



**The Importance of Disciplining the
Choice of Policy Instrument to the
Effectiveness of the *GATT* as
International Law Disciplining
Agricultural Trade Policies**

Brett Gerard Williams

Department of Law

University of Adelaide

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PART 5

THE THESIS AND ITS IMPORTANCE

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ABSTRACT

This work seeks an answer to the legal difficulties in applying the GATT to agriculture.

It concludes by providing the answer in the following thesis which applies not only to agriculture but to any sector of trade. The thesis is that:

- (1) in order to make the GATT operate effectively as a regulator of economic relations *between* states, it is a necessary condition of success that the rules are constructed so that they can operate effectively as a regulator of the way governments regulate economic relations between entities *within* states; and
- (2) in order to operate effectively as a regulator of the way governments regulate economic relations between entities *within* states, it is a necessary condition that the rules are constructed so as to properly embody the ranking of trade policy instruments that economic theory and public choice theory suggest, preferring *price-based border instruments* to *quantity-based border instruments* and preferring *non-border instruments* to *border instruments*.

Part 1 introduces the problems with applying the GATT1947 rules to agriculture and introduces the search for an explanation in the way that the rules regulate different policy instruments.

Part 2 uses certain economic and public choice theory to compare, in terms of likelihood and of cost, the choices that an individual state can make between policy instruments, so as to propose criteria for the optimal construction of GATT rules.

Part 3 analyzes the GATT1947 rules relating to import barriers, export subsidies and domestic support and comprehensively examines the legal problems in applying them to agricultural trade. It concludes that deficiencies in the way the rules embodied distinctions between different policy instruments did contribute to the difficulties in applying the rules to agriculture.

Part 4 examines whether these deficiencies were remedied during the Uruguay Round by examining the negotiation on agriculture and the relevant post-WTO legal instruments.

Part 5 concludes, specifically, that the thesis provides, in relation to agricultural trade, both an explanation for the past problems and solutions for the future and, more generally, that the analysis of the agricultural sector supports the application of the thesis to GATT rules generally, regardless of sector.

This work contains no material which has been accepted for the award of any other degree of diploma in any university or other tertiary institution and, to the best of my knowledge and belief, contains no material previously published or written by another person, except where due reference has been made in the text.

I give my consent to this copy of my thesis, when deposited in the University Library, being available for loan and photocopying.

Dated theday of.....1999.

.....
Brett Gerard Williams

Dated the 12th day of AUGUST 1999.

Brett Gerard Williams

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GATT, "Statement by the Representative of the Federal Republic of Germany", Annex to "Import Restrictions of the Federal Republic of Germany", Report adopted on 30 November 1957; (L/768), BISD, 6S/55.

GATT, "Safeguard Action For Development Purposes", Decision of 28 November 1979 (L/4897), BISD, 26S/209.

GATT, "Declaration on differential and More Favourable Treatment Reciprocity and Fuller Participation of Developing Countries", Decision of the CONTRACTING PARTIES of 28 November 1979, L/4903, BISD, 26S/203.

GATT, "Working Party - Sugar, L/5924, GATT BISD 29S/82-90.

GATT, "Working Party - Sugar", Report to the Council adopted on 31 march 1982 (L/5924), GATT BISD 29S/82-90.

The Importance of Disciplining the Choice of Policy Instrument to the Effectiveness of GATT as International Law Disciplining Agricultural Trade Policies

PART 1

Is There a Link Between The Problem With Agriculture Under GATT Rules And Policy Choice Under GATT Rules?

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| Chapter 1 | The Problem With GATT Rules And Agriculture And An Approach To The Problem |
| Chapter 2 | The Framework Of GATT Rules - Regulation Of The Four Principal Policy Instruments |



CHAPTER 1

THE PROBLEM WITH GATT RULES AND AGRICULTURE AND AN APPROACH TO THE PROBLEM

"... the play opens with "kind old Uncle GATT", a 4m-tall one-headed giant with enormous arms dressed in a red cape, who sees himself as the referee of world trade. Things start to go wrong when the actors run out of script and their fax machine, through which they are receiving extra lines, breaks down. By the end of the play, Uncle GATT has turned into an indecisive three-headed caterpillar with a gun."

"Farce-fed, trade style", a review of "GATT, The Play", by Justine Ferrari in her column, "Melba" in *The Australian*, 19 January 1994, p9.

INTRODUCTION

Why did kind old Uncle GATT change into a three headed caterpillar with a gun and will the Uruguay round have prevented it from happening again? In "GATT, The Play", the reason that Uncle GATT changed from a kindly referee of world trade into a three headed caterpillar with a gun was that the actors did not know what or who Uncle GATT was supposed to be. Perhaps, this is not a too far fetched metaphor for the way that the application of GATT¹ rules to agriculture evolved between 1947 and the Uruguay Round.² It may even be a good metaphor for the future.

¹ *General Agreement on Tariffs and Trade*, Geneva, opened for signature 30 October 1947 (hereinafter referred to as "GATT") 61 Stat A3; TIAS No 1700; 55 UNTS 187. The GATT, itself did not come into force. It came into provisional operation under various Protocols (See infra, Chapter XX). The first version of the agreement published by the parties to it is contained in Volume 1 of *General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents* (hereinafter referred to as BISD) (The Contracting Parties to the General Agreement on Tariffs and Trade, Geneva, 1952). That version incorporates amendments made up to May 1952. The pre-Uruguay Round version of the GATT is contained in BISD Vol 4 (1969). This is now commonly referred to as the GATT1947 to distinguish it from the GATT 1994 applying under the *Agreement Establishing the World Trade Organization*: see footnotes 3 and 4 below. In this thesis, references to the GATT in any pre-WTO context can be taken to be references to the GATT 1947 and references to the GATT in any post-WTO

This thesis deals with both the past and the future. It analyzes the way that the GATT1947 applied to agriculture between 1947 and the Uruguay Round. It analyzes the Uruguay Round negotiation on agriculture and it also analyzes the reforms affecting agricultural trade brought into effect by the *Agreement Establishing the World Trade Organization*³ through the Multilateral Agreements on Trade in Goods including the *GATT 1994*⁴ and the *Agreement on Agriculture*.⁵

In 1986, world leaders acknowledged that the GATT rules had not worked very well in application to agriculture when they adopted as a particular objective of the Uruguay Round the task of bringing agricultural trade under operationally effective legal disciplines.⁶ The analysis to follow shows that, even in the early years of the GATT, there was a realization that the GATT was not achieving liberalization in the agricultural sector and that there was a sequence of unsuccessful attempts to improve this situation. The combination of the lack of legal disciplines and the changes in the market brought about the situation in agricultural markets that was labelled by Johnson in 1973 as 'disarray'.⁷ The description 'disarray' was coined again after the start of the Uruguay Round in a quantitative assessment of the distortions of agricultural policies by Anderson and Tyers.⁸ This thesis does not attempt to add to such earlier studies of the practical impact of the problems with regulating agricultural trade. The description of the non-legal aspects of the problem with international regulation of agricultural trade, its scope and practical effects, is limited to that contained in

context can be taken as references to the *GATT 1994* as subject to any of the other Multilateral Agreements on Goods.

- 2 There have been eight rounds of multilateral tariff negotiations ("MTN"s) by the contracting parties to the *GATT* (see below in Chapter 2). The eighth round of MTNs commenced in 1986 in Punta Del Este in Uruguay and is called the Uruguay Round. See "Ministerial Declaration on the Uruguay Round", 20 September 1986. BISD 33S/39; (1986) 25 ILM 1623; *GATT Focus*, October 1986, pp1-6.
- 3 *Marrakesh Agreement Establishing the World Trade Organization* 15 April 1994, Marrakesh, ("*WTO Agreement*") In force 1 January 1995, Aust TS 1995 No 8; 33 ILM 1144.
- 4 *General Agreement on Tariff and Trade 1994*, in Annex 1A to the *WTO Agreement* ("*GATT1994*").
- 5 *Agreement on Agriculture* in annex 1A to the *WTO Agreement* ("*Agreement on Agriculture*" or "*Agriculture Agreement*").
- 6 See "Ministerial Declaration on the Uruguay Round", 20 September 1986. BISD 33S/39; (1986) 25 ILM 1623; *GATT Focus*, October 1986, pp1-6
- 7 Johnson, D.G., *World Agriculture in Disarray* (Fontana, London, 1973). See also the 1991 edition.
- 8 Anderson, K. & Tyers, R., *Disarray in World Food Markets: A Quantitative Assessment* (Cambridge University Press, Cambridge, 1992).

the following brief outline.⁹ This outline of the problem also refers to some of the legal and historical aspects which are fully explored later in the thesis.

Generally, the thesis responds to two questions:

- (1) Why was the GATT unsuccessful in relation to agricultural trade? and
- (2) Has the Uruguay Round solved the problem?

However, this thesis responds to those questions with a particular approach. It is an approach that requires analysis of some of the ideas that are the foundations of the rules. It is an approach that looks for the answers to the problem with applying the GATT to agriculture in the construction of the GATT rules rather than in the qualities of agriculture. It looks for an answer in the ideas which underpin the GATT. The approach to the problem is outlined later in this chapter.

THE GATT

THE GATT - ITS FORMATION AND FOUNDING IDEAS

To a not insignificant degree, the GATT was founded upon ideas not merely political expediency or commercial interests. Certainly, the GATT grew out of particular historical events of the depression and the second world war but its creation was more than merely a response to circumstances. It grew out of a vision for the future which, it was hoped, would be far different from the first 45 years of this century. That period had been dominated by two world wars and the Great Depression. The pre-existing influence of the great powers of Europe had been permanently changed and the pre-existing expectation of continual

9 In addition to the abovementioned works of Johnson and of Anderson and Tyers, the problems of agricultural trade are dealt with, for example, in McCalla, Alex F. & Josling, Timothy E., *Agricultural Policies and World Markets* (MacMillan, New York, 1985), Hathaway, Dale E., "Agricultural Trade Policy for the 1980s" in William R Cline (ed) *Trade Policy in the 1980s* (Institute for International Economics, Washington DC, 1983) and in Hathaway, Dale E., *Agriculture and the GATT: Rewriting the Rules* (Volume 20 in the series *Policy Analyses in International Economics*) (Institute for International Economics, Washington DC, 1987) (covering the problems of agricultural trade and the difficulty in applying the GATT to agricultural trade) or the briefer outline of those legal problems in Tangermann, Stephan, "Proposals for a "Rule-Oriented Liberalization of International Agricultural Trade" in Petersmann, Ernst Ulrich & Hilf, Meinhard (eds) *The new GATT Round of Multilateral Trade Negotiations* (Volume 5 in *Studies in Transnational Economic Relations*) (Kluwer, Deventer & Boston, 1988) pp243-264, esp 246-255. and in World Bank, *World*

economic growth tempered by business cycles had been shattered by the severity of the depression. The end of the war left a number of countries completely devastated and left a larger number saddled with enormous economic costs of rebuilding, or payment of debt incurred to pay for the war effort. The simple fact of necessity motivated some international cooperation.

