저작자표시-비영리-변경금지 2.0 대한민국

이용자는 아래의 조건을 따르는 경우에 한하여 자유롭게

- 이 저작물을 복제, 배포, 전송, 전시, 공연 및 방송할 수 있습니다.

다음과 같은 조건을 따라야 합니다:

저작자표시. 귀하는 원저작자를 표시하여야 합니다.

비영리. 귀하는 이 저작물을 영리 목적으로 이용할 수 없습니다.

변경금지. 귀하는 이 저작물을 개작, 변형 또는 가공할 수 없습니다.

- 귀하는, 이 저작물의 재이용이나 배포의 경우, 이 저작물에 적용된 이용허락조건을 명확하게 나타내어야 합니다.
- 저작권자로부터 별도의 허가를 받으면 이러한 조건들은 적용되지 않습니다.

저작권법에 따른 이용자의 권리에 의하여 영향을 받지 않습니다.

이는 이용허락규약(Legal Code)을 이해하기 쉽게 요약한 것입니다.

Disclaimer
Legal Issues on Shipbuilding Financing in The WTO System

Analysis of the Korea-Commercial Vessels dispute (2002) and Korea-EU FTA and their implications for the DSME Normalization Plan (2015)

WTO 체제에서 조선업계 지원의 국제법 문제 고찰

2017년 2월

서울대학교 国際大 學院
國際學科 國際通商専攻
鄭 善 英
Legal Issues on Shipbuilding Financing in The WTO System

Analysis of the Korea-Commercial Vessels dispute (2002) and Korea-EU FTA and their implications for the DSME Normalization Plan (2015)

by

Seon Yeong Jeong

A thesis submitted in conformity with the requirements for the degree of Master of International Studies (M.I.S.)

Graduate School of International Studies
Seoul National University
Seoul, Republic of Korea

February 2017
Legal Issues on Shipbuilding Financing in The WTO System

Analysis of the Korea-Commercial Vessels dispute (2002) and Korea-EU FTA and their implications of the DSME Normalization Plan (2015)

Abstract

The purpose of this thesis is to determine the applicability of the Panel Ruling in 2005 for addressing issues raised by the EU and Japan on the DSME Normalization Plan in 2015. Moreover, it will show that Section 11 of Korea-EU FTA includes crucial provisions which may be interpreted to mean that the measures of DSME could be found to include prohibited subsidies.

The DSME Normalization Plan announced by KDB on October 29th, 2015 was publicly criticized as prohibited subsidies by EU and Japan in Working Party 6 of OECD. Even though the liquidity injection had to be repeated in 2016, the government of Korea assured that its measures are consistent with international regulations. The confidence of GOK derived from their victories in WTO dispute in 2002 through 2005, Korea-Commercial Vessels.

However, as the Korea-EU FTA went into force on 1 July 2011, the measures taken by KDB to rescue DSME from its near-insolvency can be seen to be in breach of the FTA. The EU attempted to expand the meaning of prohibited subsidies by explicitly indicating that certain measures which are “responsible for covering debts or liabilities of certain enterprises” and “loans and guarantees, cash grants, capital injections below market prices or tax exemptions” are prohibited. Those provisions reflect the EU negotiators’
intent to secure its shipbuilding industry by preventing the GOK from providing liquidation supports to Korean shipyards in the future.

As the international forum for dispute settlement is no longer limited to the WTO Dispute Settlement Understandings, no one can assume that GOK will win again in the international litigations on measures for DSME.

Keywords: Prohibited Subsidies, Shipbuilding, Shipyards, The Subsidies and Countervailing Duties, Korea-Commercial Vessels, Korea-EU FTA, DSME Normalization Plan

Student number : 2014-24283
### ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>APRG</td>
<td>Advance Payment Refund Guarantee</td>
</tr>
<tr>
<td>DP</td>
<td>Direct Payment</td>
</tr>
<tr>
<td>DSU</td>
<td>Dispute Settlement Understanding</td>
</tr>
<tr>
<td>EC</td>
<td>European Community</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>GOK</td>
<td>Government of Korea</td>
</tr>
<tr>
<td>KDB</td>
<td>Korea Development Bank</td>
</tr>
<tr>
<td>KEXIM</td>
<td>Korea Export and Import Bank</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
</tr>
<tr>
<td>PSL</td>
<td>Pre-Shipmenent Loan</td>
</tr>
<tr>
<td>SCM</td>
<td>Subsidies and Countervailing Measures</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
</tr>
</tbody>
</table>
# Table of Contents

**CHAPTER I. INTRODUCTION**

**CHAPTER II. HISTORY OF INTERNATIONAL SHIPBUILDING INDUSTRY AND ITS SUBSIDY ISSUES**
- 2.1. Shipbuilding Industry since the 1950’s  
- 2.2 International Negotiation to Limit Subsidies to Shipyards
  - 2.2.1. The OECD Arrangement
  - 2.2.2 The OECD Sector Understanding of ships and WP6
  - 2.2.3. The Agreement of Subsidies and Countervailing Duties of WTO

**CHAPTER III. SUBSIDY ISSUES OF SHIPBUILDING INDUSTRY OF KOREA**
- 3.2. The DSME Normalization Plan
  - 3.2.1. Financial Status of DSME
  - 3.2.2. DSME in the Shipbuilding Industry
  - 3.2.3. The DSME Normalization Plan (2015)

