

Emerging Rules on Cross-border Subsidies: A Typological Analysis and Proposals for China's Approach

Ding Ru, Xiang Yiqian*

Abstract: A cross-border subsidy refers to a subsidy whose provider and receiver are located in the territories of different countries. In recent years, new rules on cross-border subsidies have been included in both the EU law and some regional trade agreements. The new cross-border subsidy rules are considered an attempt to counteract the effect of certain foreign investment activities, which will impact China's foreign investment including that within the Belt and Road Initiative (BRI). Considering the cross-border subsidy rules' distinctive characteristics and potential adverse impact on international trade and investment, this article aims to provide a typology of these new rules to facilitate analysis of whether they are consistent with the WTO rules. Moreover, this article argues that China should take a holistic approach to counteract the potential impact of these rules by utilizing the WTO dispute settlement mechanism, updating the investment agreements, and formulating domestic regulations.

Keywords: Cross-border Subsidy Rules, WTO, Belt and Road Initiative

I. INTRODUCTION: EMERGING RULES ON CROSS-BORDER SUBSIDIES

In the context of intensive global connectivity based on supply chains, government behaviors and their influence increasingly exceed a single country's territory, which creates new issues for international economic law. This phenomenon

* Ding Ru, Associate Professor, School of International Law, China University of Political Science and Law. Email: dingrulaw@cupl.edu.cn.

Xiang Yiqian, Master Degree Candidate, School of International Law, China University of Political Science and Law.

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is particularly relevant to the international rules on subsidies and countervailing measures since subsidies and their countermeasures are the government's important tools for achieving foreign policy goals. One new phenomenon is the emergence of the new cross-border subsidy rules. Traditionally, subsidy rules seem to only govern subsidies provided within a single country's borders, meaning that the subsidy's provider and receivers are in the same country. For instance, the World Trade Organization (WTO)'s Agreement on Subsidies and Countervailing Measures (SCM Agreement) defines a subsidy as a financial contribution provided "within the territory of a Member".¹ However, in recent years, new rules on cross-border subsidies have been included in both the EU law and some regional trade agreements. Cross-border subsidy is a subsidy of which the subsidy provider and receiver being physically located in different countries. Following Benitah's example,² in their recent article, Crochet and Hegde used the term "transnational subsidies", which means "a subsidy granted to a benefit recipient manufacturing the product at issue outside the country of the granting government".³ This definition's scope is confined to manufacturing subsidies. In this article, we use the term "cross-border subsidy" to encompass subsidies in non-manufacturing sectors, such as the service sectors.

The new cross-border subsidy rules would arguably have a significant impact on foreign investment activities. The government's financial contributions to enterprises located in another country would be considered as "subsidies" under these new rules and would be subject to different forms of countermeasures such as punitive duties or fines, or injunctions to revoke transactions. As Crochet and Hegde noted, the new cross-border subsidy rule is an attempt to counter the effect of certain foreign investment activities, especially those part of the Belt and Road Initiative (BRI).⁴ Countries could also potentially abuse these rules by imposing countervailing measures or other countermeasures for political and protectionist purposes. Although research on different types of

1 Article 1, Definition of a Subsidy, Agreement on Subsidies and Countervailing Measures (hereinafter SCM Agreement).

2 Marc Benitah, *The WTO Law of Subsidies: A Comprehensive Approach*, Wolters Kluwer, 2019, p. 605.

3 Victor Crochet and Vineet Hegde, China's "Going Global" Policy: Transnational Production Subsidies under the WTO SCM Agreement, *Journal of International Economic Law*, Vol. 4, 2020, p. 841.

4 *Ibid.*, p. 842.

cross-border subsidy rules already exists,⁵ there is a lack of a comprehensive analytical framework to distinguish between different types of rules to facilitate our analysis of their consistency or inconsistency with existing international economic law. Moreover, when considering the new rules' potential impact on China, more studies should focus on the issue from China's perspective.

In this context, this article focuses on the issue of whether these new rules on cross-border subsidies are “as such” and “as applied” inconsistent with WTO rules. This article also discusses how the Chinese government may respond to these rules. Part II introduces the cross-border subsidy rules and related countervailing practices, and Part III provides a typology of these rules based on their remedial measures. Part IV analyzes rules on cross-border subsidies under the WTO law following Part III's typology. Part V relies on China's perspective to analyze the influence of these rules on China's outward investment, and Part VI proposes a holistic view and strategies for the Chinese government. Part VII is the conclusion of this article.

II. THREE SOURCES OF THE NEW CROSS-BORDER SUBSIDY RULES

Currently, cross-border subsidy rules are found in three main sources. The first is WTO Members' practices of trade remedy investigation. For instance, the European Commission (EC) treated cross-border subsidies as countervailable subsidies under the EU Anti-subsidy Regulation. In this situation, the landmark case is the EC's decision to impose the definitive countervailing duties on imports of certain woven and/or stitched glass fibre fabrics originating in China and Egypt in June 2020 (the *Glass Fibre Fabrics Case*).⁶ The second source is WTO Members' domestic or internal market law. The EC made the first move by presenting a proposal on foreign subsidies in May 2021, namely the *Proposal*

5 Edwin Vermulst and Juhi Dion Sud, The European Union's New Move against China: Countervailing Chinese Outward Foreign Direct Investment, *Global Trade and Customs Journal*, No. 9, 2020, p. 413; See *Supra* n. 3; Gary Horlick, An Annotated Explanation of Articles 1 and 2 of the WTO Agreement on Subsidies and Countervailing Measures, *Global Trade and Customs Journal*, Vol. 8, No. 9, 2013, pp. 297-298.

6 Commission Implementing Regulation (EU) 2020/776 of June 12, 2020, Imposing Definitive Countervailing Duties on Imports of Certain Woven and/or Stitched Glass Fibre Fabrics Originating in the People's Republic of China and Egypt, hereinafter referred to as the *Glass Fibre Fabrics Case*.

for a Regulation of the European Parliament and of the Council on Foreign Subsidies Distorting the Internal Market (*EC Foreign Subsidies Regulation Proposal*). Potentially due to the EU's influence, some members of the United States Senate are proposing a revision to the US Tariff Act of 1930 to add rules on foreign subsidies.⁷ The third source is regional trade agreements (RTAs). In the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the non-commercial assistance provisions in the Chapter on State-owned Enterprises and Designated Monopolies provides rules on cross-border subsidies.⁸ Although the above mentioned practices and rules all address certain issues related to cross-border subsidies, they have differences in several aspects, including their scopes and remedy measures. This part introduces these three sources respectively, with the examples of the *Glass Fibre Fabrics Case*, the *EC Foreign Subsidies Regulation Proposal*, and the CPTPP's provisions on non-commercial assistance.

A. Trade Remedy Practices: The *Glass Fibre Fabrics Case*

The *Glass Fibre Fabrics Case* refers to the EU's investigation and decision of imposing a countervailing duty on imports of glass fibre fabrics from China and Egypt. In this case, two Chinese enterprises invested in Egypt's Suez Economic and Trade Cooperation Zone (Suez Economic Zone) and respectively established two local enterprises under Egyptian law — Jushi Egypt (established in 2012) and Hengshi Egypt (established in 2014). The Suez Economic Zone is a collaborative project between the Chinese and Egyptian governments that is considered an important achievement as part of China's Belt and Road Initiative.⁹ The two Egyptian companies used raw materials, technologies, and funding

7 "Addressing the growing problem of cross-border subsidization, as foreign governments subsidize their own manufacturers not only at home but in third country markets as well". See Brown, Portman Introduce Legislation to Strengthen Trade Remedy Laws, Protect American Workers, August 22, 2021, <https://www.brown.senate.gov/newsroom/press/release/brown-legislation-strengthen-trade-laws-protect-american-workers> (Last Visited on June 2, 2022).

8 Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), Chapter 17 State-owned Enterprises and Designated Monopolies, Articles 17.6.1(c), 17.6.2(c) and 17.6.3. Same rules are present in the United States-Mexico-Canada Agreement (USMCA), Chapter 22 State-owned Enterprises and Designated Monopolies, Articles 22.6.4(c), 22.6.5(c) and 22.6.6.

9 China-Egypt Taida Suez Economic and Trade Cooperation Zone: African Star of the Belt and Road, <http://fec.mofcom.gov.cn/article/fwydy/zgzx/201811/20181102811468.shtml> (Last Visited on May 27, 2022).

from their Chinese counterparts during their production, which is a common practice among multinational conglomerates. The two Egyptian companies exported glass fibre fabric products to the EU market. The EU's domestic industries requested the EC to initiate a subsidy and countervailing investigation of these companies' exports, which concluded that these products received subsidies and should be subject to countervailing duties.

