United States – Subsidies on Upland Cotton

WT/DS 267

Oral Statement by the European Communities

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**TABLE OF CONTENTS**

I. INTRODUCTION..................................................................................................... 1

II. THE ROLE OF THE PEACE CLAUSE................................................................... 2

III. INTERPRETATION OF THE PEACE CLAUSE....................................................... 3

   A. Article 13 is not an affirmative defence................................................................. 3
   B. Relevant comparison for the purposes of Article 13.................................................. 4
   C. The meaning of “decided during the 1992 marketing year”..................................... 4
   D. The meaning of the term “Support to a specific commodity” ................................... 6

IV. THE INTERPRETATION OF ANNEX 2 OF THE AGREEMENT ON AGRICULTURE (THE “GREEN BOX”) ................................................................. 7

   A. Type of Production.................................................................................................... 8
   B. A defined and fixed base period.............................................................................. 10

V. INTERPRETATION OF THE AGREEMENT ON AGRICULTURE /RELATIONSHIP WITH THE SCM AGREEMENT AND GATT 1994 ............................. 10

   A. Are domestic content subsidies expressly permitted by the Agreement on Agriculture ? ......................................................................................................................... 10
   B. Export credit guarantees which operate as export subsidies are subject to Agreement on Agriculture obligations on export subsidies ................................. 12

VI. MEASURES BEFORE THE PANEL (FSC REPLACEMENT SCHEME).................. 14

VII. CONCLUSION..................................................................................................... 14
I. INTRODUCTION

1. Mr. Chairman, Distinguished Members of the Panel, the European Communities is grateful for the opportunity to express its views in this third party session.

2. We would first like to welcome the involvement of Benin in this procedure. The European Communities is of the view that the involvement of least developed countries in dispute settlement is highly desirable. We hope that other least developed countries follow Benin's lead.¹

3. This is a complex case which raises many difficult and important interpretative issues. Those responsible for drafting Article 13 of the Agreement on Agriculture have left you with some difficult questions. Despite those difficulties, Article 13 in particular, and the Agreement on Agriculture more generally, represent a finely balanced and much fought over package of rights and obligations assumed by WTO Members. The European Communities is confident that this Panel will undertake a careful examination of these very precise terms and preserve the delicate balance of rights and obligations which has been negotiated.

4. This dispute raises a large number of issues. In our interventions, we have concentrated on those issues of principle which we consider are of systemic concern. Today, we will largely address issues which were not addressed in our written submission. At the same time, we also consider it necessary to revisit some issues which we have already addressed in order to rebut some of the arguments raised by other parties.

5. The European Communities starts by setting out its conception of the role of the peace clause (section II). We will then address several questions of interpretation relating to the peace clause (section III). We then turn to consider the interpretation of Annex 2 of the Agreement on Agriculture (the Green Box) (Section IV) before considering the status of domestic content subsidies and export credits under the Agreement on Agriculture (Section V). We conclude with some

¹ This text was not in the written statement circulated at the third party session, but reflects unscripted comments made during that session.
comments on one of the requests for preliminary rulings raised by the United States (Section VI).

II. THE ROLE OF THE PEACE CLAUSE

6. We turn first to consider the role of the Peace Clause (Article 13).

7. The European Communities views Article 13 as one element regulating the interface between the Agreement on Agriculture and the SCM Agreement. It defines, in some cases, how subsidies granted pursuant to the Agreement on Agriculture should be treated for the purposes of countervailing duty investigations, and in other cases exempts such subsidies from actions under the SCM Agreement. The European Communities disagrees with both Brazil and the United States as to how the term “exempt from action” should be understood. However, while we disagree with the United States’ logic, we do not disagree with the practical result of the application of its logic.