**CHAPTER IV. KOREA-COMMERCIAL VESSELS DISPUTE IN WTO**
- 4.1. Issues Raised in Korea-Commercial Vessels (2002)
- 4.2. Arguments and Findings of Korea-Commercial Vessels
  - 4.2.1. As Such Claim: WTO-inconsistency of KEXIM Legal Regime
  - 4.2.2. As Applied Claim: WTO-inconsistency of Individual measures

**CHAPTER 5. SUBSIDY ISSUES OF KOREA-EU FTA**

**CHAPTER 6. CONCLUSION**
Chapter I. Introduction

In November, 2015, the EU and Japan officially issued complaints regarding a plan by Korea Development Bank, the Korean state-run bank, to provide liquidity supports to Daewoo Shipbuilding and Marine Engineering (DSME). At a meeting of the Working Party on Shipbuilding (WP6) of the Organization for Economic Cooperation and Development (OECD) in Paris, the DSME Normalization Plan of KDB was fiercely criticized because those measures were seen to be inconsistent with the SCM Agreement. The EU and Japan strongly implied that they would bring the case to international litigation. The Korea Development Bank (KDB) and Korea Eximbank (KEXIM) announced that it would submit reports to prove that the plan for DSME was not in breach of international trade regulations.

In 2002, similar support measures provided to Korean shipyards during the 1998 Asian Financial Crisis were disputed in WTO. The Panel Report, which was circulated in 2005, concluded those measures were consistent with the SCM Agreement. On the current schemes for the DSME, GOK made it public that, if a similar dispute arose, it expected to win again.

However, what needs to be understood here is the logical reasoning of the Panel Ruling in 2005 to predict the actual outcomes of potential disputes in the future. Moreover, there is now a new forum for international trade regulation between Korea and the EU. It is Korea-EU FTA which went into force on 1 July 2011. It writes that both the measures “responsible for covering debts or liabilities of certain enterprises” and loans and guarantees...“below market prices or tax exemptions” are prohibited. Therefore, it opened up a new avenue for the EU to condemn the DSME Normalization Plan for including prohibited subsidies.

The purpose of this thesis is to clarify the applicability of the Panel Ruling in 2005 to address issues raised by the EU and Japan on the DSME Normalization Plan in 2015. Moreover, it will show that Section 11 of Korea-EU FTA includes
crucial provisions under which the measures of DSME could be found to comprise prohibited subsidies.

Chapter II. History of International Shipbuilding Industry and Its Subsidy Issues

2.1. Shipbuilding industry since the 1950’s

“The Capacity of the world’s shipbuilding industry has exceeded the demand for new ships for more than three decades.” The truth was that the governments of industrialized nations had protected the ship-builders since the early periods of industrialization. In the 1960’s, subsidies to shipyards became common and global.

This tendency can be traced back to at least the end of World War II, when the ship-building market boomed with the rapidly increasing demands for new ships, at a time when British shipbuilders were leading the market. However, Japan was quickly catching up with Britain. The Shipbuilders of Association of Japan (SAJ) was already established to operate the national economic development plan for shipyards and improve ship-building technology in 1947. The British government launched a financial assistance program for shipbuilders since 1966 as British shipyards began to lose new ship orders to Japanese shipyards.

However, the program was unable to produce the desired results. In 1972, the Booz-Allen and Hamilton Report concluded that the reason why British shipbuilders are behind was not lack of government support. It was due to “poor management, poor labor relations, poor working practices, poor delivery, poor financial contract terms and lack of investment.”

As Japan caught up with the European shipyards, the world ship-building capacity continued to grow in the 1970’s. However, the two oil shocks of the 1970’s increased the cost of subsidization of EEC and other OECD members as interest rates skyrocketed. The EEC then tried to reduce its number of shipyards and persuade OECD members to take similar measures. The following graph shows that the EEC succeeded in reducing its shipbuilding capacity throughout the 1970’s and 80’s. The British government nationalized British Shipbuilders Ltd in 1977 after years of accumulative loss.

---

2 Ibid, p.192.
Figure 2 World Order Book at Year-End (Source: The Shipbuilders Association of Japan)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total EU</td>
<td>26.8</td>
<td>32.6</td>
<td>32.6</td>
<td>25.2</td>
<td>21.3</td>
</tr>
<tr>
<td>Total AWES³</td>
<td>37.5</td>
<td>37.6</td>
<td>37.6</td>
<td>29.3</td>
<td>25.9</td>
</tr>
<tr>
<td>Japan</td>
<td>37.8</td>
<td>40.3</td>
<td>40.3</td>
<td>38.3</td>
<td>35.9</td>
</tr>
<tr>
<td>Korea</td>
<td>1.6</td>
<td>3.7</td>
<td>3.7</td>
<td>16.0</td>
<td>21.5</td>
</tr>
<tr>
<td>China</td>
<td>0.2</td>
<td>0.2</td>
<td>2.2</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 1 Merchant Shipbuilding Output New-Building Market Share (%)

*source: J. King*

³ AWES is Association of West European Shipbuilders. AWES includes EU countries, Norway, and Poland.
Table 2 EU Operating Aid Ceilings, 1987-2000

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Aid Ceiling (%)</td>
<td>28</td>
<td>28</td>
<td>26</td>
<td>20</td>
<td>13</td>
<td>9</td>
<td>9</td>
<td>9</td>
</tr>
</tbody>
</table>


2.2 International Negotiation to limit subsidies to shipyards

2.2.1. The OECD Arrangement

During the 1970’s Japan took 50% of world ship orders at prices far below those of Europe. In response, the EEC pressured Japan to make concessions to change its new building output plan in 1980 from 6.5 million gt to 2.5 cgt and 6.4 cgt in 1985. Japan also reduced the number of berths in 1980’s from 138 to 88.