This case's distinctive feature is that the EC treated the raw materials that those two Egyptian companies imported from China and the funding they received from Chinese banks as "subsidies" from the Egyptian government.¹⁰ The EC reached this conclusion based on a two-step legal reasoning. First, the EC found that the raw materials that these two companies exported from China and the loans they received from Chinese banks constituted subsidies. A common EU practice is to treat Chinese state-owned enterprises (SOEs) and state-owned commercial banks (SOCBs) as "public bodies",¹¹ and then consider the products purchased through SOEs and loans or guarantees from SOCBs as financial contributions from the government. Although the WTO Appellate Body and scholars consider this practice discriminatory and inconsistent with WTO rules,¹² it is still a routine part of the EU's trade remedy investigations. This case is novel since the EC considered that the "cross-border" supply of these goods and services may also constitute "subsidies". Since the WTO's SCM Agreement explicitly confines its scope to domestic subsidies based on the term "within the territory of a Member" in Article 1, the EC would breach this provision if it directly views cross-border subsidies as countervailable.

The EC then moved to the second step of its legal reasoning. Citing the

10 The "subsidies" found by the EC mainly include the following categories: loans provided by the Export-Import Bank of China and China Development Bank. See the *Glass Fibre Fabrics Case*, section 4.3 Preferential financing, section 4.4 Export credit insurance, section 4.5 Provision of goods for less than adequate remuneration, and section 4.6 Revenue foregone.

11 Public body is one of the three subsidy providers in Article 1.1(a)(1) of the SCM Agreement, and the other two providers are government and private body. Once a non-governmental entity is regarded as a public body, it can be deemed to be able to provide subsidies directly just like government, and may be regulated by SCM Agreement more easily. But if the entity is not regarded as public body but regarded as private body, only by demonstrating it is entrusted and directed by governments can SCM Agreement regulate it. See Ding R., *Public Body or Not: Chinese State-owned Enterprise*, *Journal of World Trade*, No. 1, 2014, p. 167.

12 Ding R., *Interface 2.0 in Rules on State-owned Enterprises: A Comparative Institutional Approach*, *Journal of International Economic Law*, No. 3, 2020, p. 637.

*Draft Articles on Responsibility of States for Internationally Wrongful Acts*¹³ adopted by the International Law Commission in 2001 (ILC Articles), the EC attributes the cross-border subsidies provided by Chinese “public bodies” to the Egyptian government, and concluded that China’s cross-border subsidies can be considered as those from the Egyptian government. By virtue of Article 11 of the ILC Articles,¹⁴ the EC reasoned that the Egyptian and Chinese governments, through signing the *China-Egypt Economic and Trade Cooperation Agreement (China-Egypt Cooperation Agreement)*, satisfied the “acknowledges and adopts” requirement under Article 11, hence the Chinese public bodies, i.e. SOEs/SOCBs’ cross-border subsidization can be attributed to the Egyptian government. The EC concluded that the Egyptian government should be deemed as the “provider” of this subsidy.¹⁵ The EC relied on this reasoning to effectively turn a cross-border subsidy into a domestic subsidy that was within the scope of the WTO’s SCM Agreement.

After establishing that cross-border subsidies constitute “subsidies” under the SCM Agreement, the EC needs to further prove the existence of “specificity” i.e. that these “subsidies” are specific to certain regions or enterprises “within the jurisdiction of the granting authority” as required by Article 2 of the SCM Agreement.¹⁶ The EC reasoned that based on the *China-Egypt Cooperation Agreement*, the Chinese government supports its enterprises’ investment in the Suez Economic Zone with the Egyptian government’s acknowledgement and adoption. The EC further reasoned that the Egyptian government has acknowledged and adopted the designation by the Chinese government of the Suez Economic Zone as an “overseas investment territory” under the Article 4 of the *China-Egypt Cooperation Agreement*.¹⁷ The EC then concluded that cross-border subsidies pertaining to this zone have regional specificity because they “fall within the jurisdiction of the granting authority”.

13 https://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf (Last Visited on June 2, 2022).

14 Article 11 of the ILC Articles stipulates: “Conduct which is not attributable to a State under the preceding articles shall nevertheless be considered an act of that State under international law if and to the extent that the State acknowledges and adopts the conduct in question as its own”.

15 The *Glass Fibre Fabrics Case*, paras. 685-699.

16 Article 2, SCM Agreement.

17 The *Glass Fibre Fabrics Case*, paras. 703-705.

Here, the EC did not specify whether it referred to China or Egypt's jurisdiction.¹⁸

In summary, the cross-border subsidy rules represented in the EU's trade remedy practices comprised the following three main elements:

- a. Proving cross-border trade and investment as cross-border subsidies.
- b. Proving cross-border subsidies are domestic subsidies by establishing a "acknowledgement and adoption" connection between two different WTO Members under the ILC Articles.
- c. Proving cross-border subsidies are specific within one jurisdiction based on the "acknowledgement and adoption" relationship between two WTO Members.

B. Domestic/Internal Market Law: *EC Foreign Subsidies Regulation Proposal*

The *EC Foreign Subsidies Regulation Proposal* was promulgated on May 5, 2021 and designed to regulate cross-border subsidies that enter the EU's internal market. This Proposal differs from the cross-border subsidy rules represented in trade remedy practices as it targets overseas subsidies for EU enterprises or transactions within the EU's internal market. Those who made this regulation intended it to become another important pillar of the EU's competition disciplines.¹⁹ For example, regarding China's overseas investment in the EU, this regulation governs potential subsidies when Chinese enterprises invest in the EU's market.

The *EC Foreign Subsidies Regulation Proposal* is under review and not yet in effect. The rules promulgated in the Proposal can be divided into three modules: 1) general rules; 2) special rules on transnational M&A; and 3) special rules on transnational government procurement.²⁰ The general rules stipulate the scope, definitions, cause of actions, and redressive measures. The other two sets of rules provide specialized requirements for the cases of concentration

¹⁸ *Ibid.*

¹⁹ *EC Foreign Subsidies Regulation Proposal*, p. 3.

²⁰ Chapter 3 of the *EC Foreign Subsidies Regulation Proposal*, "Concentrations", stipulates cross-border subsidy rules pertaining to transnational M&A. Chapter 4, "Public Procurement Procedures", stipulates cross-border subsidy rules pertaining to governmental procurement.

and government procurement. When applying the general rules as examples, the proposed regulation mainly contains the following elements:

a. Scope

Article 1 of the *EC Foreign Subsidies Regulation Proposal* provides that this law is designed to address the disturbance of foreign subsidies when the receivers are engaging in economic activities in the EU internal market. “Engaging in economic activities in the EU internal market” means that a company is acquiring or merging with another company established in the EU or is participating in public procurement.

b. Definition of “foreign subsidy”

Article 2 articulates the constituent elements of foreign subsidies, which follows the structure of the SCM Agreement’s definition of subsidy but expands its scope to encompass cross-border foreign subsidies. This provision states that “a foreign subsidy shall be deemed to exist where a third country provides a financial contribution which confers a benefit to an undertaking engaging in an economic activity in the internal market and which is limited, in law or in fact, to an individual undertaking or industry or to several undertakings or industries”.²¹

c. Cause of action — “distortions on the internal market”

Article 3 of the *EC Foreign Subsidies Regulation Proposal* stipulates the substantive condition for taking remedial actions. If a cross-border foreign subsidy distorts the EU’s internal market, the rules would authorize EU authorities to impose redressive measures. Internal market distortions mean that cross-border subsidies improve the undertaking’s competitive position and negatively affect internal market competition. Whether the internal market is distorted shall be determined based on the subsidy’s amount and nature, the undertaking’s and market’s situation, this undertaking’s level of economic activity on the internal market, as well as the foreign subsidy’s purpose and conditions. Different from the WTO’s SCM Agreement that requires a WTO Member to prove “adverse effect” to trade or “injury” to the importing market’s industries, this new rule adopts a broader concept of “distortion on the market”. As stated in the regulation’s

²¹ See Article 2 of the *EC Foreign Subsidies Regulation Proposal*, “Undertaking” is a term of art under the EU anti-trust law. It refers to any entity engaged in an economic activity regardless of its legal status.

“Explanatory Memorandum”, this aligns with the EU’s trilateral statements with the US and Japan. The concept of “market distortion” was developed during the series of trilateral statements. This Proposal is an explicit attempt to implement this concept into rules within the EU.

d. Redressive measures

Article 6 of the Proposal provides for adoptable redressive measures and commitments acceptable to the EU. These measures and commitments include: offering access under fair and non-discriminatory conditions to infrastructure receiving subsidies, reducing capacity or market presence, refraining from certain investments; licensing on fair, reasonable, and non-discriminatory terms of assets acquired or developed with the help of foreign subsidies; publication of research and development (R&D) results, divestment of certain assets, requiring the undertakings to dissolve concentration, and repayment of foreign subsidies. These measures and commitments aim to restrict operations, which resembles remedial measures under competition laws.²²

e. Procedural requirements

Article 7 to Article 16 of Chapter 2 set out general requirements on *ex officio* investigation procedures.

f. Special rules on concentrations and government procurement

Chapters 3 and 4 provide special requirements for corporate M&A and government procurement.

