ANNEX B

EXECUTIVE SUMMARIES OF THE ORAL STATEMENTS OF THE PARTIES – FIRST MEETING

ANNEX B-1

ORAL STATEMENT OF

B. EXPORT AND ACTIONABLE SUBSIDY – INSISTENCE ON CURRENT SUBSIDIES AND EFFECTS

6. There is no rule in the WTO that provides that a violation is forgiven once it is in the past. Obligations are drafted in the present tense to express the intention that they should apply all the time – in the past, in the present and in the future!

7. Of course, it may not always be possible to remedy past violations of WTO obligations. However, the Panel is not, in these proceedings, required by its terms of reference to specify what action Korea may have to take to bring itself into conformity with its WTO obligations.

C.

13. Korea's argument that a double violation would create a double remedy fails. Assume that Korea implements an adverse Panel finding that KEXIM pre-shipment loans are prohibited subsidies by making them also available for sales to domestic buyers. In such case, the subsidy would no longer be *de jure* export contingent. However, it remains a subsidy benefiting the production of ships and continues to contribute to serious prejudice. Whether a Member has brought all its subsidies in compliance with Article 3 and or 5 *SCM Agreement* may raise new and difficult questions. However, these are to be addressed in the implementation phase and are not relevant to the prior issue of establishing violations of WTO law.

III. THE EXPORT SUBSIDY COMPLAINT

A. THE THREE LEVELS OF THE EC COMPLAINT

1. The individual export subsidy transactions

14. The EC identified in its first written submission over 200 individual cases in which KEXIM

would not, according to Korea, violate the *SCM Agreement.* So WTO Members would be required to bring action against each individual subsidy grant once it has been made. And then, they would only have a pyrrhic victory. The scheme itself would not have to be changed, according to Korea, because it would still be non-mandatory.

C. SAFE HAVEN ARGUMENTS

31. Pre-shipment loans and APRGs do not fall within the scope of the first paragraph of item (k) (in the case of pre-shipment loans) or items (j) (in the case of the APRGs) of Annex I to the *SCM Agreement.*

1. Pre-shipment loans

32. Korea attempts to pass off credits to exporters as export credits within the meaning of item (k). There is a clear and important distinction between these two concepts.

33. An export credit is provided to *buyers*, not exporters, *for a period that extends past the time of delivery*. The OECD, for example, defines the notion as follows:

> Broadly defined, an export credit is an insurance, guarantee or financing arrangement which enables a foreign buyer of exported goods and/or services to defer payment over a period of time. … Export credits may take the form of "supplier credits" extended by the exporter or of "buyer credits" where the exporter's bank or other financial institution lends to the buyer (or his bank).

34. Indeed, the fact that export credits may only take the form of 'supplier credits' or of 'buyer credits' as defined above, **is** "*the shared understanding*" of all OECD shipbuilding nations - including Korea. The notion was considered so obvious that at the latest discussions on a revised text of the "Sector Understanding on Export Credit for Ships" the parties agreed to drop a specific reference into the text.

35. This understanding of the meaning of export credits has also been implicit in WTO jurisprudence discussing the applicability of item (k) of the Illustrative List.

36. Korea's pre-shipment loans, by contrast, are production loans granted to manufacturers who engage in exporting certain capital goods from Korea independent of any credit granted to the buyer (who may be entirely unaware of this loan to the exporter). Furthermore, the period of the loan is closely tied to the date of delivery (hence "*pre-shipment* loans"). These are not the characteristics of export credits, which are loans provided, directly or indirectly, to buyers, extending past the time of delivery. Item (k) is simply not applicable to Korea's pre-shipment loans.

2. APRGs

37. Similarly, APRGs are neither export credit guarantees nor, as Korea argues in the alternative, guarantee programmes against increases in costs. APRGs are, instead, guarantees of credits to Korea's exporting manufacturers.

38. Export credit guarantees are those provided to a *bank* or to the *exporter* to guarantee that the foreign buyer will repay the export credit that has been accorded to him. APRGs, by contrast, are made available to foreign *buyers* to ensure the repayment of sums paid in advance of the delivery of a capital good, in the event of default by the exporting manufacturer.

