Bench Memorandum

Subsidia – Agricultural Subsidies on Sweet Biscuits, Wheat & Pork

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The case regarding Subsidia's agri-subsidies on sweet biscuits, wheat and pork raises many legal issues and was drafted with inspiration from the three decisions: *Canada – Dairy, EC – Sugar* and *US – Cotton*. In order to ensure that the students focus their discussions on the same range of issues, a list of claims are included in the section regarding the dispute – *the box at the end of the case*. In the same box, there are only listed three relevant WTO decisions, so the students should be expected to be able to follow the arguments and structure of arguments put forth in those three cases to organize their own cases. As it has been clarified in the answers to the questions posed by the students (hereinafter Answers), the students should *only* focus on those legal claims listed in the box at the end of the case. There are many other interesting legal issues to analyze, but since we have directed the students to only focus on the legal issues in the box, we should not "reward" them for advancing arguments concerning issues not listed in this box.

The bench memo begins with a brief introduction to the WTO's Dispute Settlement system. The balance of the memo is divided into a general introduction to the 3 issues, followed by a description of what the complainant and the respondent should, could and *must* address.

The bench memo attempts to include overview of the basic relevant WTO issues for purposes of assisting those judges who may not have the WTO as a core expertise area.

The WTO's Dispute Settlement Mechanism

The WTO's dispute settlement mechanism has arguably been the most successful international dispute settlement mechanism in history, and one of the busiest – more than 330 disputes have been referred to the Dispute Settlement Body (hereinafter the DSB). The dispute settlement mechanism is governed by the Agreement called the the Understanding on Rules and Procedures Governing the Settlement of Disputes (hereinafter the DSU)

Like many international arbitral mechanisms, the WTO's dispute settlement process provides first for mandatory consultation between the Members concerned.[1] However, if the consultations do not resolve the matter to the satisfaction of the complaining Party within 60 days of the request for consultations, the complaining Party may request the establishment of a dispute resolution panel.[2] The responding Party can effectively delay establishment of a panel by an additional 30 days, to the following monthly meeting of the DSB.

The panel process itself consists of the submission of memorials or briefs and one or more hearings before a panel, and the issuance of a written report. The decisions, once final, are published on the WTO's Internet website, http://www.wto.org. The entire process, from the first panel request to the DSB approval, normally requires about 20 months, much quicker than most national court systems.

Appellate Body: Decisions handed down by the panels can be appealed to the Appellate Body, which consists of seven persons, which may, upon the application of a party, review a panel

[1] DSU Article 4.
[2] DSU Article 6.

decision as to issues of law and legal interpretations.[3] The Appellate Body reviews legal questions, and is designed to provide a level of continuity and consistency in decisions that would be difficult to achieve otherwise with diverse members of numerous panels. A majority of the panel decisions to date have been referred to the Appellate Body. While the Appellate Body has never completely reversed a panel decision, it has frequently reversed the panels' reasoning and conclusions on key issues.

Losing Party's Options: Once the panel decision and the Appellate Body decisions have been adopted by the Dispute Settlement Body, the rules provide the defending party with the choice of (1) agreeing to change the practice held to violate the agreement;[4] (2) agreeing to accept the obligation to compensate the aggrieved party, usually through lowering tariffs on goods of interest to the aggrieved party;[5] or (3) retaliation by the aggrieved Member, after approval of the amounts by the DSB, through denial of commensurate trade benefits pursuant to virtually automatic WTO authorization.[6] (Compliance is, however, the preferred option.). Thus, a WTO Member can never be forced to comply with a WTO decision by changing its laws or regulations, although the choice not to comply could have significant adverse economic consequences through compensation to or retaliation by the injured Member.

Types of Reports: This case operates with several different types of reports. Firstly, there is the original panel report. The panel report can be appealed and this leads to the Appellate Body Reports. Upon implementation, the winning party can request a 21.5 panel (consisting of the original panelists if possible) to be established, which lead to the issuance of a 21.5 panel report to verify whether implementation was correct. The 21.5 panel report can also be appealed, which leads to the issuance of a 21.5 Appellate Body Report. In *Canada – Dairy,* there were two recourses to DSU Article 21.5.

Semi-Automatic Nature/Decision Making in the DSB: Under the prior GATT dispute settlement system, a consensus was required among the Contracting Parties for the establishment of a panel, the adoption of a panel report, and the authorization of retaliation, which meant that any Contracting Party could block adoption. The DSU, in contrast, operates on the basis of "negative consensus" basis, i.e., the decision to establish a panel, adopt reports and authorize suspension of concessions are taken unless there is a consensus not to make such decisions.[7] In nearly eleven years, the Members have never mobilized a negative consensus and consequently all panel or Appellate Body reports presented to the DSB have been adopted.

Sweet Biscuits – Agreement on Agriculture

The case clarifies that "sweet biscuits" fall under the **Agreement on Agriculture** (hereinafter AoA) because HS 1905.31 is within the scope defined by Annex 1 and Article 2 of the AoA (HS Chapters 1-24). The case, moreover, clarifies that the legal issue regarding sweet biscuits is whether the measures taken by the respondent Member are compatible with AoA Articles 3, 8 and 9. The sweet biscuits issue is an issue of cross-subsidization developed from *Canada – Dairy* and *EC-Sugar*. However, before entering into the sweet biscuit analysis, a brief explanation of export subsidies within the AoA is included.

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[3] DSU Article 17.
[4] DSU Articles 19 and 21.
[5] DSU Article 22.
[6] DSU Article 22.
[7] DSU Articles 6, 16.4, 17.14, 22.6.

<u>Export agri-subsidies</u> are, unlike non-agri-subsidies, consistent with the WTO obligations *if* they are granted within the limits of the scheduled commitments in both *budgetary* and *quantitative* terms (AoA Articles 3.3, 8 and 9).

Export subsidies are according to AoA Article 1(e) "subsidies contingent on export performance," including those export subsidies defined in AoA Article 9.1, which reads as follows:

> "The following export subsidies are subject to reduction commitments under this Agreement:
>
> (a) the provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance;
>
> (b) the sale or disposal for export by governments or their agencies of non-commercial stocks of agricultural products at a price lower than the comparable price charged for the like product to buyers in the domestic market;
>
> (c) payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived;
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> (d) the provision of subsidies to reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services) including handling, upgrading and other processing costs, and the costs of international transport and freight;
>
> (e) internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments;
>
> (f) subsidies on agricultural products contingent on their incorporation in exported products."

There is a certain overlap among the sub-paragraphs in AoA Article 9.1,[8] and the bench memo offers some guidance as to which sub-paragraphs the teams should rely on.

Amber box (domestic support) and export subsidies are, moreover, subject to reduction commitments, but because the facts of the case do not mention any issues concerning this, the students should not focus too much time on clarifying anything about reduction commitments. For a brief introduction into the "traffic light" approach, *see* the WTO Secretariat's presentation attached as Annex 1 to this case.

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[8] This was also noted by the Panel and the Parties to the dispute in *Canada – Dairy*. *See* Canada – Dairy, Panel Report, para. 7.35.

<u>The sweet biscuit legal issues arise</u> out of the unanswered questions from *Canada – Dairy* and *EC – Sugar*. In these cases, Canada and the EC were found in violation of AoA Articles 3 and 8 – under AoA Article 9.1(c). Both cases involved exports in quantities beyond the scheduled commitments. As well as both cases involved a "scheme" whereby it was possible to export "excess quantities" below the average cost of production. The Appellate Body found that there was "cross-subsidization" from Amber box to the "excess quantities" of exports and therefore an unscheduled export subsidy, which is not in conformity with AoA Articles 3 and 8.

<u>The sweet biscuit scenario aims primarily at sparking a discussion of whether cross-subsidization can take place from the scheduled export quantities into the "excess quantities" of exports</u> (i.e. the exports that are supposed to be unsubsidized). This is referred to as **export-export cross-subsidization**. In practice this type of allocation means that the profits earned from exports of the subsidized portion (the scheduled portion) of the sweet biscuits are utilized to lower the price on the unsubsidized portion of sweet biscuits. This is only possible if the subsidies (whether Amber box or export subsidies) are *very generous*, but the AoA does not regulate *how generous* WTO Members are allowed to be with the amounts of subsidies they schedule. As further discussed below, the legal issue is whether this type of "internal allocation of funds" within the exporting companies can constitute an unscheduled subsidy within the meaning of AoA Article 9.1(c).

The size of the boxes are not accurate, but merely examples to understand the different categories of sweet biscuits.

Domestically sold sweet biscuits with Amber box subsidies

Exported sweet biscuits (600.000 tonnes) with scheduled export subsidies

Exported sweet biscuits beyond the 600.000 tonnes – supposed to be unsubsidized.

One of the key issues in the legal analysis is that the Appellate Body has set the benchmark for finding "payments" in AoA Article 9.1(c) to be "below the average total cost of production." Moreover, the "payments" need "only" be "financed by virtue of government action," and the subsidy can therefore be established without it being paid directly by the government (recalling the subsidy is in the form of internal allocation of funds in the export companies). Based on these factors, it is possible to establish an unscheduled subsidy (i.e. an illegal subsidy) *if* a country has scheduled commitments under the AoA and exports "excess quantities" below the total average cost of production. (Other relevant factors are discussed below).

