# WORLD TRADE ORGANIZATION

RESTRICTED

**WT/DSB/M/141**
14 February 2003

(03-0965)


**Dispute Settlement Body**
**17 January 2003**

**MINUTES OF MEETING**

Held in the Centre William Rappard
on 17 January 2003

*Chairman: Mr. Carlos Pérez del Castillo (Uruguay)*

Subjects discussed: Page



## 1. United States – Countervailing duties on certain corrosion-resistant carbon steel flat products from Germany

(a) Implementation of the recommendations of the DSB

1. The Chairman recalled that in accordance with the DSU provisions, the DSB was required to keep under surveillance the implementation of recommendations and rulings of the DSB in order to ensure effective resolution of disputes to the benefit of all Members. In this respect, Article 21.3 of the DSU provided that the Member concerned shall inform the DSB, within 30 days after the date of adoption of the panel or Appellate Body report, of its intentions in respect of implementation of the recommendations and rulings of the DSB. He recalled that at its meeting on 19 December 2002, the DSB had adopted the Appellate Body Report in the case on: "United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany" and the Panel Report on the same matter, as modified by the Appellate Body Report. He invited the United States to inform the DSB of its intentions in respect of implementation of the DSB's recommendations.

2. The representative of the United States said that his delegation was pleased to inform Members that the United States intended to implement the DSB's recommendations in a manner that respected its WTO obligations. He said that the United States would need a reasonable period of time in which to do so. His delegation stood ready to discuss this matter with the EC in accordance with Article 21.3(b) of the DSU.

3. The representative of the European Communities said that the EC wished to note that the Panel and the Appellate Body were not alone in judging the US measure as flawed. The US Court of International Trade had already done so twice in February 2002 and again in October 2002, in accordance with a remand procedure. The EC believed that US Department of Commerce had all the

time it needed to correct its mistakes. Therefore, the EC considered that the United States should promptly implement the DSB's rulings in this case by immediately lifting the WTO-incompatible duties on carbon steel flat products from Germany.

4. The DSB took note of the statement, and of the information provided by the United States regarding its intentions in respect of implementation of the DSB's recommendations in this case.

## 2. Canada – Measures affecting the importation of milk and the exportation of dairy products: Second recourse to Article 21.5 of the DSU by New Zealand and the United States

(a) Report of the Appellate Body (WT/DS103/AB/RW2 – WT/DS113/AB/RW2) and Report of the Panel (WT/DS103/RW2 – WT/DS113/RW2)

5. The Chairman recalled that at its meeting on 18 December 2001, the DSB had decided, in accordance with Article 21.5 of the DSU, to refer to the original Panel the matter raised by New Zealand and the United States concerning Canada's implementation of the DSB's recommendations in this case. The Report of the Panel contained in document WT/DS103/RW2 – WT/DS113/RW2 was circulated on 26 July 2002. On 23 September 2002, Canada had notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel. At the present meeting, he wished to draw attention to the communication from the Appellate Body contained in document WT/DS103/30 – WT/DS113/30 transmitting the Report of the Appellate Body on this matter, which had been circulated in document WT/DS103/AB/RW2 – WT/DS113/AB/RW2 on 20 December 2002, in accordance with Article 17.5 of the DSU. He reminded delegations that in accordance with the Decision on Procedures for the Circulation and Derestriction of WTO Documents contained in document WT/L/452, the Appellate Body Report and the Panel Report had been circulated as unrestricted documents. He said that the Reports were now before the DSB for adoption and that this adoption procedure was without prejudice to the right of Members to express their views on the Reports.