However, beyond simple necessity, motivations for international cooperation also drew on a surge of idealistic thinking eager to ensure that the past should not repeat itself. Such thinking centred on issues of war and peace and there was much said and written about the failure of the League of Nations to prevent World War II. Visions of new international institutions were beginning. Beyond the key issue of war and peace, the memory of the depression was strong and the connection between economic and commercial circumstances and war and peace was regarded as significant.¹⁰ A key influence on U.S. policy was the then Secretary of State, Cordell Hull. He wrote :

I have never faltered, and I will never falter in my belief that enduring peace and the welfare of nations are indissolubly connected with friendliness, fairness, equality and the maximum practicable degree of freedom in international trade.¹¹

It was from this mixed background of necessity and idealism that a series of meetings of international representatives were held from as early as 1942. By 1944, a plan had been devised to create three new international organizations: the International Bank for Reconstruction and Development (the World Bank), the International Monetary Fund and a International Trade Organization.

The purpose of the bank was to ensure that there would be sufficient funds available to rebuild countries destroyed during the war and to otherwise assist economic development. The purpose of the International Monetary Fund was to create a stable regime of currency values. It must be remembered that all countries in the world had fixed exchange rates in 1947 and that because of the competing rounds of devaluations that had occurred in the

Development Report 1986 (World Bank, Washington DC, 1986) (describing agricultural policies in both developed and developing countries and their effects on world markets).

10 Eg, see Brown, William Adams, Jr, *The United States and the Restoration of World Trade, An Analysis and Appraisal of the ITO Charter and the General Agreement on Tariffs and Trade* (The Brookings Institution, Washington DC, 1950) pp1-4.

1930's, a currency devaluation was regarded to some extent as an unfriendly act in international relations. Therefore, it was perceived that such currency adjustments should only occur within certain guidelines which would be set out in the treaty establishing the Fund.

The third organization, the International Trade Organization ('ITO') never came into existence. It was intended to create treaty obligations that would prevent a repeat of the protectionism and the discrimination which had occurred in the 1930's. That rise in protection arose in a number of countries. The most well known measure was the famous Smoot-Hawley *Tariff Act* of 1931 in the USA which increased tariffs on the USA's imports.¹² It was followed by a round of retaliation from many countries. The effect on world trade had been devastating. There was agreement among economists that the restriction of world trade had imposed substantial economic costs making the depression worse. The existence of discrimination had been exacerbated in the early 1930s with the establishment of imperial preference as a policy of the British empire. In subsequent years, there was some credence lent to the view that discrimination against Germany had been a factor contributing to the deterioration in relations with Germany. The ITO was intended to create a framework of multilateral obligations which would reverse the wave of pre-war discrimination and protectionism and prevent such a situation arising again. A cornerstone of the new arrangement was an unconditional most favoured nation clause which would prevent Members from discriminating among countries in trade relations. The text of a Charter for the ITO was negotiated in a series of conferences (which are more fully described in the next chapter) and the final text of the treaty was negotiated in Havana, Cuba in March 1948 and ever since has been referred to as the Havana Treaty.¹³ The ITO Charter never came into force but part of the Charter (through a process which is also more fully described in the next chapter) came into provisional application as the GATT.

The GATT, then, was part of a deliberate effort to construct a stable, prosperous and peaceful world. Even after giving appropriate recognition to the commercial and political

11 Cordell Hull, *Economic Barriers to Peace*, (Woodrow Wilson Foundation, New York, 1937)p14. Hull was Secretary of State from 1933 until 1944.

12 Jackson, John H., *World Trade and the Law of GATT* (Bobbs Merrill Co, Indianapolis, 1969), p9.

13 Dam, Kenneth W., *The GATT - Law and International Economic Organization* (The University of Chicago Press, Chicago and London, 1970) p10, especially note 2

pressures that shaped the GATT, one must allow some room for the influence of ideas: the ideas of equality and non-discrimination manifest in the most favoured nation principle and the ideas of economic theory manifest in the recommendations for the reduction of trade barriers. The GATT was an innovative and adventurous way to put these ideas into practice to solve some of the problems of the past and to attempt to prevent them happening again.

COMPROMISES IN THE ORIGINAL GATT RULES AND THEIR RELEVANCE TO AGRICULTURAL TRADE

The manifestation of the ideas of non-discrimination and trade liberalization was substantially compromised in the construction of the GATT rules and these compromises were particularly important in the future application of the GATT to agriculture. These compromises and their impact on agricultural trade are described in detail in later chapters.

As an introduction, the most important compromises that affected agriculture were due to the USA's need to accommodate its agricultural program within the rules. This resulted in the insertion of an exception for import restrictions necessary to protect programmes aimed at controlling the quantity of certain agricultural products and in the complete omission from the original agreement of any substantive rules on export subsidies. The agreement included an exception for restrictions imposed for balance of payments reasons and, at the time that the GATT commenced, such restrictions were imposed on a range of products including many agricultural products. In addition, an exception given to pre-existing legislation protected a variety of restrictions on imports of agricultural products. The non-discrimination principle was also compromised by an exception for free-trade areas and customs unions which subsequently became a significant factor in agricultural protection.

THE PROBLEM WITH APPLYING THE GATT TO AGRICULTURE

The technical legal difficulties in applying the GATT to agricultural trade are dealt with in detail in subsequent parts of this work. Those technical difficulties contributed to a lack of liberalization of agricultural trade. This lack of liberalization and its cost have been documented and estimated elsewhere.¹⁴ Therefore, the following description of the scope

14 See the references above at fn 7,8 & 9. In addition, on the cost of agricultural policies, see, eg, Anderson, K. & Tyers, R., *Global Effects of Liberalizing Trade in Agriculture* (Thames Essay, Trade Policy Research Centre, London 1987), Tyers, R., & Anderson, K., "Liberalising OECD agricultural

and the consequences of the problem with applying the GATT to agriculture is intentionally brief. It covers the changes in agricultural trade over the first 45 years of the GATT, the failure of the GATT in application to agriculture in terms of what statistics show about the liberalization or lack of it that has been achieved in the agricultural sector, the costs of that lack of liberalization and the obstacles to reform.

AGRICULTURAL POLICIES AND MARKETS

At the inception of GATT, it was certainly not only the United States that had policies to support and protect the agricultural sector. At this time, many countries were mindful of the food shortages that had occurred during the war and so they persisted with or adopted food self sufficiency policies. In theory, allowing for the limited exceptions in the agreement, these policies were to be subject to GATT rules and this sector was to be liberalized along with others.

Despite the widespread use of protection in the agricultural sector, after the war, international agricultural trade still grew due to the population and economic growth at the time.¹⁵ This trend of growth in international agricultural trade continued until the early 1970's. The most significant change in trade over this period was the change in the position of Western Europe from being the world's major import market for agricultural products in 1960 to being substantially less reliant on imports by 1973. For example, in 1960/61, the countries that would later make up the European Community of ten nations ('EC10')¹⁶ imported 21 million tons of grain but by 1972/73 this had fallen to 13 million tons.¹⁷

Toward the end of this period, the demand for food increased significantly more than the production of food so in 1972 there was a substantial increase in the price of a number of food commodities and in the volume of international trade.¹⁸ In a short time formerly food sufficient countries like Japan and the USSR became substantial food importers. For

production in the Uruguay Round: effects on trade and welfare" (1988) 39(2) *Journal of Agricultural Economics* 197-216.

15 This description of the changes in agricultural markets draws substantially on Hathaway, *Agriculture and the GATT: Rewriting the Rules* (1987).

16 The formation of the European Community, the constitutive instruments and terminology used to describe the community are dealt with below in chapter 10.

17 See Hathaway, *Agriculture and the GATT*, pp8-12

18 See Hathaway, *Agriculture and the GATT*, p8.

example, in 1972/73, Japan imported 21 million tons of grain compared with only 5 million tons in 1960/61 and the USSR imported 21 million tonnes of grain after having been a net exporter of 6 million tons in 1960/61.¹⁹ The policy response of governments in all parts of the world was to implement policies to increase production such as price guarantees, production subsidies, or incentives for increasing acreages, or for use of fertilizers.²⁰ The private sector also responded to the higher price. The number of cultivated hectares increased from about 650 million to 700 million in only a few years.²¹

Between 1971 and 1980 many of the world's currencies were changed from fixed to floating rate regimes. A major consequence was the appreciation of the US dollar against a number of other currencies. As a result, over this period, real prices of agricultural commodities were moving in different directions for different countries. The general trend was that in terms of US dollars prices were falling and in terms of the currencies of Germany, Great Britain, France, Canada and Australia prices were rising and increasing the incentive to produce in such countries.²²

By 1980/81 world trade in grain had increased to 215 million tonnes being 3 times its level in 1960/61 and world trade accounted for 14.7 percent of world consumption compared to the 8.6 percent it had been in 1960/61.²³ Import requirements had grown considerably. For example, the imports of grain by Japan and the USSR had risen by 1980/81 to 24 million tons and 33 million tons respectively and those of China had increased to 14 million tons from a range between 3 and 7 million tons for every year between 1961 and 1972.²⁴ By 1982, the EC10 had become a net exporter of grain to the extent of 4 million tons.²⁵ Other countries which had previously been food importers became food exporters. These included India, Pakistan, Saudi Arabia and Great Britain. In 1982, demand ceased to rise but the policies to encourage high levels of production remained. Naturally, under these conditions world prices fell. At this point, price support schemes which had been established in times

19 See Hathaway, *Agriculture and the GATT*, pp8-12.

20 See Hathaway, *Agriculture and the GATT*, p13.

21 As above.

22 Hathaway, *Agriculture and the GATT*, p14

23 Hathaway, *Agriculture and the GATT*, p13.

24 See Hathaway, *Agriculture and the GATT*, Table 2.3 "Net Imports of wheat and course grains" on p10.

25 See Hathaway, *Agriculture and the GATT*, p13.

of higher prices began to be utilized in vastly increasing volumes and stocks began to accumulate.