This was not the first attempt to limit capacity and regulate subsidies to shipyards. GATT first introduced “a non-exhaustive list of prohibited export subsidies on non-primary goods (1960 Declaration).” This was based on the draft of OEEC, which transformed into OECD in 1960. The draft included regulations on export credit guarantees and insurance and referred the cost to the government as a standard to decide whether those constitute “prohibited subsidy.”

In 1960, EEC also tried to resume negotiation on export credit regulation including in the OECD, but it was opposed by the US. Only because of the oil

---

4 Supra note2. p.193
5 Compensated Gross Tons
shocks of the 1970’s did the US finally return to the negotiation and the first agreement was reached in 1978. It was called “Arrangement on Guidelines of Officially Supported Export Credits.” (OECD Arrangement) It was not an OECD Act. OECD only provided the negotiation platform and administrative supports. Therefore, the OECD Arrangement is a non-binding and flexible agreement, which was considered to be the right form due to the flexible and dynamic characteristics of export credits.

The enforcement mechanism of the OECD arrangement is the threat of matching, which allows the members to match its export credit policy if one of the members deviate from the Arrangement and subsidize more than the agreed level. This is contradicted by the dispute settlement understandings of WTO which enforces observance.

2.2.2 The OECD Sector Understanding of ships and WP6

The OECD’s Sector Understanding for Ships (SSU) is an annex understanding of The OECD Arrangement of Officially Supported Export Credits. It has contributed to narrow down the differences in export credit policies to shipbuilding industry.

The Working Party on Shipbuilding (WP6) of SSU is the only platform for governments to negotiate on shipbuilding policy, including subsidy issues. In 1992, the OECD shipbuilding agreement was achieved but it could not enter into force as the US Congress did not ratify it. The OECD shipbuilding agreement was focused on addressing subsidies and injurious pricing practice. EU proposed new negotiation on this issue after 1992 as China, a non-member of OECD, became a participant of the special negotiation group of WP6.

Moreover, EU argued that there should be a common action to address the problem of over-capacity in shipbuilding sector, but it was fiercely opposed by
Asian members, Korea, China and Japan. The proposal for new shipbuilding agreement by EU was finally abandoned in 2010.

2.2.3. The Agreement of Subsidies and Countervailing Duties of WTO

In 1980, the terms of the 1960 Declaration were reflected in item (j) and (k) of the Tokyo Round subsidies Code. Item (j) dealt with export credit insurance and guarantees, and “prescribed that premium rates could not be manifestly inadequate to cover the cost to the government.” Item (k) was related to official financing support and its 2nd paragraph included the safe haven provision. It states that export credit shall not be “prohibited”, if the measure follows the interest rate provisions of international undertaking.

In the Uruguay Round (1986), parties still disputed whether the export credits are subsidies and CVD can be practiced. The Subsidy and Countervailing duties Agreement (the SCM agreement) succeeded item (j) and (k). Particularly noteworthy was the fact that the SCM Agreement also included the definition of “subsidy” and “clarifies that OECD Arrangement conforming export credit support can still be a ‘subsidy’ if it confers a benefit.”

In the years that followed, there were two WTO disputes on export credits that are pertinent to the topic at hand: Brazil-Aircraft (1997), Korea-Commercial Vessels (2002). With regard to the first dispute, in the late 1990’s Canada issued a complaint about the interest rate support program of Brazilian Aircraft manufacturer, Embraer. The ECA of Brazil compensated any difference between its interest rate and other competitors’ interest rates to foreign buyers. The Panel

---

7 Supra note 6. P.10.
8 Ibid, p.12.
first assured that the “international undertaking” in item (j) of the Illustrative list undoubtedly indicates the OECD Arrangement.

After the Brazil-Aircraft dispute, the OECD launched the Knaepen Package (1999) in order to make the Arrangement more consistent with the SCM Agreement. It focused on setting guidelines for interest rates and premium rates which reflect market benchmarks. Since the Panel found that export credits constitute a “prohibited subsidy” by conferring benefits to recipients when the interest rates or premium rates are below the market benchmark. The Knaepen Package introduced Minimum Premium Rates (MPR) as a market benchmark for export credit insurances and guarantees.

The second dispute Korea-Commercial Vessels (2002) ultimately established the definition of export credits under the auspices of WTO. It defined export credits as “financial contribution to a foreign buyer.” This dispute illustrated the difference in definition and understanding of export credits between WTO and OECD. It also addressed the criteria of safe haven provision application in the second paragraph of item (k). Korea argued that if export credits and guarantees are in accordance with the OECD benchmarks MPR, then it doesn’t constitute the “prohibited subsidy” due to the safe haven provision. However, the Panel found that the safe haven provision is only limited to “interest rate provisions” which refers to the CIRR of the OECD Arrangement. After the dispute, the EC concluded that the OECD Arrangement “is unlikely to provide ‘safe haven’ protection at the WTO if challenged.”

---

9 Supra note 7. P.9.
Chapter III. Subsidy Issues of Shipbuilding Industry of Korea


During the Asian Financial Crisis, KEXIM reached agreement with the creditors of Korean shipyards with regard to the restructuring plans of Daewoo Shipbuilding & Marine Engineering (DSME), Samho Heavy Industries (SHI) and Daedong Shipbuilding and Co (Daedong, current STX). The EC brought this deal to WTO alleging that it involved prohibited subsidies in the meaning of Subsidies and Countervailing Duties of WTO (SCM Agreement). Moreover, APRG (Advance Payment and Refund Guarantee) and PSL (Pre-Shipment Loan) of KEXIM provided to Korean shipyards was also alleged to be prohibited subsidies, since the terms and conditions of those schemes were more favorable than those of commercial banks.