6. The representative of New Zealand said that his country welcomed the adoption of the Panel and Appellate Body Reports that had confirmed New Zealand's longstanding view that replacement measures introduced by Canada following the adoption of the DSB's recommendations and rulings in the original Canada - Dairy dispute were inconsistent with Canada's obligations under the Agreement on Agriculture. New Zealand believed that through their Reports the Panel and Appellate Body had made an extremely useful contribution to the interpretation of the WTO export subsidy disciplines in the agricultural sector. While it was a sad fact that agricultural export subsidies, unlike other export subsidies, were not yet totally prohibited under WTO rules, these Reports served as a reminder to WTO Members that the export subsidy provisions of the Agreement on Agriculture could not be easily evaded. This was an excellent message at this time as Members were negotiating the elimination of agricultural export subsidies.

7. The focus of this dispute was the "Commercial Export Milk" (CEM) scheme introduced by Canada as a replacement for the "Special Milk Classes" (SMC) programme that had been found in 1999 to be inconsistent with Canada's export subsidy reduction commitments under the Agreement on Agriculture. However, the significance of the Reports went well beyond this particular Canadian scheme. The Panel and Appellate Body rulings should serve to convince other Members that might have been thinking of adopting similar schemes to the Canadian one that they simply should not go there. New Zealand welcomed in particular the clarification that the Appellate Body had provided on both key aspects of Article 9.1(c) of the Agreement on Agriculture: i.e. on the issue of "payment" and on the issue of "financed by virtue of governmental action". In relation to "payment", the Appellate Body had taken the opportunity to elaborate on the constituent elements of the "average total cost of production" test outlined initially in its December 2001 ruling relating to the first recourse to Article 21.5 by New Zealand and the United States. The Appellate Body had made it clear that the

application of this test to determine whether agricultural products were being made available for export at less than the average total cost of production had to be on a basis of "all monetary and non-monetary costs of production, such as the costs of family labour and management, and of owner's equity" (para. 110 of the AB Report). The Appellate Body had also clarified the "average total cost of production" was to be measured on an industry-wide basis – on the basis of the average costs of all producers, rather than on the basis of individual producer's costs.

8. The other key issue, as he had noted, was the "financed by virtue of governmental action" aspect of Article 9.1(c). On this point, the Appellate Body had found that governmental action in the form of the high administered price enabled milk producers to secure highly remunerative prices for sales of domestic milk. As a result of this, producers were able to make sales of CEM at below the average total cost of production. Therefore, governmental action regulating the returns to producers on the domestic milk market cross-subsidized sales by milk producers to processors of dairy products for export. Put simply, the Appellate Body had put paid to attempts to manipulate domestic support programmes in a manner which resulted in exports that would not take place in the absence of such governmental measures.

9. The Panel had made an alternative finding that the CEM scheme breached Article 10.1 of the Agreement on Agriculture dealing with circumvention of export subsidy commitments. Given that it had already found that the CEM scheme fell within the list of export subsidies set out in Article 9 of the Agreement, the Appellate Body had declined to rule on this alternative finding. New Zealand would, however, take this opportunity to reiterate its view that the "anti-circumvention" objective of Article 10 demanded that a broad approach was taken to the scope of export subsidies covered by that provision.

10. New Zealand very much hoped that Canada would now take prompt action to implement the rulings of the Panel and Appellate Body in this matter. Earlier this week, New Zealand and the United States had participated in consultations with Canada at which Canada had provided some information on its intentions in this regard. Although the Article 22.6 arbitration process was due to resume on 17 January 2003, following the adoption of the Panel and Appellate Body Reports, New Zealand and Canada had agreed on 16 January 2003 that the arbitration proceedings remain suspended until 7 February to allow time for further consultations. In conclusion, he said that it was important to recall the fact that this dispute related to replacement measures – the CEM scheme – introduced by Canada in the wake of the findings that its earlier SMC scheme was inconsistent with its WTO commitments. Accordingly, while New Zealand welcomed Canada's statement that it would indeed dismantle the CEM scheme, it would also underline that implementation of the rulings would require Canada to ensure not only the elimination of the CEM Scheme, but also that no new circumventory measures were introduced in its place. Accordingly, New Zealand did not wish to see the history of this dispute repeated further so that yet a further "three letter" scheme succeeded the previous two. In the meantime, and while noting that the Article 22.6 arbitration remained suspended until 7 February, New Zealand reserved all of its WTO rights in relation to this matter.