By the time the Uruguay round began in 1986 signs of strain were manifesting themselves. Food stockpiles had reached excessive levels, the cost of agricultural protection policies had ballooned enormously, the value of international agricultural trade had decreased and prices in many commodities has fallen. Agricultural exporting countries had seen their agricultural export earnings deteriorate.

THE FAILURE TO LIBERALIZE TRADE IN AGRICULTURE

Over its 45 years, the GATT 1947 had some successes and failures. Agriculture is not the only area in which success has been limited. A number of other areas have also been fairly unsuccessful in terms of the liberalization achieved. These include textiles, footwear and clothing and a large number of what are generally grouped together as tropical products. However, in manufactured trade, the GATT has achieved very significant trade liberalization. In the area of trade in manufactured goods the average level of tariffs fell from an average of 40% in 1945 to an average of 5% in 1979.²⁶ While this reduction is reasonably indicative of the liberalization of trade in manufactured products, a similar statistic in respect of agricultural trade would not be.

For the agricultural sector, reductions in tariffs only tell part of the story. Non-tariff barriers have also been important. These non-tariff barriers have existed in the form of prohibitions, quotas, tariff-quotas, customs valuations based on reference prices rather than actual prices, variable levies and minimum import prices. Non-tariff barriers were more prevalent in relation to agricultural products than industrial products. A 1984 World Bank study of 7 industrial countries plus the EEC showed that those countries applied quantitative restrictions to 17.2 % of the total of agricultural import items but to only 6.7 % of the total of all items of manufactures, and applied minimum price policies to 29.7 % of the total of all agricultural items but to only 9.4 % of the total of all items of manufactures.²⁷

26 J.Michael Finger and Andrzej Olechowski (eds), *The Uruguay Round: a Handbook for the Multilateral Trade Negotiations* (World Bank, Washington, 1987), Ch 6, p37.

27 World Bank, *World Development Report* (World Bank, Washington, D.C., 1986).

Protective policies were not only manifested in border measures whether tariff or non-tariff.²⁸ There were many other measures which were designed to protect the prices of agricultural goods and the income of farmers. These occurred in the form of policies to influence both the sales by farmers to their domestic market and also the sales by farmers to export markets. With respect to domestic markets, these policies included government purchases at minimum prices, or subsidies paid to supplement the prices that farmers received from the market, and subsidies or tax exemptions related to inputs like fuel or fertilizer. The consequence of such policies was that production increased, in some cases creating an excess which had to be either stored or exported. With respect to the policies that directly stimulated exports, these took the form of straight forward export subsidies and tax exemptions under a variety of names, for example, commodity schemes, restitution payments, and foreign aid.

Therefore, assessing and comparing protection levels is complicated by the mixture of policy instruments involved. Generally for industrial products the tariff level alone is a reasonable indicator of the difference between internal and external prices. As mentioned above, after the Tokyo round²⁹ the average tariff on industrial goods in all GATT countries was only 5%. However, with respect to agricultural products, tariffs are not indicative of the difference between internal and external prices. A World Bank study in 1986 measured the difference between internal and external consumer prices "the nominal protection coefficient" for nine agricultural products for a number of industrial countries in the period 1980-1982 with the following results:³⁰

28 The use of past tense to describe the situation between 1947 and the Uruguay Round is not intended to imply that the description of the use of non-tariff barriers is not still accurate in respect of the present time.

29 The seventh round of multilateral trade negotiations. The rounds of negotiations are listed in chapter 2 and more fully described in Part 3.

30 World Bank, *World Development Report* (World Bank, Washington DC, 1986). The figures quoted are the weighted average figures drawn from separate nominal protection coefficients calculated for wheat, coarse grains, rice, beef and lamb, pork and poultry, dairy products and sugar. The EC includes members of the EC in 1982 (i.e it excludes Greece, Portugal and Spain). Other Europe consists of Austria, Finland, Sweden, and Switzerland.

Country	Nominal Protection Coefficient
Australia	1.09
Canada	1.16
European Community	1.56
Other Europe	1.81
Japan	2.08
New Zealand	1.00
United States	1.17
Weighted Average	1.43

There was a very broad gap between the 43 % protection applied for agricultural trade and the 7% or so per cent applied for trade in manufactures.

THE IMPACT OF THE FAILURE TO LIBERALIZE

The failure to liberalize agriculture has a number of different costs. Firstly, there is the cost of agricultural support, in absolute terms, in the industrialized countries. An idea of the magnitude of the cost is given by some statistics on the budgetary cost of agricultural support. "In 1986, the US and the EC each spent nearly [US]\$25 billion on farm programmes".³¹ In the same year, OECD countries transferred \$108.7 billion to agricultural producers through subsidies and price support (12% through direct payments by government and 82% by other protective mechanisms).³²

Secondly, there is a net cost to global economic welfare that is incurred by the misallocation of resources caused by agricultural protection and support. In a 1988 study, Tyers and Anderson estimated this at an annual loss of US\$40 billion.³³ A 1987 OECD study added

31 Rayner, A.J., Ingersent, K.A. & Hine, R.C., "Agriculture in the Uruguay Round: An Assessment" (1993) 103 *The Economic Journal* 1513-1527 at 1514 quoting from Roningen, V & Dixit, P., *Economic Implications of Agricultural Policy Reforms in Industrial Market Economies* (USDA Staff Report No AGES 89-363, Washington DC, 1989) p1.

32 Rayer, Ingersent & Hine, as above at p1515 citing OECD, *Agricultural Policies, Markets and Trade: Monitoring and Outlook, 1990* (OECD, Paris, 1990) Table IV.3.

33 Tyers, R. & Anderson, K., "Liberalising OECD agricultural production in the Uruguay Round: effects on trade and welfare" (1988) 39(2) *Journal of Agricultural Economics* 197-216.

the budgetary cost on taxpayers to the increased cost placed on consumers and estimated the cost in ECUs in the EEC at 56.5 billion, in the USA at 26.2 billion and in Japan at 23.8 billion.³⁴

Thirdly, there is the loss to agricultural exporters caused by protection in other countries. Solely in respect of Australian exports to the EEC, it has been estimated that Australian agricultural exports were lower by about A\$1 billion per year than they would have been in the absence of the EEC protective policies.³⁵

In addition, there is a cost in terms of the effects on the integrity of the GATT legal system as a whole. Prior to the Uruguay Round, there was a significant risk of disputes in agricultural trade policy spilling over into non agricultural trade.

COMPLEXITY AND SIGNIFICANCE OF THE PROBLEM

Some of the factors contributing to this disparity between the liberalization achieved in manufactured trade and the lack of it in agricultural trade emerge from the detailed analysis of the application of the GATT. Some of the factors that will emerge are:

- nations have a great inclination to have their own agricultural industries particularly those which supply food; the stated reasons for this generally revolve around food security but they also involve a desire to maintain the income of the farming sector, to maintain a decentralized distribution of population or a desire to preserve a rural way of life;
- nations have been much less inclined to offer reductions in protection in these food producing industries than in most other industries where they have displayed a greater willingness to share in the benefits of international competition and specialization;

34 OECD, "Cost of Agricultural Policies" Annex III in *National Policies and agricultural trade* (OECD, Paris, 1987) pp125-135.

35 See Australian Bureau of Agricultural and Resource Economics (authors: Paul Riethmuller, Ivan Roberts, L. Paul O'mara, Graeme Tie, Vivek Tulpule, Moazzem Hossain & Nico Klijn), *Proposed strategies for reducing agricultural protection in the GATT Uruguay Round* (AGPS, Canberra 1990) p4 referring to a figure of A\$845 per year in 1984.85 values for annual Australian exports of course grains, meat dairy products and sugar and citing Bureau of Agricultural Economics, *Agricultural Policies in the European Community: Their origins, nature, and effects on production and trade* (Policy Monograph No. 2, AGPS, Canberra, 1985).

- nations have displayed a greater tendency to break GATT rules in relation to agricultural products, or at least to use available loopholes to escape the application of the rules;
- nations have been more inclined to assert their 'sovereign right' to autonomously control their own economies in relation to policy in agriculture than in relation to policy on other sectors of their economies.

An influential study³⁶ made at the commencement of the Uruguay Round on the problems of applying the GATT to agriculture reached four conclusions on existing government policies :

- (1) that national policies developed in the 1970's in order to expand output were no longer appropriate, given the present and prospective market situation;
- (2) national policies were transferring the excess capacity into major trade problems;
- (3) major changes in trade policy without attendant changes in domestic policies would not deal with the problem;
- (4) even fundamental changes in long-run policies would not deal with the current short-run problems of substantial excess capacity relative to world demand.

These conclusions pointed to an extremely controversial aspect of agricultural protection. The suggestion that reform of agriculture would require changes to domestic policies raises a question as to the extent to which domestic economic policies should be subject to regulation by international law. The suggestion that domestic policies need to be altered begs for some criteria for determining when a policy shifts from being a matter of domestic concern to being one with which your international neighbours have a legitimate concern. This problem has been crucial to the problems of agricultural trade over the years and was crucial to the outcome of the Uruguay Round.

AN APPROACH TO THE PROBLEM

Having given an indication of the seriousness of the consequences of the difficulties in applying the GATT to agriculture, I now set out the approach to the problem which is taken

in this thesis. The opening paragraphs of this chapter stated that this thesis responds to two questions:

- (1) Why was the GATT unsuccessful in relation to agricultural trade? and
- (2) Has the Uruguay Round solved the problem?

but that it does so with a particular approach, one that requires analysis of some of the ideas that are the foundation of the GATT. The particular approach taken to the problem, here, is as follows.