The Panel of Korea-Commercial Vessels dispute concluded that the individual PSLs and APRGs issued to each shipyard were prohibited subsidies. However, the restructuring packages and tax recessions were found to be consistent with the SCM Agreement. Taking this WTO dispute, GOK could remove burdens on international regulatory issues of restricting packages performed during 1998 Asian Financial Crisis.10

---

10 Japan-DRAM dispute (2010) was another source of relief for GOK as the restructuring packages of Hynics were found consistent with SCM Agreement.
3.2. The DSME Normalization Plan

3.2.1. Financial Status of DSME

However, restructuring of Korean shipyards is present concern for GOK. KDB (Korea Development Bank) launched the Normalization Plan for DSME (Daewoo Shipbuilding & Marine Engineering) on October 29th, 2015 as its financial status went on the verge of default on its loans.

DSME was one of the beneficiaries of restructuring packages, tax recessions, APRGs and PSLs which were measures at issue in Korea-Commercial Vessels (2002). After the Asian Financial Crisis (1998) KDB bought majority of its shares and KEXIM became its major creditor.

As of June 2016, a working capital deficit is over 5.05 trillion won with long-term debts of 2.38 trillion won and equities of 421.6 billion won.

Source: Financial Supervisory Service

Figure 3 Shareholders of DSME as of September, 2015 (%)

Figure 3 Shareholders of DSME as of September, 2015 (%)

10
In other words, currently there is no private proprietor of DSME. KDB attempted to privatize the state-owned DSME since 2002. However, no acceptor came out to pay enough to compensate the accumulative financial supports of KDB and KEXIM since 1998.

### 3.2.2. DSME in the Shipbuilding Industry

Throughout 2000’s DSME ranked No.2 in global shipbuilding industry in compensated gross tonnage. It has been known for high value-added vessels such as off-shore plants, LNG Containers etc. By 2015, DSME had the world’s “largest back log on premium vessels such as LNG and LPG ships account for 42 percent of them.”

---

However, DSME had struggled from low operating profits due to decreases in orders in the midst of the financial crisis. Its operating profit hit 471 million dollars in 2014 but it abruptly turned to 43 million losses in 2015. The report of this sudden, massive loss of DSME led to the Normalization Plan of KDB. The main causes of this abrupt reversal in operating loss are discussed below.
First, the main problem was plunging oil prices. DSME had focused on offshore plant business from the early 2000’s. As oil price had sky-rocketed since the late 1990’s, offshore rig projects were booming in the Pacific and the Atlantic oceans. However, lowering oil prices significantly decreased economic feasibility of deep-sea drilling rigs which led to owners’ refusals on taking over completed offshore plants and subsequent delay on payment.

Second, DSME had made long-tail payment contracts under which majority of payment is concentrated at the finishing process of shipbuilding and taking over. Due to these long-tail payment deals, DSME became more dependent on state bank loans.

Third, its reckless business management had also been considered to be one of the main sources of its low performance. DSME had aggressively engaged in overseas expansion mainly by buying in offshore affiliates since 2008. It invested in more than 10 affiliates including, US-based DeWind and Future Leadership Center (FLC), Canada-based DSME Trenton, a wind-power generation join venture, Daewoo Mangalia Heavy Industries, and other subsidiaries in Romania, Shandong, etc.

Fourth, it seriously lost trust from creditors due to its allegations on embezzlement and accounting fraud in June, 2016. In July 2015, DSME announced that it committed accounting fraud to hide losses from offshore plants. The hidden loss amounted to 2.8 billion dollars. The Board of Audit and Inspection (BAI), the national audit agency found that DSME had overstated its operating profit in 2013 and 2014. Deloitte Anjin, the former auditor of DSME was criticized for collusion in this accounting fraud. A former Deloitte Anjin executive was arrested and
Investors filed a lawsuit against Deloitte in November, 2016. The damage of investors was estimated to be over 100 billion won.\(^\text{12}\)

### 3.2.3. The DSME Normalization Plan (2015)

*Table 3 Contents of Issues of Korea-Commercial Vessels and the current DSME Normalization Plan*

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt forgiveness</td>
<td>O</td>
<td>included</td>
<td>included</td>
</tr>
<tr>
<td>Debt and interest relief</td>
<td>O</td>
<td>included</td>
<td>included</td>
</tr>
<tr>
<td>Debt-to-Equity swaps</td>
<td>O</td>
<td>included</td>
<td>included</td>
</tr>
<tr>
<td>PSL, PSG</td>
<td>X</td>
<td>included</td>
<td>included</td>
</tr>
<tr>
<td>APRG</td>
<td>X</td>
<td>included</td>
<td>included</td>
</tr>
</tbody>
</table>

On October 29\(^\text{th}\) 2015, KDB officially announced the DSME Normalization Plan. It proposed liquidity support of 4 trillion won through loans, investment and debt-for-equity swaps. Under this plan, KDB, DEXIM and K-sure agreed to issue APRG up to 5 trillion won.

In late 2015, DSME posted an operating loss of 3.2 trillion won and is predicted to see potential loss of 3 trillion. However, KDB concluded that its going-concern value exceeds the liquidation value. This was based on Sam-Jeong report published after 3-month research on financial status and recovery value of DSME.