The EC argued strongly against this type of logic based, *inter alia*, on the assertion that the utilization of the benchmark of below the average total cost of production resembled a blunt anti-dumping provision, as well as that internal allocation of funds in a private company could not be considered to constitute a "benefit", which is a constitutive element of "subsidy" within the meaning of Article 1 of the Agreement on Subsidies and Countervailing Measures. The analysis developed by the Appellate Body of AoA Article 9.1(c) also means that if a country does not subsidize an agri-product, it is not a problem in relation to the WTO obligations if it exports below the total average cost of production, unless there is an issue of dumping, which also requires a finding of material injury.

Whether cross-subsidization can also be established under AoA Article 9.1(a) and (f) is more doubtful, and this will be analyzed further below. It is important to keep in mind that the export subsidy granted to the quantity of sweet biscuits that is properly scheduled *is* in conformity with the

AoA. This export subsidy is most likely an export subsidy within the meaning of AoA Article 9.1(a) and (f).

"Cross-subsidization" is defined by the Panel in the second recourse to DSU 21.5 in *Canada - Dairy* – as summarized by the Appellate Body:

> "The Panel used this term to describe the fact that sales revenues from one market—the domestic market—finance a portion of the costs associated with sales made in another market—the CEM [export] market. (Panel Report, paras. 5.127, 5.130, and 5.134)"[9]

As mentioned above, the sweet biscuit issue aims primarily at discussing export-export cross-subsidization. Such a case has never been brought before a panel in the WTO.

Cross-subsidization was discussed in both *Canada – Dairy* and *EC – Sugar* and the teams should therefore rely on those cases for developing their analyses. *If* the students should also discuss cross-subsidization from Amber box to the "excess quantities" of exports that will be understandable as they might rely heavily on *Canada – Dairy* and *EC – Sugar.* However, the case includes references to the fact that Subsidia has developed a system by which they distinguish clearly between Amber box and export subsidies as well as the case reveals that Competia argues that "the export subsidies *'must be overly generous as to export that many sweet biscuits produced with expensive domestic ingredients.'"* Some points should therefore be subtracted if the teams overlook these "hints" for discussing export-export cross-subsidization. However, discussing cross-subsidization from both Amber box and export subsidies into the "excess quantities" of exports may be the "safest" way to discuss the case – complainants usually outline each scenario that could lead to a violation of the obligations.

Both teams should be able to understand the issue of **burden of proof** in these types of cases. The normal burden on the Complainant to prove the elements of its case is shifted by virtue of AoA Article 10.3, whereby it is up to Subsidia to prove that the "excess quantities" of exports are *not* subsidized, once it has been established that Subsidia's exports exceeds its quantitative commitment (which is a fact in the case). This means that once Competia has proved that Subsidia exports sweet biscuits in quantities beyond its scheduled commitments, it is up to Subsidia to prove that that those "excess quantities" are not supported by a subsidy within the meaning of AoA Article 9.1:

> "the European Communities must provide prima facie evidence that excess exports of sugar are not subsidized. A respondent (as the European Communities is in the present dispute) should be able to, or may be able to, make a demonstration that the measure is not caught by caught by one or other of the definitions in Article 9.1(a) to (f) of the *Agreement on Agriculture*. The respondent should also be able to demonstrate that the challenged measure is not a "subsidy contingent upon export performance" within the meaning of Article 1(e) of the *Agreement on Agriculture*. The European Communities should be aware of its obligations under the *Agreement on Agriculture* and should also be cognisant of its subsidies programmes. This general principle is recognized also in Article XVI:4 of the *WTO Agreement* which provides that "Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements". The requirements of Article 10.3 of the *Agreement on Agriculture* are based on the assumption that Members are aware of the subsidies they provide to their own producers. If there are, in fact, no subsidies, the European Communities should be

[9] Canada Dairy 21.5, Appellate Body Report, 2nd case, footnote 133. On the issue of finding cross-subsidization, s*ee generally* Canada – Dairy 21.5, 2nd case, Appellate Body Report, paras. 148-154; upholding the panel's findings in Canada – Dairy 21.5 2nd case, Panel Report, paras. 5.127-5.135.

> able to make this demonstration." (footnote omitted) – (in this case, Subsidia is in the position of defending a subsidy as the EC was in the excerpt above). [10]

Arguments by the Parties:

Competia must initiate its case by arguing that it finds the Subsidian sweet biscuit scheme in violation of the (*articles already provided for in the case)* AoA Articles 3, 8 and 9.

Competia will only have to establish that Subsidia exports sweet biscuits in "excess of" the quantities scheduled by Subsidia, which is a stipulated fact in this case, and then the burden is shifted to Subsidia by virtue of AoA Article 10.3.

Subsidia can first and foremost argue that the case should be dismissed because Subsida fully keeps its budgetary commitments under the AoA and Competia hence do not have a case.

Subsidia bears the burden of establishing that the "excess exports" are not subsidized within the meaning of AoA Article 1(e), which means it does not provide any of the subsidies listed in AoA Article 9.1.

Given the fact that *Canada – Dairy* and *EC – Sugar* utilized AoA Article 9.1(c) for establishing "payments" in the form of cross-subsidization from the subsidized portion of the sales into the unsubsidized portion of the sales, the students should rely primarily on AoA Article 9.1(c). AoA Article 9.1(c) is therefore analyzed firstly below, followed by a brief analysis of the remaining sub-paragraphs of AoA Article 9.1.

Does the sale of cheap "excess quantities" of sweet biscuit exports constitute an export subsidy within AoA Article 9.1 (c) in the form of cross-subsidization?

The Panel in *Canada – Dairy* defined the test as:

> "(a) the presence of "payments on the export of an agricultural product";
>
> (b) which are "financed by virtue of governmental action"."[11]

Criterion (a):

The Appellate Body in the first recourse to 21.5 in *Canada – Dairy* established **"payments"** from the benchmark of whether the price on the exported item was *below the average total cost of production* – a benchmark which has been followed since (i.e. in the second recourse to 21.5 in *Canada – Dairy* and in *EC – Sugar*.)[12]

If the students follow the analysis in *EC – Sugar*, they will see that "payments" can either be "cross-subsidization" or "payments-in-kind." [13] The facts of this case do, however, *not* suggest any issues relating to "payments-in-kind" in terms of "cheap" inputs for the "excess production" – rather the facts of the case reiterates that *unless* the producers of sweet biscuits gets a subsidy, the sweet biscuits are very expensive to produce because the inputs are expensive. The teams should therefore focus their efforts on the "cross-subsidization" issue.

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[10] EC – Sugar, Panel Report, para. 7.229.

[11] Canada – Dairy, Panel Report, para. 7.89.

[12] *See* Canada – Dairy 21.5, Appellate Body Report, paras. 88, 95-96; Canada – Dairy 21.5 2nd case, Appellate Body Report, paras. 88, 95-98, 104; EC – Sugar, Appellate Body Report, para. 267.

[13] *See e.g.*, EC – Sugar Panel Report, (DS265), paras. 7.254-270, which also gives a good explanation of the issue of below the cost sale of CEM milk in *Canada – Dairy.*

Regarding distinguishing between cross-subsidization and payments-in-kind, the students should be able to find some extra guidance from the Answers:

> **"How are Subsidian sweet biscuit exporters able to sell sweet biscuits below world market prices in spite of purchasing their input ingredients at world market price?**
>
> Answer: that is the issue in this case. Utilize case law to find similar situations. Hint: look at Competia's arguments in the facts regarding that the export subsidies must be overly generous. – And the domestic ingredients are not sold at world market prices: the subsidies are supposed to bring the prices down to market prices, but the subsidies must be very generous and bring the prices too far down..
>
> **Are domestic sugar, butter and wheat flour sold at below their average total cost ofproduction?**
>
> No, the sweet biscuit manufacturers get subsidies for sweet biscuits because the domestic ingredients are very expensive."

Subsidia will have to establish that the "excess quantities" are not supported by "payments" in the form of cross-subsidization.

Firstly, Subsidia can aim at arguments surrounding the benchmark for "payments": Subsidia will not be able to deny that the "excess quantities" are priced *below the average total cost of production*, but Subsidia could argue that the sweet biscuits it exports are merely 5-10 % below the world prices for sweet biscuits and hence negligible or *de minimis,* and this therefore cannot be enough for establishing a "payment" – in particular because the Appellate Body in e.g. *EC – Sugar* (referring to the Appellate Body in *Canada Dairy 21.5*) also used the term "well under" the average total cost of production, as well as "not remotely cover the cost of production."[14]

We don't know *how much* in excess we are discussing, however the Answers clarifies one aspect:

> **"Is the scheduled quantity of 600.000 tonnes of sweet biscuits equivalent to the 90% of sweet biscuits that are currently exported?**
>
> Answer: No, the 90 % of the exports (produced with domestic ingredients) exceeds the 600,000 tonnes independently. (To clarify the numbers: Subsidia exports in exceess of its scheduled commitments on exports (i.e. more than 600,000 tonnes). 60% of the total production is exported, 90% thereof are produced with domestic ingredients (expensive ingredients))."