It is sought to determine:

- (1) whether there was a causal link between:
 - (a) the way in which GATT 1947 rules distinguished between different types of governmental trade and commercial policy instruments; and
 - (b) the failure of the GATT rules in application to agriculture; and
- (2) if so and to whatever extent there was a link,
 - (a) whether any such deficiencies in the rules have been remedied in the Uruguay Round in the formulation of the GATT 1994; and
 - (b) what influence this will have on whether the post-Uruguay Round rules are likely to be successful.

There are a variety of other approaches that could be taken, but are not taken in this work, to analyzing the failure of the GATT in relation to agriculture. The practical reason for not pursuing other approaches is that any attempt to pursue any of the other approaches would impair the thorough investigation of the approach that I have chosen to pursue. For example, one could view the relationship of this failure with the difficulties in enforcement of the rules and in the operation of the dispute settlement system. Certainly, these had a role and many of these difficulties are brought to light in the process of analyzing the application

of the rules to agriculture but, here, it is not intended to focus upon the enforcement of the rules but rather upon the content of the rules. One could view the relationship between the failure and the nature of the system as one which operates only in the international sphere without direct application in domestic legal systems and without conferring rights or remedies upon private actors. Such questions are certainly interesting and though necessarily interrelated with all questions of the effectiveness of the GATT are omitted for the practical reason stated above and also for the reason that it is assumed that it is, at least, possible that GATT rules can be effective even if they operate only on the international plane without direct effect. One could view the relationship between the failures and the special characteristics of agriculture, perhaps to assess whether agriculture is so different from other sectors that it is not possible to effectively regulate agricultural trade under the same rules as are to be used to regulate other sectors of trade. While some attention is paid to the special characteristics of agriculture, it is assumed throughout this work that it is possible to regulate all sectors of trade with the same set of international rules. This attitude to the uniqueness of agriculture is an important aspect of the approach to this study. Agriculture is regarded as a sector in which there are significant political pressures for protection which may be different in degree from other sectors but are not different in kind. The study proceeds on the basis that the reason for the failure in the application of the GATT rules to agriculture derives from defects in the content of the rules rather than from any inherent quality of the agriculture sector which would make it impossible to apply the rules successfully to agriculture.

This approach of looking for defects in the content of the rules and analyzing their connection to the failures in relation to agriculture is even more focussed than that. The search for defects in the rules is focussed upon the way that the rules of the GATT should and do distinguish between different instruments of trade and commercial policy. The thesis examines the rationale for distinguishing between instruments, whether there are ideas relating to the differences between policy instruments which could be embodied in the rules. Petersmann has pointed out that ideas drawn from economic theory are reflected to a large extent in the way that the GATT rules applies to different instruments:

GATT law ranks the various trade policy instruments according to their respective welfare costs in almost the same way as economic theory suggests:

the less trade-distorting a policy instrument tends to be, the less legal restraints GATT law places on its use.³⁷

The task undertaken here is to search for deficiencies in the embodiment of those ideas in the rules. If those ideas were less than perfectly embodied in the rules, then an examination can be made as to whether the deficiencies in the embodiment of those ideas was a cause of the problems in applying the GATT to agriculture. Secondly, an examination can be made as to whether those defects have been remedied by the amendments made in the Uruguay Round to the rules applicable to agriculture and from that some observations can be made as to whether the post-Uruguay Round rules are likely to be more successful in application to agricultural trade.

After elucidating the rationale for distinguishing between different instruments, this thesis:

- (1) searches for defects in the way that the rationale for distinguishing between different policy instruments was embodied in the rules; and
- (2) analyzes the way that GATT rules affected trade in agricultural products between 1948 and the Uruguay Round and identifies and explains the areas of difficulty which might be characterized as failures;

so as to be able to make an assessment of whether the defects in the embodiment of the distinctions between instruments in the rules (referred to in paragraph (1)) contributed to the failures in the application of the rules to agriculture (referred to in paragraph (2)).

Then, the thesis examines the changes made in the Uruguay Round to the rules applicable to agriculture. To the extent that some connection is found between any such defects and the failure in applying the rules to agriculture, the thesis examines whether the Uruguay Round remedied the way that the rationale for distinctions between instruments is embodied in the rules applicable to agriculture and, upon the basis of the examination, makes a judgement as to whether the post Uruguay Round rules are likely to be more successful in disciplining agricultural policies and liberalizing agricultural trade.

37 See, Petersmann, Ernst-Ulrich, "National Constitutions, Foreign Trade Policy and European Community Law" (1993) 2 *European Journal of International Law* 1-35 at p32.

RATIONALE FOR DISTINCTIONS BETWEEN POLICY INSTRUMENTS

The examination of the economic and political rationale for distinguishing between different policy instruments is an important and integral step in this work. This examination necessarily involves the explanation of some theory of international economics and some theory of the political economy of government decision making, often called 'public choice theory'. The explanation of the economic and political-economy theory does not assume any prior knowledge or familiarity with the subject matter. There are two other important points to be made about the economic and political theory that is explained and drawn upon in this thesis.

Internal Effects Rather Than External

This thesis draws on ideas advanced by, inter alia, Petersmann and Roessler which stress the role of GATT rules in regulating the relations between citizens within states as opposed to their role in regulating relations between states.³⁸ Therefore, the explanation of the economic and political theory is directed at what happens within a single state imposing trade and commercial policy instruments. The economic theory is aimed at explaining the effect of different policy instruments on the aggregate economic welfare of the state imposing the instrument and on the redistributive effects of the different policy instruments within that state. The explanation of the political economy theory is directed toward explaining the way that an individual state makes choices relating to protection and, in particular, the choice between different policy instruments.

Limitation to Four Principal Policy Instruments

The explanation of the theory and the subsequent use of it is simplified by limiting the examination of different policy instruments to only four policy instruments. Although, there are a variety of policy instruments which may be used to provide assistance to particular economic sectors, I have chosen to deal with only four such instruments because most of the various policy instruments used by governments can be characterized as a form of one of these four, or a combination of one or more of them. The four instruments to be considered here are:

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- (1) import tariffs;
 - (2) quantitative import restrictions (import prohibitions and quotas);
 - (3) export subsidies;
 - (4) domestic production subsidies.

Each of the four policy instruments described provides assistance to domestic producers. Both import tariff and import quotas assist domestic producers by reducing the quantity of import below what they would otherwise be. Export subsidies help domestic producers sell to foreign markets and domestic subsidies help domestic producers sell to any market. The operation of these four principal instruments is explained below.

An extension of this analysis to other instruments is left for other work. In particular, the fourth category could be extended to other types of domestic subsidy which are not directly related to production. However, the within analysis of the differences between instruments does not extend to examining the differences between different types of domestic subsidies.

The Import Tariff

An import tariff, also known as a customs duty, is a tax payable upon the import of a product. It is payable by the importer to the government of the country into which it is imported. The amount of a customs duty can be calculated in different ways. It may be calculated as an amount per unit of the quantity of the commodity being imported (called a 'specific' tariff or duty) or as a proportion of the value of the import (called an 'ad valorem' tariff or duty). The total price paid by the consumer in the importing country is equal to the sum of the amount received by the foreign seller (for simplicity, ignoring the role of importers, wholesalers, shippers and other intermediaries) and the amount received by the government.

38 See the references in chapter 8, below, under the heading "GATT Rules as Constitutional Constraints".

The Import Quota

An import quota is a restriction on the quantity of a particular product that may be imported into the domestic market. The most restrictive form of an import quota is an import prohibition which is a quota of zero. The imposition of an import quota places an absolute limit on the quantity of imports.

The Export Subsidy

A subsidy is a transfer from a government to an economic entity whether by cash payment, tax rebate, concessional provision of a government service or any other means. A subsidy protects or assists domestic producers because it gives them an advantage over foreign competitors. It is necessary to distinguish between export subsidies and other subsidies. An export subsidy can be defined as a subsidy, the payment of which is contingent upon an export sale. An export subsidy gives the exporter an advantage in selling to foreign markets. Usually, an export subsidy is used in a situation in which there is an excess of domestic supply over demand in distinction from the two import barriers, the import tariff and the quota, which are used in the situation in which there is an excess of domestic demand over supply.

The Domestic Production Subsidy

Domestic production subsidies increase the return received by the domestic producer from all sales not just from export sales. The simplest form of domestic production subsidy is a supplementary payment to producers paid in respect of the sale of each unit of production. Such subsidies are commonly called 'deficiency payments' because they make up the deficiency between the price that producers receive on the market and the price that the government wants the producers to receive. Another form of domestic production subsidy occurs when the government buys each unit of production from producers at a higher price than the government then on-sells it to consumers. This form of subsidy is commonly called 'a price-support scheme' or a 'dual-price scheme' because it creates a duality of prices in the economy: one price for producers and another price for consumers.

OUTLINE OF THE THESIS

Here follows an outline of the thesis which is divided into five parts.

PART 1 IS THERE A LINK BETWEEN THE PROBLEM WITH AGRICULTURE UNDER GATT RULES AND POLICY CHOICE UNDER GATT RULES?

Part 1 consists of this chapter introducing the problem with the application of the GATT and the next chapter explaining the framework of GATT rules with an emphasis on the regulation of the four principal policy instruments. This chapter has proposed a particular way of approaching the questions of "Why were there problems applying the GATT to agriculture?" and "Did the Uruguay Round fix the problems?". This approach looks for the causes of the problems in the rules themselves rather than in any unique quality of the agricultural sector. The particular approach taken is to analyze why the GATT rules should and do distinguish between different policy instruments and to look for any link between any deficiencies in distinguishing between policy instruments and the difficulties in applying the GATT to agriculture.

The second chapter offers a description of the framework of GATT rules. The description is set out so as to clearly distinguish between the way that the four principal policy instruments are regulated under the rules. This chapter will serve as a basis for the analysis of the application of the rules to agriculture in the period 1947 to 1994. It is one of the necessary foundations of the assessment of whether the rules appropriately embodied distinctions between different policy instruments and of whether any deficiencies in that embodiment contributed to the problems in applying the GATT to agricultural trade. This description of the rules also serves as the basis for the analysis of the changes made in the Uruguay Round to the rules applicable to agricultural trade.