39. Korea tries to rely, in the alternative, on a further element of item (j) and to present APRGs as a guarantee programme against increases in the cost of exported products.

40. Item (j) is expressed to cover guarantee programmes ***against*** increases in the cost of exported products. It is an increase in the cost of the exported *product* that is to be covered, not the overall *expenses* of the exporter or credit risks taken by the purchaser.

41. Korea's broad interpretation would allow any subsidy to the exporter or to exported products that is formulated as a "guarantee programme" to be covered by item (j) since any such subsidy will tend to reduce the cost of manufacturing the exported goods for the exporter or of buying the exported goods for the purchaser.

IV. THE ACTIONABLE SUBSIDY COMPLAINT

A. SUBSIDIE

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B. SERIOUS PREJUDICE

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another specialised ship type on major trading relations (i.e. substitute a container ship for an LNG), there is no such clear division *within* the categories of specialised ship types, e.g. container ships.

54. Although further distinctions can be made by ship size, there is no strict rule for such distinctions, and sub-divisions depend on who is making them and for what purposes. Moreover, at least on smaller routes, there is overlap and different sizes of ships of one type are generally substitutable.

55. From the point of view of a **shipbuilder**, that is from the supply-side perspective, there is even greater potential for substitution between products. In the eyes of a shipbuilder, a ship is an assembly of steel panels, into which is fitted machinery, pipes, cables, accommodation and so on, and the ultimate function of the ship is largely irrelevant. In the eyes of a shipbuilder, a tanker, a dry bulk carrier and a container ship are broadly similar products, even though the arrangement and proportions of the parts that are assembled differ in each product. Whilst shipbuilders seek to improve economic efficiency by building similar products, very few shipyards specialise in a single product type.

3. No obligation to quantify

56. There is no obligation to quantify the effects of subsidies unless a complainant wishes to use Article 6.1(a) of the *SCM Agreement* in conjunction with Annex IV, which is no longer in force. The existence of purely qualitative presumptions in Article 6(1)(b)-(d) of the *SCM Agreement* corroborates that an adverse effects claim can be made without a quantitative calculation.

4. Actionable subsidy to be demonstrated subsidy by subsidy

57. There is no obligation to make a price depression or suppression case on a vessel by vessel basis. Article 6.3(c) refers broadly to the effect of a subsidy on prices on a market. A price in the market is generally the average of numerous sales of numerous products. If Korea had its way, the reference to price depression or suppression would be redundant since all cases under Article 6.3(c) would require proving lost sales with respect to one particular vessel.

5. Additional Serious Prejudice requirement?

58. The EC considers that under Art. 6.3(c) of the *SCM Agreement*, a complainant must show that:

(1) there is price depression or suppression,

(2) such price depression or suppression is significant, and

(3) subsidies are *a* cause of significant price depression or suppression;

then

(4) *ipso facto*, the effect of the subsidies is serious prejudice to the interests of the EC

59. Subsidies need not be shown to be the exclusive cause of price depression or suppression. A cause is sufficient. In fact previous GATT Panel reports referred to the subsidies as "contributing" or "amplifying" cause.

ANNEX B-2

ORAL STATEMENT OF KOREA

(18 March 2004)

I. INTRODUCTION AND OVERVIEW

1. Korea would like to thank the Panel, the Facilitator and the Secretariat for all of their hard work on a number of difficult matters.

2. Before going further into the legal and factual questions before the Panel, Korea would like to recall some of the broader aspects of the history of this dispute including the financial crisis that swept into Korea from Southeast Asia and how the EC has dealt with its shipbuilding industry for decades.

3. The European shipbuilding industry has been the beneficiary of decades of heavy subsidization, particularly direct operating subsidies meant to convey a focused and specific competitive advantage. There have also been healthy doses of export subsidization which even the Commission has had to constrain (but certainly not stop). Regional subsidies, research and development subsidies (including a new programme to provide R&D subsidies of 25 per cent), restructuring subsidies (totally inconsistent with the EC's arguments before this panel) tied aid export subsidies, and so forth. The amount of subsidization provided to the EC shipbuilding industries is enormous. Indeed, it is so enormous that it lends new meaning to the term "floating currencies".