It is notable that in comparison to cross-border rules represented in the EU’s trade remedy investigations, the *EC Foreign Subsidies Regulation Proposal* does not closely fit trade rules. Although the definition of the “foreign subsidy” tends to resemble that of the “subsidy” under the SCM’s Agreement, the remedial measures, or “redressive measures” under the Proposal are not the traditional countervailing measures such as countervailing duties at borders. Moreover, the Proposal does not limit its application scope to trade in goods, which also differs from the traditional trade remedy rules.

C. Regional Trade Agreement: CPTPP

The CPTPP lacks a provision explicitly referring to “cross-border subsidies”.

22 Zhong Mingzhao (Ed.), *Competition Law* (Edition 3), Law Press China, 2016, p. 278.

The rules on cross-border subsidies are implicit in the CPTPP's Chapter 17 on State-owned Enterprises and Designated Monopolies. Non-commercial assistance refers to financial contributions that state-owned enterprises obtain by virtue of their governmental ownership or control, and are essentially a subsidy provided to SOEs.²³ Paragraphs 1 to 3 of Article 17.6 list situations of non-commercial assistance that are subject to disciplines under the CPTPP, part of which involves rules on cross-border subsidies.

Subparagraph (c) of paragraph 1 and subparagraph (c) of paragraph 2 under Article 17.6 of the CPTPP stipulate that any signatory party and its state-owned enterprises shall not provide non-commercial assistance to an enterprise that is a covered investment that provides service in the territory of another party. Paragraph 3 of Article 17.6 of the CPTPP requires that any party shall not provide non-commercial assistance to an enterprise that is a covered investment that produces and sells goods in the territory of another party and thereby causes injury to that other party. As under these provisions, the covered investment is located in the territory of another party instead of the party providing non-commercial assistance. Under this provision, the subsidy provider and receiver must be located in different countries or separate customs territories. The CPTPP's cross-border subsidy rules are comprised of the following three main elements:

a. Scope

These rules regulate only cross-border subsidies/non-commercial assistance provided to state-owned enterprises. The non-commercial assistance is defined following the structure and content of the SCM Agreement's definition of "subsidy".

b. Obligations

First, on trade in services, no government of the signatory party shall cause adverse effects to any other parties through providing cross-border subsidies to its state-owned enterprises that are covered investments in another

²³ Pursuant to the definition on non-commercial assistance under Article 17.1 of CPTPP, just like subsidies under the SCM Agreement, non-commercial assistance requires the government or state-owned enterprises to offer direct transfers of funds or potential direct transfers of funds, or provide goods or services on terms more favorable than market conditions. Meanwhile, "non-commercial" means being different from market conditions which is consistent with the concept of "benefit" under the SCM Agreement. Therefore, non-commercial assistance is essentially a kind of subsidy.

signatory party. Second, regarding trade in services, no state enterprises or state-owned enterprises shall cause adverse effects to any other parties through providing cross-border subsidies to their state-owned enterprises that are covered investments in another signatory party. Third, regarding production and sale of a good, no government of the signatory party shall cause injury to a domestic industry through providing cross-border subsidies to its state-owned enterprises that are covered investments in another signatory party.

c. Remedial measures

Different from the cross-border subsidy rules represented in the *Glass Fibre Fabrics Case* or in the *EC Foreign Subsidies Regulation Proposal*, these rules under the CPTPP lack specific rules on the remedial measures in response to a cross-border subsidy. The remedy is only available after a dispute settlement procedure. Pursuant to Chapter 28 of the CPTPP, disputes regarding non-commercial assistance can be submitted to the dispute settlement body for arbitration.²⁴ If the dispute settlement body rules that a party's behaviors do not conform to Article 17.6, the losing party shall eliminate this nonconformity wherever possible.²⁵ As "retaliation", the complaining party may also seek three interim measures to urge this party to eliminate nonconformity, i.e. compensation, suspension of benefits, and monetary assessment.²⁶ Different from the WTO's dispute settlement procedure, there is no authorization for unilateral trade remedy measures as provided in the SCM Agreement under the WTO. As a consequence, although parties cannot impose countervailing duties against cross-border subsidies, they have more autonomous rights to impose retaliatory measures after a dispute settlement procedure.

D. Characteristics of the New Cross-border Subsidies Rules

Cross-border subsidy rules represented in the three different sources share commonalities. All of these rules contain at least three elements: identification of cross-border subsidies; substantive rules on the cause of action; and remedial

²⁴ According to Article 28.3 of the CPTPP, unless otherwise provided in this Agreement, the dispute settlement provisions of this Chapter shall apply to all disputes related to the CPTPP. Since the application of dispute settlement provisions is not expressly excluded in Chapter 17, disputes involving non-commercial assistance rules can also be submitted to the dispute settlement body.

²⁵ The CPTPP, Article 28.19.2.

²⁶ The CPTPP, Article 28.20.

measures. Compared with the traditional subsidy rules under the SCM Agreement, the distinctive characteristics of the new cross-border subsidy rules are that: 1) the regulated subsidy provider and receiver are not in the territory of the same Member; 2) the rules are not confined to trade in goods; and 3) the remedial measures are not limited to countervailing measures. The first two characteristics are embodied in the identification of the cross-border subsidies, and the third one is reflected in the remedial measures. The rules have different scopes and content, and the following part proposes a typology of these rules based on their different remedial measures.

III. TYPOLOGIES OF CROSS-BORDER SUBSIDY RULES

A typology of cross-border subsidy rules can be based on different criteria. This article focuses on the differences in the rules' remedial measures. Remedial measures are important for cross-border subsidy rules.²⁷ On one hand, adopting remedial measures is the only way for the rules to impact business transactions in international trade. On the other hand, remedial measures determine which international-level rules may govern the specific rules on cross-border subsidies. In the *Glass Fibre Fabrics Case*, since the remedial measures are countervailing duties, these rules shall be analyzed under the SCM Agreement and Article VI of GATT 1994 pursuant to Article 10 of the SCM Agreement. Based on remedial measures, existing cross-border subsidy rules can be categorized into three types: 1) rules with countervailing measures as a remedy; 2) rules with redressive measures as a remedy; and 3) rules with the suspension of concessions as a remedy.

A. Type One: Countervailing Measures as a Remedy

Cross-border subsidy rules with countervailing measures as a remedy are represented by either trade remedy rules or trade remedy practices. The typical example is the *Glass Fibre Fabrics Case* mentioned in Part I. In this case, the EC

²⁷ Relief measures are measures adopted by a country according to relief rules. Strictly speaking, relief rules are the legal consequence element in the constituent elements of legal rules. For a discussion about the legal consequence element, see Shu Guoying (Ed.), *Jurisprudence* (Edition III), China Renmin University Press, 2012, p. 58; Zhang Wenxian (Ed.), *Jurisprudence*, Higher Education Press, Peking University Press, 2011, pp. 69-73.

sought relief of the injury caused by cross-border subsidies by imposing countervailing duties. Pursuant to Article 10 of the SCM Agreement, any rules with countervailing measures as remedial measures must comply with the SCM Agreement and Article VI of GATT 1994. In other words, a WTO Member shall not utilize countervailing measures unless it shows there is a “subsidy” falling within the scope of the SCM Agreement. It is thus a central issue whether the “cross-border subsidies” that the EU countervailed are actionable “subsidies” under the SCM Agreement.

Moreover, even if a cross-border subsidy may constitute a “subsidy” under the SCM Agreement, a WTO Member shall meet procedural requirements under this Agreement by offering negotiation opportunities to the investigated party, the imposition of countervailing duties being based on evidence, and conducting sunset reviews.²⁸ This is particularly important in a case of cross-border subsidy investigation, since this subsidy could involve three WTO Members, i.e. subsidy providing, subsidy receiving (exporting), and importing Members. Evidence related to the case may be concurrently located in the territories of the three Members.

B. Type Two: Anti-competition Redressive Measures as Remedy

Type Two cross-border subsidy rules refer to the rules under which remedial measures are anti-competition redressive measures. The *EC Foreign Subsidies Regulation Proposal* is a typical example. The remedy for cross-border subsidies is a set of restrictive injunctions or fines. Article 6 of the Proposal sets out the general rules on “commitment and redressive measures”. It lists 8 categories of redressive measures, all of which could restrict enterprises’ operations. For instance, an enterprise receiving “foreign subsidies” shall reduce their capacity or market presence, or refrain from investment activities, publication of R&D results, and divestment of certain assets. These redressive measures under the Proposal resemble sanction measures under the competition law.²⁹ All

²⁸ For requirements on countervailing investigations and countervailing measures under the SCM Agreement, see Han Liyu, *World Trade Organization Law*, China Renmin University Press, 2014, pp. 153-157.

