AFTER BREXIT: State Aid under WTO disciplines

David Unterhalter SC and Thomas Sebastian

Amidst the speculation as to what legal regime is likely to govern the UK's trading relationships with its major trading partners after Brexit, the safest view is that it is far too soon to tell. But one outcome is tolerably clear. The UK's membership of the World Trade Organization ("**WTO**") will provide the floor of rights and obligations that will govern the UK's relationship with other WTO members, including the EU post-Brexit. In a worst case, if the two year period under Article 50 runs out without agreement on key areas of trade, the WTO Agreements are likely to be determining until some future agreement is reached. And the same is true of the UK's relationship with other trading partners: until bilateral agreements are concluded, the WTO Agreements are likely to prevail. However, the UK's position as a member of the WTO, once it leaves the EU, is not without some legal complexity (and we will return to this topic separately).

Those who believe that an EEA-based deal between the UK and the EU-27 is possible will be comforted by the prospect of little change to the UK's application of EU law on state aid. As George Peretz QC has explained, an EEA-based deal would see the restoration of much of this body of law. On the other hand, a failure to agree an EEA-based deal would leave room open for the negotiation of a free trade agreement. Agreements of this kind permit more flexibility but they take time, usually much more than two years, even where the parties have aligned incentives and significant common ground. In this more dismal scenario, the WTO Agreements will fill the gap.

What will this mean for state aid disciplines? State aid under WTO rules will be a rather different body of law. We offer a few thoughts in three areas: the substantive rules, their enforcement and the institutional arrangements of WTO dispute settlement.

Substantive rules and enforcement

The agreement of principal relevance in the WTO context is the Agreement on Subsidies and Countervailing measures (the "SCM Agreement").[1]

The SCM Agreement defines a subsidy in Article 1 which reads:

> "*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:*

[1] Subsidies are also addressed in the WTO Agreement on Agriculture and the GATT 1947.

(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)(1);

(footnote original) 1 In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

(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) to (iii) 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."

It will be immediately apparent to EU lawyers that there is considerable overlap between the WTO concept of "*subsidy*" and the concept of "*state aid*" under Article 107(1) TFEU. Both concepts involve: (1) measures which are taken by governments or which are imputable to governments; (2) the grant of benefits (to use WTO terminology) or advantages (to use EU terminology) which are assessed using market-based tests[2]; and (3) measure which are not generally applied but which are specific (to use WTO terminology) or selective (to use EU terminology). Moreover, measures which are purely regulatory in nature, for

[2] Compare Appellate Body Report, *Canada-Aircraft*, para. 157 and Case C-39/94 *SEFI*, para. 60.

instance exemptions from labour or environmental standards, would fall outside the scope of both sets of rules as WTO law requires the presence of a "*financial contribution*"/"*income or price support*" while EU law requires the use of "*state resources*".

That is not to say that the concepts are identical. For instance, measures which do not involve any cost to the government, such as a price control measure would clearly be outside the scope of Article 107(1) TFEU but may fall within the scope of the SCM Agreement.[3] Likewise, the three-step EU law approach to the assessment of selectivity in cases involving tax exemption measures,[4] mercifully, has no direct analogue in WTO law.

While the scope of application of the WTO and EU law rules on subsidies are similar, there are significant differences in how subsidies are regulated in both systems. We highlight three differences.

First, while EU law creates a uniform legal regime WTO law differentiates between different categories of subsidies. Under WTO law, only export subsidies and import substitution subsidies are prohibited *per se*. For all other types of subsidies a further showing of one or more listed adverse effects needs to be made before the granting WTO Member State will be required to terminate its subsidy programs.[5] These adverse effects are difficult to establish and cannot be compared to the far less stringent EU law requirement that subsidies must demonstrably distort competition and trade between EU Member States.

Second, EU law allows for *ex ante* approval by the European Commission of particular categories of justified subsidies under Articles 107(2) and 107(3) TFEU. No such option is available under WTO law.

