

INTERNATIONAL TRADE SUBSIDY RULES AND TAX AND FINANCIAL EXPORT INCENTIVES

FROM LIMITATIONS ON FISCAL SOVEREIGNTY
TO DEVELOPMENT-INDUCING MECHANISMS

PAULO PENTEADO DE FARIA E SILVA NETO

Master of Laws (LL.M.), Harvard Law School
Master of Philosophy (M. Phil.), University of Brasília
Bachelor of Laws (LL.B.), University of São Paulo Law School
Bachelor in Business Administration (B.B.A.), Fundação Getulio Vargas
Former Judicial Clerk - Supreme Court of Brazil (STF)
Tax and International Business Transactions Attorney in Brazil and New York

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FOREWORD

Luis Eduardo Schoueri¹

The concerns regarding development and the inequality of conditions between developed and developing countries have been a part of the international agenda when it comes to trade liberalization since the Tokyo Round under the former General Agreement on Trade and Tariffs (GATT). On that occasion, developing countries, inspired by the works performed in the ambit of the United Nations Conference on Trade and Development (UNCTAD) and of the Economic Commission for Latin America and the Caribbean (ECLAC), claimed that the international trade liberalization could not be carried out without a special treatment assigned them, *i.e.*, the promotion of free trade could not override development concerns. At that time, an outcome of such perspective was the adoption of the so-called enabling clause, which enabled developing countries to enter into regional agreements.

The development issue has remained a crucial subject within the debates surrounding the position of the underdeveloped countries *vis-à-vis* the World Trade Organization (WTO) legal framework. This is the concern of Paulo Penteado de Faria e Silva Neto, as he, based in a notion of redistributive justice, equity and fairness, urges for a regulation of the international trade which reveals itself less detrimental to developing countries. A reform in the WTO legal structure, which is allegedly based in the Washington Consensus and its neoliberal rationale, in the sense of increasing the freedom of developing countries when dealing with their development policy

¹ Tenured Professor specializing in tax legislation in the Department of Economic and Financial Law of the Law School of the University of São Paulo (USP).

would then be needed due to a primary sense of justice and fairness: every country would have the right to seek its development without barring the others' progress. To this effect, one may understand the presumption adopted for the author's research, according to which the promotion of international trade is only advantageous to developing countries under certain conditions, which usually deviate from the archetype drawn by the WTO and by those who advocate a liberal concept of "free trade".

The author identifies a tension between the current WTO regulations and the development which the developing countries seek based on their legitimate "right to development" (which does not comprise a narrow view of development as a mere quantitative and material progress, but is rather concerned with equality and distributional issues) in a sense that most of the effective trade-related incentive policies, as tax incentives programs, would almost invariably be deemed as a prohibited export subsidy under the current international trade law provisions, namely the Agreement on Subsidies and Countervailing Measures (ASCM). As argued by the author, the general and broad definition of subsidy provided by the ASCM would not be satisfactory to the developing countries' interests, as it does not comprise the necessary exceptions for such countries' needs - fact that would forbid the developing countries from making use of the several tax and financial incentive instruments, so necessary in the context of economic development, which are at their disposal. Paulo Penteado, nevertheless, does not naively suggest the legalization of subsidies, but rather indicates the benefits that could derive from a "more focused and targeted system of permissible incentives" and proposes an exception to the concept of subsidy which would allow developing countries more "policy space" in using export incentives.

The author, questioning the current WTO regime, which he points as having adopted solely the prevailing interests of developed countries without taking into account the needs of developing nations, considers the subsidies as valid instruments to achieve development, which lie within the "policy space" of the developing countries. To this effect, the author considers, for instance, an expansion of the concept of

"domestic incentives", which are outside the WTO jurisdiction, when it comes to development-related policies.