Competia will of course argue the opposite on this issue – and Competia should of course note that the relevant figures to pay attention to is the 10-15% below the average cost of production.

The case does not provide any facts to how many tonnes of sweet biscuits are exported as "excess exports", so both teams may provide alternative arguments on this – recalling the Appellate Body in *EC – Sugar* noted the quantity of excess exports as being a factor:

> "Given the huge volumes of C sugar exports and the price at which C sugar is being sold on the world market, we concur with the Panel that such production quantities cannot be deemed 'incidental'. We note in this context that C sugar represents between 11 and 21 per cent of the European Communities' total quota production, and that between 1997 and 2002, exports ranged between 1.3 and 3.3 million tonnes."[15] (footnote omitted)

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[14] *See* EC – Sugar, Appellate Body Report, paras. 257,

[15] EC – Sugar, Appellate Body Report, para. 267. The EC has scheduled app. 1.3 million tonnes sugar and exported app. 4 million tonnes sugar, *see e.g.,* EC – Sugar, Panel Report (DS265), para. 7.230.

Secondly, ***Subsidia*** can discuss whether cross-subsidization can be established at all. Without establishing cross-subsidization, there is no basis for alleging that the excess quantities sold below the average total cost of production are caused by any WTO-inconsistent behavior by the Subsidian government.

On the issue of cross-subsidization, each team could choose different avenues. However, the teams should preferably have demonstrated an understanding that this case aims at an export-export cross-subsidization issue. If the teams also discuss cross-subsidization from domestic support that is fine, but it should detract some points if the teams miss out on the export-export issue.

General Observations on Cross-Subsidization:

Cross-subsidization is about the *explanation* of *how* the "excess exports" can be exported at prices below the average total cost of production. The issue is therefore whether cross-subsidization constitutes a "payment."

Subsidia could first and foremost argue (as did the EC in *EC – Sugar* without much luck) that there is no "transfer" of resources in the situation of "cross-subsidization" because it is a private decision regarding internal allocation of funds if an exporter wishes to sell its products below the average cost of production. Subsidia stays within its scheduled limits when it pays out subsidies, and**,** hence, it does not provide any "payments on exports" to the "excess quantities."[16] The EC moreover argued that "the Panel's interpretation turns Article 9.1(c) into 'a prohibition of low priced exports' and a 'sort of blunt anti-dumping instrument'."[17]

Competia could argue that the broad statement from the Appellate Body in *EC – Sugar* would clarify that it is irrelevant whether there are distinct "markets" and "parties" involved when the exporters are able to sell below the total average cost of production:

> "The European Communities' approach is, in our view, too formalistic. To illustrate, one could envisage a scenario under which the producers of C sugar are legally distinct from the producers of A and B sugar. In this situation, the European Communities' approach could recognize that a "payment" under Article 9.1(c) could exist because there would be a transfer of economic resources between different parties. If, however, these same producers of A, B, and C sugar were integrated producers and organized as single legal entities, a payment under Article 9.1(c) would not exist, because the transfer would be merely "internal". We do not believe that the applicability of Article 9.1(c) should depend on how an economic entity is legally organized.
>
> Accordingly, we do not share the European Communities' objections to the Panel's findings on 'cross-subsidization' in the case before us. In this respect, we are also mindful of the fact that, in the ordinary course of business, an economic operator makes a decision to produce and sell a product expecting to recover the total cost of production and to make profits. Clearly, sales below total cost of production cannot be sustained in the long term, unless they are financed from some other sources. This is especially true when the volume of the loss-making sales is substantial."[18] (footnotes omitted)

And in relation to the argument of a prohibition of low priced exports, Competia should recall the Appellate Body's conclusion:

> "We also reject the European Communities' allegation that, by upholding the Panel's finding, our interpretation of Article 9.1(c) would turn this provision into "a prohibition of low priced exports".[19] Article 9.1(c) addresses "payments on the export ... financed by

[16] *See generally* EC – Sugar, Appellate Body Report, para. 29.
[17] EC – Sugar, Appellate Body Report, para. 258.
[18] EC – Sugar, Appellate Body Report, paras. 265-266.
[19]European Communities' appellant's submission, para. 180.

> virtue of governmental action". What is at issue is whether the product receives an export subsidy within the meaning of Article 9.1(c), and not merely whether exports sales are being made at low prices."[20]

This essentially means that the other parts of AoA Article 9.1(c) must also be fulfilled, and it is not just a "blunt" anti-dumping provision to "catch" all low cost exports. It is therefore vital that the teams also develop arguments to establish that the remaining criteria are fulfilled and not just focus on the benchmark for establishing "payments."

Subsidia could draw the attention to the Panel's emphasis of the cumulative advantages of the production of Sugar C, which is not present in the sweet biscuit scheme as there are no apparent *incentives* to produce excess sweet biscuit as was the case with Sugar C:

> "In any event, we also note that the Panel did not describe "cross-subsidization"—the "payment" at issue—as consisting *merely* of an "internal allocation", within one single economic entity, of that entity's resources. Rather, the Panel considered the cumulative advantages that sugar producers receive from the operation of the EC sugar regime to be a key component of the "payment" in the form of cross-subsidization. The Panel went on to state that "to the extent that the fixed costs of A, B and C [sugar production] are largely paid for by the profits made on sales of A and B sugar, the EC sugar regime provides the advantage which allows ... sugar producers to produce and export C sugar at below total cost of production." (Panel Reports, para. 7.310) (footnote omitted) The Panel concluded that "this cross-subsidization constitutes a payment in the form of a transfer of financial resources." (*Ibid.*)"[21]

"Benefit"?

It will be an advantage if the teams discuss the issue of a "benefit". Under Article 1 of the SCM Agreement, a subsidy is defined as a financial contribution which confers a "benefit." This requirement is not relevant for finding "payments" under AoA Article 9.1(c):

> "Having addressed, and rejected, the European Communities' argument that the Panel's finding is in error, because the "payment" at issue is only an "internal allocation" of resources and it is "notional", we turn to another argument put forward by the European Communities. The European Communities argues that, because the alleged "cross-subsidization" involves no "transfer of resources" to the sugar producers, it confers no *benefit* upon these producers and, therefore, cannot be considered to provide a subsidy.[22] The European Communities disagrees with the Panel's finding that Article 9.1(c) does not require the demonstration of a benefit for a measure to constitute a "payment" within the meaning of that provision.
>
> The chapeau of Article 9.1 provides: "The following export subsidies are subject to reduction commitments". Hence, Article 9.1 sets forth a list of practices that, by definition, involve export subsidies. In other words, a measure falling within Article 9.1 is deemed to be an export subsidy within the meaning of Article 1(e) of the *Agreement on Agriculture*. We observe that Article 9.1(c) requires no independent enquiry into the existence of a "benefit"."[23]

It should, moreover, be noted that "payments" do not need to be made by the government, but can be made by private parties.[24] Moreover, "payments" can be established from the internal allocation of funds:

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[20] EC – Sugar, Appellate Body Report, para. 283.
[21] EC – Sugar, Appellate Body Report, footnote 425.
[22] European Communities' appellant's submission, para. 191.
[23] EC – Sugar, Appellate Body Report, paras. 268-269.
[24] *See e.g.,* EC – Sugar, Appellate Body Report, para. 259.

> "Accordingly, we do not share the European Communities' objections to the Panel's findings on "cross-subsidization" in the case before us. In this respect, we are also mindful of the fact that, in the ordinary course of business, an economic operator makes a decision to produce and sell a product expecting to recover the total cost of production and to make profits. Clearly, sales below total cost of production cannot be sustained in the long term, unless they are financed from some other sources."[25]

This type of reasoning distinguished AoA Article 9.1(c) from AoA Article 9.1(a), and AoA Article 9.1(a) is thus probably not useful for establishing the existence of an export subsidy under the sweet biscuit scenario:

> "We note, first, that Article 9.1(c) does not qualify the term "payments" by reference to the entity making, or the entity receiving the payment. This may be contrasted with, for instance, Articles 9.1(a) and 9.1(b) of the *Agreement on Agriculture*, which specifically refer to the entities making and also, in the case of Article 9.1(a), to the entity receiving the alleged export subsidy. Moreover, Article 9.1(c), on its face, does not qualify the meaning of the term "payments", other than by requiring that the alleged "payments" be "on the export of an agricultural product" and "financed by virtue of governmental action"."[26]

Moreover, the following passage supports this:

> "…Article 9.1(c) explicitly excludes a reading of the word "financed" whereby payments must be funded from government resources, as the provision states that payments can be financed by virtue of governmental action "whether or not a charge on the public account is involved". Thus, under Article 9.1(c), it is not necessary that the economic resources constituting the "payment" actually be paid by the government or even that they be paid from government resources. Accordingly, although the words "by virtue of" render governmental action essential, Article 9.1(c) contemplate that payments may be financed by virtue of governmental action even though significant aspects of the financing might not involve government."[27]

Under AoA Article 9.1(a), is no case to law to illuminate whether cross-subsidization in the form of internal allocation of funds could be held to satisfy the requirement of the subsidy being paid by the government. It is most likely not a close enough connection.