²⁹ The redressive measures under the *EC Foreign Subsidies Regulation Proposal* have referred to the sanction measures under the Antitrust Law, e.g. forbidden merger, transfer of partial assets, etc. under the system of concentration of undertakings. See *supra* n. 21, Zhong Mingzhao (2016), p. 278.

these redressive measures require enterprises that receive “foreign subsidies” to give up some of their legally protected rights, including their ability to determine their investment strategy as well as their right of intellectual property to protect their R&D results.

Unlike the first type of cross-border subsidy rules, the second type is essentially a new type that the SCM Agreement can hardly cover. The SCM Agreement regulates subsidies that directly impact foreign trade, while this new type of rules governs subsidies that impact domestic competition. The scenarios regulated do not necessarily involve international trade. The *EC Foreign Subsidies Regulation Proposal* mainly targets subsidies for investments in the EU.

The critical issue with this type of cross-border rules is whether these rules fall within the mandate of existing WTO rules. One may argue that since Type Two cross-border subsidy rules are “WTO extra”, they are free from the WTO’s disciplines. This article argues that these rules are considered under the WTO’s disciplines. If the implementation of Type Two rules causes foreign products or services to enjoy a treatment different from that available to domestic products or services, the rules could violate the non-discrimination obligations under the GATT 1994 or the *General Agreement on Trade in Services* (GATS).

Moreover, if the remedial measures deprive the investors of the right to gain on assets or discriminate against investors, these cross-border subsidy rules or their application is also subject to the rules in international investment agreements.³⁰

C. Type Three: Suspension of Concessions as Remedial Measures

Type Three refers to cross-border subsidy rules where the remedial measures are available after an international dispute settlement procedure. As they authorize the right to implement remedial measures after a third-party dispute settlement procedure, Type Three rules may constrain the signatory countries to unilaterally abuse remedial measures against cross-border subsidies.³¹

30 For international investment related issues under the *EC Foreign Subsidies Regulation Proposal*, see Ye Bin, On Investment Protection Issues under the EU White Paper on Levelling the Playing Field as Regards Foreign Subsidies, *Chinese Review of International Law*, No. 6, 2020, pp. 82-83.

31 For a detailed discussion of countermeasures, see *supra* n. 27, Han Liyu (2014), pp. 151-152; Peter Van den Bossche Werner Zdouc, *The Law and Policy of the World Trade Organization*, Cambridge University Press, 2017, pp. 1288-1291 & 1325-1327.

The CPTPP represents an example of Type Three cross-border subsidy rules. Chapter 17 of the CPTPP does not authorize any unilateral remedial measures against cross-border subsidies, but requires the parties to submit disputes involving cross-border subsidies to the dispute settlement panel under the CPTPP. The complaining party can suspend its commitments towards the challenged party only when the dispute settlement panel rules that a party's cross-border subsidy breaches the CPTPP.

Notably, substantive rules and relief rules may not be in the same chapter of RTAs, and these rules can be intact only if they are combined. For example, Article 17.6 of the CPTPP only sets out the substantive legal elements of which cross-border subsidies shall be disciplined, including: 1) the subsidy receiver must be a state-owned enterprise; 2) the subsidy provider can be a government, state enterprise, or state-owned enterprise; 3) the subsidization must influence a covered investment; and 4) the subsidized products or service must adversely affect or cause injury to another signatory party. However, the remedial measures that the parties can adopt are not prescribed in Chapter 17. The parties can confirm the rules on remedial measures only if they refer to Chapter 28 "Dispute Settlement" of the CPTPP.

IV. ANALYSIS OF CROSS-BORDER SUBSIDY RULES UNDER WTO RULES

The WTO is debating reforms, and the emergence of cross-border subsidy rules will impact the future development of WTO subsidy rules. It is necessary to understand the relationship between cross-border subsidy rules and WTO rules as well as clarify whether different types of cross-border subsidy rules are compliant with WTO rules. This part will analyze the three types of cross-border subsidy rules under the WTO rules.

A. Type One Rules Are Inconsistent with WTO Rules

Type One rules fall within the SCM Agreement since the rules authorize unilateral countervailing measures in response to cross-border subsidies. For example, the EU's trade remedy in the *Glass Fibre Fabrics* Case has several

non-conformities with WTO rules. Type One rules are currently represented only in WTO Members' trade remedy practices and have not yet become laws, regulations, or other instruments of a Member that have general and prospective applications. WTO Members may not challenge this practice through "as such" claims. However, the practice in each case can be challenged as inconsistent with WTO rules based on "as applied" claims.

1. Inconsistent with Article 1.1(a)(1) "Within the Territory of a Member"

A subsidy under Article 1.1 (a)(1) of the SCM Agreement must first be a financial contribution by a government or any public body in the territory of a Member. Based on a textual interpretation, it seems that the indefinite article "a" only makes a general reference, thus it may be argued that there is no corresponding relationship between "a member" and "a government". A government may be one Member's government, or another Member's government. If following this interpretation, the definition of "subsidy" under the SCM Agreement may cover cross-border subsidies.

Nevertheless, from the systemic interpretation perspective, cross-border subsidies do not fall within the scope of the SCM Agreement's definition of subsidy. First, the specificity provision under the SCM Agreement in Article 2.1 stipulates that a "specific subsidy" is specific to an enterprise, industry, or group of enterprises or industries "within the jurisdiction of the granting authority". The expression of "within the jurisdiction of the subsidy provider" requires that the subsidy's provider and receiver are located within the same Member's borders.³² Second, Article 25.2 of the SCM Agreement stipulates that Members shall notify regarding any subsidy granted or maintained in their territories. This provision also suggests that an actionable subsidy is one provided within a Member's territory. Third, WTO dispute settlement practice indicates that cross-border transactions may not constitute a "subsidy" under the SCM Agreement. In the *EU — Large Civil Aircraft Case (DS316)*, the panel

³² Based on the negotiation background of the SCM Agreement, "jurisdiction" refers to territorial jurisdiction rather than personal jurisdiction or other types of jurisdiction. "It was proposed to clarify that specificity may exist only in the territory of a signatory". Meeting of November 6, 1990, Note by the Secretariat, Negotiating Group on Subsidies and Countervailing Measures, para. 3, MTN/GNG/NG10/24, November 29, 1990.

held that a multilateral financial institution does not necessarily constitute a government or public body in the territory of a Member referred to in Article 1.1 of the SCM Agreement.³³ In the vast majority of circumstances, when a multilateral financial institution provides a subsidy, the institution and the subsidy receiver are not located in the territory of the same Member. This panel's ruling implies that the providers and receivers of subsidies should be interpreted under the SCM Agreement as within the territory of the same Member.

As described in Part I, in the *Glass Fibre Fabrics Case*, the EU evaded the requirement of “within the territory of a Member” based on a “two-step legal analysis”. The key step in this analysis is that the EC referred to Article 11 of the ILC Articles, and attributed the subsidy provided by “Chinese public bodies” to the Egyptian government, thus making it the subsidy provider.³⁴ This seems to have fulfilled the requirement of “within the territory of a Member”, but a critical analysis shows that this legal construction is inconsistent with WTO rules. The fundamental weakness in the EC's legal reasoning is its attribution analysis based on the ILC Articles.

First, the ILC Articles is not an intrinsic constituent of the WTO rules. According to the WTO Appellate Body ruling, when interpreting WTO rules, relevant international laws independent of WTO rules can be referenced, provided that the following three premises are satisfied: first, it must be international law; second, they must be relevant international laws; and third, they must be international laws among the Members.³⁵ It cannot be assumed that all the provisions of the ILC Articles are applicable to interpretations of any WTO rules. Whether a particular provision in the ILC Articles can be relevant to the interpretation of a term or rule in the WTO requires a case-by-case analysis based on the above criteria.

Second, Article 11 of the ILC Articles is not an international law relevant to Article 1 of the SCM Agreement. Article 11 of the ILC Articles addresses how to attribute a state's behaviors to another state.³⁶ Article 1 of the SCM

³³ *European Communities and Certain Member States — Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/AB/R, para. 7.888.

³⁴ *The Glass Fibre Fabrics Case*, paras. 685-699.

³⁵ *United States — Definitive Anti-dumping and Countervailing Duties on Certain Products from China (US — AD&CVD (China))*, WT/DS379/AB/R, para. 307.

³⁶ Footnote 9 of Article 11 of the ILC Articles.