11. The representative of the United States said that his country was pleased that these Reports were before the DSB at the present meeting. The Reports showed that the Appellate Body and the Panel considered the issues with care and precision. The United States wished to thank the members of the Appellate Body, the Panel, and the Secretariat for their hard work on this matter. The United States particularly wished to thank the Panel members for most of whom this was the third panel proceeding on the same topic. Their service had begun in August 1998. Their years of continued service were a credit to the WTO as an institution. The United States, of course, supported adoption of these Reports, which concluded that Canada had acted inconsistently with its obligations under the Agreement on Agriculture by providing export subsidies listed in Article 9.1(c) of that Agreement in excess of the quantity commitment levels specified in Canada's Schedule. The Appellate Body and the Panel had, therefore, appropriately found that Canada had failed to implement the DSB's recommendations in the original dispute on Canada's dairy export practices. The United States now

expected Canada to comply promptly. He said that Canada, New Zealand, and the United States had agreed that the Article 22 arbitration proceedings should remain suspended until 7 February 2003, while the parties consulted regarding the steps Canada was taking to comply.

12. The representative of Canada said that, as Members were aware, on 20 December 2002, the Appellate Body had upheld a second Article 21.5 Panel ruling that through the combination of the supply of Commercial Export Milk and the operation of Special Milk Class 5(d), Canada was providing export subsidies in excess of its quantity commitment levels, inconsistently with its obligations under the Agreement on Agriculture. Canada was aware that these Reports would be adopted at the present meeting. Nevertheless, Canada had a number of serious reservations about the reasoning used, and the conclusions reached, by the Appellate Body in this case.

13. The Appellate Body decision had established a new standard for determining the existence of an export subsidy. In doing so, the Appellate Body had blurred the distinction between domestic support measures and export subsidies. This could have important systematic implications both in interpreting existing agreements and in the context of the current WTO negotiations on agriculture. The Appellate Body had stated that Canada's right to operate its supply management system was not at issue. Moreover, in its Report of December 2001, the Appellate Body had made strong statements regarding the nature of government involvement needed to establish the necessary link with "payments" to find export subsidies under Article 9.1(c). The Appellate Body had clearly stated that the mere existence of a regulatory system under which third parties could freely make and finance "payments" would not suffice. Despite this, in the Report to be adopted at the present meeting, the Appellate Body had wrongly used the presence of Canada's supply-managed, WTO-consistent system to find government presence in private commercial export milk practices.

14. The finding of the Appellate Body clearly went beyond the ordinary meaning of the words in the Agreement on Agriculture. It could not be justified within the context provided by other WTO Agreements, in particular the SCM Agreement. In its interpretation of Article 9.1(c), the Appellate Body had used a novel "cost of production" standard to determine the existence of a payment. Nowhere in the Agreement on Agriculture was this standard set out. Moreover, this new standard had found its way into another WTO dispute, a fact that should be of concern to all Members. Despite the WTO-consistency of Canada's domestic supply, management system, the Appellate Body had ruled that "by virtue of" governmental actions regulating the domestic milk market, Canadian federal and provincial governments financed payments. In effect, the Appellate Body had found that Canada's supply management system cross-subsidized export sales. Nowhere could this "cross-subsidization" standard be found in the Agreement on Agriculture. Again, Members should be concerned with the Appellate Body's approach. Despite persuasive arguments presented by Canada and the EC, the Appellate Body had also failed to provide any explanation as to why a finding of cross-subsidization could be found within the ordinary meaning of the words in Article 9.1(c) of the Agreement on Agriculture. The Appellate Body had failed a fundamental obligation of the treaty interpreter, which was to consider the context of the provision at issue, which in this case included the definition of "subsidy" in Article 1 of the SCM Agreement. The Appellate Body had clearly gone beyond what WTO Members had agreed in the Uruguay Round negotiations.