DSME has also engaged in a self-rescue plan since 2015. It has sold off its offshore affiliates in stages and sought to cut its workforce for by two-thirds. KDB expected the capital-to-liabilities ratio would fall below 500% by 2016 with deliveries of completed vessels upon which most of the payments were to be settled.

Particularly noteworthy fact is that DSME announced its new LNG containment technology in May 2016 with which it would save around KRW 12 billion in royalties it has paid to Gaztransport and Technigaz S.A. (GTT), a French engineering company. DSME has recently made a successful bid in 6 LNG carriers from Teekay Corporation in 2016.\textsuperscript{13} LNG container had been the key products of DSME since the 1990’s.

However, DSME hardly picked up from its ongoing operating losses in 2016. In October 2016, the largest stakeholders, KDB and KEXIM announced a new debt restructuring scheme under which outstanding loans of KDB’s 1.9 trillion won and KEXIM’s 1.1 trillion won would be converted to equity in order to reduce debt-to-capital ratio of DSME. If these rescue packages don’t go well according to its schedule, the fund loss of two state lenders is predicted to reach up to 13 trillion won.\textsuperscript{14}


Chapter IV. Korea-Commercial Vessels Dispute in WTO

4.1. Issues raised in Korea-Commercial Vessels (2002)

(i) *The Act Establishing KEXIM* to provide Korean exporters of capital goods with financing at preferential rates

(ii) *The pre-shipment loan (PSL) and advance payment refund guarantee (APRG) schemes* established by KEXIM

(iii) *The individual granting of pre-shipment loans and advance payment refund guarantees* by KEXIM to Korean shipyards, including Samho Heavy Industries (SHI), Daedong Shipbuilding Co. (Daedong), Daewoo Heavy Industry (DHI), Daewoo Shipbuilding and Marine Engineering (DSME), Hyundai Heavy Industry.

(iv) *Corporate restructuring measures* including debt forgiveness, debt and interest relief and debt-to-equity swaps, affecting Daewoo-SME, Samho-HI and Daedong

4.2. Arguments and Findings of Korea-Commercial Vessels

Since there was no argument between parties on whether the measures at issue were export-contingent, what was conclusive in the case was whether there exist subsidies. According to the SCM Agreement, subsidy exists “if there is a financial contribution by a government or public body that confers a benefit.”

---

4.2.1. As Such Claim: WTO-inconsistency of KEXIM Legal Regime

Agreement on Subsidies and Countervailing duties (SCM agreement) suggests three conditions by which a measure can be found to be a subsidy. First, there should be “a financial contribution”. Second, the subject should be “a government or any public body” in the meaning of Article 1(a). Third, the complaining party has to demonstrate that benefit was conferred in the meaning of Article 1(b).

a. Financial Contributions

First, the Panel acknowledged that it makes a “financial contributions” to shipbuilders of Korea. However, it does inevitably confer benefits to them through those financial contributions. EC strongly argued that the loans and loan guarantees to shipbuilders are “direct transfer of funds within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement.” Korea objected to this argument that the KEXIM measures are not considered to be a “government practice” and it does not constitute a “financial contribution.” KEXIM has only been involved in banking functions like any private banks in Korea.

The panel was up to the EC at this point. The argument of Korea was that the Panel has to show first whether the measures at issue make financial contributions, and then those contributions conferred benefits. However, the Panel found that “confering benefits” is a key to filter out commercial acts. Therefore, the parties don’t have to show whether there was a financial contribution. Even if they have to, a financial contribution is a broader concept, which includes any “functions of taxation and expenditure of revenue”. In this sense, the KEXIM functions are considered to constitute “financial contributions.”

---

16 Ibid, para.7.25.
b. Public body

Korea made an argument that an institution is a “public body” when it confers a benefit which markets cannot provide. However, the Panel saw that “benefit test” has to be distinguished from the “public body” issue. Whether there are “benefits conferred” would filter out commercial acts as mentioned above. If the argument of Korea is deemed correct, one institution can be both “public body” and “private body” depending on the nature of each individual action that it takes.

The Panel also saw that “public body” is an institution which is “controlled by the government.”17 It pointed out that the fact that 51% of KEXIM and KDB shares are owned by the government well explains its public characteristics. Another issue was the president appointment procedure of two banks. The president of Korea has the right to appoint and dismiss the bank presidents. The annual KEXIM Operation Programs also have to go through Ministerial approval.

c. Export Contingency

Since the measure at issue satisfies the first and second conditions, the last condition, “benefit conferred,” plays the determinant role in deciding whether they are subsidies. To constitute “a subsidy”, a measure has to be proved that it is a subsidy by satisfying “financing contribution” and “public body” provisions. To constitute a “prohibited subsidy,” a subsidy should be contingent upon “export performance.”

The EC argued that “the financial contributions” made by KEXIM are “for the purpose of facilitating exports of ship-building companies.”18 Korea didn’t contest the export contingency. Therefore, the issue of whether KEXIM Legal Regime

17 Ibid, para.7.50
18 Ibid, para. 7.107
mandates to confer benefits to ship-building companies played a key role in the findings of this Korea-Commercial dispute.

d. Mandatory/discretionary distinction

To find whether KEXIM as such is inconsistent with WTO or only its individual measures were so, the rule of “mandatory/discretionary distinction” is applied.

“According to the traditional mandatory/discretionary distinction, only measures mandating confer benefits which receivers cannot get in the market be condemned as such WTO-inconsistent.”