In sum: Both teams should be able to put forth arguments (pro and con) that it is possible for Subsidian sweet biscuit exporters to provide sweet biscuits in excess quantities below the average total cost of production. First, the export subsidies granted to the exports of sweet biscuits produced with domestic ingredients are so generous as to cover the loss with providing extra exports at low prices (whether produced with cheap imported ingredients or expensive domestic ingredients). Second, some exporters may also sell sweet biscuits to the domestic market and use some of those generous Amber box subsidies to cover the losses for exporting at too low prices.

The next criterion in the test is the issue of whether the "payments" are **"on exports."** This analysis is quite difficult to understand in *EC – Sugar* because the Appellate Body seems to differentiate its analysis from the "payments-in-kind; i.e. below the cost sales of C beet" and "cross-subsidization":

> "We note, first, that the Panel interpreted the phrase 'on the export' in the context of its analysis of 'payments' in the form of below-cost sales of C beet, and not in the context of examining 'payments' in the form of cross-subsidization. In relation to below-cost sales of C beet, the Panel stated that 'payments' 'on the export' need not be 'contingent on' the export but, rather, need be 'in connection' with exports.[28] When analyzing whether

[25] EC – Sugar, Appellate Body Report, para. 266.
[26] EC – Sugar, Appellate Body Report, para. 262.
[27] Canada – Dairy 21.5, Appellate Body Report, para. 114.
[28]Panel Reports, para. 7.275.

> 'payments' in the form of 'cross-subsidization' were 'on the export', the Panel did *not* use the same reasoning. Instead, the Panel based its findings on the following reasoning:
>
> C sugar [can] only be sold for export. If not reclassified, C sugar "may not be disposed of in the Community's internal market and must be exported without further processing." Because of that legal requirement, advantages, payments or subsidies to C sugar, that must be exported, are subsidies "on the export" of that product.[29] (footnote omitted)"[30]

Subsidia can argue that the "payments" are *not* "on export" because the "excess quantities" of sweet biscuits are not subject to any direct or indirect "mechanism" that in any manner gives incentives to export the excess quantities as was the case in *EC – Sugar* and *Canada – Dairy*. For example, producers sell such sweet biscuits in the domestic market, since there is no restriction on such sales comparable to the EC restrictions on C beet.

This is also reiterated in the Answers:

> **"Level of government control over the sweet biscuit market:**
>
> The facts do not mention anything about Subsidian control over the market, therefore you may assume the Subsidian government has no control over the market."

Competia may – on the other hand –argue that the test from C beet in *EC – Sugar* is the relevant test in this scenario "in connection" with exports, and the funds from the subsidies in either "Amber box" or the generous export subsidies are clearly allocated to the excess quantities and hence utilized "in connection" with exports.

Criterion (b): Whether the "payments" "on exports" are "**financed by virtue of government action"** – is yet another complicated test:

> With respect to the words "by virtue of", the Appellate Body has previously held that there must be a "nexus" or "demonstrable link" between the governmental action at issue and the financing of payments.[31] The Appellate Body clarified that not every governmental action will have the requisite "nexus" to the financing of payments.[32] For instance, the Appellate Body held that the "demonstrable link" between "governmental action" and the "financing" of payments would not exist in a scenario in which "governmental action ... establish[es] a regulatory framework merely *enabling* a third person freely to make and finance 'payments'."[33] In this situation, the link between the governmental action and the financing of payments would be "too tenuous", such that the "payments" could not be regarded as "financed by virtue of governmental action" within the meaning of Article 9.1(c).[34] Rather, according to the Appellate Body, there must be a "tighter nexus" between the mechanism or process by which the payments are financed (even if by a third person) and governmental action.[35] In this respect, the Appellate Body clarified that, although governmental action is essential, Article 9.1(c) contemplates that "payments may be financed by virtue of governmental action even though significant aspects of the financing might not involve government."[36] Thus, even if government does not fund the payments itself, it must play a sufficiently important part in the process by which a private party funds "payments", such

[29] *Ibid*, para. 7.321 (quoting Article 13(1) of Council Regulation (EC) No. 1260/2001).
[30] EC – Sugar, Appellate Body Report, para. 274.
[31] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 113; Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 130.
[32] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 131.
[33] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 115. (emphasis added)
[34] *Ibid*.
[35] *Ibid*.
[36] *Ibid*, para. 114.

> that the requisite nexus exists between "governmental action" and the "financing".[37] The alleged link must be examined on a case-by-case basis, taking account of the particular character of the governmental action at issue and its relationship to the payments made.[38]

The critical issue must be whether the sweet biscuit "scheme" merely *enabled* the exporters to sell at low prices or whether there is a *tighter nexus* in form of a mechanism or process. In *EC – Sugar,* the panel's findings on the issue regarding "cross-subsidization" (not appealed) centered around the *incentive* to produce Sugar C as well a series of factors that illuminated the high degree of government control over the entire Sugar area, which was utilized to transfer funds from the subsidized Sugar A and B into the "unsubsidized" Sugar C category.[39] Based on this, the Panel concluded:

> "In the Panel's view, the EC sugar regime and the cross-over benefits that it creates are thus the direct and foreseeable consequences of actions by the European Communities, within the meaning of Article 9.1(c) of the *Agreement on Agriculture,* not merely the decisions of private sugar producers responding to market incentives.
>
> Therefore, the Panel finds that the production of C sugar receives a payment, through cross-subsidization resulting from the operation of the EC sugar regime; there is a payment, in the form of transfers of financial resources on export *financed by virtue of governmental action.*"[40]

Both teams should therefore focus their arguments on the degree of control the Subsidian government has over the market. This may be the weakest area for Competia because the facts of the case do not give any indication of any type of *incentive* or *mechanism* by which the Subsidian government controls the market (recall also Answer on government control). Subsidia's strongest argument is therefore that each exporter *freely* can decide to export beyond the subsidized portion.

AoA Article 9.1 (a) and AoA Article 9.1(f)

As already mentioned, the scheduled export subsidy for sweet biscuits is most likely an export subsidy within the meaning of AoA Article 9.1(a) and (f), but the "excess quantities" are not supported directly by any export subsidies. If the export subsidy is so generous that it can be utilized on a greater quantity than the scheduled quantity, this does not involve any "extra funds" or put differently, it does not constitute a "new" subsidy. It is still the same amount of money we are analyzing. The effect of the money granted is that it sponsors cross-subsidization and this cross-subsidization is funded from the "internal allocation" in a private company of the generous amounts granted as export subsidies. The cross-subsidization is hence not a *direct subsidy,* nor is the cross-subsidization *contingent on incorporation in exported products* – it is a result of "internal allocation of funds." Note also the issue of establishing the direct link to the government in the analysis of AoA 9.1(c) above.

Article 10 – Anti Circumvention is purposefully excluded from the Competia's stated claims in the box in the end of the case.

Request for remedies:

There are no expedited rules for withdrawal of subsidies not in conformity with the AoA, and Competia will therefore have to request the Panel to require Subsida to withdraw its AoA

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[37]Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II),* para. 133.
[38]Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II),* para. 134 (referring to Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US),* para. 115).
[39] *See e.g.*, EC – Sugar, Panel Report (DS265), paras. 7.330-7.332.
[40] EC – Sugar, Panel Report (DS265), paras. 7.333-7.334.

inconsisten subsidies according to DSU Article 19.1, which is within a RPT as laid down in DSU Article 21.3 (15 months).

Wheat – The SCM Agreement, Part III

The wheat issue is defined so as to force examination of whether scheduled export subsidies have to comply with Part III of the SCM Agreement. The students should be able to pick this up from the box in the end of the case as well as from Answers:

> **"Scheduled commitments for <u>wheat:</u>**
>
> As illuminated in the box at the end of the case, the legal claim for "wheat" is brought under SCM Part III. The exact level in figures is irrelevant for answering this question. Subsidia maintains a portion of scheduled export subsidies on wheat (e.g. an AoA Article 9.1(a) subsidy). Moreover, the facts leaves it open whether Subsidia also has an unscheduled export subsidy as Subsidia may exceed its quantitative commitments. The task is therefore to analyze SCM Part III on the scheduled portion of the export subsidies – and if you think there is an unscheduled portion; then make a separate analysis for this portion also. Do not worry about the figures."

There is also a strong argument that the export subsides are prohibited under Part II, Article 3.1(a) of the SCM Agreement, but this part of the case is designed to require the parties to discuss Part III. No WTO Member to date has asked the DSB to deal with an export subsidy under Part III rather than Part II of the SCM Agreement, but it is reasonable to consider that a Member might well argue the two (Parts II and III) in the alternative, particularly given the ambiguity of the scope of the "except as provided in the Agreement on Agriculture" language of the *chapeau* of Article 3.1.