4. Large amounts of these subsidies have provided short-term bandages and kept in business small and uneconomical yards that have not had sufficient incentive to grow and learn and expand on their own.

was reached between the Government of Korea and the IMF and interim funding was provided. In turn, the Korean government used these funds to provide liquidity to the banks. There were conditions attached to this provision of funds, but they were market reinforcing conditions. Banks needed to reduce their outstanding bad debts. They needed to meet BIS standards. They needed to ensure that all restructurings and workouts were done pursuant to market principles including maximization of returns from their debt.

7. In the IMF's view, Korea implemented this market-based approach with great success. As Korea has pointed out in its First Submission, in responses to the EC Commission's several requests, the IMF specifically made the point that they were very satisfied that Korea was undertaking this painful process based on market principles. Korea is not arguing that this panel is somehow estopped from pursuing its inquiries because of the IMF's position. Rather, the point is simply that the IMF's views in this regard are important factual evidence of Korea's market-based approach to restructuring to put in the balance when the Panel weighs the facts of the case.

8. Regarding the EC's approach to this dispute, instead of using its First Submission to set the framework of the dispute and to advance all of the facts and proof needed to support its *prima facie* case, the EC took the route of simply dumping thousands of pages of information in the Panel's lap (information provided by Korea, it must be noted) and asking you to take over proving their case for them. According to the EC, they consider that they do not need to do anything more than make mere assertions.

9. Obviously, the EC's approach is not consistent with the jurisprudence of WTO dispute settlement and neither is it consistent with the most basic tenets of due process required under general principles of international law. With respect to the Panel's duties, the Appellate Body in *Japan – Agricultural Products II* made it very clear in confirming long-standing jurisprudence. The panel is to use its information gathering authority to help it understand the parties' arguments, not to make the complainant's case for it.

10. Neither is the burden on Korea in this respect. Korea is designated by the treaty as being the "respondent" in this case. This means, sensibly enough, that Korea is obliged to answer the EC's arguments and refute its positions, to *respond* once the EC has established a *prima facie* case based on supported arguments

These sets of claims raise serious questions about how to evaluate and remedy alleged violations. The overlapping claims of export subsidization and trade effects with respect to the same alleged subsidies risks the possibility of finding adverse effects caused by a combination of export and non-export subsidies when the non-export subsidies alone would not have resulted in an affirmative finding. That would be inequitable in a situation where the export subsidies would be remedied separately under Part II and should not therefore be included in determining whether a second remedy is appropriate. That would be double-counting and would be as inappropriate in this setting as parallelism problems have been found to be in Safeguards cases. Therefore, while it is true that multiple claims sometimes arise under multiple WTO provisions, no other WTO provisions are like Part III of the SCM Agreement. Unique circumstances require unique solutions.

II. ALLEGATIONS OF PROHIBITED SUBSIDIES

13. As an initial matter, the EC must establish that KEXIM bank is a so-called "public body". There is no firm definition in the SCM Agreement of what the term "public body" means. It is a case-by-case assessment that must be established by a complainant to the satisfaction of the Panel.

14. The EC points to government ownership of KEXIM. It is true that KEXIM is majority owned by the government. But it is well established that ownership alone is insufficient. The EC also points to a public policy purpose for KEXIM. Yes, the actions of KEXIM are focused on the export sector, but privately owned institutions can have sectoral charters, too. Many countries are familiar with this in their own banking systems. That does not make such institutions public bodies. Something more is needed.

15. It seems clear that something more is the issue of whether or not the entity is fulfilling a function that by its nature is "governmental". These include regulatory and taxation functions most predominantly. Conversely, entities that function on a commercial basis in their normal activities are not considered "governmental", as indicated in Article I of the GATS.