EC asserted that KEXIM Legal Regime mandates to confer benefits to Korean shipbuilders by providing loans and loan guarantees with more favorable terms than those of commercial banks. According to EC, KEXIM does not have to engage in reasonable market–oriented functions as government would fund KEXIM without limit.

Korea argued that that KEXIM was involved in “commercial financial services, except the long-term export credits with deferred payment terms that are regulated by the OECD Arrangement.” Moreover, the government funds on KEXIM is not different from the market behaviors. It is common that “the major shareholders receive less dividends and take more risks than other minor shareholders, and, as mentioned above, GOK is a major shareholder of KEXIM.

The Panel supported Korea here and decided that KEXIM Act did not “mandate” KEXIM to conduct WTO-inconsistent measures by conferring benefits. It found that “the source of KEXIM funds is irrelevant to the issue of whether or not the KEXIM legal regime mandates subsidization.” Furthermore, it concluded that

19 Ibid, para.7.58.
20 Korea’s Second Written Submission, para.99.
21 Supra note3. Para.7.85.
even though the KEXIM Act precisely writes that KEXIM should adjust interest rates with market terms, it does not conclusively lead to below-market-terms, or subsidization.

Therefore, the KEXIM Legal Regime does not mandate to confer benefits to recipients and as such engage in WTO-inconsistent measures. In this case, the Panel has to look through individual measures of KEXIM and find WTO-inconsistency separately.

4.2.2. As Applied Claim: WTO-inconsistency of Individual measures

a. WTO-inconsistency of APRG\textsuperscript{22} s and PSLs\textsuperscript{23}

A judgement was needed now as to whether “terms more favourable than the recipients could have obtained on the market,” a phrase which defines the standard of WTO-inconsistency. The EC argued that interest rates of PSLs and premiums of APRGs were below market terms conditions of Korean commercial banks and foreign banks.

Korea submitted that the foreign banks could include the country risk of Korea which is not reflected in Korean domestic banks. (Country risk spread) The difference in the terms between KEXIM and domestic commercial banks are originated from credit crunch in Korean financial market during 1998 Asian Crisis. (Credit risk spread)

On country risk spread, the Panel found that it should be included by both domestic and foreign providers whenever a currency exposure is incurred. In fact, the APRG was provided in US dollars, therefore the risk of dollar should be reflected within the terms of any providers.

---

\textsuperscript{22} Advance Payment Refund Guarantees
\textsuperscript{23} Pre-Shipment Loans
Furthermore, the Panel ruled that KEXIM conferred benefit by failing to include credit risk in its Interest Rate Guidelines. The Guidelines only apply to PSL but the Panel assumed that it also applied to pure cover measures as APRGs.\textsuperscript{24} In conclusion, the Panel found that “benefit conferred”, hence the transactions of providing APRGs and PSLs to Daewoo, Samho/Halla, STX/Daedong, Hanjin and Samsung were “prohibited subsidy.”

b. WTO-inconsistency of Debt restructuring packages and tax concessions

The EC submitted to the Panel that the Daewoo workout, Halla reorganization and Daedong reorganization involved prohibited subsidy. “The workout plan of Daewoo comprised three elements: the spin-off from DHI of two new companies, DSME (shipbuilding) and DHIM (machinery); debt-for-equity swaps; and debt rescheduling.”\textsuperscript{25} Halla reorganization included debt forgiveness, a debt-for-equity swaps. Daedong was reorganized through debt restructuring, a capital infusion and the issuance of corporate bonds. STX acquired shares and additional bonds of Daedong.

The EC argued that no foreign creditors participated in the restructurings. This shows that the decision to restructure and not liquidate, is \textit{as such} against the market principles. The Panel rejected this argument and found that there can be various grounds for the decisions of foreign creditors. It further mentioned that “there was a certain generalized flight of foreign capital from Korea during the financial crisis, reflecting investors’ wariness of the overall situation”.\textsuperscript{26}

Furthermore, the Panel accepted the argument of Korea that the restructuring of three companies were based on the Anjin report which concluded that the going concern value of them exceeded their liquidation value. The EC doubts the

\textsuperscript{24} \textit{Ibid.} Para.7.157  
\textsuperscript{25} \textit{Ibid.} Para.7.336  
\textsuperscript{26} \textit{Ibid.} Para.7.434
objectivity and accuracy of the analysis of the Anjin report, and even some errors were found. However, the Panel accepted the Anjin report as the relevant basis for the restructurings, and decided that it was fairly on market terms.

On *as applied* claim of debt write-off and rescheduling, EC failed to present any decisive evidence or argument based on its terms or conditions, but depended on the fact that no foreign creditor participated in debt forgiveness or rescheduling. This argument was also not accepted by the Panel, either. In the transaction of debt-for-equity swap, the EC argued that the creditors overpaid for the equity. It suggested that two months later, an Australian investor purchased shares of DSME at much lower prices. However, the Panel also rejected that the only relevant market benchmark is the one at the same time as the transaction. In conclusion, there was no “benefit conferred” and financial contributions in restructurings were not “prohibited subsidy”. 
Chapter 5. Subsidy issues of KOREA-EU FTA

As Doha Development Agenda continues to sink, regional trade agreements have flourished. Now it is common that certain regions are affected by two or more trade pacts. As these trends persist, “forum shopping” becomes an issue in international trade disputes. Forum shopping indicates that complaining countries will tend to choose the best-suited trade pacts among others for its own interests when it tries to bring certain countries to trade dispute settlement understandings. For example, subsidies to Mexican exporters can be alleged in both NAFTA and WTO dispute settlement understandings. In this case, the US would choose a DSU which has a higher probability of winning.