As reiterated in Answers, it should be noted that the facts of the case leave open the question of whether Subsidia exports quantities beyond its scheduled commitments. Some teams may therefore argue there are *two* categories of exports: one in conformity with the AoA, and one Competia would argue not to be in conformity with the AoA. Both categories are analyzed identically under Part III of the SCM Agreement, but Subsidia should try to prevent Part III of the SCM applies to scheduled subsidies.

Competia bears the **burden of proof** for establishing that Subsidia's export subsidies violates the obligations laid down in Part III or the SCM Agreement.

<u>Must the export subsidies on wheat comply with SCM Part III?</u>

<u>Scheduled (i.e. "legal" for purposes of AoA) Wheat Export Subsidies</u>

The mere invocation of the SCM Agreement by Competia on a subsidy in conformity with the AoA *should* spark objections from ***Subsidia*** on the grounds that Part III of the SCM Agreement does not apply to scheduled export subsidies under the AoA.

The issue is not clarified in any WTO decisions, so the teams have "room" to develop creative arguments. However, a few points will be made for the bench memo.

Competia can argue that it is already established that SCM Part III applies to scheduled subsidies as seen in *US – Cotton.*[41] But ***Subsidia*** can argue that this situation is different because this is an issue of Export subsidies, not Amber box as was the case in *US – Cotton.*

[41] Brazil did not question whether the US Amber box support in issue for the SCM Part III claim indeed was "legal" Amber box. *See* US – Cotton, Panel Report, para. 7.415.

Apart from noting that Part III was analyzed in *US – Cotton,* it would be an advantage if the teams also analyzed the relevant Articles in the SCM and AoA. A few things should be noted in relation to the notion of "exempt from actions" and the principle of *lex specialis.*

"Exempt from actions" means that relevant SCM or GATT clauses could *not be invoked* against the AoA subsidy.[42] This was laid down in the now expired "peace clause" in AoA Article 13, which for purposes of export subsidies, reads as follows:

> "export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be:
>
> …
>
> exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement."[43]

Moreover, both SCM Article 5 *in fine* and 6.9 included *specific* references stating that the disciplines of those Articles were subject to AoA Article 13. The Agreements in several places includes the references in both SCM and AoA – perhaps to make sure the users of the Agreement would notice the relationship when reading either of the Agreements.

However, regardless of *why* there was a reference in both SCM Articles 5, 6 and AoA Article 13, the result is the same: *Upon expiry* of AoA Article 13, SCM Article 5 and 6 must be understood as being subject only to the "fall-back" ***lex specialis*** provision in AoA Article 21.1.

AoA Article 21.1 reads as follows:

> "The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement."

The Panel in *US – Cotton* defined the *lex specialis* principle as laid down in AoA Article 21.1 to mean that:

> "In the event of a conflict between the provisions of the *Agreement on Agriculture* and a provision of the *GATT 1994* or another covered agreement pertaining to multilateral trade in goods in Annex 1A of the *WTO Agreement*, the rights and obligations in the *Agreement on Agriculture* would prevail to the extent of that conflict."[44]

The Appellate Body in *US – Cotton,* agreed with the Panel that AoA Article 21.1 would apply in three situations:

> "... where, for example, the domestic support provisions of the *Agreement on Agriculture* would prevail in the event that an explicit carve-out or exemption from the disciplines in Article 3.1(b) of the *SCM Agreement* existed in the *text* of the *Agreement on Agriculture*. Another situation would be where it would be impossible for a Member to comply with its domestic support obligations under the *Agreement on Agriculture* and the Article 3.1(b) prohibition simultaneously. Another situation might be where there is an explicit authorization in the text of the *Agreement on Agriculture* that would authorize a measure that, in the absence of such an express authorization, would be prohibited by Article 3.1(b) of the *SCM Agreement*."[45]

However, the Appellate Body – referring its holdings in *EC – Bananas III* and *Chile – Price Band System,* further added that:

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[42] *See e.g.*, US – Cotton, Panel Report, paras. 7.320-7.325.
[43] AoA Article 13(c)(iii).
[44] US – Cotton Panel Report, para. 7.657.
[45] US – Cotton, Panel Report, para. 7.1038; US – Cotton, Appellate Body Report, para. 532.

> "The Appellate Body has interpreted Article 21.1 to mean that the provisions of the GATT 1994 and of other Multilateral Trade Agreements in Annex 1A apply, "except to the extent that the *Agreement on Agriculture* contains specific provisions dealing specifically with the same matter". There could be, therefore, situations other than those identified by the Panel where Article 21.1 of the *Agreement on Agriculture* may be applicable."[46] (footnote omitted)

Based on the above excerpts of *US – Cotton*, ***Competia*** may argue that AoA Articles 8 and 9 dealing with scheduled export subsidies do *not* "deal specifically with the same matter" as SCM Part III. To emphasize this point, Competia can argue that SCM Articles 5 and 6 included references to AoA Article 13 because Part III of SCM otherwise *would* apply to scheduled export subsidies. To support this position, Competia could draw the attention to the Panel's analysis in *US - Cotton*:

> "The Panel notes that the wording of the reference to the *Agreement on Agriculture* found in Article 3.1 of the *SCM Agreement* differs from those found in Articles 5 and 6.9. However, this difference appears to be due to the fact that both agreements contain export subsidy disciplines, but only the *SCM Agreement* contains actionable subsidies obligations."[47]

In other words: SCM Article 3.1 refers to the AoA in general, which means the *lex specialis* principle in AoA Article 21.1, whereas SCM Article 5 and 6 only refers to AoA Articles 13. After the expiry, the usual *lex specialis* principle in AoA Article 21.1 still applies, but it is not relevant for "actionable subsidies" because this discipline is not covered in the AoA and SCM therefore applies independently from any disciplines in the AoA.

One of ***Subsidia's*** best arguments are that trade distortion is a well-know effect of export subsidies, but with the AoA compromise they are nevertheless still legal if they are within the scheduled limits. Therefore, SCM Part III and AoA Articles 3.3., 8 and 9 "deal specifically with the same matter" and the SCM Part III does *not* apply to scheduled export subsidies. Subsidia could, moreover, emphasize the difference between Amber box and export subsidies (that Amber box are not as trade distorting in nature as export subsidies) and Part III of SCM therefore applies to scheduled Amber box – as seen in *US – Cotton*. Subsidia could explain that most export subsidies would not survive the disciplines of SCM Part III and it would be undermining the compromise reached in the AoA.

In *US – Cotton*, the issue was whether the disciplines of SCM Article 3.1(b) – domestic content subsidies – applied to scheduled Amber box subsidies.[48] The Appellate Body analyzed whether AoA paragraph 7 of Annex 3 and Article 6.3 were to be considered *exceptions* to SCM Article 3.1(b):

> "Like paragraph 7 of Annex 3, Article 6.3 does not explicitly refer to import substitution subsidies. Article 6.3 deals with domestic support. It establishes only a *quantitative* limitation on the amount of domestic support that a WTO Member can provide in a given year. The quantitative limitation in Article 6.3 applies generally to all domestic support measures that are included in a WTO Member's AMS. Article 3.1(b) of the *SCM Agreement* prohibits subsidies that are contingent—that is, "conditional"—on the use of domestic over imported goods."[49] (footnotes omitted)

The Appellate Body thereafter upheld the findings of the Panel:

> "Article 6.3 does *not* provide that compliance with such "domestic support reduction commitments" shall necessarily be considered to be in compliance with other applicable

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[46] US – Cotton, Appellate Body Report, para. 532.
[47] US – Cotton, Panel Report, para. 7.278.
[48] *See e.g.*, US – Cotton, Appellate Body Report, para. 533.
[49] US – Cotton, Appellate Body Report, para. 544.

> WTO obligations. Nor does it contain an explicit textual indication that otherwise prohibited measures are necessarily justified by virtue of compliance with the domestic support reduction commitments."[50]

If Competia or Subsidia raises the issue of exceptions, Competia can argue that AoA Articles 3.3, 8 or 9 do not constitute an "exception" to SCM Part III because nothing in the text of AoA Articles 3.3, 8 or 9 indicates that conformity with those Articles provides automatic compliance with other WTO obligations. How Subsidia will argue that AoA Articles 3.3, 8 or 9 provides for an exception to SCM Part III is up to their own creativity.

Unscheduled (i.e. "not legal" for purposes of AoA) Wheat Export Subsidies

As for the unscheduled subsidies or "excess quantities," it is clear that the SCM applies as they do not enjoy any benefits – if such exist – from being consistent with the AoA obligations.

Is there a violation of SCM Article 5 under 6.3(c) or (d)?

First of all, ***Competia*** needs to establish that there is a **"subsidy"** within the meaning of SCM Article 1.1 and that the subsidy is **"specific"** within the meaning of SCM Article 2 as required by SCM Article 1.2. Note that this would not be necessary if Competia were relying on Part II, Article 3.1(a)—prohibited export subsidies—because all export subsidies are deemed specific under Article 2.3.