Agreement does not provide any term or rule relevant to analyzing the attribution issue between two WTO Members. However, Article 11 of the ILC Articles is not an international law relevant to Article 1 of the SCM Agreement and thus cannot be used to interpret it.³⁷

Third, the Appellate Body's reasoning in the dispute *United States — Definitive Anti-dumping and Countervailing Duties on Certain Products from China* (*US — AD&CVD (China)*) (DS379) does not provide a legal foundation for the EC's practice. China argued in *US — AD&CVD (China)* that Articles 4, 5, and 8 shall be relevant in interpreting the relationship between "government", "public body" and the "private body". The Appellate Body noted that "[b]oth Article 1.1(a)(1), on the one hand, and Articles 4, 5, and 8 of the ILC Articles, on the other hand, set out rules relating to the question of attribution of conduct to a State".³⁸ Due to the strong relevance between the three provisions in the ILC Articles and Article 1.1(a) of the SCM Agreement, the Appellate Body considered Articles 4, 5, and 8 of the ILC Articles as one among several interpretative elements in reaching its interpretation of the term "public body".³⁹ This is a different scenario as compared to the EC's practice in the *Glass Fibre Fabrics Case*, where the provision that the EC relied on is irrelevant to the interpretation of the phrase "within the territory of a Member".

Therefore, the EC's practice of attributing one Member's conduct to another Member in its countervailing investigation has no basis under the WTO rules, and the countervailing duties imposed are inconsistent with the SCM Agreement.

2. Inconsistent with Article 1.1(b) "A Benefit Is Thereby Conferred"

Under Article 1.1(b) of the SCM Agreement, a government-provided financial contribution constitutes a subsidy only if it involves conferring a benefit to the recipient. When analyzing whether this benefit is conferred, the recipient of the financial contribution and a market benchmark must be compared.⁴⁰ According to WTO jurisprudence, the default definition of market benchmark is

³⁷ *Supra* n. 5, pp. 419-420.

³⁸ *Supra* n. 34, para. 309.

³⁹ *Ibid.*, para. 316.

⁴⁰ *Canada — Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, paras. 153, 154 & 157.

the domestic market of the financial contribution's provider.⁴¹ The investigating Member can adopt an external or out-of-country benchmark (foreign market's price) only when it can prove there is a distortion of in-country prices.⁴² In the *US — Carbon Steel (India)* (DS436), the Appellate Body held that to analyze whether in-country prices are distorted or market-determined, an investigating authority may examine the relevant market's structure, including the entities operating within that market, their market shares, along with any entry barriers. This could also require assessing the behavior of entities operating within that market to determine whether the government or entities acting on the government's behalf can exert market power to distort in-country prices.⁴³

In the *Glass Fibre Fabrics Case*, when determining whether a benefit is conferred, the EC chose Egypt's market benchmark rather than China's market price, which was related to the alleged financial providers' location.⁴⁴ If the existence of market distortion cannot be proven based on this evidence, the investigating authority should not use an out-of-country benchmark to determine whether a financial contribution confers a benefit.⁴⁵ The EC's analysis essentially used an out-of-country benchmark to analyze the existence of a benefit without

41 Before cross-border subsidy issues arose, as the financial contribution provider and receiver are located in the territory of the same Member, the provider's market and the receiver's market refer to the same market. So the WTO Dispute Settlement Body does not further divide these two types of market. However, judging from relevant provisions on conferring benefits, the SCM Agreement tends to determine the market with the provider's location. Article 14(a) of the SCM Agreement stipulates "government provision of equity capital shall not be considered as conferring a benefit, unless ... inconsistent with the usual investment practice of private investors in the territory of that Member". Based on the logic in this provision, without the foregoing "government", the following "private investors in the territory of that Member" cannot be identified. It is thus argued that the market benchmark under the SCM Agreement refers to the domestic market where the provider is.

42 Landmarking disputes on this issue include *United States — Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada* (US — Softwood Lumber IV) (DS257), *US — AD&CVD (China)* (DS379), *United States — Countervailing Duty Measures on Certain Products from China* (DS437) (US — Countervailing Duty Measures (DS437)) and *United States — Countervailing Measures on Certain Hot-rolled Carbon Steel Flat Products from India* (US — Carbon Steel India (DS436)).

43 Appellate Body Report, *US — Carbon Steel India*, WT/DS436/AB/R, para. 4.157.

44 The *Glass Fibre Fabrics Case*, para. 702.

45 For the application of out-of-country benchmark rules, see Chen Weidong, *Analyzing the Application of Out-of country Benchmarks in the Case of United States — Definitive Anti-dumping and Countervailing Duties on Certain Products from China*, *Law Science*, No. 2, 2012, pp. 10-12; Yu Minyou and Liu Xuehong, *Extra WTO Obligations in China's Subsidy Field from the Perspective of External Benchmarks*, *International Trade*, No. 2, 2015, pp. 58-60; Dou Ximing, *On External Benchmarks during the Identification of Subsidy Benefits under the WTO Framework*, *Tribune of Political Science and Law*, No. 5, 2013, p. 186.

fulfilling its preconditions. Therefore, the EC's "benefit" analysis is allegedly inconsistent with the SCM Agreement.

3. Inconsistent with Article 2 "Within the Jurisdiction of the Granting Authority"

Under the SCM Agreement, a subsidy can be actionable only when it is "specific" to the limited recipient(s). The chapeau of Article 2.1 in the SCM Agreement states that the paragraphs herein are designed to determine "whether a subsidy is specific ... within the jurisdiction of the granting authority", and explicitly refers to specificity within the jurisdiction of the subsidy's granting authority. Crochet and Hedge studied the SCM Agreement's negotiation history and found that its negotiation group expressly stated that specificity only exists in the signatories' territories, so here "jurisdiction" should refer to territorial jurisdiction.⁴⁶

In the *Glass Fibre Fabrics Case*, the EC first found that loans that Chinese banks provided to Egyptian enterprises in the Suez Economic Zone were "subsidies" based on its peculiar attribution analysis. Then, to fulfill the specificity requirement, the EC adopted arguably weak legal reasoning. When analyzing the existence of the "preferential loan", the EC first reasoned that Egypt relied on "acknowledgement and adoption" to become the provider of subsidies in the form of preferential financing from Chinese banks. Then, the EC reasoned that since the subsidies were only limited to the Suez Canal area, they were specific to enterprises within the granting authority's jurisdiction.⁴⁷ In reaching this conclusion, the EC did not cite any evidence that could indicate that this "preferential financing" was *de jure* or *de facto* limited to companies in the Suez Economic Zone. The EC's fundamental flaw was that it deemed the Egyptian government as the "granting authority" of a financial contribution from a Chinese bank, which lacks a sound basis in WTO rules.

In conclusion, if using countervailing measures such as remedies to address the cross-border subsidies of imported goods, a WTO Member would be very likely in breach of provisions under the SCM Agreement, including but not limited to Article 1.1(a)1, Article 1.1(b), and Article 2. This article analyzed the example of the EC's practice and legal reasoning, and it is possible to

⁴⁶ *Supra* n. 3, p.11.

⁴⁷ The *Glass Fibre Fabrics Case*, paras. 703-705.

develop other approaches. Nevertheless, regardless of the approaches for legal reasoning, countervailing measures against cross-border subsidies face multiple challenges under the current WTO rules on subsidies and countervailing measures.

B. Type Two Rules Potentially Breach Non-discriminatory Treatment Obligations

The Type Two rules govern cross-border subsidies from a foreign state to a domestic market. For example, they govern a situation when a Chinese company acquires a German company's shares. This rule is directly related to foreign investment activities rather than cross-border trade. There are no restrictive rules under the WTO that forbid a Member from adopting a law to regulate foreign subsidies or authorize redressive measures. The existing WTO rules only apply when the domestic rules affect trade in goods or services during implementation. This article uses the currently disclosed texts of the *EC Foreign Subsidies Regulation Proposal* as a case study to find that Type Two rules in its application may result in inconsistency with the non-discrimination obligations under the *General Agreement on Tariffs and Trade* (GATT) and GATS.

1. Inconsistency with National Treatment Obligation of GATT 1994

If the *EC Foreign Subsidies Regulation Proposal* is implemented, it may impact trade in goods. For example, the rules can affect trade in goods by restraining foreign goods importers within EU territory. Under this circumstance, as a law, regulation and rules that could affect the sale and use of foreign products within EU territory, the *EC Foreign Subsidies Regulation Proposal* should observe the national treatment obligation regarding the internal regulations of Article 3.4 of GATT 1994.

