

WORLD TRADE ORGANIZATION

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Committee on Subsidies
and Countervailing Measures

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SUBSIDIES

Responses to Questions Posed by the UNITED STATES¹ Regarding the New and Full Notification of CANADA²

The following communication, dated 21 September 2004, is being circulated at the request of the Delegation of Canada.

Industrial Programmes

I. DEFENCE INDUSTRY PRODUCTIVITY PROGRAMME

US Question 1

Please explain in more detail the types of organizations that are eligible to receive funding under this programme. For example, are private companies eligible?

US Question 2

Please also explain which industries are considered producers of "viable defence or defence-related products". Additionally, is funding under this programme only used to fund public defence-related projects, or is funding also available for commercial projects, e.g., commercial aircraft/engines?

Response

The Defence Industry Productivity Programme originated in 1959 when the Canada/United States Defence Production Agreement went into effect, and terminated with the Federal Budget of 28 February 1995. Since the termination of DIPP in 1995, the Government of Canada has not entered into any new agreements, and redirected its activities to the orderly sun-setting of all DIPP agreements. These sun-setting activities have focussed on fulfilling the disbursement of all funding obligations contained in multi-year agreements committed to prior to the time DIPP was terminated, maintaining the current status of all reporting and repayment obligations in its agreements, protecting the interests of the Government of Canada, conducting audits, and managing the closure of project files as appropriate. The DIPP portfolio is largely closed, with a current legacy of only 113 projects still in effect. There has been no expenditure of funds for DIPP since 31 March 1999.

¹ G/SCM/Q2/CAN/18

² G/SCM/N/95/CAN

(Specific Response to US Question 1). The types of organizations that were eligible were broadly defined as any individual, partnership, association, co-operative, institution or body corporate or any trustee or legal representative thereof but not including a legal entity that was owned or controlled by the government of a country other than Canada unless the entity was likely to make a significant contribution to the development of the Canadian defence-related industry. As well, eligible projects had to relate to the development, manufacture, or support of defence-related products.

(Specific Response to US Question 2). Given the broadly based eligibility criteria for both applicants and projects, many manufacturing industries were legitimately considered to be viable defence or defence-related producers. DIPP was not used to support defence procurement. Dual-use military/commercial projects were assessed on the merits of their respective attainment of defence-related production or improvements to the base of defence industries in Canada. Commercial aircraft/engine developments were ineligible if there was no demonstrated enhancement of economic growth through the promotion of viable defence or defence-related products.

II. ONTARIO COMMUNITY FUTURES PROGRAMME

US Question

Please explain whether there are conditions/limits on the industries eligible for assistance under this programme. What industries have benefited from this programme?

Response

There are no restrictions as to the industries eligible for assistance under this programme. Proposals must be for local investment and must demonstrate that funds will be used to assist existing businesses to stabilize or expand or to help local entrepreneurs to develop and diversify the local economy by creating new businesses. The programme is directed at small and medium-size businesses (SMEs). Loans cannot exceed \$125,000.

A very broad range of industries have benefited from this programme, including industries in retail trade, manufacturing, aquaculture, knowledge-based activities; tourism; services (including personal/professional services); and agriculture and food processing.

III. COASTAL QUEBEC, COMMUNITY ECONOMIC ADJUSTMENT INITIATIVE PROGRAMME & FISHERIES ACCESS PROGRAMME

US Questions

Would you please explain in more detail the types of activities funded by the above-listed programmes? Please also explain whether each of these programmes take into account overcapacity and/or overproduction when granting funding.

Response

Coastal Quebec

Special Fund for the Economic development and adjustment of Quebec Fishing Communities, SFQC, was established in 1995 under TAGS (The Atlantic Groundfish Strategy, 1994). The main objective of TAGS was to mitigate the impact of the stock reductions on the affected economies of Canada's Atlantic coast and included economic development measures.

The programme was extended to March 2003 in 1999. It has since expired.

Activities funded by the programme went towards diversifying and strengthening the economy of the regions and communities affected by the groundfish crisis and therefore reduce the dependence on the fisheries resource. More specifically, SFQC support was directed toward commercial projects, feasibility studies and projects aimed at developing new ocean-based resources as well as non-fisheries entrepreneurship. The majority of projects were not fisheries related and any projects related to fisheries concerned underutilised species.

The programme therefore did not encourage overfishing or overcapacity.

Response

The Community Economic Adjustment Initiative (CEAI)

The Community Economic Adjustment Initiative (CEAI) was announced on 12 January 1999 and began operationally in June of that year. CEAI supported no new projects after 31 March 2001.

The programme provided contributions to projects that:

- would help diversify the local economy;
- would have tangible and sustainable economic benefits such as job creation;
- would have community support;
- would leverage other (private or public) funding; and
- were not eligible for funding under any other existing programme.

The types of projects most commonly funded were: waterfront improvements, museums and historic sites, tourist attractions, and trails or walkways. CEAI funding was provided to businesses on terms comparable to those available through financial institutions.