The Panel report in *US – Cotton* discusses (paras. 7.1109 ff.) the specificity issue in some detail, and is applicable, *mutatis mutandis*, to the wheat issue in this case. There, there were a series of U.S. support programs for cotton, i.e., user marketing (step 2) payments to domestic users and exporters; marketing loan program payments; crop insurance payment and cottonseed payments, most of which were admitted by the U.S. to be specific. The Panel noted that "subsidies that are, either in fact or in law, specifically granted to an 'enterprise' or 'industry' (or group of enterprises or industries) meet the 'specificity' criteria in Article 2 of the SCM Agreement," and that "an industry, or group of 'industries,' may be generally referred to by the type of products they produce."[51] Most of the U.S. programs were determined by the panel to be specific, based on "a textual analysis of 'the legislation pursuant to which the granting authority operates,' to discern whether or not it 'explicitly limits access to a subsidy to certain enterprises' leads us to conclude that such subsidies are 'specific'…." The Panel noted that some of the subsidies were available only with regard to upland cotton, while others 'pertain to a restricted number of agricultural products, but are not widely or generally available in respect of all agricultural production, let alone the entire universe of United States production of goods."[52] (The specificity issue was not appealed in *US – Cotton*.)

To the extent that the specificity analysis is applicable to an export subsidy that is being analyzed under Part III rather than Part II, it is relevant that the facts regarding the wheat export subsidy do not indicate whether it is provided to other agricultural products or industries. However, it would be reasonable to assume that the subsidy is not provided to all agricultural products so that the "pertain to a restricted number" language from *US-Cotton* would be applicable. It would also be reasonable for the teams to rely on SCM Agreement Article 2.1, and minimize any further discussion of specificity, going directly instead to the substance of "serious prejudice" under Part III of the SCM Agreement.

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[50] US – Cotton, Appellate Body Report, para. 545. *See* also id., at 546.
[51] US – Cotton, Panel Report, paras. 7.1138, 7.1142.
[52] US – Cotton, Panel Report, paras. 7.1149-7.1151.

For this **substantive discussion of the serious prejudice claim,** it is noted that the facts lead directly to the issue of "world market share," which is SCM Article 5(c) along with 6.3 (d). There are, moreover, "extra hints" in the Answers as to finding the "correct" clause:

> **"Wheat market share in 2005:**
>
> We didn't know when the case was brought by Competia before year 2005 was over, and it is not relevant, as you have the facts from the 3 previous years, which is sufficient.
>
> **In what specific form does Subsidia provide the "price-contingent" export subsidies? In particular, how are export subsidies being linked to wheat prices ?**
>
> It is not relevant to analyze these facts in order to analyze the issue under SCM part III. Hint: one of the categories under SCM Part III "fits" the facts you have.."

SCM Article 5 reads as follows:

> "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:
>
> (a) injury to the domestic industry of another Member[11];
>
> (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994[12];
>
> (c) serious prejudice to the interests of another Member.[13]
>
> ___________
>
> [11] The term "injury to the domestic industry" is used here in the same sense as it is used in Part V.
>
> [12] The term "nullification or impairment" is used in this Agreement in the same sense as it is used in the relevant provisions of GATT 1994, and the existence of such nullification or impairment shall be established in accordance with the practice of application of these provisions.
>
> [13] The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice."

SCM Article 6.3(c) and (d) read as follows:

> "Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:
>
> ...
>
> (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;
>
> (d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity[17] as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.
>
> ___________

> [17]Unless other multilaterally agreed specific rules apply to the trade in the product or commodity in question."

If the students wish to analyze any other sub-paragraph of Article 5 or 6.3, they will not have sufficient facts. It will, however, be understandable if they analyze Article 6.3(c) because this was analyzed in *US – Cotton.* In *US – Cotton*, the Appellate Body analyzed the relevant appealed issues under SCM Article 6.3(c) and found that the "price-contingent"[53] subsidies constituted serious prejudice.[54] The wheat subsidies are also "price-contingent," and this may confuse some students to go along with SCM Article 6.3(c).

SCM Article 6.3(d):

The wheat issue is intended to be analyzed under SCM Article 6.3(d) regarding world market shares. The Appellate Body in *US – Cotton* did, however, not analyze SCM Article 6.3(d) because it had already found the US in violation of SCM Article 6.3(c).[55] It must therefore be expected that the students will follow the analysis set out in the *US – Cotton* Panel Report, and perhaps include some references to the issues that were appealed, but not opined upon.

The Panel in *US – Cotton* initiated the analysis of SCM Article 6.3(d) as follows:

> "Having established that these subsidies may be actionable for the purposes of Article 5, we observe that there is no disagreement between the parties that an examination under Article 6.3(d) may precede any examination under Article 5(c) of the *SCM Agreement*. There is also no disagreement, in this part of this dispute, that an affirmative conclusion under Article 6.3(d) is a necessary element for an affirmative serious prejudice finding under Article 5(c). We therefore first examine the elements of Brazil's claim under Article 6.3(d) of the *SCM Agreement*."[56]

Article 6.3(d) consists of 6 elements:

(i) the effect of the subsidy;

(ii) is an increase in the world market share;

(iii) of the subsidizing Member;

(iv) in a particular subsidized primary product or commodity;

(v) as compared to the average over the preceding period of three years; and

(vi) this increase "follows a consistent trend over a period when subsidies have been granted."[57]

In *US – Cotton,* the parties disputed the definition of "world market share", and the Appellate Body ended up *not* ruling on the issue.[58] The facts of the wheat issue only mention one set of numbers referring to the "world market shares" and the students should hence rely on those as being the relevant numbers for purposes of SCM Article 6.3(d).

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[53] *See* US – Cotton, Panel Report, para. 7.1305-7.1307 (non-price-contingent subsidies), and paras. 7.1290-7.1304 (price-contingent subsidies).
[54] *See* US – Cotton, Appellate Body Report, para. 496. *See also* US – Cotton, Panel Report, para. 7.1416.
[55] *See* US – Cotton, Appellate Body Report, paras. 507-512.
[56] US – Cotton, Panel Report, para. 7.1419.
[57] *See* US – Cotton, Panel Report, para. 7.1420.
[58] *See* US – Cotton, Panel Report, paras. 7.1424-7.1465; US – Cotton, Appellate Body Report, paras. 497-512.

Criteria (i), (ii) and (iii):

Competia can argue that over the past 10 years, since the export subsidy has been in place, Subsidia's increase of the "world market share" has risen about 5% each year.

Subsidia can argue that although its market share has gone up, this cannot be caused by the export subsidy because in the same period, Subsidia has cut its subsidies substantially (by 36%).

Criterion (iv):

Wheat should be considered a primary product as well as a commodity. Subsidia is of course entitled to disagree.

Criterion (v):

The case includes numbers for the last three years (Subsidia's world market share was 35% in 2002, 37% in 2003 and 39% in 2004). Subsidia's can of course try to find arguments for why criterion (v) is not met, although it appears a bit difficult.

Criterion (vi):

The case also supplies information about the growth rate since the subsidy was put in place. This may also be a bit difficult for Subsidia to deny. Subsidia's best arguments are probably under criterion (i).

Generally the arguments under SCM Article 6.3(d) are the easiest part of the wheat issue – the issue of the relationship between the AoA and the SCM is more difficult.

SCM Article 5(c):

The teams will also have to analyze SCM Article 5 as well as the **"Chapeau"** of SCM Article 6.3. The Panel in *US – Cotton*, included the following in its analysis:

First it analyzed **"serious prejudice":**

> "Article 5(c) of the SCM Agreement sets out the concept of "serious prejudice" to the interests of another Member as one of three forms of "adverse effects" in Article 5 of the SCM Agreement. The chapeau of Article 6.3 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply."(emphasis added) Article 6.3(c) defines one circumstance in which such "serious prejudice" "may" arise."[59]

The Panel did *not* find it necessary to analyze SCM Article 5(c) independently once it had found SCM Article 6.3(c) to be satisfied. The Appellate Body described the Panel's holding as follows:

> "Thus, the Panel provided two alternative reasons for finding that the significant price suppression it had found amounted to serious prejudice within the meaning of the Article 5(c) of the *SCM Agreement*. The Panel's primary reason was that if the effect of a subsidy is significant price suppression within the meaning of Article 6.3(c), this is sufficient, without more, to conclude that the subsidizing Member has caused serious prejudice to the interests of another Member within the meaning of Article 5(c). The Panel's alternative reason was that, even if this is not sufficient, Brazil had fulfilled the burden of demonstrating that the United States had caused serious prejudice to the interests of Brazil within the meaning of Article 5(c)."[60] (footnotes omitted)

[59] US – Cotton, Panel Report, para. 7.1368.
[60] US – Cotton, Appellate Body Report, para. 486.

The Appellate Body did, however, not opine on the issue because it turned out that the parties did not appeal the finding.[61] Based on that uncertainty, Subsidia could argue that independent finding of "serious prejudice to the interest of another Member" within SCM Article 5(c) is necessary. Competia could of course argue the opposite.