Based on WTO rules and practices, a three-layer analysis should be applied to determine whether an internal regulation is inconsistent with the national treatment obligation. First, to confirm whether the regulation referred to in Article 3.4 of GATT 1994 exists; second, to confirm whether domestic products and foreign products are like products; last, to confirm whether the treatment accorded to foreign products is less favorable than that enjoyed by

domestic products.⁴⁸ Regarding the *EC Foreign Subsidies Regulation Proposal*, the issue is whether it accords non-discriminatory treatment to all WTO Members. Competition conditions are the key to understanding “equivalent treatment”. In previous GATT/WTO dispute cases, panels and the Appellate Body have repeatedly noted that “treatment no less favorable” means that domestic and foreign products face equal competition conditions.⁴⁹ Even if the same regulations apply to both domestic and foreign products, as long as the regulations result in foreign products facing worse competition compared with domestic products, e.g. foreign products must meet extra procedural requirements, the commitment of national treatment obligation is breached. The *EC Foreign Subsidies Regulation Proposal* “as such” and “as applied” may cause foreign products to face competition worse than that available to EU’s products.

Firstly, corresponding to the *EC Foreign Subsidies Regulation Proposal* that disciplines foreign subsidies in the EU, the *EU State Aid Rules* are domestic regulations governing EU members’ domestic subsidies.⁵⁰ According to these rules, the EU restricts this subsidy only when an EU member provides a subsidy that distorts competition and damages trade among EU members.⁵¹ In comparison, the *EC Foreign Subsidies Regulation Proposal* stipulates that as long as a cross-border subsidy adversely affects competition rather than distorts both competition and trade, the EU may adopt redressive measures in response to the foreign subsidy.⁵² The legal standard of triggering a redressive measure for the *EC Foreign Subsidies Regulation Proposal* is lower than that of the *EU State Aid Rules*. Consequently, it is more likely that foreign products affected by a cross-border subsidy will be regulated. In this situation, foreign imported products may face worse competition than EU domestic products.

Secondly, the *EC Foreign Subsidies Regulation Proposal* and *EU State Aid Rules* provide different remedial measures, which may also cause foreign

48 *Supra* n. 30, Peter Van den Bossche Werner Zdouc (2017), p. 625.

49 Panel Report, US — Section 337 Tariff Act (1989), L/6439 - 36S/345, para. 5.11; *Japan — Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R, para. 10.379.

50 The *EU State Aid Rules* comprise several EU regulations, of which the most important is Article 107 of the Treaty on the Functioning of the European Union. For a compilation of the *EU State Aid Rules*, see European Commission, *EU Competition Law: Rules Applicable to State Aid*, https://ec.europa.eu/competition/state_aid/legislation/compilation/state_aid_15_04_14_en.pdf (Last Visited on May 27, 2022).

51 Treaty on the Functioning of the European Union, Article 107.1.

52 *EC Foreign Subsidies Regulation Proposal*, Article 3.

products to face comparatively worse competition. Under these rules, if the subsidy receiver returns the state aid it received, other EU members do not have to adopt relief measures.⁵³ In comparison, according to Article 6 of this Proposal, besides repaying the cross-border subsidy, the subsidy receiver will also face redressive measures including divestment of its assets and reduction of its market presence. An undertaking that receives foreign subsidy will face stricter remedial measures compared with one that receives a subsidy within the EU. Since an undertaking receiving “foreign subsidies” could be more likely to engage in foreign trade compared with those that only do business within the EU’s internal market, this Proposal may cause foreign products to face less favorable competition compared with EU’s domestic products. Therefore, this Proposal’s implementation could make it inconsistent with the national treatment obligation under the GATT 1994.

2. Inconsistency with National Treatment Obligation of GATS

Cross-border subsidy rules in the *EC Foreign Subsidies Regulation Proposal* may also affect trade in services. For example, it could affect trade in services by restricting foreign service suppliers’ operation by controlling their commercial presence in the EU territory. The national treatment obligation under the GATS is conditioned on a WTO Member’s commitment. If a WTO Member has committed to provide “national treatment” in its service schedules, the Members should observe the national treatment obligation under Article XVII of the GATS.

According to Article XVII of the GATS, when formulating and implementing measures affecting the supply of services, a Member shall accord treatment regarding services and service suppliers of any other Member no less favorable than that it accords to its own like services and service suppliers. Similar to Article III of GATT 1994, an analysis under Article XVII of GATS focuses on discrepancies between competition conditions.⁵⁴

53 For relief measures against EU state aids, see Zhang Tong (Ed.), *An Introduction to European Union Law*, China Renmin University Press, 2011, pp. 304-305.

54 *Supra* n. 30, Peter Van den Bossche Werner Zdouc (2017), pp. 661-662; *Supra* n. 27, Han Liyu (2014), pp. 151-205.

As a set of rules governing post-market-access activities,⁵⁵ the *EC Foreign Subsidies Regulation Proposal* should observe the national treatment obligation under Article XVII of GATS. If a Chinese company that provides medical services invests in the EU market through mergers and acquisitions and then successfully acquires an EU company that becomes a foreign subsidiary of this Chinese company, this may constitute a Mode 3 trade in services under the GATS. This transaction is also under scrutiny of this Proposal if it is implemented. Pursuant to Chapter 3 of this Proposal, this Chinese company needs to declare whether it has received subsidies from China or any other countries, and the EC may adopt redressive measures such as disclosing the R&D results. However, under the *EU State Aid Rules*, EU's domestic service providers do not face the same remedial measures as foreign service providers. As a result, this Proposal's implementation could breach EU's commitment to national treatment in its schedules under the GATS.⁵⁶

3. Inconsistency with the Most-favoured-nation (MFN) Treatment Obligation under GATT and GATS

Considering the legislative background, the cross-border subsidy rules in the *EC Foreign Subsidies Regulation Proposal* may discriminate against specific Members during implementation, particularly China, and thus could be inconsistent with the most-favoured-nation (MFN) treatment obligation. This is a general obligation in both trade in goods and in services. The MFN obligation requires WTO Members not to implement discriminatory treatment among goods or services originating from or directed to different Members. Discriminatory treatment could be *de jure* or *de facto*. *De facto* discrimination refers to seemingly neutral measures that essentially discriminate against specific Members during implementation.

The legislative history of the *EC Foreign Subsidies Regulation Proposal* indicates that this set of rules could be implemented in a discriminatory manner against Chinese products or services. This Proposal's legislative statement mentions China several times. To illustrate the influence of foreign subsidies,

55 The *EC Foreign Subsidies Regulation Proposal* intends to regulate entities engaging in economic activities in the EU internal market, and relevant entities can engage in economic activities in the EU internal market only after gaining market access. In this sense, the *Foreign Subsidies Regulation Proposal* constitutes a post-market-access rule.

56 Trade in Services – European Union – Schedule of Specific Commitments, GATS/SC/157, p. 7.

it refers to a report of the European Court of Auditors, indicating that cross-border subsidies that China provided have distorted competition in the EU market. Regarding the design of rules, this Proposal referred to the opinions of research reports that mainly study the “Made in China 2025” policy.⁵⁷ Academic research also suggests that one of the EU’s purposes for promulgating this Proposal is to cope with subsidies related to the Belt and Road Initiative.⁵⁸ Thus, it is predictable that this regulation would consider Chinese entities’ investment or transaction in the EU as main targets. If this Proposal is applied out of proportion to Chinese entities, it will lead to *de facto* discriminatory treatment towards Chinese goods or services. In this circumstance, the EU’s practice would breach the MFN treatment obligations under the GATT or GATS.

In summary, Type Two rules may breach the national treatment obligation and the MFN treatment obligations. Hence, they are potentially inconsistent with WTO rules.

C. Type Three Rules Are WTO-consistent

Compared with the previous two types of cross-border subsidy rules, Type Three rules are generally consistent with WTO rules. Since Type Three’s remedial measure of is suspension of concessions after a dispute resolution, these rules exist only in bilateral or regional trade agreements. The WTO rules in Article XXIV of GATT 1994 set out two requirements for free trade agreements. The first is an internal requirement among the agreement’s parties, substantially eliminating trade-restrictive measures among them. The second is an external requirement for WTO Members who are not parties to the agreement, which requires Members not to impose duties and regulations on non-parties stricter than the general restrictive level implemented before the RTA.⁵⁹

⁵⁷ EC Foreign Subsidies Regulation Proposal, footnotes 8 & 34.

⁵⁸ Raf Casert, EU Plans Tightening Foreign Investment, with Eye on China, *Yahoo News*, May 5, 2021, <https://news.yahoo.com/eu-plans-tightening-foreign-investment-110308934.html> (Last Visited on May 27, 2022); Alicia García-Herrero, Europe’s Crusade to Fend off Chinese Interference Falls Short, *Bruegel*, May 10, 2021, <https://www.bruegel.org/2021/05/europes-crusade-to-fend-off-chinese-interference-falls-short/> (Last Visited on May 27, 2022).

⁵⁹ The WTO Dispute Settlement Body has only heard a limited number of appeals involving Article XXIV of GATT 1994 and Article V of GATS. As a part of regional trade agreements, cross-border subsidy rules regarding dispute settlement are unlikely to be challenged of violating the WTO rules. For WTO appeals under Article XXIV of GATT 1994 and Article V of GATS, *see supra* n. 30, Peter Van den Bossche Werner Zdouc (2017), pp. 1102 & 1112.