8. The term “exempt from action” cannot mean, as Brazil claims, that, even if the peace clause is applicable, the Panel must examine Brazil’s claims under the SCM Agreement, and that if the Panel finds that the United States has acted inconsistently with the SCM Agreement, the DSB should somehow “refrain” from recommending the United States to bring itself into conformity with the SCM Agreement. The European Communities finds it difficult to imagine how the DSB, operating under the negative consensus rule, could refrain from recommending the United States bring itself into conformity should the Panel find that the United States had acted inconsistently with the SCM Agreement. Moreover, the United States can reasonably argue that it is not required to bring itself into conformity with the SCM Agreement by withdrawing measures which it is perfectly entitled to maintain under the Agreement on Agriculture, pursuant to both Article 13 and Article 21. The only answer to this question is that if the United States is entitled to peace clause protection, the Panel cannot find in favour of Brazil’s SCM Agreement claims.

9. The European Communities does not agree with the United States that Article 13 prevents a Member from requesting consultations or the establishment of a panel
with respect to a measure which might be entitled to Article 13 protection. It is not, as the US argues, the mere fact that the defendant Member is unable to block a request for consultations, or for establishment of a panel, that the applicability of the peace clause has come before this Panel. The need for the Panel to adjudicate this issue flows from the fundamental principle underlying the WTO Agreement that every question of interpretation of the WTO Agreements which “affects the operation of any covered agreement” must be subject to the DSU.\(^2\) However, as we have noted, if the Panel determines that the US measures in question are protected by Article 13, it cannot find in favour of Brazil’s claims under the SCM Agreement.

III. INTERPRETATION OF THE PEACE CLAUSE

10. The Panel has a number of challenging questions before it on the interpretation of various aspects of Article 13(b). The European Communities turns now to set out its position on some of the issues before the Panel.

A. Article 13 is not an affirmative defence

11. The European Communities will only briefly touch upon the issue of the burden of proof for Article 13. The European Communities has yet to hear a credible response to the argument that putting the burden of proof on the defendant has perverse effects. As the European Communities and the United States have pointed out, when a complainant brings a case only under the Agreement on Agriculture (for instance alleging breach of Article 6) it will bear the burden of proof. However, if Article 13 is considered an affirmative defence, when a complainant brings a dispute under Articles 5 and 6 of the SCM Agreement and, for instance, Article 6 of the Agreement on Agriculture, the complainant would be required to prove a breach of Article 6 while at the same time the defendant would also be required to prove that it had not infringed Article 6 of the Agreement. The burden of proof cannot switch between parties simply on the basis of whether the complainant cites the SCM Agreement or not, but this would be the result of interpreting Article 13 as an affirmative defence.

\(^2\) Article 4.2 DSU.
12. Further confirmation that Article 13 is not an affirmative defence can be drawn from the fact that Article 13 also regulates the application of countervailing duties on agricultural subsidies. In this context, a determination that the subsidy in question is not protected by Article 13 must be taken by an investigating authority before it may impose countervailing duties. Article 13 is consequently a pre-condition for an individual Member in taking action against subsidised exports. It cannot, in that context, be considered as a defence for exporters co-operating in an investigation and may, as the United States have pointed out, be used as the foundation for a claim in a WTO dispute by the exporting Member that countervailing duties have been illegally imposed. There is no reason why that conception of Article 13 should change simply because the issue arises in WTO dispute settlement.

   B. Relevant comparison for the purposes of Article 13

13. Brazil has argued that any breach of the 1992 level during the 9 year implementation period removes the protection of Article 13.³ The European Communities agrees with the United States that this is incorrect.⁴ The present tense of the phrase “do not grant support” makes this clear. The comparison for the purpose of Article 13(b) must be between the level of support decided in the 1992 marketing year and that granted by virtue of the measures being challenged. This would typically mean the most recent marketing year.

   C. The meaning of “decided during the 1992 marketing year”

14. We now turn to consider the meaning of the phrase "decided during the 1992 marketing year". Brazil argues that the term “decided” refers to a decision to budget a specific amount of domestic support over a number of years.⁵ Brazil then goes on to suggest that because the United States did not make a “decision” during marketing year 1992 with respect to upland cotton, the only decision which the United States can be said to have made during marketing year 1992 was the

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³ Brazil’s First Written Submission, paras 142 and 146-150.

⁴ US First Written Submission, paras 79 and 90.