Subsidia could also argue that the situation is different for purposes of SCM Article 6.3(d) because the analysis of sub-paragraph (d) unlike (c) does not involve any analysis of the *effect* on Competia:

> "For the purposes of this dispute, we do not believe that it is necessary to develop a fixed interpretation of the outer parameters of what may constitute "serious prejudice" to the interests of another Member within the meaning of Article 5(c) of the *SCM Agreement*. At the very least, given the subject matter covered by the *SCM Agreement* – government subsidies in respect of goods – the effects-based situations identified in the sub-paragraphs of Article 6.3, and the reference in the chapeau of Article 6.3 to serious prejudice "in the sense of" Article 5(c), **we believe that such "serious prejudice" may involve the effects of subsidies on the complaining Member's trade in a given product. That is, it addresses the volumes and prices and flows of such trade, which may, by logical extension, affect a producing Member's domestic production of that product. We therefore consider that a detrimental impact on a complaining Member's production of, and/or trade in, the product concerned may fall within the concept of "prejudice" in Article 5(c) of the *SCM Agreement*.**
>
> Moreover, the prejudice involved must be "serious". In one of its ordinary meanings, "serious" means "important" and "not slight or negligible". Thus, the prejudice in terms of the effect on Brazil's production of, and/or trade in, upland cotton must be such as to affect Brazil's production of upland cotton, to a degree that is "important", "not slight or negligible", or meaningful." (footnotes omitted, emphasis added in **bold** letters)[62]

As provided in the case: "Competia claims – based on a series of complex economic calculations – that the fluctuations in its world market share are caused by the trade-distorting effect of the price-contingent subsidies provided by Subsidia." Competia should then argue that this amounts to "serious prejudice to its interest."

Request for remedies:

Competia should request the Panel to require Subsida to remove the subsidy or "its adverse" effects as provided for in SCM Article 7.9. SCM Article 7.9 is a faster remedy (six months) than the usual 15 months provided for in DSU Article 21.3. If it had been a claim under SCM Article 3, the withdrawal would have to be "without delay" as provided for in SCM Article 4.7.

Pork – Agreement on Agriculture

The pork issue is very similar to the sweet biscuit issue, but the pork cross-subsidization happens from Blue box into export.

However, the first issue ***Competia*** can raise is whether this type of Subsidian domestic support falls within the definition of **Blue box** as laid down in AoA Article 6.5(a):

> "Direct payments under production-limiting programmes shall not be subject to the commitments to reduce domestic support if:
>
> (i) such payments are based on fixed area and yields; or
>
> (ii) such payments are made on 85 or less of the base level of production; or

[61] *See* US – Cotton, Appellate Body Report, para. 488.
[62] US – Cotton, Panel Report, para. 7.1392-7.1392.

(iii) livestock payments are made on a fixed number of head."

Competia bears the **burden of proof** as this is not an issue caught by AoA Article 10.3. If Competia succeeds in establishing that the measure is Amber and not Blue box, the support will not be in conformity with AoA Articles 6 and 7:

To schedule Amber box domestic support, a Member must include the total AMS Part IV of its schedule.[63] The exception for *de minimis* support is not relevant for the facts of the pork issue (Subsidia appears to subsidize far beyond any *de minimis* limits).[64] When Subsidia has scheduled its pork-support as Blue box, this means that is *has not* included the support in its total AMS.[65] Therefore, *if* the Panel should find the domestic support to be Amber box, and the support is not included in the total AMS under Part IV of its schedule, the support is *not* in conformity with AoA Article 6 and 7.

The students may also wish to note the issue of reduction commitments. If the domestic support is *not* Blue box, it is most likely Amber box and hence subject to the reduction commitments for Amber box. Amber box is subject to reduction commitment of 20% in the total AMS[66] in the period 1995-2000. Export subsidies are subject to a 36% cut by value and 21% cut by quantity in the same period.

Competia could question whether the "starting point" of production is too high to even schedule it as a Blue box subsidy. Subsidia is the leading exporter of pork, and once the reduction goal for year 2015 is reached, it will still be leading exporter of pork.

Another issue could be whether the reduction of the production is "sufficient". Subsidia cuts the production with 2 million swine over a period of 15 years. In percentages, cutting the production from 9 to 7 million is a cut of 22%.

This issue has never been subject for review by any panel, so the teams may or may not be able to develop creative arguments here.

Competia should also (as its primary claim or as an alternative to the above if the Panel should not find the domestic support to be Amber and hence illegal) raise the issue of finding an **unscheduled export subsidy.** Again, it is important to recall that AoA Article 10 regarding anti-circumvention is purposefully excluded and the students should focus on AoA Articles 3 and 8 for finding export subsidies that are not in conformity with the AoA.

Another thing to recall is that, unlike in the sweet biscuits scenario, Subsidia has not scheduled *any* export subsidies in the pork scheme. This means that the export subsidy must be found on *all* the exports, and there is *no* issue of any "excess quantities" as none are scheduled. Another consequence is that since there are no scheduled commitments, AoA Article 10.3 does not reverse the **burden of proof**, and it is up to Competia to establish that Subsidia's pork exports are supported by an export subsidy within the meaning of AoA Article 9.1. However, before going into AoA Article 9.1, the facts should be clarified.

What happens in this scenario is that the farmers are able to sell swine cheaply to the pork manufacturers because swine producers get paid a certain amount of money for each swine they produce. In turn, pork manufacturers/exporters are capable of exporting huge amount of pork products at very low prices. This scenario is a scenario of *"payments-in-kind."*

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[63] AoA Article 6.1.
[64] AoA Article 6.4.
[65] AoA Article 6.5.
[66] AMS is defined in AoA Article 1 (a).

Regarding the production-limitation, it should be noted that in theory, the farmers will be able to provide cheaper and cheaper swine as the years go by and they are entitled to the same amount of money, but only are allowed to produce less swine. This may, however, not happen in practice as the farmers probably wish to earn the same amount of profits as the previous years and hence gradually charge higher and higher prices for the swine in order to make up for the lost profits caused by a smaller amount of swine sales each year.

Does the sale cheap swine constitute an export subsidy under AoA Article 9.1(a)?

Competia will probably be most successful in relying on AoA Article 9.1(c) rather than (a) for the same reasons as outlined under the sweet biscuits issue – namely that the cheap swine are *not* provided directly by the government, but are provided by the farmers. However, on cross-subsidization, it was an issue of "internal allocation of funds" on which the Appellate Body stated:

> "We note, first, that Article 9.1(c) does not qualify the term "payments" by reference to the entity making, or the entity receiving the payment. This may be contrasted with, for instance, Articles 9.1(a) and 9.1(b) of the Agreement *on Agriculture*, which specifically refer to the entities making and also, in the case of Article 9.1(a), to the entity receiving the alleged export subsidy. Moreover, Article 9.1(c), on its face, does not qualify the meaning of the term "payments", other than by requiring that the alleged "payments" be "on the export of an agricultural product" and "financed by virtue of governmental action"."[67]

Moreover, the following passage supports this:

> "…Article 9.1(c) explicitly excludes a reading of the word "financed" whereby payments must be funded from government resources, as the provision states that payments can be financed by virtue of governmental action "whether or not a charge on the public account is involved". Thus, under Article 9.1(c), it is not necessary that the economic resources constituting the "payment" actually be paid by the government or even that they be paid from government resources. Accordingly, although the words "by virtue of" render governmental action essential, Article 9.1(c) contemplates that payments may be financed by virtue of governmental action even though significant aspects of the financing might not involve government."[68]

Regarding the degree of government involvement for 9.1(a), the Panel opined:

> "The question of government involvement required under Article 9.1(a) is one of degree that must be addressed on a case-by-case basis. In this dispute, we need to examine first how milk is made available under Classes 5(d) and (e). Thereafter, we need to assess the extent to which Canadian governments or their agencies are involved in this process. On that basis – and applying the ordinary meaning of the term "provision by governments or their agencies" referred to above, in its context and in light of the object and purpose of the Agreement on Agriculture - we will then decide whether or not the payment in kind made under Classes 5(d) and (e) can be said to be provided by Canada's governments or their agencies."[69] (Footnotes omitted)

As a result, the Panel found the involvement was enough to satisfy AoA Article 9.1(a) and this was upheld by the Appellate Body:

> "As outlined above, the CDC, advised by other bodies acting under the authority delegated to them by governments, decides whether or not any and how much milk can be exported. The CDC then – in a very direct way, by providing a permit – makes milk available under Classes 5(d) and (e). Finally, the provincial milk marketing boards, acting under delegated authority, physically offer the milk to processors. We find, therefore, on the basis of the specific circumstances of this case, that the milk made available to processors for export under Classes

[67] EC – Sugar, Appellate Body Report, para. 262.
[68] Canada – Dairy 21.5, Appellate Body Report, para. 114.
[69] Canada – Dairy, Panel Report, para. 7.67.