Under Chapter 17 of the CPTPP, when a CPTPP party provides a cross-border subsidy as disciplined under the relevant provisions of Article 17.16, the remedial measure is that the adversely affected party may resort to the dispute resolution provided by the agreement. If the CPTPP dispute resolution panel finds that the subsidizing party breached the rules, it needs to bring its measures into conformity by taking actions such as withdrawing the subsidies. If the subsidizing party does not comply, the challenging party is entitled to suspend its concessions to the subsidizing party under the CPTPP. The CPTPP rules do not impose extra restrictions on non-parties and thus is consistent with the external requirement. Therefore, the Type Three rules on cross-border subsidies are initially WTO-consistent. However, if a WTO panel based on an economic analysis determined that the CPTPP rules' implementation has elevated the general restrictive level that non-parties face, the rules may be found as inconsistent with the external requirement.⁶⁰ However, no case brought before the WTO has challenged the consistency of RTAs.

D. Summary

This analysis shows that cross-border rules, especially the first and second types, could be used in ways inconsistent with WTO rules. At the international level, rules should be implemented to discipline countermeasures against cross-border subsidies. From China's perspective, it is necessary to evaluate these rules' potential impact on Chinese companies' outbound investment and trade activities.

V. THE IMPACT OF CROSS-BORDER SUBSIDY RULES ON CHINA'S FOREIGN INVESTMENT

Among multiple new disciplines proposed in the context of reforming international subsidy rules, the cross-border subsidy rules have an arguably more significant influence on foreign trade and investment activities. Most notably, the

⁶⁰ In the *Turkey — Restrictions on Imports of Textile and Clothing Products* case, the Appellate Body once noted that an economic analysis should be made to determine whether a regional trade agreement has elevated the general restrictive level confronting a non-party, see *Turkey — Restrictions on Imports of Textile and Clothing Products*, WT/DS34/AB/R, para. 55.

cross-border subsidy rules would directly impact trade in services and foreign investment activities. The Trilateral Statements made by the US, EU, and Japan proposed new subsidy rules on the so-called “over-capacity” issues,⁶¹ but they still confine the scope of the rules to within trade in goods. The cross-border subsidy rules, especially Type Two and Type Three, will discipline trade in goods, trade in services, and cross-border investments. Moreover, the current SCM Agreement only governs subsidization in trade in goods, and the GATS provides no substantial rules on subsidies in services. Thus, if the cross-border subsidy rules are incorporated into the WTO system in the future, it would extensively expand the scope of international subsidy rules. Considering the cross-border rules’ expansive scope, it is necessary to evaluate their impact on China’s foreign trade and investment.

A. A New Layer of Discriminative Practice: Countervailing Measures against Chinese Overseas Investment

China has been one of the main countries that countervailing measures have significantly affected.⁶² Some WTO Members, including the US and EU, have adopted special rules and practices in countervailing investigations against Chinese exports. For example, the US and EU often use the out-of-country or surrogate benchmark in evaluating whether a Chinese financial contribution provides a benefit to a recipient based on either “non-market economy” or “market distortion” analysis and rhetoric.⁶³ Moreover, the US and EU have been treating Chinese commercial entities as governmental “public bodies” to treat their transactions as “subsidies”, which would give the investigation authorities more policy options for imposing countervailing duties. These practices were highly controversial, and some scholars argued that they were discriminatory against WTO Members including China, India, and others, and constitute

61 See the Seventh Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union.

62 Statistics on Countervailing Actions, WTO, June 30, 2021, https://www.wto.org/english/tratop_e/scm_e/scm_e.htm (Last Visited on May 28, 2022); Hufbauer G. C., Will Industrial and Agricultural Subsidies Ever Be Reformed? Peterson Institute for International Economics, March 2021, <https://www.piie.com/publications/policy-briefs/will-industrial-and-agricultural-subsidies-ever-be-reformed> (Last Visited on May 28, 2022).

63 Lang A., Heterodox Markets and “Market Distortions” in the Global Trading System, *Journal of International Economic Law*, No. 4, 2019, pp. 687-701.

abuse of countervailing measures.⁶⁴

The implementation of Type One cross-border subsidy rules are likely to further expand the application scope and could increase possibilities of abuse of countervailing measures against exports from China and other WTO Members. In the *Glass Fibre Fabrics Case*, Chinese overseas investment in Egypt faced countervailing duties when they exported to the EU. When the EU's investigating authority determined whether they should impose a countervailing duty, it adopted previously controversial methodologies including the "public body" analysis and "out-of-country benchmark". This authority also relied on the two-step "attribution" analysis to deem financial services and goods from China as a subsidy provided by the Egyptian government. In short, it would add another layer of abusive practices in countervailing investigations. As a consequence, Chinese overseas enterprises will most likely face more countervailing measures on their exports to the EU market and potentially to the US market.

B. A New Form of Potentially Discriminatory Practice: Redressive Measures towards Foreign Investment

Type Two cross-border subsidy rules will directly impact international investment. For example, the cross-border subsidy rules in the *EC Foreign Subsidies Regulation Proposal* are essentially a regulatory barrier to foreign investment entering the EU market. When Chinese enterprises invest in the EU, they have already faced the EC's anti-monopoly reviews⁶⁵ and potential screening at the national level under the guidance of the EU's regulations on foreign direct investment.⁶⁶ The newly proposed *EC Foreign Subsidies Regulation* will form another hurdle for Chinese enterprises to enter the EU market. The China Chamber of Commerce to the EU (CCCEU) issued a public statement to express its

⁶⁴ *Supra* n. 12.

⁶⁵ Council Regulation (EC) No 139/2004 of 20 January 2004 on the Control of Concentrations between Undertakings, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32004R0139&from=EN> (Last Visited on May 28, 2022).

⁶⁶ Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a Framework for the Screening of Foreign Direct Investments into the Union, <https://eur-lex.europa.eu/eli/reg/2019/452/oj> (Last Visited on May 28, 2022).

concerns about the rationality and necessity of this new legislative initiative.⁶⁷ Scholars also analyzed this Proposal's adverse impact on Chinese investment.⁶⁸

The major legal concern with this proposed regulation is that it could be implemented in a discriminatory manner detrimental to a fair and equitable economic order among major trade and investment partners. However, the Proposal does not fall squarely into the current WTO rules on subsidies and countervailing measures, thus WTO Members can barely challenge this rule with "as such" claims under the SCM Agreement. Part III provided the basis for challenging this Proposal's implementation under the GATT 1994 and GATS, but no explicit rules govern the potential abuse of redressive measures provided under the *EC Foreign Subsidies Regulation Proposal*. The lack of international rules on this matter would cause Chinese enterprises and other WTO Members' enterprises to have limited remedies when facing unfair redressive measures against their investment activities.

C. Impact on the BRI's Implementation

The BRI is an international cooperation initiative that China proposed in 2013. As of February 2022, 148 countries and 32 international organizations have signed cooperative agreements or MOUs (Memorandum of Understandings) with China under the BRI.⁶⁹ As Lin noted, the BRI's vision is to address the development deficit in underdeveloped areas of the world.⁷⁰ One key strategy to achieve this vision is to develop cooperation on infrastructure construction. China's development path provided an example of how infrastructure upgrades can boost a country's economy.

It will be impossible to implement infrastructure projects under the BRI without cross-border investment and trade that has policy support. For instance, Article 3 of the *China-Poland MOU on Jointly Advancing the "Belt and Road"*

67 CCCEU Statement on EC Proposal for Regulation on Foreign Subsidies, http://en.ccceu.eu/2021-05/07/c_1432.htm (Last Visited on June 2, 2020).

68 Zhang Zhiping and Wang Xinglei, Behind the EU's Promulgation of White Paper on Levelling the Playing Field as Regards Foreign Subsidies, *Foreign Investment in China*, No. 13, 2020; *Supra* n. 29.

69 A List of Countries that Have Signed Cooperative Agreement or MOU with China, *Yidaiyilu.gov.cn*, February 7, 2022, <https://www.yidaiyilu.gov.cn/xwzx/roll/77298.htm> (Last Visited on May 28, 2022).

70 Build the BRI to Fix the Global Development Deficit and Governance Deficit — An Interview with Justin Yifu Lin, *Yidaiyilu.gov.cn*, December 20, 2021, <https://www.yidaiyilu.gov.cn/xwzx/gnxw/208522.htm> (Last Visited on May 28, 2022).

Construction states that China and Poland should rely on governmental cooperation to provide financing support to key projects. Part 2 of the *Joint Statement between the People's Republic of China and the Republic of Kazakhstan* states that capacity and investment cooperation should be strengthened by implementing preferential loans intended to enhance China and Kazakhstan's capacity-related cooperation. This political will is critical and essential for international cooperation on infrastructure projects. These projects rarely receive support from private investment due to the market failure to capture these projects' true value based on their ability to promote societal development.