⁵ Brazil’s First Written Submission, paras 139 and 140.
continued funding of its programmes for upland cotton. Brazil then calculates the US’ budgetary outlays in respect of upland cotton in 1992; in other words, Brazil looks at the support actually granted.6

15. The European Communities is concerned that Brazil appears to consider that the support “decided” in the sense of Article 13 can be equated with the support granted as Brazil has done in its use of US budgetary outlays. Such an interpretation ignores the meaning of the word "decided". That the use of the word "decided" cannot be equated with the term "granted" is illustrated by the following.

16. First, the use of the word “decided” itself is notable. It is, however, notable primarily for what it is not. WTO Members did not use the word “granted” which is the word which one would expect to be used had this phrase been intended to refer only to the domestic support actually used during the 1992 marketing year. The use of the word “decided” stands out particularly when it is compared to the use of the word “grant” in the very same sentence. The United States has made the same point with respect to the decision not to use the word “provided”.7 If WTO Members had intended that the support granted in the most recent period was to be compared to that granted in marketing year 1992 the word “decided” would not have been used. For this reason, Brazil’s use of US budgetary outlays for marketing year 1992 is clearly flawed.

17. Second, the word “decided”, meaning “settled, certain”;8 also implies a one-off decision. It would be odd to talk of an administration “deciding” countless applications for support under a particular programme. However, this is what Brazil’s use of US budgetary outlays implies.

18. Finally, the use of the word “during” confirms that WTO Members intended that the decision need not be of application only in marketing year 1992 but may also

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6 Brazil’s First Written Submission, paras. 141-145.
7 US First Written Submission, paras.83-84.
cover future periods. The use of the word “during” (meaning “in the course of”) implies a one-off decision, and does not suggest that the period of application of the decision must be limited to marketing year 1992. Had WTO Members intended a limitation to the support provided or granted in 1992 the word “for” would have been used in place of “during”. This further confirms that Brazil's use of US budgetary outlays cannot be considered correct.

19. Consequently, Article 13(b)(ii) and (iii) are intended to set up as a benchmark an amount of support adopted by some form of decision (be it political, legislative or administrative) in which support for a specific product is decided and allocated for future years. It is clearly not intended to set up a comparison between domestic support granted in 1992 and domestic support granted in a more recent period. The European Communities respectfully requests the Panel not to follow Brazil's equation of the term decided with the term granted.

20. For the European Communities, the question of what decision was adopted during 1992 by the United States is a question of fact which we do not take a position on, especially as we are not fully aware of all the elements which might be relevant.

D. The meaning of the term “Support to a specific commodity”

21. The United States has argued that the term “support to a specific commodity” is synonymous with the term “product-specific support”. Brazil had, in its First Written Submission, taken all support which was specific to cotton, and added to it a proportion of generally available support intended to represent the amount of such support which could be attributed to cotton.

22. The European Communities shares the approach of the United States. Quite simply, support which is provided to a number of crops cannot at the same time be considered “support to a specific commodity”. Such support is “support to several commodities” or "support to more than one commodity".

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10 US First Written Submission, paras. 77-78.
11 Brazil’s First Written Submission, para. 143.
23. With respect, Brazil and New Zealand are wrong to suggest that the word “specific” was added to make clear that the applicable benchmark under Article 13 was not the overall level of subsidies decided but rather was to be undertaken on a product-by-product basis. A brief glance at the *SCM Agreement* finds it replete with references to “a product” or “a subsidised product”. Consequently, it could make no sense to interpret Article 13 as being based on overall support. The word “specific” was not, therefore, inserted to differentiate the use of Article 13 in respect of specific products to the application of Article 6 to overall agricultural support, but rather as a qualifier to the word “support”.

24. Consequently, the Panel should conclude that the correct comparison is between product specific support decided in 1992 and product specific support currently provided.

