L1=7&L2=4, visited on 20 January 2006.

14 The NACC subsidy definition, for instance, does not include grants governments provide to finance the capital formation of enterprises, or to compensate them for the damage or loss of their investment. While the public supply of goods or services is not included either in the NACC subsidy definition, transfer payments made by governments to cover losses of state owned enterprises are considered to be subsidies according to the definition.

15 Public goods display the characteristics of non-rival consumption and non-exclusivity. A classic example of a public good is knowledge, when one person's acquisition of knowledge does not influence the ability of another person to acquire the same knowledge (e.g. to read a book), and where nobody can be denied access to the good (i.e. anybody can read the book).

households, not-for-profit organisations, state-owned enterprises, such as hospitals, and the government as a provider of goods and services that could be supplied commercially (Boss and Rosenschon, 2002). According to the bi-annual subsidy report of the German Government (BMF, 2003), defence expenditures (in pursuit of national interest) are, for instance, not considered to be subsidies. Conversely, if private provision of a good or service is possible, government funding may be presumed to result in subsidization. In practice, it is however not necessarily easy to make this distinction. For example, fundamental research carried out within companies may be commercially profitable and, in addition, produce positive external effects for society at large. Government support to R&D can be justified on the ground of the existence of such positive externalities. Yet, it is difficult to identify the exact compensation that allows companies to internalize positive spillovers. Any assistance beyond that amount results in subsidization of R&D activities that would in any case be profitable.

The effects of a transfer are relevant for a number of subsidy definitions that play a role in this Report, including the definition of subsidies that is known as the "producer subsidy equivalent" (PSE). The PSE is used by the OECD among others to quantify support to agricultural producers (OECD, 2005a).[16] This measure is based on the difference between domestic producer prices and world market prices and thus includes the effects of border protection. The effect of transfers is also relevant in the EU definition of "state aid", where "subsidies" are limited to (actual and potential) financial transfers to firms (i) if an economic advantage is obtained that a company would not have received in the normal course of business and (ii) if it affects the balance between certain firms and their competitors. The EU prohibits such "state aid", as it implies that certain economic sectors, regions or activities are treated more favourably than others (European Commission, 2002a). Hence, conferral of a benefit with selective access differentiates "state aid" by EU countries from financial transfers under market conditions, as well as horizontal measures open to all companies such as public education programmes.[17] Not surprisingly, the definitional criteria used in the WTO under the Agreement on Subsidies and Countervailing Measures (SCM) are similar to such laws seeking to preserve a level playing field among companies in different jurisdictions (see below). Given the importance the SCM Agreement attaches to the effects of transfers, the degree to which benefits are "passed through" from (direct) recipients of transfers to others (indirect recipients) has played an important role in WTO disputes.[18]

In sum, in comparing subsidy statistics from various sources, the definitional differences need to be kept in mind. Definitions may be narrower or wider as regards recipients, form, objectives and effects of government support, such that the relative size of transfers covered by one definition compared to another is not easy to tell.[19] Subsidy definitions are context-specific, and the same country may adopt a variety of definitions for different purposes. For instance, in order to ensure international comparability, German National Accounts Statistics do not include preferential tax treatment and soft loans. But these items are included in the Annual Subsidy Report of the German Government, which is geared towards measuring government financial flows other than administration-related expenses. By the same token, the German Subsidy Report excludes support to research and development (unless provided to individual companies for research projects the commercial exploitation of which is imminent or likely in the foreseeable future), but such payments are captured in national accounts irrespective of the beneficiary. Finally, in regard to impact, the Subsidy Report of the German Government includes a range of budgetary outlays that need not be notified as state aid pursuant to Articles 87 and 88 of the EC Treaty, since they are not considered to affect competition in the internal market,

16 Based on Steenblik (2003): Timothy Josling (1973) was the first to apply the PSE. The concept was then extended and refined by agricultural economists in the Directorate for Food, Agriculture and Fisheries of the OECD (1987) and the Economic Research Services of the US Department of Agriculture. It has since been applied to measure subsidies to coal production (Steenblik and Wigley, 1990) and was eventually tried in the case of fisheries.