From a historical and comparative perspective, cross-border support through financial or other forms is highly significant in supporting cooperation on international development. The post-World-War-II-era Marshall Plan, the United States' Build Back Better World, and the EU's Global Gateway all need policy and financial support to promote projects that would benefit future generations. The cross-border subsidy rules can address WTO Members' concerns about the potential adverse spill-over effects of international cooperative projects, but may also lead to abuses of countervailing measures or redressive measures towards welfare-enhancing and development-friendly projects. There should be more discussion and studies on how cross-border subsidy rules adversely impact global economy and development.

VI. PROPOSALS FOR CHINA'S APPROACH

The Chinese government should take strategic steps in response to the emerging rules on cross-border subsidies. The three types of rules on these subsidies should be understood holistically rather than as separate sets of disciplines. The WTO is a venue for consultation and dispute resolution on this matter. In addition, international investment rules can be a possible legal vehicle to address the adverse impact of these rules on foreign investment activities. It is also worth considering whether China should incorporate an investment subsidy review mechanism under the current investment law or competition law framework.

A. Taking a Holistic View of the Rules on Cross-border Subsidies

Regardless of their remedial measures, the new rules on cross-border subsidies

are targeted towards foreign investment activities. The Type One rules would influence cross-border investment in an exporting country, and the importing country would implement them under the trade law regime. The Type Two rules would impact cross-border investment in the host country, who could utilize redressive measures under the competition law. The Type Three rules would potentially influence both of these scenarios, but their direct impact would be limited since the current RTA rules provide no explicit unilateral remedies. However, it is possible that Type Three rules would further develop into bilateral, regional, or multilateral rules that provide legal remedies like those in Type One and Type Two.

Underlying the rules on cross-border subsidies, the common theoretical inquiry is whether international rules should regulate so-called cross-border subsidies and their countermeasures. Further economic analysis is required to provide a comprehensive answer for how WTO rules should address new phenomena in the future. This analysis is beyond this article's scope. This article intended to and provided an analysis under the WTO rules. This led to the conclusion that cross-border subsidy rules could be used in a way that was inconsistent with WTO rules. Therefore, rules should be implemented to discipline countermeasures against cross-border subsidies.

This article calls for a holistic view of the varieties of cross-border subsidy rules. This view shows that different forms of these rules are targeting the same type of activity: cross-border investment. It also shows that it is insufficient to address measures in response to cross-border subsidies within the restrictions of international trade rules. Countries such as China that these rules could impact should take both defensive and progressive measures. The WTO provides a platform for defensive measures, while international investment agreements and domestic rules could potentially provide one for progressive measures.

B. Seeking Consultation and Remedies at the WTO

Although the WTO Appellate Body is currently in an impasse, the WTO's consultation and panel proceedings are actively functioning. In the 29 ongoing disputes of which panels have been composed, 28 of the panels were composed

after the Appellate Body halted.⁷¹ Moreover, 52 WTO Members including China and the EU are Members of the Multi-party Interim Appeal Arbitration Arrangement (MPIA), which may be an alternative appeal mechanism for these Members.

Part III thoroughly analyzed the potential inconsistencies of the Type One and Type Two cross-border subsidy rules. China can consult with the EU to counteract its practice in the *Glass Fibre Fabrics Case*. The EU's investigations are "as applied" inconsistent with the SCM Agreement. Specifically, the EU's practice breached Article 1.1(a)(1), Article 1.1(b), and Article 2. China should challenge this investigation as part of a holistic strategy towards formulating new rules on cross-border subsidies. Regarding the *EC Foreign Subsidies Regulation Proposal*, China may resort to the WTO if it comes into force and has applied to Chinese enterprises in a discriminatory manner. These claims may be based on the non-discrimination obligations under the GATT 1994 and GATS.

C. Enhancing Rules on Protection of International Investment

Cross-border subsidy rules will adversely affect international investments. Thus, from China's perspective, international investment agreements would counter the effects of unilateral measures against cross-border subsidies. First, existing bilateral investment treaties (BITs) will provide another layer of remedies for investors who face discriminatory treatment by the host state. If the *EU-China Comprehensive Agreement on Investment (CAI)* would come into force, investors could have more remedies available when facing discriminatory treatment under the *EC Foreign Subsidies Regulation*. Articles 4 and 5 of CAI are national treatment and the MFN treatment provisions, based on which the Chinese investors may invoke an investor-state arbitration proceeding to seek remedies.

Second, in future regional or bilateral investment agreements, China could negotiate a new type of provision to protect investment promotion activities. International cooperation to build infrastructure could provide positive

71 Current Status of Disputes, https://www.wto.org/english/tratop_e/dispu_e/dispu_current_status_e.htm (Last Visited on May 26, 2022).

spillover effects for the local and international economy.⁷² Traditionally, international investment rules protect international investment *per se*. For example, the fair and equitable treatment provision in a BIT could protect foreign investment with a minimum standard of treatment under customary international law,⁷³ and the expropriation provision describes the standard for investment compensation. However, there is a lack of protection of investment promotion activities. This provision's exact form and content requires further analysis, which is not within this article's scope. However, the new provision should at least require that the host state cannot arbitrarily impose injunctive or punitive measures against investment promotion activities.

D. Domestic Foreign Subsidy Review Mechanism

In June 2021, the US president and G7 leaders agreed to launch a new infrastructure partnership, Build Back Better World (B3W). This aims to help narrow the \$40+ trillion infrastructure gap in the developing world by 2035.⁷⁴ In July 2021, the EC approved conclusions on “A Globally Connected Europe”, which aims to promote its development policy through investing in infrastructure.⁷⁵ There may be competition involving large-scale investment promotion of international infrastructure projects. From China's perspective, it should take precautionary steps to formulate its domestic regulatory scheme in response to this trend.

If a Chinese company's investment is adversely affected by a foreign state's support either in China or in a third country, there should be regulatory tools that compare with those in the EU and other major economies. China may extend the scope of its competition review mechanism to foreign subsidies.

72 Bräutigam D., Aid “with Chinese Characteristics”: Chinese Foreign Aid and Development Finance Meet the OECD-DAC Aid Regime, *Journal of International Development*, No. 5, 2011, pp. 760-763.

73 The fair and equitable treatment provisions are interpreted differently depending on the exact text of the investment treaties and the arbitral tribunals. Schreuer C. and Dolzer R., *Principles of International Investment Law*, Oxford University Press, 2022, p. 134-160.

74 President Biden and G7 Leaders Launch Build Back Better World (B3W) Partnership, The White House, June 12, 2021, <https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/12/fact-sheet-president-biden-and-g7-leaders-launch-build-back-better-world-b3w-partnership/> (Last Visited on May 28, 2022).

75 A Globally Connected Europe: Council Approves Conclusions, Council of the EU, July 12, 2021, <https://www.consilium.europa.eu/en/press/press-releases/2021/07/12/a-globally-connected-europe-council-approves-conclusions> (Last Visited on May 28, 2022).

For instance, Article 15 of the *Detailed Rules for the Implementation of the Fair Competition Review System* stipulates that Chinese administrative institutions shall not illegally provide specific operators with preferential policies, including financial awards and subsidies as well as preferential tax policies. This provision may be extended to authorize a review of foreign subsidies, whose functions will resemble those of the *EC Foreign Subsidies Regulation Proposal*.

The ultimate solution for Chinese companies who could be adversely affected by foreign companies with support from subsidies would be to reach a multilateral agreement on prohibiting regressive cross-border subsidies, while also encouraging the implementation of a coordinated and development-friendly plan for infrastructure projects in underdeveloped regions. Before reaching this consensus, domestic trade remedies against imports just like the EU's practice could be a deterrence against other WTO Members' trade remedy measures. However, this unilateral strategy is far from the optimal scenario for the international community.

VII. CONCLUSION

Cross-border investments can energize the international economy and may provide synergy among developed and developing countries to pursue common prosperity. At a time when the WTO is calling for resilience and cooperation, and as the world needs revitalization from its economic downturn during the pandemic, cross-border cooperation on infrastructure projects provides a golden opportunity for the international community. The newly emerged rules on cross-border subsidies could harm international cooperation that creates new business and employment opportunities. There could be regressive regulatory competition to discipline so-called cross-border subsidies that adversely impact international investment. This article provided a definition and a typology of rules on cross-border subsidies, and demonstrated potential remedies that WTO Members may resort to if the implementation of these rules adversely impacts them. For China, the BRI is a new vision of the world economic relationship based on mutual understanding and win-win cooperation. This article argues

that the holistic approach to address the concerns about countermeasures against Chinese foreign investment should be both defensive and constructive. This article also provided preliminary suggestions for updating models of international investment agreements to further protect investment promotion activities.