PART 2 THE ECONOMIC AND POLITICAL DISTINCTIONS BETWEEN POLICY INSTRUMENTS

This part of the thesis contains the examination of the economic and political differences between the four principal policy instruments which is essential to establish the framework within which the application of the GATT to agriculture is analyzed. Chapter 3 introduces this part of the thesis by setting out the objective of discovering the rationale for the GATT

rules to distinguish between different policy instruments. There follows a description of the way that the instruments cause changes to the prices and quantities of production, consumption, and import or export. Then, this part assesses the effects of these changes in prices and quantities upon the economic welfare of different entities. That analysis leads to some conclusions about which entities in the community gain and which lose from each of the four policy instruments and whether the community in aggregate wins or loses. The analysis is taken a step further so as to arrive at a ranking of the policy instruments in terms of the cost to the rest of the community of providing assistance to particular producers. This economic analysis is broken up into 3 separate chapters and is explained in a manner which does not assume any prior knowledge of the relevant economics.³⁹

This part of the thesis also examines political aspects of protection: first, the non-economic⁴⁰ factors that lead to demands for protection; and secondly, the way that political decisions with respect to protection are made. This analysis of the political factors provides some insights into both the choice of the level of protection and the choice of the policy instrument, in particular, arriving at a ranking of the principal policy instruments in order of the likelihood that the political decision making process will result in their adoption.

The last chapter of this part of the thesis, chapter 8 compares the conclusions as to the economic cost of certain policy instruments with the conclusions as to the political likelihood that the political decision making process will result in the choice of one political instrument rather than another. From this it proposes not only that guidance of parties' choice of instrument should be one of the functions of the GATT but that it is crucial to the successful application of the rules. The chapter concludes by proposing some criteria for the way that GATT rules should be designed so as to optimize the performance of this function.

39 Whilst an understanding of the within described principles of economics is essential to an understanding of the whole of this thesis, a reader with existing knowledge of partial equilibrium analysis (or more sophisticated analysis) of trade instruments may only need to read the conclusions at the end of chapters 4, 5 and 6 rather than the whole text of those chapters.

40 See the elaboration in chapter 4 upon the use of the term 'non-economic'.

PART 3 THE APPLICATION OF THE PRE-URUGUAY ROUND GATT TO AGRICULTURE

This part of the thesis analyzes whether the pre-Uruguay Round GATT rules did appropriately distinguish between different policy instruments, examines the various problems with the application of the GATT to agriculture between 1948 and the Uruguay Round, and assesses whether any deficiencies in the way that the distinctions between policy instruments were embodied in the rules were a cause of the difficulties in the application of the rules to agriculture. Before commencing that analysis, the introductory chapter to this part reviews the rules portrayed in the introductory description of the framework of GATT rules and makes some observations as to whether those rules were consistent with the criteria proposed for successfully distinguishing between different policy instruments. The main analysis is also preceded by a description of some historical background relating to the application of the GATT to agriculture which is an essential prerequisite to the subsequent detailed analysis. The main part of the analysis is divided in the same way that the Uruguay Round negotiators divided their consideration of agricultural trade: import barriers, export subsidies and domestic support. The rules in these three areas occupy separate chapters. Also separated from the main analysis but left until the end is a description of the various initiatives taken by the parties over 45 years to try to improve the application of the GATT to agriculture. One reason for dealing with this separately and after the detailed analysis is that this arrangement facilitates some continuity in leading into the Uruguay Round negotiation in the next part.

This final chapter in this part sets out the ways in which the pre-Uruguay Round GATT was deficient in the way that it distinguished between different policy instruments and argues that there was a link between these deficiencies and the problems that arose in applying the rules to agricultural trade.

PART 4 THE URUGUAY ROUND NEGOTIATION AND THE POST-URUGUAY ROUND GATT RULES APPLICABLE TO AGRICULTURE

This part of the thesis assesses whether the defects in the rules identified in Part 3 and submitted to have been one of the causes of the problems in applying the GATT to agriculture were remedied in the Uruguay Round. It does so by describing and analyzing

the post-Uruguay Round GATT rules which are applicable to agricultural trade. The author leads into the description of the rules with a description of the Uruguay Round negotiation on agriculture. The description of the negotiation is interrupted to consider whether the negotiators might have reached a better result sooner if they had placed more emphasis on the principles described in Part 2 of this thesis. The detailed description of the rules again follows the division into rules on import barriers, rules on export subsidies and rules on domestic support.

This part concludes with an assessment of whether the defects that were enumerated at the end of Part 3 of the thesis have been remedied in the post-Uruguay Round rules. From that assessment, some predictions can be made as to whether the new rules will be more successful in liberalizing agricultural trade and in achieving conformity with the rules.

PART 5 CONCLUDING OBSERVATIONS

This part reflects upon the conclusions that have already been made about the importance of regulating the choice of policy instrument and the relationship between this factor and the problems in applying the GATT to agriculture. It will remain to make some observations about the relative importance of the ideas the subject of this work to the specific problem of international regulation of agricultural policies and also to the regulation of international trade generally. In particular, it considers what the analysis of agriculture has indicated about the way in which ideas relating to the function of GATT as a regulator of relations *within* states are important to the function of GATT as a regulator of relations *between* states. It concludes with a more general consideration of the construction of international economic law and the role that ideas must play in the political negotiations by which such international economic laws are constructed.

CHAPTER 2

THE FRAMEWORK OF GATT RULES REGULATING THE FOUR PRINCIPAL POLICY INSTRUMENTS

The GATT legal structure is unusual in that it rests, not on conventional ideas of legal obligation per se, but on a root concept of mutual and reciprocal "benefit".

Robert E. Hudec, "Regulation of Domestic Subsidies Under the MTN Subsidies Code", in Wallace, Loftus & Krikorian. *Interface Three: Legal Treatment of Domestic Subsidies* (The International Law Institute, Washington DC, 1984), p1.

1 INTRODUCTION

This chapter describes the scheme of regulation under the *GATT* (ie *GATT 1947*¹) which applied to agricultural trade from the commencement of the *GATT* until the Uruguay Round. While many aspects of the rules have been changed by the *Marrakesh Agreement Establishing the World Trade Organization* ('*WTO Agreement*'),² the general framework of the rules remains the same. Since this chapter lays a foundation for an analysis in subsequent chapters of the way that the rules were applied to agricultural trade between the commencement of the *GATT* and the Uruguay Round, this chapter describes the rules as they were during that period. In some instances, the description is accurate with respect to the pre-World Trade Organization ('*WTO*') period but is no longer true of the post-*WTO GATT* and, in other instances, the description is accurate in respect of the pre-*WTO GATT* and remains an accurate description of the post-*WTO GATT*. In some aspects, the differences between the pre-*WTO GATT* and the post-*WTO GATT* are minor and, in other aspects, they are vast. No attempt is made in *this* chapter to explain the extent of those changes that were made in the Uruguay Round so there is no attempt to point out which aspects of the pre-*WTO* rules did not survive the Uruguay Round, nor to describe the post *WTO GATT*. This restriction of the subject matter of this chapter also has an impact on the

1 See Chapter 1 footnote 1.

language employed. In general, the description is written in the past tense, even though, much of what is described in this chapter is still accurate in respect of the post-WTO GATT. In a few instances, where the descriptions are completely accurate both in respect of pre and post-WTO law, the present tense is employed. Even there, such description must be qualified by the fact that references to the law applying under GATT 1947 involve references to the institution of the CONTRACTING PARTIES and whilst some such descriptions of the law may still, in other respects, be an accurate description of the law applying under the post-WTO GATT, the reference to the correct institution acting under the WTO Agreement would have to be substituted for the reference to the CONTRACTING PARTIES in order for the description of GATT 1947 to remain a correct statement of the current law. In some such situations, the law has been stated with the reference to the institution which acted under the rules under GATT 1947 without any attempt to identify the institution acting under the post-WTO GATT. Despite the dominant use of past tense in this chapter, it is still intended that this description of the GATT rules should also form the background of the discussion in part 4 of the thesis about the changes to the rules made in the Uruguay Round and the post-WTO GATT rules. The primary function of this chapter, though, is to form the basis of the discussion in Part 3 of the way that the GATT applied to agricultural trade between 1948 and the Uruguay Round. It also provides sufficient background to the discussion in Part 2 of some of the functions of the GATT, particularly its role in guiding choice of policy instrument.

As explained in the introductory chapter, this description of the framework of GATT rules has a particular focus on the way that the GATT regulated the use of the four principal policy instruments which are the subject of detailed examination in this thesis: import tariffs, import quotas, export subsidies and domestic subsidies.³ Each of the four

2 *Marrakesh Agreement Establishing the World Trade Organization* 15 April 1994, Marrakesh, ('WTO Agreement') in force 1 January 1995, Aust TS 1995 No 8; 33 ILM 1144.

3 Compare this approach with those taken in Dam, Kenneth W., *The GATT - Law and International Economic Organization* (University of Chicago Press, Chicago 1970) chapters 3 to 9; Hoekman, Bernard & Kostecki, Michael, *The Political Economy of the World Trading System- From GATT to WTO* (Oxford University Press, Oxford, 1995) chapter 4; Jackson, John H., *World Trade and the Law of GATT* (Bobbs-Merrill, Indianapolis 1969) chapters 9 to 28; Lowenfeld, Andreas F., *Public Controls on International Trade* (Volume VI of *International Economic Law* (Mathew Bender, New York, 2nd ed 1983) ch2; McGovern, Edmond, *International Trade Regulation: GATT, the United States and the European Community* (Globefield Press, Exeter 2nd ed 1986) chapters 5 to 13; Seyid Muhammad, V A, *The Legal Framework of World Trade*, (Stevens & Sons, London, 1958) chapters

instruments of protection were subject to different regulation under GATT rules. The rules relating to import tariffs provided a framework for negotiated obligations as to the maximum levels of tariffs and provided for a limited number of ways that those obligations could be varied or temporarily deviated from. The rules relating to quotas essentially comprised a blanket prohibition to which some exceptions were made. The rules relating to export subsidies prohibited some export subsidies for some parties and the rules relating to domestic subsidies left them unregulated directly, but regulated indirectly by the rules on tariffs. Both types of subsidies were also affected by the rules on countervailing duties.