17 While the latter, in reality, may lower the cost of labour for some firms and not for others, they are primarily targeted at the creation of equal opportunities for workers. In fact, Filges et al. (2003) have shown that properly designed education policies, while leading to large transfers from advantaged to disadvantaged workers, result in relatively small losses to economic efficiency.

18 See Section F for a more detailed discussion of WTO rules and disputes related to subsidies.

19 For statistical definitions it also matters which administrative unit dispenses the subsidy, as some subsidy definitions include all administrative units at federal/central, state and local level, while others only refer to subsidies provided by the federal/central government. This aspect is further discussed in Section E.1.

such as social adjustment measures in the coal sector.[20] The various definitions used in national and issue-specific contexts and their statistical implications will be further touched upon in Section E on the incidence of subsidies.

Last but not least, it may be worthwhile noting that economic analysis is not usually very concerned with the different type of subsidy instruments and the way they work in practice. Rather, it tries to identify so-called market failures and ask the question whether a government intervention can be justified from a welfare point of view. If the market failure can be corrected through a change in price signals given to certain actors, subsidies can represent a valid policy option. Usually it is then assumed that the correct amount is given to the appropriate recipient, and little attention is given to the various forms that a subsidy may take in practice, although this aspect is not unrelated to its ultimate impact. Subsidies are, for instance, often modelled as a transfer reducing the recipient firm's marginal cost of production with the aim of achieving a predefined allocative impact.[21] In practice, it is rather difficult to design government programmes having such a precise impact, and pragmatic criteria, like the ones discussed above, have to be used to restrict the scope of what measures constitute a "subsidy" in any given context.

3. THE DEFINITION OF SUBSIDIES IN THE WTO

Neither the GATT nor the Tokyo Round Subsidies Code contained a definition of the term "subsidy". This changed when the WTO SCM Agreement came into being. SCM Article 1 is entitled "Definition of a Subsidy" and spells out the conditions under which a subsidy is deemed to exist. First of all, there must be a "financial contribution by a government or any public body" (SCM Article 1.1(a)(1).[22] The different forms of financial transfers that were mentioned above are listed explicitly, namely (i) direct transfers of funds, including potential transfers, such as loan guarantees, (ii) foregone revenues that are otherwise due and (iii) goods and services provided by the government other than general infrastructure. Under the last point, government purchases are also mentioned. Article 1.1.(a)(1)(iv) specifies that subsidies are also deemed to exist if 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 under (i) to (iii). In addition to financial contributions by a government within the meaning of Article 1.1(a)(1), SCM Article 1.1(a)(2) mentions any form of income or price support in the sense of Article XVI of GATT 1994, i.e. support which operates directly or indirectly to increase exports of any product from, or reduce imports into, a Member's territory. SCM Article 1.1(b) stipulates that any such financial contribution or income or price support pursuant to Article 1.1(a) must confer a benefit to the recipient if it is to be considered a subsidy in the sense of the Agreement.[23]

Thus, in terms of the terminology used above, the SCM Agreement appears to exclude from its subsidy definition transfers falling into the third category (i.e. regulatory policies), but seems to take a rather inclusive approach with respect to the forms transfers can take within the other two categories.[24] The Panel in *US–Export Restraints*, for instance, concluded that export restraints did not constitute a subsidy, as they did not

20 See BMF (2003), in particular Annex 1 and Annex 8, Section 4, for a comparison of the subsidy definition used by the German Government in this with the definitions embraced for the purposes of national accounts, EC State Aid and a review undertaken by the Kiel Institute of International Economics.

21 See, for instance, Collie (2000) in his article on prohibited state aid in the European Union.

22 SCM Article 1.1(a)(1)(iv) also provides for the fact that a private body may make the financial contributions on behalf of the government.