16. The EC has asserted that the KEXIM Act and the APRG and pre-shipment loan programmes are inconsistent with the requirements of Part II of the SCM Agreement, "as such". In order to get there, the EC looks for support in the Appellate Body decision in *US – Sunset Review*. However, the issue there was whether a non-legally binding measure could be challenged, not whether a discretionary measure could be challenged on an "as such" basis. In other words, the issue was a preliminary jurisdictional question as to whether there was a justiciable matter; it was not a question of whether the measure was mandatory or discretionary. Certainly there was no hint in the *US – Sunset Review* case that the Appellate Body intended to overturn substantial GATT and WTO jurisprudence regarding the distinction between discretionary and mandatory provisions.

17. Korea would also like to note that the APRG and pre-shipment programmes are types of lending activities; there is no underlying written rule to challenge. They are mere practices. This is the sort of question that was before the Appellate Body in *US – Sunset Review*. To the question as to whether the EC is legally permitted to pursue a claim against these practices, Korea would answer yes, provided of course that the EC presents proven facts and arguments to establish a *prima facie* case. However, to argue that two "programmes" that are really nothing but types of lending practice can be challenged "as such" as establishing the existence of prohibited export subsidies, simply makes no sense at all.

18. The KEXIM Act provides authorization for a wide ranging set of financial activities related to the export sector. It also requires KEXIM to act on a commercial basis to maximize returns and, in fact, the evidence is that KEXIM has consistently operated at a profit. KEXIM is required to set its base rates according to market conditions. Credit risk spreads must be taken into account; collateral is

required accordingly. KEXIM borrows funds from many sources, generally from international markets. And, contrary to what the EC asserts, KEXIM does in fact compete with other institutions. This requirement is clear from a review of the whole KEXIM Act, not just the snippet cited by the EC. Most importantly, it is quite clear from the facts in the record.

19. The so-called "market adjustment rate" in the APRG and pre-shipment loan programmes does not mandate below-market rates as is asserted by the EC. In fact, the market adjustment rate is not relevant to the setting of the basic rate which is *built up* from the cost of funds to determine the lending or guarantee rate. Rather, the market adjustment rate is a limiting factor on how much of a *downward* adjustment can be made under the discretion of the lending office. As is normally the case in any banking business, the bank officials in charge of disbursing loans and guarantees have a certain amount of discretion that they can exercise in making final offers in order to bring in business. This is typically based on competitive pressures, the customers' payment history, etc. The "market adjustment rate" is intended to limit the ability of the bank officials responsible for that portfolio to make too large a downward adjustment in setting rates.

20. On the issue of the existence of benefits to the recipients of the APRG and pre-shipment loans, as complainant, the EC carries the burden of demonstrating that these programmes were applied in a manner more favourable to the recipients than what was available on the market. The EC has not met its burden. Indeed, here again, we see only the most cursory analysis of the issue. The EC has offered the APRG rates charged by a couple of non-Korean banks several years ago to support its allegations. However, this is far from establishing a legitimate market benchmark. These APRGs represented a statistically irrelevant sample. Further, APRGs are a highly technical and specialized area and the guarantee rates can be influenced by an assessment of the customer's past performance and likely future performance. This can be very difficult to assess for a bank dabbling in the market from afar. In addition, the EC ignores the substantially different characteristics of these APRGs. The KEXIM APRGs were always secured by substantial collateral, including the so-called Yangdo-Dambo which establishes important security interests on the hull and materials. In contrast, certain foreign supplied APRGs only had a security interest in certain bank accounts for a minority of coverage of the guarantee.

21. It is also worth noting that the alleged below-market APRGs were advanced during the period of the Asian financial crisis. However, as noted at the outset, this was a difficult period during which funding and guarantees of any sort were difficult to obtain. The main concern of Korean banks was with meeting and maintaining BIS standards and issuing APRGs was adverse to maintaining BIS rates.