It is intended that the following exposition should offer an understanding of the general rules relating to each of the four principal policy instruments and the exceptions to them. It should highlight the way that the rules influence the choice of policy instrument and provide the necessary background to an assessment of whether the way they influence that choice is desirable. To accommodate the overlapping of many of the exceptions and to simplify the explanation of the dispute settlement system, the material is arranged in the following order:

- The Negotiating History of the GATT
- The Legal Framework of The GATT
- The Rules Relating to Import Tariffs
- The Rules Relating to Import Quotas
- The Rules Relating to Export Subsidies
- The Rules Relating to Domestic Subsidies
- The Consequences of Breaching the Rules
 - Violation nullification or impairment
 - Non-violation nullification or impairment
- Countervailing Duties
- Exceptions to the General Rules

4,5,7 & 8; Finlayson, Jock A., "Canada and the International Regulation of Trade Barriers: The General Agreement on Tariffs and Trade", ch1 in Paterson, Robert K., *Canadian Regulation of International Trade and Investment* (The Carswell Company Limited, Toronto, 1986); Davey, William J., "The WTO/GATT World Trading System: An Overview" in Pescatore, Davey & Lowenfeld, *Handbook of GATT Dispute Settlement* (Transnational Juris Publications, New York, 1991-Release 4, July 1994) pp7-63; Ryan, K.W., *International Trade Law* (Law Book Co, Sydney 1975) ch1; Tzionas, Ioannis Alex., "Structure and Operation of the GATT", chVI in Hazel Fox (ed), *International Economic Law and Developing States: An Introduction* (The British Institute of International and Comparative Law, London, 1992)(Vol II in International Economic Law Series).

- The Overall Scheme of Regulation of the Four Principal Policy Instruments

This overview omits discussion of some aspects of the GATT rules. Some aspects of the rules are discussed only to the extent that it is necessary to fully explain the way that the principal policy instruments are regulated. In particular, this chapter (and this thesis) deals only in an incidental way with the way the rules regulate non-discrimination. That omission is not intended to underplay the importance of non-discrimination as a foundation of GATT rules. For present purposes, non-discrimination is of importance because it was a significant factor in the negotiation of the GATT and, in particular, was a major reason for the desire to prohibit quantitative restrictions. The incidental treatment of non-discrimination, the cursory treatment of some aspects of GATT law and the complete omission of some other aspects are necessary in order that this thesis may concentrate on comparison of the way that different policy instruments were regulated.

Before describing the rules regulating each of the instruments, it is useful to offer some of the negotiating history of the rules. In addition, it is important to put the rules in their legal context by

- (1) describing the way in which they came into force;
- (2) explaining the institutional framework within which the Agreement operated;
- (3) explaining how the GATT operated multilaterally;
- (4) setting out some distinctive fundamental characteristics of the GATT legal system;
and
- (5) taking note of some sources of flexibility in GATT rules.

2 THE NEGOTIATING HISTORY OF THE GATT

At some stages of this thesis, it is necessary to refer to the negotiations and the antecedent documents upon which the GATT was founded. Therefore, before beginning the description

of the content of the rules themselves, a brief review of the negotiating history of the GATT is offered here.⁴

The GATT came about as a result of two tracks of negotiation: first, bilateral negotiations initiated of the USA, and secondly, international negotiations begun with war-time discussions between the USA and UK governments and continued under sponsorship of the United Nations after its formation in 1945. Apart from the obvious factor, World War II, there are two key historical factors that affected these negotiations. First, there was the desire of most countries to gain access to the market of the United States. Such access was severely restricted by tariff levels which had been raised to their highest ever levels⁵ by the *Smoot Hawley Tariff Act* of 1930.⁶ The second factor was the desire of the United States for the elimination of Imperial preference which had existed since the *Ottawa Agreement on Imperial Preference* of 1932⁷ enacted shortly after the United Kingdom had introduced a general tariff abandoning its prior policy of free trade.⁸

4 For interesting and thorough first hand accounts of the series of negotiation which gave birth to the GATT, see Brown, William Adams, Jr, *The United States and the Restoration of World Trade, An analysis and Appraisal of the ITO Charter and the General Agreement on Tariffs and Trade* (The Brookings Institution, Washington, DC, 1950) (hereinafter 'Brown') and Wilcox, Clair, *A Charter For World Trade* (The Macmillan Company, New York, 1949) (hereinafter 'Wilcox'). Both books were intentional contributions to the debate in the United States over whether to ratify the Havana Charter. Brown's book contains a provision by provision analysis of the Havana Charter and an analysis of the relationship between the GATT and the Havana Charter. Wilcox, who was head of the USA delegation in London and deputy head in Geneva and Havana, also gives an excellent account of the negotiation and the contents of the charter of the International Trade Organization, although with fairly minor treatment of the GATT. A broader description of the negotiation of post war institutions, which focuses on the relationship between the UK and the USA and on the internal politics in both countries is Gardner, Richard N., *Sterling-Dollar Diplomacy in Current Perspective: The Origins and the Prospects of Our International Economic Order* (Columbia University Press, New York, 2nd ed, 1980 (originally published in 1956)) It contains an excellent bibliography of primary materials and writing on the era in history; Other useful sources include: Crawford, J.G., *Australian Trade Policy 1942-1966 A Documentary History* (Australian National University Press, Canberra, 1968); Part 1 of Robert Hudec, *The GATT Legal System and World Trade Diplomacy* (Butterworth Legal Publishers, Salem, New Hampshire, 2nd ed, 1990); Chapter 2 of Jackson, J., *World Trade and the Law of GATT* (1969) and Penrose, E.F., *Economic Planning for the Peace* (Princeton University Press, Princeton, New Jersey, 1953), a fascinating account of the internal and inter-personal politics in the United States that contributed to its international economic negotiations.

5 See Wilcox (1949) p8.

6 46 Stat 590 (1930); see Wilcox (1949) p8.

7 The Ottawa agreements were a series of agreements dated 12 August between British Imperial countries. They came into force on 12 October 1932. See Wilcox (1949) p8; Brown (1950) pp41-42.

8 The UK legislation was *An Act to provide for the imposition of a general ad valorem duty of customs* 22 Geo.5 c.8 (29 February 1932). See Wilcox (1949) p8. Generally, on the influence of Imperial Preference on the negotiation of the GATT, see Gardner (1980), pp51-52.

The United States and the United Kingdom first manifested a common approach to international economic relations during World War II. In 1941 they signed the joint declaration called the *Atlantic Charter* under which both countries agreed to try "to further the enjoyment by all states ... of access, on equal terms, to the trade and raw materials of the world".⁹ To ensure that British Imperial preferences would not be affected, Prime Minister Churchill insisted that the obligations be qualified with the words "with all respect to their existing obligations".¹⁰

The Atlantic Charter was followed by the *Mutual Aid Agreement* of February 1942.¹¹ This agreement between the United Kingdom and the United States provided that the US and the UK would cooperate to promote economic prosperity and would hold further meetings to agree on joint action and to seek participation of other countries. Article VII of the *Mutual Aid Agreement* provided that such joint action should be directed to, inter alia, "the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers".

During 1943, the USA and the UK held discussions on how to put the obligations in Article VII into effect. British proposals had derived largely from a submission from the economist James Meade: "A Proposal for an International Commercial Union".¹² A significant aspect of the UK proposals was that there should be an 'across the board' cut to all tariffs of all member countries on all products. The USA reaction to this proposal was mixed, largely because it already had legislation in place authorizing the bilateral negotiation of item by item tariff cuts. In 1934, largely in reaction to the political processes that had led to the

9 Article IV of the "Declaration of Principles, known as the Charter, issued by the Prime Minister of the United Kingdom and the President of the United States of America, 14 August 1941." *League of Nations Treaty Series*, vol 204, p384. Extracted in Crawford, *Australian Trade Policy 1942-1966*, p9 and in Brown (1950) p48. The Atlantic conference is described in Gardner (1980) p40-53.

10 Article IV, as above. On the insertion of these words, see "Safeguards For Imperial Preference - Extract from a speech by the Prime Minister of the United Kingdom (W S Churchill) in the House of Commons, 21 April 1944" in Crawford, JG, *Australian Trade Policy 1942-1966* (Australian National University, Canberra, 1968) pp10-11 (sourced from P.D. (H. of C.), vol 399, pp579-580. (This information is presented without trying to convey any view as to whether Churchill was a supporter of Imperial Preferences.)

11 *Agreement Between the Government of the United Kingdom and the Government of the United States of America on the Principles applying to Mutual aid in the Prosecution of the War against Aggression* Washington 23 February 1942 *League of Nations Treaty Series*, vol 204, p389. Extracted in Crawford, p9; See also Brown, p48;

12 "A Proposal for an International Commercial Union" reproduced in "James Meade's War-time Proposal for a Liberal Trade Regime" (1987) 10 *The World Economy* 399-407.

enactment of the Smoot Hawley Tariff, the congress had passed the *Reciprocal Trade Agreements Act* which gave the President power to negotiate tariff reductions with other countries and to proclaim the reduced tariffs into US domestic law.¹³ The USA preferred that an international agreement would operate on the same basis. This issue became an integral part of the main point of contention which was whether Imperial Preferences would be eliminated or to what extent they would be reduced. Without going into the complexities of the internal politics within the USA or the UK, in general terms, the position was that the UK refused to abolish preferences except in exchange for a general tariff reduction¹⁴ and the USA wished to make a substantial reduction of tariffs contingent on abolition of preferences.¹⁵

By the end of the war, the negotiation had moved to consideration of a 'bilateral-multilateral' model in which tariff reductions would be negotiated following the method previously used under the US trade legislation. These would be multilateralized by including a most favoured nation clause. In addition, margins of preferences would be frozen and reduced as tariff rates fell. On 6 December 1945, simultaneously with the settlement of the UK's financial liabilities to the USA relating to the war effort, the two countries released a joint statement saying that the UK was in agreement with an American document entitled "*Proposals for Consideration by an International Conference on Trade and Development*".¹⁶ The relevant provisions of the *Proposals* were broad enough to be consistent with a general multilateral tariff cut or with bilaterally negotiated MFN tariff cuts and with either elimination, reduction or freezing of preference margins.

13 *Reciprocal Trade Agreements Act* 1934; 48 Stat 943 (codified at 19 USCA 1351). The authority given to the President lasted for 3 years. The delegation of authority has been continued by a series of legislation, although a lapse occurred prior to the 1974 enactment. For a listing of the legislation between 1934 and the *Trade Agreements Act* of 1979, see John H Jackson & William J Davey, *Legal Problems of International Relations* (West Publishing Co, St Paul, 1986) p145, fn36.