Paulo Penteado, when looking for a normative base for a lawful concession of export incentives by developing countries, addresses the so-called tax sovereignty, by which a country is supposed to design and control its tax system, and its limits in face of the WTO rules. However, the author does not criticize the current trade regulations by means of the usual claim concerning tax sovereignty losses, but rather makes an interesting argument whereby a "development sovereignty" comprising a complex of rights would ensure an enlarged policy space for the use of export incentives, through tax and financial tools, by developing countries, which would be justified as long as necessary to shorten the inequality between developed and developing countries.

The author not only addresses the relevance of the concession of export subsidies as a policy for national development, but also analyzes the conditions for its successful implementation, as the transparency and monitoring of the use of the resources, the application of the resources in productive activities, the prioritization of strategic areas and the discussion regarding the distribution of the gains and losses generated. It is not clear, however, how to distinguish between allowed and forbidden subsidies. The WTO's experience with red, green and yellow subsidies should be considered.

Paulo Penteado puts to the test the liberal view towards the trade liberalization whereby the subsidies would be *per se* harmful, as they would allegedly distort the allocation of resources and give rise to a negative effect in the decisions of the market and its agents - the author points out that the redistributive effect of the adoption of export tax incentives by developing countries may improve the overall global welfare. Thus, in order to review this position regarding the State intervention in the process of economic development and to point the failures of the neoliberal agenda, the author makes good use from elements of the thoughts of members of the "New Development Economics", namely the ones of Joseph Stiglitz. As addressed by the author, some "heresies" condemned

by the market liberalism ideology which inspired the current international trade rules may reveal themselves, in an astonishing clash, as "indispensable means" for reaching development.

Accordingly, the liberal view pledges a tax neutrality which does not immediately imply efficiency, since neutralizing taxation would only make sense if all other factors were also neutralized. In other words, considering the enormous differences between developed and developing countries, tax (and subsidies) could be an instrument to allow competition which would otherwise be unfair. If one considers, for instance, that workforce in developed countries is usually better prepared, then one would also expect greater productivity in such environment, *vis-à-vis* developing countries. Of course one could claim that the latter should make all efforts for improving their educational systems (which would require a higher taxation, rather than tax incentives); a realistic approach however, shows that local manufacturers will have higher costs to reach a productivity comparable to their foreign competitors. Once again, tax (and subsidies) may be a tool to be considered.

Finally, the author analyzes the WTO concept of subsidy and its categories in light of the US-Foreign Sales Corporations ("US-FSC") decision, a concrete case settled under the dispute settlement mechanism of the WTO in which the European Union challenged the United States' special tax regime for such kind of corporations as a forbidden export subsidy. Paulo Penteado finds in the systematic refusal of the United States in complying with the WTO ruling in the case another reason for the adoption of a development-related exception to the general concept of subsidy, since, curiously, the country which is the very advocate of the free trade ideal seems not ready to adopt the measures proposed by the dispute settlement body of the WTO when the case deals with its own national welfare. The author also points the Brazil-Aircraft case as an example of how the fairness of the international trade rules, namely the subsidy concept's "benefit" element, could be questioned when it comes to development issues, since, in this situation, the incentive would not be aimed at conferring an advantage, but rather to the removal of existing disadvantages.

From his whole research, one may fully understand the author's assertion whereby development concerns should be taken seriously by the international trade regime in such a way that the WTO should change its role in the tax ambit from an "empty limitation on fiscal sovereignty of countries in the name of 'free trade'" to an arrangement where developing countries should be able to achieve their development goals by means of benefits granted by their tax systems. As suggested by the author, to link the legitimacy of a tax subsidy to the development degree of a country would be a step forward towards a fair international trade. Taxation would reveal itself, once again, as a tool for development. It is difficult not to agree with the author's arguments, but one should note that this should not imply recognizing legitimacy of all sorts of subsidies. The latter should be avoided and justification based on developing arguments should not imply a free-pass against WTO rules. Proportionality seems to be the correct approach to apply the author's proposition towards the so-called "built-in exception", *i.e.*, one should consider, on a case-by-case approach, the benefits of the subsidy *vis-à-vis* the risk of protectionism. Existing WTO panels do not seem to be prepared to such consideration. This seems to be the most important contribution of Paulo Penteado's study.