22. The selection by the EC of corporate bonds as a benchmark comparison to a pre-shipment loan is virtually a random grasp for an argument by the EC. The corporate bonds the EC refers to were of different terms than the programmes the EC compares them to. These bonds were generally for 3 years. In stark contrast, the pre-shipment loan programmes were for shorter periods of time, generally less than 6 months. The EC does not make any attempt at all to adjust for these term differences which is the most basic question in lending or to determine how the financial crisis impact these term differences. A review of the actual applicable corporate bond rates, as demonstrated in Korea's first submission, shows that in every instance, the actual bond rate was considerably lower than the EC's hypothetical rate.

23. Furthermore, the EC also ignores the fact that pre-shipment loans always carried other assurances. Generally, security interests were offered in the form of Yangdo-Dambo as well as other corporate guarantees and security interests of various types. The EC compares such loans with corporate bonds for which collateral was normally not provided. The question of security interests and guarantees is another major determinant of interest rate charges. Of the Korean shipbuilders,

Daedong offered collateral for its corporate bonds, but the actual Daedong bond rates were considerably lower than the hypothetical suggestions of the EC.

24.

corporate restructuring schemes and that was the extent of the Korean government's involvement. The EC certainly cannot maintain that

obligation to (re)consider the conditions of application of the SCM Agreement."[1] It is remarkable that they ignore this, but it is not surprising. The fact is the EC cannot identify any current beneficiaries of the alleged subsidies. The debts were the responsibility of the prior equity holders. But these equity holders were virtually wiped out.

37. In the case of DSME and Samho Heavy Industry, the new owners were the creditors who found the value of their loans seriously impaired and were left with salvaging the best returns possible out of the insolvent companies. The new owners simply were looking for the best return on their new equity. In the case of STX Shipbuilding Co., Ltd., a non-creditor buyer (STX) bought out substantially all the ownership of the old Daedong and the proceeds of this buyout were paid out to the creditors of Daedong. Presumably, this simple set of facts is why the EC tries to hide the lack of current beneficiaries behind the blurring of the identities of the three companies when the EC keeps referring to the companies with compound names linked with slashes. However, that attempt to blur the identities only shows that the EC is focusing on the assets, not the legal or natural persons. But, as is also clear from the EC's successful cases, the Appellate Body found that "any analysis of whether a benefit exists should be on 'legal or natural persons' instead of on productive operations."[2]

these potential like product categories. No market studies; no descriptions of the relative physical characteristics; no facts regarding end uses or consumer perceptions. Simply nothing at all.

47. The EC does not address the question of what EC interests have been seriously prejudiced and how that might have occurred. There is no evidence supplied about the state of the EC industry or "industries", since we do not know if the EC claims one or several industries. It seems clear from the scheme of Articles 5 and 6 that a showing of adverse effects must satisfy the requirement of a causal

52. There is also the question of why the EC narrowed its claims and excluded price undercutting and attempted to rely on some undefined market mechanism that could have caused the price suppression and depression that the EC alleges. The reasons are twofold. First, the evidence is weak with respect to price comparisons and causation based on the Korean ships. It is non-existent with respect to the effect of the subsidy. Second, a review of the language of Article 6.5 shows that among other elements, it refers to a comparison of the prices of the subsidized and "non-subsidized like products" (which, of course, is also reflected in Article 6.4). The EC cannot demonstrate that their ships are non-subsidized because, in fact, they are the most subsidized ships in the world.

53. What is absolutely critical here is that the panel not allow the EC to make a case on price undercutting but avoid the requirements of Article 6.5. As a matter of law, the EC cannot be permitted to do this. Thus, at every single step in this process the Panel must press the EC on just what the market mechanism is -- to the *exclusion* of allegations of price undercutting -- that is responsible for the serious prejudice the EC is alleging.

IV. CONCLUSION

54. In conclusion then the Panel is faced with a dispute where the complainant has been unable to prove facts or establish the requisite arguments to make a *prima facie* case with respect to any claims. The EC claims have continued to shrink to avoid matters that they cannot prove, but what is left is based on conjecture, innuendo and broad generalizations that read more like a newspaper article than submissions sufficient to carry the substantial burden of proof required of the complainant in this dispute.