14 Culbert, Jay, "War-time Anglo American Talks and the making of the GATT" (1987) 10 *The World Economy* 381-408 at 391.

15 As above.

16 These matters are dealt with in para 1 of Section B of the *Proposals*. Note that the word 'elimination' is still used in relation to preferences but it is qualified by linking it to substantial tariff reductions. The joint statement and other documents resulting from these negotiations are published in *Federal Reserve Bulletin* (January 1946) pp14-19; the "The text of the "Proposals" is published by the US Department of State as *Proposals for Expansion of World Trade and Employment*, Department of State Publication 2411, Commercial Policy Series 79 (November 1945), and also as *Proposals for an International Conference on Trade and Employment* in NZ Dept of External Affairs Publication No14. Generally, see Brown (1950) p54.

Two months later, at the first meeting of the Economic and Social Council of the United Nations (established under the *United Nations Charter* which had come into force on 26 June 1945¹⁷) a resolution was passed calling for an International Conference on Trade and Employment.¹⁸ The resolution set agenda items and appointed a preparatory committee.

In December of 1945, the United States had already invited some other governments to participate in tariff negotiations.¹⁹ After the establishment of the Preparatory Committee for an International Conference on Trade and Employment, the United States extended the invitation to all of the members of the Preparatory Committee. The invitations initiated the procedures under the United States' *Trade Agreements Act*.²⁰

The first meeting of the Preparatory Committee was scheduled to begin on 15 October 1946. Before that date, the United States produced a *Suggested Charter* as a basis for the negotiation to be conducted by the Preparatory Committee.²¹ It contained chapters dealing with employment, commercial policy, restrictive business practices, intergovernmental commodity arrangements, and organization. Commercial policy was dealt with in chapter IV. It provided for item by item bilateral tariff negotiations to be multilateralized by a most favoured nation clause and for preferences to be automatically reduced by tariff reductions.²²

The *Suggested Charter* contemplated the contingency that it would be possible to reach agreement on tariff reductions before it would be possible to bring the entire charter into effect. Accordingly, Article 56 of the *Suggested Charter* provided for an Interim Tariff Committee the members of which should be "those members of the Organization which

17 (1945) 1 UNTS xvi.

18 The UN Economic and Social Council is constituted under Chapter X of the Charter of the United Nations. This resolution was adopted at the first meeting of the UN Economic and Social Council; see 1 U.N. ECOSOC Res 13, UN Doc E/22 (18 February 1946). The resolution is quoted in full in Brown (1950) at p59.

19 US Stat Dept, Press Release of 16 Dec 1945, 13 Dept State Bull 970 (1945); See Lowenfeld (1983), pp11-15.

20 See Brown (1950) p56; Wilcox (1949) p40. For a summary of the procedures required to be followed under the Act, see Brown (1950) pp16-18.

21 United States, *Suggested Charter for an International Trade Organization of the United Nations*, US Department of State Publication No 2598, Commercial Policy Series No 93 (1946) pIII (citation from Hudec 1990 p12 fn3). The Suggested Charter is also published as "United States Draft Charter", Annexure 11 to the *Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, see below. Generally, see Wilcox (1949) pp40-42.

22 See *Suggested Charter* Articles 8 & 18.

shall have made effective the General Agreement on Tariffs and Trade dated, 194.....*" The footnote said:

This Agreement refers to the proposed arrangement for the concerted reduction of tariffs and trade barriers among the countries invited by the United States to enter into negotiations for this purpose. It is contemplated that the Agreement would contain schedules of tariff concessions and would incorporate certain of the provisions of Chapter IV of the Charter (e.g., the provisions relating to most-favoured-nation treatment, to national treatment on internal taxes and regulations, to quantitative restrictions, etc.).

At the first (London) session of the Preparatory Committee meeting, there was some reluctance from France and the United Kingdom about using the *Suggested Charter* as a basis for negotiations. However, discussions did proceed on the basis of the *Suggested Charter* with sub-groups discussing the subject matter of its chapters.²³

The report of the First Session of the Preparatory Committee, issued on 26 November 1946, included a draft charter for an International Trade Organization ('*London Draft Charter*').²⁴

Commercial policy was dealt with in chapter V. Separate resolutions were adopted:

- scheduling a second session of the Preparatory Committee in Geneva;
- appointing a Drafting Committee to meet in New York before the second session of the Preparatory Committee; and
- recommending that the tariff negotiation meetings under the United States *Trade Agreements Act* be held under the sponsorship of the Preparatory Committee as part of its second session in Geneva.

The *London Draft* of the charter for an International Trade Organization also contemplated that a General Agreement on Tariffs and Trade might come into force before the charter itself. Article 67 of the *London draft* incorporated Article 56 of the *Suggested Charter* and its reference to a General Agreement on Tariffs and Trade.

23 The sub-group on Commercial Policy was chaired by Dr H C Coombs of Australia. It is interesting to note that the economist Mr J E Meade was a member of the delegation of the United Kingdom. Some years after, in 1955, he published the influential work, *Trade and Welfare* (Oxford University Press, Oxford, 1955). The head of the United States delegation was Mr Clair Wilcox who in 1949 published *A Charter For World Trade* (The Macmillan Company, New York 1949) an account of the London and subsequent negotiations.

24 *Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, U.N.Doc E/PC/T/33 (London, Oct 46).

The Report of the London Session also adopted a set of procedures for the tariff negotiations to be held under the United States *Trade Agreements Act*.²⁵ The procedures proposed that the results of the tariff negotiations

be incorporated in an agreement among the members of the Preparatory Committee which would also contain either by reference or reproduction, those general provisions of Chapter V of the Charter considered essential to safeguard the value of the tariff concessions and such other provisions as may be appropriate. ... A draft outline of a General Agreement on Tariffs and Trade appears in Section I. The Drafting Committee should consider this outline and prepare a more complete draft for the consideration of the Preparatory Committee at its Second Session.²⁶

In fact, it was Section K (rather than Section I) which was headed "*Tentative and Partial Draft Outline of General Agreement on Tariffs and Trade*". It contained a bare framework with even the essential details left out.

The drafting Committee met in New York between 20 January and 25 February 1946.²⁷ It furthered the drafting of the proposed Charter for an International Trade Organization and prepared a draft text of the General Agreement on Tariffs and Trade ready for submission to the Second (Geneva) Session of the Preparatory Committee.²⁸

The second (Geneva) session began on 10 April 1947. By 22 August 1947, the negotiation of a draft charter for the International Trade Organization was completed ready for submission to the United Nations Conference on Trade and Employment scheduled for late 1947.²⁹ Tariff negotiations continued for a further two months during which some further changes to the General Agreement were also agreed. In the closing stages of the negotiation, the USA again pressed the UK and Commonwealth countries for the

25 "Multilateral Trade Agreement Negotiations: Procedures for Giving Effect to Certain Provisions of the Charter of the International Trade Organization by Means of a General Agreement on Tariffs and Trade Among the Members of the Preparatory Committee", Annexure 10 to the *Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*. UN Doc E/PC/T/33 (London, Oct 46).

26 Section H, 2 of Annexure 10 to the Report cited above.

27 At that time, Lake Success, New York was the usual meeting place for the U.N. Economic and Social Council.

28 *Report of the Drafting Committee of the Preparatory Committee*, UN Doc E/PC/T/34. See also Interim Report of the second session of the Preparatory Committee of the United Nations Conference on Trade and Employment (UN Doc E/469), 14 July 1947.

29 *Report of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, UN Doc E/PC/T/186 (Geneva, August 1947).

elimination of preferences.³⁰ The UK resisted any further dismantling of imperial preference and the USA, more or less to save face, withdrew a few of the tariff reductions which had been 'on the table' and accepted the deal the UK was offering.³¹ As the negotiation of tariff reductions closed, it became apparent that a number of countries might have difficulty putting the General Agreement into effect for the interim period during which it was intended to operate pending the International Trade Organization coming into being. Since many countries had existing legislation which was contrary to the provisions of the draft charter for the International Trade Organization and of the proposed General Agreement, it would be necessary for the implementation of both agreements to be approved by legislation. A number of countries were reluctant to put international trade matters to their legislatures twice: once to implement the GATT; and a second time to implement the ITO.

The twenty three participants in the Second Session of the Preparatory committee signed the General Agreement.³² The Agreement provided for entry into force upon a required number of instruments of acceptance being deposited.³³ To overcome the problems with bringing it into effect, eight of those twenty three participants reached a compromise. They agreed that most of the provisions of the Agreement, apart from the provisions on tariff reductions, reduction of preferences and the most favoured nation clause, would operate only to the extent not inconsistent with already existing legislation. This arrangement was put into effect by a *Protocol of Provisional Application of the General Agreement on Tariffs and Trade* which provided for the General Agreement to apply provisionally from 1 January 1948.³⁴ This arrangement enabled the Agreement to come into force without the need for parties to ask their legislatures to change pre-existing legislation.

30 See "Statement Made by Mr Clair Wilcox to Representatives of the British Commonwealth, Geneva, Switzerland, September 16 1947" in USA Dept of State, *Foreign Relations of the United States 1947*, Volume I (United States Government Printing Office, Washington, 1973) (Department of State Publication 8674) pp983-993.

31 See "Memorandum by the Minister-Counselor for Economic Affairs at London (Hawkins), and by Mr Winthrop G Brown" London, 24 September 1947 in USA Dept of State, *Foreign Relations of the United States 1947*, Volume I (United States Government Printing Office, Washington, 1973) (Department of State Publication 8674) pp996-998.