23 Therefore, government programmes that constitute financial contributions but do not improve on the market conditions available to the recipient are excluded from the applicability of the Agreement. In *Canada–Aircraft*, the Appellate Body confirmed that a financial contribution had to make the recipient "better off" and that the appropriate basis for comparison was the marketplace in order to identify its trade-distorting potential (Appellate Body Report: para. 157).

24 Certain aspects from the list of financial contributions contained in SCM Article 1.1(a)(1)(i)-(iv) were disputed on several occasions. For instance, a normative benchmark was found to be necessary in order to determine what constituted foregone tax revenue that is "otherwise due". Here, the Appellate Body held that the fiscal treatment of legitimately comparable income needed to be contrasted with the treatment of income subject to the contested measure. Importantly, it cautioned that for the purposes of this comparison, it might not always be possible to identify a general tax rule that would apply to the revenues in question in the absence of the contested measure (*US-FSC*, Appellate Body Report: paras. 89-91).

represent a financial contribution by the government. Moreover, export restraints could not be considered to represent a financial contribution in the sense of Article 1.1.(a)(1)(iv) of the SCM Agreement.[25] The Panel Report stressed that government entrustment or direction was "different from the situation in which the government intervenes in the market in some way, which may or may not have a particular result simply based on the given factual circumstances and the exercise of free choice by the actors in that market".[26] Using a hypothetical example, the panel illustrated that a "tariff" could not constitute a financial contribution, even if it conferred a benefit to specific downstream producers. It added that if the concept of financial contribution were about the effects, rather than the nature of a government action, this concept would effectively be eliminated, leaving "benefit" and "specificity" as the sole determinants of the scope of the Agreement.[27]

The SCM Agreement makes limitations as to the range of (direct or indirect) recipients of subsidies when it comes to determining whether subsidies as defined in SCM Article 1.1 are subject to the further provisions in the SCM Agreement. Indeed, even if the existence of a subsidy has been established according to the definitional criteria in Article 1.1, Article 1.2 restricts the application of further disciplines to those subsidies that are "specific" to individual or groups of "enterprises or industries", as specified in SCM Article 2.[28]

This and other provisions in the Agreement referring to producers of subsidized products imply that transfers to consumers may not be covered. Also, the references to "enterprises located ... within the jurisdiction of the granting authority" contained in SCM Article 2.2 and to a Member's own "territory" in GATT 1994 Article XVI appear to preclude the applicability of these disciplines to ODA benefiting firms in other countries. SCM Article 2 provides a number of principles to guide the determination of "specificity". Most notably, a subsidy is to be considered "specific" if access to it is explicitly limited to certain enterprises. Conversely, if eligibility of enterprises is based on objective criteria and conditions, such as size,[29] and if it is automatic, specificity does not exist. SCM Article 2 acknowledges that, according to these principles, a subsidy programme may appear non-specific, but turn out to be specific in the way it is implemented. SCM Article 2.1(c) illustrates some of the factors to be examined in that regard, such as the use of a subsidy programme by a limited number of certain enterprises or the manner in which discretion has been exercised by the granting authority in making the awards.

The intricacies of this definition became apparent in a number of WTO disputes. Interpretations of different aspects by panels and the Appellate Body will be further discussed in Section F.

[25] *US–Export Restraints*, Panel Report: para. 8.69.

[26] *US–Export Restraints*, Panel Report: para. 8.31.

[27] *US–Export Restraints*, Panel Report: paras. 8.37-8.38.

[28] SCM Article 2.3 states that all prohibited subsidies under SCM Article 3 – i.e. subsidies contingent on export performance or on the use of domestic over imported goods - are deemed to be specific.

[29] However, SCM Article 2.2 makes it clear that a subsidy that is limited to certain enterprises located within a designated geographical region is to be seen as specific.