> 5(d) and (e) at a discounted price, is provided by Canada's governments or their agencies in the sense of Article 9.1(a)."[70]

The **relationships between government agencies** were not analyzed for purposes of AoA Article 9.1(a) in *EC – Sugar* because AoA Article 9.1(c) was utilized the below the cost sales of C beet as well as for cross-subsidization. Only the *direct* subsidies granted to Indian and ACP sugar was analyzed under AoA Article 9.1(a).

Based on the above, it is probably difficult for Competia to establish that the Subsidian government provides the cheap swine, because the facts of the case do not give any indications that any government agencies in any manner is involved with the sale of swine in Subsidia.

On the issue of **benefit**, the Appellate Body held that there must be a benefit when finding whether "payments-in-kind" constitute a subsidy for purposes of AoA Article 9.1(a):

> "In our view, the term "payments-in-kind" describes one of the *forms* in which "direct subsidies" may be granted. Thus, Article 9.1(a) applies to "direct subsidies", *including* "direct subsidies" granted in the form of "payments-in-kind". We believe that, in its ordinary meaning, the word "payments", in the term "payments-in-kind", denotes a transfer of economic resources, in a form other than money, from the grantor of the payment to the recipient. However, the fact that a "payment-in-kind" has been made provides no indication as to the economic *value* of the transfer effected, either from the perspective of the grantor of the payment or from that of the recipient. A "payment-in-kind" may be made in exchange for full or partial consideration or it may be made gratuitously. Correspondingly, a "subsidy" involves a transfer of economic resources from the grantor to the recipient for less than full consideration. As we said in our Report in *Canada – Aircraft*, a "subsidy", within the meaning of Article 1.1 of the *SCM Agreement*, arises where the grantor makes a "financial contribution" which confers a "benefit" on the recipient, as compared with what would have been otherwise available to the recipient in the marketplace.[71] Where the recipient gives full consideration in return for a "payment-in-kind" there can be no "subsidy", for the recipient is paying market-rates for what it receives. It follows, in our view, that the mere fact that a "payment-in-kind" has been made does not, *by itself*, imply that a "subsidy", "direct" or otherwise, has been granted."[72]

On the issue of **benchmark** for AoA Article 9.1(a), the following should be noted:

In *Canada – Dairy*, the Panel operated with two possible benchmarks. First, was the milk provided by the provincial milk boards for export use (the payment-in-kind) at a price below the milk price prevailing in the Canadian market? Second, was the milk price also lower than the milk price obtainable by the processors from any other source?[73]

For the *Canada – Dairy* Panel, if it could be shown that the milk provided by the provincial milk boards was at a price below milk obtainable from any other source, it will also be below the first benchmark price, and "a bounty or benefit – i.e., something the would otherwise not have obtained – would, indeed be conferred."[74]

The Panel could, of course, have established a tougher standard for Canada, by using only the first benchmark. In that instance, Canada would have been found to have provided a subsidy because the milk provided to the processors/exporters was sold at a price lower than the prevailing market price, even if there had been an external market price that was lower. However, the Panel chose to use the second benchmark (which turned out to be irrelevant because with the high Canadian duties

[70] Canada – Dairy, Panel Report, para. 7.86.
[71] *Supra*, footnote 49, paras. 156 and 157.

[72] Canada – Dairy, Appellate Body Report, para. 87.
[73] Canada – Dairy, Panel Report, para. 7.47.
[74] Canada – Dairy, Panel Report, para. 7.48.

on imported milk any imported milk would be higher in price than the normal Canadian market price).

For example, assume the payment in kind price is 1.0, the normal price in Canada is 1.25 and the price of the imported milk is 0.9. If the first benchmark were used in this example, there is a subsidy (1.25 – 1.0). However, if the second benchmark were used, there is no subsidy, because the payment in kind price is higher than the lowest price. However, in the case, the price of imported milk was higher than the normal price in Canada, so the choice of benchmarks did not matter.

In this example, the benefit is the difference between the normal price for the product (milk in *Canada-Dairy*, and the subsidized price (whether the subsidy is paid directly or in the form of payments in kind). In this hypothetical example, the benefit is 0.25, the difference between the normal price of 1.25 and the subsidized price of 1.0 However, if the milk producers had received milk at a charge of 1.25 instead of 1.0—"full consideration" in the above quotation, there would have been no benefit and thus no subsidy.

The Appellate Body did not opine on these benchmarks, as it had already found a subsidy within the meaning of AoA Article 9.1(c). Thus, it is difficult to guess whether the benchmark – developed in later cases – in AoA Article 9.1(c) *below the average total cost of production* also applies to AoA Article 9.1(a).

Under all circumstances, the teams only have figures for world market prices and average total cost of production, so they have to work their arguments around that.

<u>Do cheap swine sales constitute an export subsidy under AoA Article 9.1(c)?</u>

We have already analyzed AoA Article 9.1(c) under the sweet biscuits scenario. However, a few differences should be pointed out at the outset. Firstly, this is an issue of **payments-in-kind** as it was the case in the analysis of below the cost sales of C beet in *EC – Sugar*, and cheap milk in *Canada – Dairy* and *Canada – Dairy 21.5*. Secondly, the **burden** is on Competia to establish there is an export subsidy.

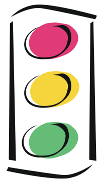
Competia can easily establish that the benchmark for **"payments"** is met because the facts of the case reveal that the pork exports are priced at 15% below the average cost of production.

On exports, follow the same type of arguments as in sweet biscuits.

Financed by virtue of government action equally follows the type of arguments in sweet biscuits.

<u>Request for Remedies:</u>

Same as under sweet biscuits.



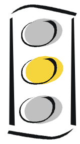
ANNEX 1

Domestic support in agriculture

THE BOXES

In WTO terminology, subsidies in general are identified by "boxes" which are given the colours of traffic lights: green (permitted), amber (slow down — i.e. be reduced), red (forbidden). In agriculture, things are, as usual, more complicated. The Agriculture Agreement has no red box, although domestic support exceeding the reduction commitment levels in the amber box is prohibited; and there is a blue box for subsidies that are tied to programmes that limit production. There are also exemptions for developing countries (sometimes called an "S&D box", including provisions in Article 6.2 of the agreement).

AMBER BOX

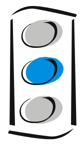


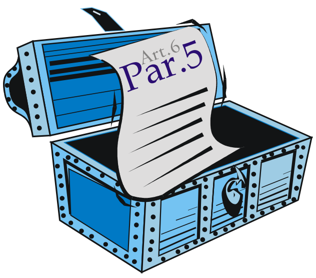
All domestic support measures considered to distort production and trade (with some exceptions) fall into the amber box, which is defined in Article 6 of the Agriculture Agreement as all domestic supports except those in the blue and green boxes. These include measures to support prices, or subsidies directly related to production quantities.

These supports are subject to limits: "de minimis" minimal supports are allowed (5% of agricultural production for developed countries, 10% for developing countries); the 30 WTO members that had larger subsidies than the de minimis levels at the beginning of the post-Uruguay Round reform period are committed to reduce these subsidies.

The reduction commitments are expressed in terms of a "Total Aggregate Measurement of Support" (Total AMS) which includes all supports for specified products together with supports that are not for specific products, in one single figure. In the current negotiations, various proposals deal with how much further these subsidies should be reduced, and whether limits should be set for specific products rather than continuing with the single overall "aggregate" limits. In the Agriculture Agreement, AMS is defined in Article 1 and Annexes 3 and 4.

BLUE BOX

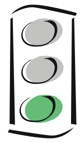




This is the "amber box with conditions" — conditions designed to reduce distortion. Any support that would normally be in the amber box, is placed in the blue box if the support also requires farmers to limit production (details set out in Paragraph 5 of Article 6 of the Agriculture Agreement).

At present there are no limits on spending on blue box subsidies. In the current negotiations, some countries want to keep the blue box as it is because they see it as a crucial means of moving away from distorting amber box subsidies without causing too much hardship. Others wanted to set limits or reduction commitments, some advocating moving these supports into the amber box.

GREEN BOX



The green box is defined in Annex 2 of the Agriculture Agreement.

In order to qualify, green box subsidies must not distort trade, or at most cause minimal distortion (paragraph 1). They have to be government-funded (not by charging consumers higher prices) and must not involve price support.

They tend to be programmes that are not targeted at particular products, and include direct income supports for farmers that are not related to (are “decoupled” from) current production levels or prices. They also include environmental protection and regional development programmes. “Green box” subsidies are therefore allowed without limits, provided they comply with the policy-specific criteria set out in Annex 2.

In the current negotiations, some countries argue that some of the subsidies listed in Annex 2 might not meet the criteria of the annex’s first paragraph — because of the large amounts paid, or because of the nature of these subsidies, the trade distortion they cause might be more than minimal. Among the subsidies under discussion here are: direct payments to producers (paragraph 5), including decoupled income support (paragraph 6), and government financial support for income insurance and income safety-net programmes (paragraph 7), and other paragraphs. Some other countries take the opposite view — that the current criteria are adequate, and might even need to be made more flexible to take better account of non-trade concerns such as environmental protection and animal welfare.