IV. **THE INTERPRETATION OF ANNEX 2 OF THE AGREEMENT ON AGRICULTURE (THE “GREEN BOX”)**

A. *First sentence of the first paragraph of Annex 2*

25. Australia has argued in its comments today that the European Communities is incorrect to consider that the first sentence of the first paragraph of Annex 2 does not impose a separate obligation. The European Communities notes, however, that Australia does not comment and does not attempt to rebut the compelling contextual arguments that the European Communities has made in its written submission. The European Communities pointed out that in several instances that the *Agreement on Agriculture* refers to the "criteria" for inclusion in the green box, specifically in Articles 6 and 7, and most importantly, in paragraph 5 of Annex 2. There is no such reference to the "fundamental requirements". The European Communities recalls that a panel is obliged to follow the accepted canons of

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12 Brazil’s First Written Submission, para. 136; New Zealand Third Party Submission Para. 2.22.

13 See, in particular, Article 6.3.

14 This section was not in the written statement circulated at the third party session, but reflects unscripted comments made during that session.

15 EC’s First Third Party Submission, paras. 15-25 and in particular paras. 22 and 23.
interpretation of international law, and therefore, to view the ordinary meaning of the words concerned in light of their context and objective. Consequently, it is clear that the first sentence of paragraph 1 of Annex 2 is not, in and of itself, an independent obligation. This does not render it inutile, as Australia charges. The first sentence sets out an objective and indicates the type of effects which respect for the criteria in the green box is deemed to create. The European Communities urges the Panel to reject Australia's unsubstantiated arguments.

B. Type of Production

26. Brazil has argued that the fact payments are reduced where fruits and vegetables, and certain other crops are grown on contract acreage for the purposes of PFC and direct payments means that the “amount of such payments [is] related to or based on, the type or volume of production [..] in any year after the base period” (Paragraph 6(b) of Annex 2). However, Brazil also appears to recognise that farmers claiming the benefit of direct payments may plant crops other than the programme crops, and may even not produce any crops. The United States asserts that no current agricultural production is required in order to benefit from direct payments.

27. Assuming the US’ assertion to be correct (as seems to be acknowledged by Brazil) the Panel is faced with a dilemma. Is the amount of funding provided by a programme, from which a farmer can benefit without producing anything, to be considered to be “based on or linked to a certain type of production”, when payments under that programme can be reduced by growing certain crops? Brazil and some third parties simply assume that where payments can be reduced by growing certain crops, the programme is based on or linked to a certain type of production. Such a view does not, however, take account of the complexity of the situation.

28. In the view of the European Communities, reducing payments under a programme, where a farmer grows fruit or vegetables does not mean that the amount of the

16 Brazil’s First Written Submission, para. 49.
17 US First Written Submission, para. 68.
payment is linked to type of production. This is because the farmer is free to produce a whole range of other crops, or even not to produce at all and receive the full payment.

29. What Brazil and other third parties fail to realise is that the reduction in payment for fruits and vegetables, if the European Communities understands correctly, is in fact designed to avoid unfair competition within the subsidising Member. Brazil and the other third parties have not challenged the right of a subsidising Member to decide decoupled payments based on past production of, or acreage utilised for, certain crops. Indeed, this is permitted in paragraph 6(a) of Annex 2. However, in the case where, for instance, upland cotton production enjoyed support, while fruit and vegetable production did not, decoupled payments based on past cotton production would allow subsidised former cotton farmers to grow fruit and vegetables, and thus unfairly compete with pre-existing fruit and vegetable producers who could not benefit from the decoupled payments because they had not produced cotton or other supported products in the base period. Thus, the reduction in payments is a necessary element in ensuring that the equilibrium established by the market for the production of fruit and vegetables is not artificially disturbed by the introduction of decoupled support.

30. Furthermore, finding that Brazil and the other third parties are correct would have perverse effects. The whole Agreement on Agriculture is geared at gradually reducing certain types of domestic support. However, if a Member could not reduce decoupled payments when certain types of products which had previously not enjoyed any support are grown, the net effect would be that WTO Members wishing to provide decoupled support would have to increase overall support, and provide producers previously excluded with support which they had not previously enjoyed. This is clearly not an effect which the negotiators of the Agreement on Agriculture intended.

31. In this light, this potential reduction of payment is very different from the prohibition set down in paragraph 6(b) of Annex 2. Paragraph 6(b) is intended to prevent an artificial pressure to produce certain crops in order to obtain decoupled payments. Reducing payments where fruit and vegetables are produced does not
act to pressure farmers into growing a particular type of crop. Rather, it prevents internal unfair competition. At the same time, as we understand the US measure, it does not oblige a farmer to produce any particular type of crop, in fact requires no production, and therefore should not be considered inconsistent with paragraph 6(b).