15. As was quite evident, Canada was disappointed with the Appellate Body's decision. However, it recognized the importance of clear, enforceable rules governing international trade and, as such, it would respect its international obligations. Indeed, immediately following the release of the decision, the Minister for International Trade and the Minister of Agriculture and Agri-Food had announced publicly that Canada would abide promptly with the DSB's rulings in this dispute. He underlined that the Appellate Body Report was particularly disappointing in light of the fact that Canada had already made extensive changes to deregulate its dairy export mechanisms after the adoption of the original Panel and Appellate Body Reports. Private commercial export milk transactions which had been established by taking "government" out of the export business were being shut down. The bulletin boards in Ontario, Manitoba and Quebec were closed. Across Canada,

producers and processors had stopped all new contracts for commercial export milk as of 31 December 2002. Since there was shared jurisdiction for the dairy industry in Canada, re-regulation would require joint efforts by federal and provincial governments. In the future, Canada would limit exports using supply-managed milk to its WTO subsidy reduction commitment levels. This change in Canada would come at a high cost for its dairy industry. As a result, total dairy exports were expected to decline substantially from the current level of Can$415 million. Finally, he wished to advise Members that the close level of consultations between Canada and the complainants in this case had continued. Since the Appellate Body's decision was released, Canada, New Zealand and the United States had explored how compliance could be achieved in a mutually acceptable manner. To permit discussions to continue to work towards a mutually satisfactory solution, the three parties had agreed to request that the arbitration requested by Canada under Article 22.6 (WT/DS103/18 and WT/DS113/18) remain suspended until 7 February 2003. This trilateral agreement was being notified formally to the DSB.

16. The representative of the European Communities said that the EC noted that the Appellate Body had been faced with intricate legal issues regarding the precise reach of the export subsidy disciplines in the Agreement on Agriculture and their relationship to the domestic support commitments. The specific questions brought to the Appellate Body were both procedural, concerning the burden of proof under Article 10.3 of the Agreement on Agriculture and substantive on whether the Canadian measure constituted "payments on the export of an agricultural product that are financed by virtue of governmental action" within the meaning of Article 9.1(c) of the Agreement on Agriculture. On the procedural point, the EC noted that the Appellate Body had reiterated an orthodox view of Article 10.3, that it was for the respondent to show that no export subsidization had occurred for exports in excess of commitment levels. However the EC was concerned that it should be a realistic possibility for the respondent to meet that burden of proof. On substantive issues, the EC failed to see any legal basis for the "average cost of production standard" developed by the Appellate Body relating to the issue of whether "payments" were made. The benchmark proposed by the Appellate Body was not recipient-oriented, thus making it possible that a measure would be found to be a subsidy although not involving a benefit. The EC also considered that the standard contained certain elements which were not appropriate "costs". Finally, the EC was concerned that the "average cost of production standard" was fundamentally unworkable and required too high a standard of proof. This was particularly serious given that the burden of proof rested on the respondent, following Article 10.3 of the Agreement on Agriculture.

17. With regard to the second element of Article 9.1(c), the EC noted that the Appellate Body had retreated from its stand in its previous report where it had highlighted that producers were not "obliged or driven" to produce additional milk for export sale, but had a free choice. The Appellate Body Report had not explained why the SCM Agreement required a governmental involvement of some mandatory character, whereas under the Agreement on Agriculture, a mere incentive effect should be sufficient. The EC also missed an explanation for why the natural spill-over effects of a perfectly legal domestic support scheme could form the decisive governmental measure to construct a WTO-incompatible subsidy. The EC noted that the Appellate Body itself had emphasized that its decision was confined to this case only and that the Appellate Body had explicitly distinguished its approach to Article 9.1(c) of the Agreement on Agriculture from the subsidy disciplines under the SCM Agreement. In conclusion, he said that the EC understood that this Report did not provide a general clarification of Article 9.1(c) and reserved its position on the reach of this export subsidy provision. The EC trusted that in future cases the Appellate Body would not automatically apply the approach taken in this case which derived from the particular facts of this case and the positions taken by the main parties.