EU obtained one more option to allege subsidy issues of Korean shipbuilding industry as KOREA-EU FTA went into force on 1 July 2011. This FTA was signed 6 years after the Panel Report of Korea-Commercial Vessels (2002) was circulated to each party.

The FTA negotiators of EU were well aware of the WTO dispute in 2002. As a result, subsidy issues were dealt with more concretely at an independent Chapter 11, Section B. FTA provisions deal with subsidies in a way to conform to the SCM Agreements. However, measures to shipyards in 2002 were specifically mentioned to be prohibited in FTA provisions, under which GOK has less capacity to argue that the current supports for Korean shipyards are consistent with international regulations on subsidies.

---

27 The EU requested consultations on Commercial Vessels of Korea on 7 March 2005. As Korea and EU couldn’t reach an agreement at consultations, the Panel was established on 21 July 2003. The Panel report was circulated on 7 March 2005.
a. Definition of subsidies

The EU-KOREA FTA refers to SCM Agreements in its definition of a subsidy, included below:

Article 11.10: Definition of a Subsidy and Specificity

1. A subsidy is a measure which fulfils the conditions set out in Article 1.1. of the SCM Agreement
2. A subsidy is specific if it falls within the meaning of Article 2 of the SCM Agreement. A subsidy shall be subject to this Section only if it is specific within the meaning of Article 2 of the SCM Agreement. 28

If a certain measure is deemed to be a subsidy under the SCM Agreement, that measure also constitutes a subsidy under the EU-Korea FTA. This is explicitly written in Article 11.13:

Article 11.14: Relation with the WTO Agreement

The provisions in this Section are without prejudice to the rights of a Party in accordance with the relevant provisions of the WTO Agreement to apply trade remedies or to take dispute settlement or other appropriate action against a subsidy granted by the other Party.

However, the FTA provisions are more specific in its definition of a prohibited subsidy, included below:

Article 11.11: Prohibited Subsidies

The following subsidies shall be deemed to be specific under the conditions of Article 2 of the SCM Agreement and shall be prohibited for the purposes of this Agreement in so far as they adversely affect international trade of Parties:

(a) Subsidies granted under any legal arrangement whereby a government or any public body is responsible for covering debts or liabilities of certain enterprises within the meaning of Article 2.1 of the SCM Agreement without any limitation, in law or in fact, as to the amount of those debts and liabilities or the duration of such responsibility; and
(b) Subsidies (such as loans and guarantees, cash grants, capital injections, provision of assets below market prices or tax exemptions) to insolvent or ailing
enterprises, without a credible restructuring plan based on realistic assumptions with a view to ensuring the return of the insolvent or ailing enterprise within a reasonable period of time to long-term viability and without the enterprise significantly contributing itself to the costs of restructuring.

This Article includes two interesting points regarding GOK’s supports to shipyards.

First, it considers “adverse effects” in establishing prohibited subsidy allegations. This concept has been disputed in actionable subsidies in the SCM Agreement, but not in prohibited subsidies. As this article embraces this condition, it broadened the meaning of prohibited subsidies.

Second, two main measures disputed in Korea-Commercial Vessels (2002) were clearly condemned as prohibited subsidies in Article 11.11 of Korea-EU FTA. The debt restricting packages and tax concessions are explicitly mentioned in provision a and APRG and PSLs are dealt with in provision b. The salient point here is that these specific forms of subsidies are not specified under the SCM Agreement.

The provision b of Article 11.11 is provided below:

… This does not prevent the Parties from providing subsidies by way of temporary liquidity support in the form of loan guarantees or loans limited to the amount needed to merely keep an ailing enterprise in business for the time necessary to work out a restructuring or liquidation plan.

Through this final statement of provision b, Article 11.11, GOK earned a cushion which provides “liquidity support in the form of loan guarantees or loans” to shipyards “for the time necessary to work out a restructuring or liquidation plan.” Since shipyards or Korea in 2015 are considered to be ailing enterprises, GOK can make an argument that it was a “temporary” support.

However, EU can also establish counter-arguments which pivot on the phrases “temporary” and “limited to the amount needed to merely keep an ailing enterprise in business.” In fact, in October 2015, KDB provided liquidity injection of 4
trillion won through loans, investment and debt-for equity swaps to DSME. However, KDB and KEXIM had outstanding loans totaling 3 trillion won again in October 2016, as the DSME teetered on the verge of insolvency. If these liquidity supports are repeated for the next couple of years, GOK can hardly argue that such measures constitute a “temporary” support. The meaning of the “time necessary to work out a restructuring or liquidation plan” was left ambiguous by FTA negotiators. It has to be clarified in future dispute settlement procedures of Korea-EU FTA.

b. Enforcement measure

There are three main enforcement measures available to Korea and EU when the other Party is considered to be in breach of Korea-EU FTA.

First, dispute settlement under Korea-EU FTA is available to both parties regarding prohibited subsidies. Chapter 14 of FTA is dedicated to Dispute Settlement Procedures including consultation, arbitration, panel ruling and compliance provisions. Parties can request establishment of Arbitration Panel when each Party cannot reach an agreement through consultation.

Whereas issues under Competition Law in Article 11, Section A is explicitly limited to incur Dispute Settlement Understandings to each party. It is available to both Parties pertinent to subsidy issues. Therefore, each party has two choices in filing cases on subsidies. They can either bring the issue to WTO DSU or FTA Arbitration Panel Ruling. This decision will be made upon consideration regarding which jurisdiction would best serve their interests. This is called “forum-shopping”.