The programme's objective was to diversify the economy, which would reduce the number of vessels and salmon fisheries-related businesses, thus decreasing overcapacity.

Response

Fisheries Access Programme

The objective of the Fisheries Access Programme is to increase commercial fishing opportunities for eligible Aboriginal groups, resulting in an enhanced level of participation in commercial fisheries by these groups. To support the enhanced level of participation in commercial fisheries, assistance includes retiring commercial licences, vessels, fishing gear and equipment, and also includes the provision of funds for the construction of vessels and gear. Funds are also provided for the development of necessary skills for Aboriginal groups to fish safely. Such development is provided through training and other skill development activities relating to the safe operation and management of commercial fisheries. The programme does not contribute to overcapacity and/or overproduction since the capacity provided to eligible Aboriginal groups is that which has already been voluntarily retired by other commercial operators.

IV. TECHNOLOGY PARTNERSHIPS CANADA

US Question Series 1

It is stated that the government's investment ratio will normally vary between 25 per cent and 30 per cent of the eligible costs of each project and, where justified, the maximum sharing ratio may reach 50 per cent if it is essential to the success of the project. Do these payments cover all costs associated with the funded project?

Response

No. The investment provided by TPC is targeted strictly towards the eligible, supported R&D-related costs of a project. There are numerous costs that TPC will not support, such as:

- (a) costs relating to infrastructure, production related capital equipment, cost overruns, and land;
- (b) Eligible yet unsupported costs, where the TPC R&D programme has deemed that the project in question would proceed within the same scope, timing or location even without additional TPC investment; and
- (c) In many cases, where TPC limits its overhead costs to 65 per cent of Direct Labour, which is often lower than the actual overhead costs being incurred by the company.

US Question Series 2

How are the royalty/repayments determined? How does the repayment schedule conform with or relate to similar, commercially funded projects? At what point in a TPC funded project does repayment occur? How is a "project's market success" defined for purposes of royalty/repayment?

Response

Royalties are determined based on a financial analysis of the project and are related to expected returns, on a case-by-case basis. TPC is a risk/reward sharing programme such that if companies expect a high return on their investment, so will TPC.

TPC will get repaid based on the success of the projects. This is dependent on the level of sales achieved by the company. Repayment typically occurs during the Benefits Phase, once the R&D portion of the project is finished, and is usually based on a straight royalty rate applied to sales of the company. As such, TPC's performance varies directly with the company's sales performance.

US Question Series 3

What percentage of investments result in "successful commercial exploitation of the results of the supported projects?" How and to what extent have these projects generated "a satisfactory return on government's investments". How is this measured?

Response

A satisfactory return on the government's investment is specifically related to the individual projects themselves, and is viewed on a case-by-case basis. In this regard, a satisfactory return could include both monetary and non-monetary benefits such as, e.g., new environmental technology, R&D capacity building, and increased intellectual property.

TPC was created in 1996/97. Given that the R&D portion of a project takes an average of about 5 years and that the benefits phase of a project averages about 10 years, it is too early to be able to generate any meaningful data on satisfactory financial returns.

US Question Series 4

It is our understanding that, as of early 2004, total TPC commitments were CN\$2.356 billion (of which about two thirds has been disbursed) and that repayments through 2002 totalled only about CN\$30 million. Could Canada please confirm or correct this statement?

Response

This is correct. However, as explained, the R&D portion of a project takes an average of roughly 5 years and the benefits phase of a project averages roughly 10 years. Accordingly, it is too early for such a statement to accurately reflect the financial returns under the programme. By 2002, repayments would have only just begun on the earliest of projects. At that time, over 90 per cent of the TPC projects would have still been in the R&D phase and therefore not generating any repayments. Since then, as expected, royalties have begun to increase dramatically, as outlined in the chart below. As the programme matures, a greater number of projects will be in the repayment phase, and repayment amounts will continue to grow in earnest.

<u>Fiscal Year</u>	<u>Repayment Amount</u>
1998-99	\$13.1M (includes the sale of warrants for \$9.3M and a settlement for \$3.5M. Royalties=0.3M)
1999-00	\$4.0M
2000-01	\$4.8M
2001-02	\$8.3M
2002-03	\$19.0M
2003-04	\$28.0M
2004-05 Forecast	\$50.0M
2005-06 Forecast	\$77.0M
2006-07 forecast	\$118.0M

The exponential growth is expected to continue over the short to medium term and will eventually plateau once the TPC portfolio reaches a steady state (value of projects entering the portfolio equals the value of projects exiting the portfolio).

V. STRUCTURED FINANCE FACILITY

US Question

Please explain how this programme is consistent with Article 3.1(b) of the Subsidies Agreement.

Response

The Structured Finance Facility does not require the use of domestic over imported goods as a condition for the granting of assistance towards the acquisition of a vessel.