18. The representative of Australia said that his delegation wished to join with others in welcoming the findings and conclusions of the Appellate Body Report in the second recourse to Article 21.5 in this dispute. The full implementation of export subsidy rules for agricultural products was important to Australia. He noted that this issue had been a longstanding one, the effect of which

had been the continuing utilization of export subsidies on dairy products by Canada above its commitment levels. Australia wished to highlight in particular the Appellate Body's comments in relation to the "spill over" effects of domestic support to provide certain benefits to export production. Importantly, the Appellate Body noted in paragraph 148 of its Report that the text of Article 9.1(c) of the agriculture agreement focused on "the consequences of governmental action", not the intent of government. It further noted that "subsidies may be granted in both the domestic and export markets, provided that the disciplines imposed by the agreement on the levels of subsidization are respected. If governmental action in support of the domestic market could be applied to subsidize export sales, without respecting the commitments members made to limit the level of export subsidies, the value of these commitments would be undermined." Australia regarded this as an important outcome in reinforcing that WTO Members could not circumvent their agricultural export subsidy commitments. As the Appellate Body noted "Canada must ensure that it confines, to its export subsidy reduction commitment levels, any export 'payments' which are 'financed by virtue of' the governmental action Canada takes to regulate the domestic milk market" (para. 153). Australia looked forward to Canada's implementation of the findings, and encouraged all Members to ensure their compliance with their agricultural export subsidy commitments.

19. The representative of Argentina said that his country had participated as a third party in these proceedings due to systemic reasons. At the present meeting he wished to express Argentina's appreciation of the Panel and Appellate Body Reports, which presented important findings for an agricultural exporter such as Argentina. First, the conclusion confirming that a system with the characteristics of the one at issue – based on the artificial separation of a market into a domestic consumption market and an export market – did indeed constitute a "payment" within the meaning of Article 9.1(c) of the Agreement on Agriculture was particularly significant. Argentina also welcomed the interpretation in the Appellate Body of the phrase in Article 9.1(c) "financed by virtue of governmental action" as inclusive of "cross-subsidization" between various private sectors, when governmental action resulted in sales that otherwise would not be made or would constitute sales at a loss, thereby confirming that this Article did not "exclude any particular form of financing" and applied to cases of governmental action that financed export payments even if this result was not the intent of the government. It should, moreover, be mentioned that the Appellate Body had confirmed the interpretation of Article 10.3 of the Agreement on Agriculture, to the effect that the complaining Member was not required to present evidence that made a *prima facie* case of the existence of an export subsidy; rather, once it had been established that the responding Member exported in excess of its quantity commitment levels, the latter shall bear the burden of proving that no export subsidies had been granted. Finally, Argentina wished to emphasize that the approach adopted by the Panel as regards ruling in the alternative on the claim under Article 10.1 of the Agreement on Agriculture was the correct one. Argentina believed that this was the right approach for dealing with claims of violations of export subsidy commitments under the Agreement on Agriculture in order to prevent their circumvention.

20. The representative of India said that since no previous speaker had referred to the systemic issues involved in this dispute, his delegation wished to take the floor in order to raise a systemic point. He said that the United States had noted that this dispute had been initiated in 1998. This meant that the dispute had continued for more than four years. This in turn demonstrated some deficiencies in the dispute settlement system. In this regard, he noted that had there been any provision for the remand authority in the DSU, perhaps the second recourse to Article 21.5 of the DSU could have been avoided.

21. The DSB took note of the statements and adopted the Appellate Body Report contained in WT/DS103/AB/RW2 – WT/DS113/AB/RW2 and the Panel Report contained in WT/DS103/RW2 – WT/DS113/RW2, as modified by the Appellate Body Report.