As discussed above, the restructuring packages and tax recessions were found consistent with WTO in 2005. However, as those two types of liquidity supports are explicitly condemned as prohibited subsidies under the Korea-EU FTA, EU could bring this case to FTA Panel Arbitration. In such a case, GOK would have fewer opportunities to demonstrate the legality of its measures.
Another issue is the possibility of private enforcement action. EU private enterprises can request dispute settlement understandings under the auspices of The European Trade Barrier Regulation. This regulation established procedures for private enterprises to request dispute settlements under international trade rules. The WTO Agreement and any trade pacts to which EU is a party are considered to be international trade rules under The European Trade Barrier Regulation. The Korea-Commercial Vessels (2002) was also the result of successful requests by EU shipyards under the Regulation. Now the private enterprises can resort to Korea-EU FTA when they consider themselves to be adversely affected by subsidies given to their competitors. “The reliance by EU enterprises on bilateral agreements to bring complaints under the Trade Barrier Regulation can be expected to contribute to monitoring the respect of the obligations contained in the FTA and to tackling barriers to trade.”

Second, annual reports on subsidies is obligated under this FTA. The relevant Article is quite specific on reporting liability of each party as below:

Article 11.12: Transparency

1. ... each party shall report annually to the other Party on the total amount, types, and the sectoral distribution of subsidies which are specific and may affect international trade. Reporting should contain information concerning the objective, form, the amount or budget and where possible the recipient of the subsidy granted by a government or any public body.

This article shows that The Korea-EU FTA established concrete transparency rules in a more austere way by necessitating the specific contents of reports, for example, “the total amount, types and the sectoral distribution of subsidies which

---


30 Ibid, p.47.
are specific and may affect international trade.” The phrase “subsidies…may affect international trade” is a broad conception under which any supporting measures to certain enterprises could easily be targeted.

Each party is obligated to “provide further information on any subsidy schemes” upon requests. This mandates the Counter-Party to take a prompt action to reply. The provision 3 of Article 11.12 is as below:

3. Upon request by a Party, the other party shall provide further information on any subsidy schemes and particular individual cases of subsidy which is specific…

This annual and upon-request obligation to report on subsidies places a distinct burden upon GOK to provide subsidies to shipyards continuously.

Fourth, unilateral action can be taken by imposing countervailing duties. As mentioned above, there is barely any distinction between prohibited subsidies and countervailing subsidies under Korea-EU FTA. Therefore, each party can alternatively choose countervailing duties without resorting to long and complicated WTO dispute settlement procedures.
Chapter 6. Conclusion

The DSME Normalization Plan announced by KDB on October 29th, 2015 was publicly criticized as prohibited subsidies by EU and Japan in Working Party 6 of OECD. Even though the liquidity injection had to be repeated in 2016, GOK assured that its measures are consistent with international regulations. The confidence of GOK derived from their victories in WTO dispute in 2002 through 2005, Korea-Commercial Vessels.

The panel of Korea-Commercial Vessels found that the KEXIM legal regime under which Korean shipyards were provided with loans and guarantees does not mandate to confer benefits to recipients. Therefore, it did not violate Articles 3.1(a) and 3.2 of the SCM Agreement.

The panel also found that the EC failed to establish that Individual restructuring packages and tax concessions given to Korean shipyards were “entrusted or directed by the government.” Hence, there was no subsidization. Those measures include debt forgiveness, debt and interest relief and debt-to-equity swaps, and the special taxation on spin-off schemes provided to Korean shipyards during the 1998 Asian Financial Crisis.

However, APRGs and PSLs were found to constitute subsidization. 31 The Interest Rate Guidelines of KEXIM did not include considerations regarding country risks. Since these considerations occurred during the 1998 Asian Financial Crisis, the omission of country risk premium of Korea is considered to generate significant differences in the terms of commercial banks. GOK had to bring those individual APRGs and PSLs into conformity with the SCM Agreement. However, most of the loans were already reimbursed and the APRGs were expired by the time that the

31 Due to concrete export contingency of those financial schemes, it automatically constitutes prohibited subsidies when they are acknowledged as subsidies.
Panel Report was circulated in 2005. In other words, Korea reported to the WTO that it did not have to do anything in particular to implement the Panel Ruling.

This WTO dispute was a big win for GOK. It provided great relief since it could show that its measures implemented during the 1998 Asian Financial Crisis were consistent with international trade regulations.

However, as the Korea-EU FTA went into force on 1 July 2011, the measures taken by KDB to rescue DSME from its near-insolvency can be found in breach of the FTA. The Korea-EU FTA enlarged the meaning of prohibited subsidies by explicitly indicating that certain measures which are “responsible for covering debts or liabilities of certain enterprises” and “loans and guarantees, cash grants, capital injections below market prices or tax exemptions” are prohibited. Those provisions reflect the EU negotiators intent to secure its shipbuilding industry by preventing the GOK from providing liquidation supports to Korean shipyards in the future.

Korea and EU can resort to both WTO Dispute Settlement Understandings and FTA Arbitrations regarding subsidies. Therefore, EU could choose to bring the DSME Normalization Plan to the FTA Arbitration where it has a better chance to win.

As the international forum for dispute settlement is no longer limited to the WTO Dispute Settlement Understandings, no one can be certain that GOK will win again in the international litigations on the measures for DSME.
References


Free Trade Agreement between the European Union and the Republic of Korea

OECD, The Arrangement on the Officially Supported Export Credits


WTO, The Agreement on Subsidies and Countervailing Duties