Third, the enforcement mechanisms under both sets of treaty arrangements differ. EU law provides for far more comprehensive and stringent enforcement mechanism than that provided under WTO law. Under EU law, the grant of state aid can trigger enforcement proceedings by the European Commission as well as proceedings by private parties in domestic courts. Those proceeding can result in an order that the beneficiary must pay back illegally granted state aid. By way of contrast, under WTO law, affected enterprises have no standing and must seek remedies through their home states.

- One remedy is for the home state to initiate an inter-state WTO dispute settlement proceedings against the subsidy-granting WTO Member. For instance, at the behest of Boeing, the United States initiated WTO dispute settlement proceedings against the European Union regarding subsidies allegedly granted to Airbus. However, a successful WTO dispute

[3] Compare Case C-379/98 *PreussenElektra*, paras. 59-62 and Article 1.1(a)2 of the SCM Agreement. See also Appellate Body Report, *Canada-Aircraft*, para. 161 and Panel Report, *China – GOES*, para. 7.86.
[4] See Commission Notice on the notion of State Aid, paras. 126-141.
[5] See Articles 5 and 6 of the SCM Agreement.

settlement proceeding will only result in an order that the subsidy-granting WTO Member must desist from granting further subsidies. No retroactive or monetary remedies are granted.

- A further remedy is for the home state to impose, following a domestic investigation, so–called "countervailing duties" on imports of products which benefit from subsidies. These "countervailing duties" will restrict access to the market of the home state but they will not necessarily result in termination of the subsidy (although they can act as an incentive for termination) and will not affect access to third-country markets.

In the final part of this post we discuss the WTO dispute settlement process (the first remedy) in more general terms.

WTO dispute settlement

The WTO's Dispute Settlement Understanding (DSU), sets out the rules and institutional arrangements under which members of the WTO are able to resolve disputes. Where a member of the WTO considers that another member has failed to comply with the provisions of the WTO Agreement, the WTO's dispute settlement system may be engaged to resolve the dispute.

Five features of the system have encouraged extensive recourse by members to the system. First, a respondent may not decline adjudication under the rules and procedures of the DSU. Provided that parties seek to reach a mutually agreed solution to the dispute, adjudication under the DSU is not elective at the instance of the respondent. Second, adjudication takes place before a panel at first instance, with rights of appeal to the Appellate Body, a standing body appointed by the membership of the WTO. These institutions have a well-established record of independence, sedulously fostered over more than twenty years. Third, the procedures followed before the panels and the Appellate Body meet rigorous standards of procedural fairness. Fourth, the outcome of the adjudication is binding. The outcome is compulsorily adopted by the membership of the WTO under a rule of negative consensus (only the successful litigant may prevent adoption). Finally, adjudication under a rule-based system of international law has created a considerable body of law that lends clarity (not always uncontroversial) to the many provisions of the WTO agreement that have been considered.

Although widely used, the system has limitations.

To begin with, as noted above, only WTO Members may bring disputes. Since the adverse effects of trade measures are suffered in the first place by firms competing in markets and not directly by member states, it is necessary for those affected to persuade a WTO Member to initiate a dispute. A decision by a Member to bring a dispute implicates the bilateral trade and diplomatic relationship that subsists between state parties. The dispute, even though well founded, may not be pursued simply because other considerations of state interest may prevail.

Furthermore, there is no WTO institution that is charged with investigating a complaint and taking steps to enforce a member's rights. There is no Commission to discharge these functions. WTO Members with complaints that their rights have been infringed must themselves engage the system of dispute settlement in their own interests and at their own cost.

Moreover, WTO treaty commitments generally have no direct effect. Save in relatively rare instances of domestic adoption, the rights and obligations under the covered agreements are not justiciable before domestic courts. Recourse to the dispute settlement system is usually one of first and last resort.

Finally, as discussed above, the remedies available in the WTO are prospective and limited in scope.