C. A defined and fixed base period

32. The European Communities would also like to comment briefly on the arguments raised by Brazil and some of the third parties with respect to the updating of the base periods in the 2002 FRSI Act. We take note of the US statement that the updating of the base period was necessary in order to bring support for oilseeds production under the direct payments scheme. In order to ensure the progressive movement of production distorting subsidies to decoupled subsidies we consider that it must be possible to have different reference periods where eligibility is based on previous eligibility for production distorting subsidies. We see nothing in paragraph 6 of Annex 2 which might prevent this. At the same time, however, the European Communities is concerned that continued updating of reference periods in respect of the same already decoupled support, creating an expectation that production of certain crops will be rewarded with a greater entitlement to supposedly decoupled payments, tends to undermine the decoupled nature of such payments.

V. Interpretation of the Agreement on Agriculture / Relationship with the SCM Agreement and GATT 1994

A. Are domestic content subsidies expressly permitted by the Agreement on Agriculture?
33. Brazil has argued that US Step 2 payments, which it alleges are conditional upon use of domestic goods, are inconsistent with Article 3 of the SCM Agreement and Article III.4 GATT 1994. New Zealand supports this claim. However, as with other claims, their analysis does not take fully into account the complexities of the situation. The European Communities agrees with the United States that subsidies contingent upon the use of domestic goods, which are maintained consistently with the Agreement on Agriculture are not inconsistent with either the SCM Agreement or GATT 1994.

34. The first question is whether subsidies contingent upon the use of domestic goods are consistent with the Agreement on Agriculture. The answer is a clear yes. Article 3.2 of the Agreement on Agriculture requires Members not to:

   “…provide support in favour of domestic producers in excess of the commitment levels specified in Section I of Part IV of its Schedule.” (emphasis added).

35. We have emphasised the phrase “in favour of”. This is significant because it does not require that support be “to” domestic producers. The same term is used in Article 1(a) (the definition of AMS) and in Article 1(h) (definition of Total AMS). Moreover, it is established with respect to Article 1 of the SCM Agreement that a financial contribution and benefit need not be bestowed on the same person. Consequently, it is simply logical that support may be provided in favour of domestic producers through the provision of funds to processors of the product concerned, and consequently that access to such subsidies be limited to domestic produce, in order to ensure that it is domestic producers who benefit from this subsidy. Indeed, WTO Members, in their wisdom, recognised precisely this possibility in Annex 3 to the Agreement on Agriculture where they explained how the AMS was to be calculated. Paragraph 7 thereof explicitly contemplates that:

   “measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products.”

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36. Consequently, it is clear that a Member has a right to provide subsidies contingent upon use of domestic products under the Agreement on Agriculture. On this, the US and the European Communities agree.

37. The second question for the Panel is how does that right relate to the prohibition in Article 3 of the SCM Agreement and the national treatment obligation in Article III.4 of GATT. Here, again, we agree with the United States.

38. Article 21.1 of the Agreement on Agriculture provides that the other goods agreements will apply “subject to” the provisions of the Agreement on Agriculture. That is, the other Annex 1A Agreements will be subordinated to the Agreement on Agriculture. A finding that a measure was a domestic content subsidy would mean that such a subsidy would be prohibited under Article 3.1(b) of the SCM Agreement and would (in all likelihood) be inconsistent with Article III.4 GATT. In such an event, the consequences of such a finding would have to be subordinated to the right to adopt such measures under the Agreement on Agriculture (provided reduction commitments are respected). Moreover, the chapeau of Article 3.1 of the SCM Agreement clearly exempts from the scope of that Article domestic content subsidies which are maintained consistently with the Agreement on Agriculture and Article III.8 may be relevant to any claim under Article III.4. GATT.

39. Consequently, Brazil’s claims that domestic content subsidies maintained consistently with the Agreement on Agriculture can be found to be inconsistent with the SCM Agreement and Article III.4 GATT should be dismissed.

B. Export credit guarantees which operate as export subsidies are subject to Agreement on Agriculture obligations on export subsidies

40. The United States maintains, in its first written submission, that Article 10.2 of the Agreement on Agriculture operates so as to exclude export subsidies in the form of export credits or export credit guarantees. This is not borne out by the text of

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Article 10.2. Article 10.2 provides for disciplines to be negotiated on the provision of export credits and export credit guarantees; it does not provide an exemption to the export subsidy obligations of the Agreement on Agriculture.

41. The United States provides numerous examples of instances in which the WTO has foreseen further negotiations. However, none of these examples support the United States argument that there are no disciplines for export credit guarantees which operate as export subsidies.

42. The best example to illustrate this point is the agreement to negotiate disciplines on harmonised rules of origin. The fact that it was agreed to have negotiations on rules of origin simply means that there is no requirement for a WTO Member to apply an as yet un-finalised set of harmonised rules of origin. However, this does not imply that a WTO Member is exempted from other WTO obligations when it comes to apply rules of origin. A WTO Member must, for instance, in applying its rules of origin, respect the most-favoured nation principle set out in Article 1 GATT. Similarly, while there may not be disciplines on the provision of export credits and export credit guarantees, clearly export credits or export credit guarantees which operate as export subsidies are subject to the export subsidy disciplines of the Agreement on Agriculture and the SCM Agreement.

43. Other examples are equally illustrative. The US cites provisions in the GATS providing for negotiations on government procurement, emergency safeguards and subsidies on trade in services. However, it does not point out the fact that these subjects are clearly not subject to GATS disciplines, and thus negotiations are required to develop even minimal disciplines. Government procurement in services is the best example – GATS disciplines are explicitly excluded by Article XIII GATS. In contrast, there is no clear exclusion of export credits or export credit guarantees which operate as export subsidies from the Agreement on Agriculture.

44. Finally, contrary to the US suggestions, such an interpretation does not render Article 10.2 meaningless. Article 10.2 is not intended to regulate export credits and export credit guarantees as export subsidies but rather to provide for a general set of disciplines comparable to the OECD guidelines for export credits for
industrial goods. That the Harbinson text (which of course has yet to be agreed) contains provisions on export credit and export credit guarantees is a recognition that disciplines must be negotiated and that clarification must be provided as to which export credits or export credits guarantees are, in the case of agricultural products, to be considered export subsidies, but is not a recognition that such support which operates as an export subsidy are not currently subject to the obligations of the Agreement on Agriculture.

VI. MEASURES BEFORE THE PANEL (FSC REPLACEMENT SCHEME)

45. The United States has argued that Brazil has failed to make a prima facie case of the inconsistency of the FSC Replacement scheme (the ETI) with the covered agreements. The European Communities must admit to being surprised that the United States considers that Brazil has to present a prima facie case of inconsistency. According to Article 17.14 of the DSU parties to a dispute must “unconditionally accept” adopted Appellate Body Reports as “a final resolution to that dispute.”\(^21\) Given that the United States must be assumed to have unconditionally accepted the findings of the Appellate Body in the FSC 21.5 dispute, which, by definition also included a finding that the United States was illegally providing export subsidies to unscheduled agricultural products such as upland cotton, the European Communities fails to see how the United States can argue that Brazil needs to establish a prima facie case. On the contrary, Brazil simply needs to assert a claim.

VII. CONCLUSION

46. This brings us to the end of our statement today. Thank you for bearing with us through a statement which was inevitably long, given the complexity of the issues, and the very short time we had to prepare our written submission.

There are a few central points which we would like to leave you with:

- The peace clause is not an affirmative defence;

- The term "decided" cannot be equated with "granted";

- Reducing payments where certain crops are grown for reasons of internal competition does not amount to basing payments on a certain type of production;

- Domestic content subsidies in favour of domestic producers are permitted under the Agreement on Agriculture, and can be maintained irrespective of other provisions; and,

- Export credit guarantees which operate as export subsidies are subject to the Agreement on Agriculture.

Thank you for your attention. We are, of course, happy to answer your questions, here or in writing.