32 The 23 countries are listed in the recitals to the GATT.

33 GATT, Article XXVI:6.

34 *Protocol of Provisional Application of the General Agreement on Tariffs and Trade*, done Geneva, 30 October 1947, BISD Vol I, p77; 55 UNTS 308; TIAS No 1770; 61 Stat.2, 1947. The governments

Between 21 November 1947 and 24 March 1948, the United Nations International Conference on Trade and Employment took place in Havana with fifty six nations (47 UN members and 9 non-members).³⁵ At the completion of the conference, on 24 March 1948, fifty three of those nations authenticated a text of the Havana Charter For an International Trade Organization.³⁶ They also adopted a resolution establishing an Interim Commission for the International Trade Organization.³⁷ At more or less the same time, the first session of the Contracting Parties to the GATT adopted rules of procedure which provided for the secretarial work for the GATT parties to be performed by the Interim Commission for the International Trade Organization.³⁸

However, the ITO never came into existence. The draft charter was submitted to the US Congress in April 1949 but was rejected. It was not submitted again and, on 11 December 1950, President Truman issued a statement that the Havana Charter would not be submitted again to the US Congress for approval.³⁹ This left in place the GATT which had been intended to be temporary.

In fact, the GATT itself never came into definitive application until the end of the Uruguay Round in 1994. The provisional application for 8 countries was to last for 46 years at the end of which, it applied to 103 countries and the Second (Geneva) Session of the Preparatory Committee for the UN Conference on Trade and Employment had become the first of eight rounds of multilateral tariff negotiations under the GATT.

acceding to this Protocol are listed in Table VID in the Appendix to the GATT, *Analytical Index: Guide to GATT Law and Practice* (GATT, Geneva, 6th ed, 1994) ("*GATT Analytical Index*").

35 See the Annex to the "Report of the Secretary-General on the United Nations Trade and Employment Conference" (Doc E/807) 2 June 1948; 7 U.N. ECOSOC p312. In addition to the participants, there were some observers: the UN member, Paraguay, the non-member, Finland, and the Allied Control Authority for Japan.

36 See the Annex to the "Report of the Secretary-General on the United Nations Trade and Employment Conference" (Doc E/807) 2 June 1948; 7 U.N. ECOSOC p312. Fifty three countries signed the Final Act of the conference which authenticated the text of the Charter for the ITO.

37 United Nations Conference on Trade and Employment, Havana, 21 November 1947 to 24 March 1948, *Final Act and Related Documents*, UN doc E/Conf.2/78 dated April 1948. See the other 3 references for the Final Act at p5 of the *GATT Analytical Index*; and see Jackson (1969) p49-50 fn1-2.

38 Rule 15 of "Rules of Procedure for Sessions of the Contracting Parties", GATT, I BISD 95; adopted GATT/1/SR.3 p2-3. See GATT, *Analytical Index*, p1009, fn4 and Jackson (1969) p145, fn2.

39 Crawford (1968) p43.

3 THE LEGAL FRAMEWORK OF THE GATT

3.1 APPLICATION OF THE GATT

As stated above, although the GATT was signed by 23 original parties,⁴⁰ its provisions did not come into definitive force until they came into force as part of GATT1994 in the WTO Agreement on 1 January 1995.⁴¹ Instead, between 1948 and 1994 the GATT applied provisionally. The *Protocol of Provisional Application* executed by eight of the original parties (and soon afterwards acceded to by most of the original 23 parties)⁴² bound the parties to:

apply provisionally on and after 1 January 1948:

- (a) Parts I and III of the General Agreement on Tariffs and Trade, and
- (b) Part II of that Agreement to the fullest extent not inconsistent with existing legislation.⁴³

For subsequently acceding parties, application of the GATT was effected by accession to the original Protocol or to a similar Protocol or by succession.⁴⁴

3.2 INSTITUTIONAL FRAMEWORK FOR THE GATT

The GATT 1947 was a treaty. It did not establish an international organization and it had little provision for institutional structure. However, over the period ending with the establishment of the World Trade Organization, the GATT 1947 functioned in many respects as if it were an organization.⁴⁵

40 The 23 original parties are named at the head of the Agreement: see I BISD 13 at 13; Entry into force is dealt with under Art XXVI.

41 See Art II:2 and Annex 1A:1 of the *Marrakesh Agreement Establishing the World Trade Organization*, 15 April 1994; in force generally and for Australia on 1 January 1995; Aust TS 1995 No 8; 33 ILM 1144.

42 *Protocol of Provisional Application of the GATT*, Geneva, 30 October 1947; I BISD 77; 55 U.N.T.S. 308; T.I.A.S. No.1770; 61 Stat.[2] 1947; The names of the original 8 appear in Art I of the Protocol; The governments acceding to this Protocol are listed in Table VID in the Appendix to GATT, *Analytical Index: Guide to GATT Law and Practice* (GATT, Geneva, 6th ed, 1994) ("GATT, *Analytical Index*").

43 *Protocol of Provisional Application of the GATT*, as above, Art I.

44 See Tables A to D in part VI "Accession and Succession to Contracting Party Status Under the General Agreement" of the Appendix to GATT, *Analytical Index*. Also see Jackson (1969) at p60 fn1 discussing two instances of ratification of the GATT itself by Haiti and by Liberia (temporarily).

45 On this issue of whether the pre-WTO GATT was an organization see, eg, Long, Olivier, *Law and its Limitations in the GATT Multilateral Trade System* (Martinus Nijhoff, Dordrecht, 1985) p44-54; and Dam, Kenneth W., "The GATT as an International Organization", ch19 in *The GATT: Law and International Economic Organization* pp335-350.

Although the ITO never came into existence, the interim arrangement whereby the United Nations Interim Commission for the International Trade Organization provided secretarial services for the GATT persisted from 1948 until 1995 when the WTO came into existence.⁴⁶ This arrangement effectively overcame the absence of provisions in the Agreement to establish a secretariat.

The abstention from creating any organization meant that the GATT did not create any organs to carry out various functions. However, the GATT did provide for the institution of the CONTRACTING PARTIES (designated by capital letters) which was the contracting parties acting jointly in accordance with the voting requirements of the Agreement.⁴⁷ Meetings of the contracting parties were held once per year.⁴⁸ A decision of the CONTRACTING PARTIES of 1960 delegated to the GATT Council the power to act between sessions of the CONTRACTING PARTIES.⁴⁹ Generally, decisions of the CONTRACTING PARTIES and of the GATT Council were taken by consensus without voting which meant that wherever a single party objected to a resolution, no resolution was taken.⁵⁰

From time to time, the CONTRACTING PARTIES adopted (unanimous) decisions regarding the interpretation of the GATT, thereby exercising a quasi-legislative function.⁵¹ The CONTRACTING PARTIES exercised an executive function by acting as a medium for communication and negotiation, and by entering into relationships with third parties.⁵² The

46 See Rule 15 of the "Rules of Procedure for Sessions of the Contracting Parties" adopted at the first session of the Contracting Parties in March 1948, I BISD 95; I do not intend to categorically state that the Interim Commission for the ITO ceased to function on 1 January 1995 as soon as the WTO came into existence - it may be that a gradual transition of responsibilities and obligations from one body to the other continued after that date or is still continuing.

47 See GATT, Art XXV:1. In the GATT itself, references to the one or more of the contracting parties uses the words 'contracting party' or 'contracting parties' in lower case but references to the contracting parties acting jointly use the words 'CONTRACTING PARTIES' in upper case. This thesis attempts to follow the same convention.

48 To the end of 1992, there had been 48 regular sessions: see GATT, *Analytical Index*, p1011.

49 "Decision of 4 June 1960 establishing the Council of Representatives", *BISD*, 9S/8-9. Prior to the establishment of the Council, most of the functions of the Council were carried out by an Intersessional Committee: see GATT, *Analytical Index* p1015, fn32.

50 The CONTRACTING PARTIES did routinely vote on accessions under Article XXXIII and waivers under Article XXV:5 but had not taken a vote on any other matter since 1959: see GATT, *Analytical Index* (6th ed) p1014. The Council had never taken a vote: see GATT, *Analytical Index* (6th ed) p1022 saying "the practice has been to proceed on the basis of consensus".

51 See Jackson (1969) p132; and Roessler, F., "The Competence of GATT" (1987) 21(3) *JWTL* 73-83.

52 See the examples cited by Roessler, "The Competence of GATT", at p80-81.

CONTRACTING PARTIES also exercised an arbitral and quasi-judicial function by issuing rulings, recommendations and authorizations to resolve disputes between contracting parties.⁵³ The CONTRACTING PARTIES delegated part of these functions, in early days, to working parties which consisted of a representative of every contracting party and, from 1952, to panels which consisted of a small number of independent experts. The recommendations of working parties and dispute settlement panels had no legal status of their own. They only acquired legal status upon being adopted by the CONTRACTING PARTIES. The fact that such decisions were always carried out on a consensus basis meant that it was possible for the losing litigant to block the adoption of a panel report. This happened several times in cases relating to agriculture, in particular, in cases relating to European agricultural policies.⁵⁴

After the Uruguay Round, with the creation of the WTO, the former functions of the CONTRACTING PARTIES and various bodies to which they had delegated functions were taken over by bodies created pursuant to the *WTO Agreement*.⁵⁵ Therefore, any reference in this chapter to the CONTRACTING PARTIES necessarily refers to the law as it was prior to the WTO coming into existence.⁵⁶

3.3 CHARACTERISTICS OF THE GATT LEGAL SYSTEM

Obligations under the GATT have always had some distinctive features which endure in the post Uruguay Round GATT.

Firstly, under the GATT, parties can unilaterally change some of their obligations.⁵⁷ In fact, the GATT draws only fine distinctions between the treatment of unilaterally initiated changes in obligations and the treatment of violations of obligations.⁵⁸

53 Principally under Art XXIII. Note that rather than executive, legislative and judicial functions, Roessler refers to four competences of the CONTRACTING PARTIES: regulatory, deliberative, legislative and external: Roessler, "The Competences of GATT", p77-81.

54 See the discussion below in Ch 12 on the *EEC Wheat Export subsidies* case and in ch13 on the *EEC Canned Peaches* case.

55 See *Marrakesh Agreement Establishing the World Trade Organization* 1994 ATS No 8, Article IV.

56 Article 2(b) of the *General Agreement on Tariffs and Trade 1994* deems references in the *GATT 1994* to CONTRACTING PARTIES to be references to the WTO. In this text, for simplicity of narrative, some of the references are in the present tense. Generally, these include statements of law where the pre and post WTO law is the same with the qualification that the relevant administering body is no longer the CONTRACTING PARTIES but is the relevant body acting under the *WTO Agreement*.

57 See the discussion of Arts XIX & XXVIII, in this chapter below.

Secondly, the GATT does not provide that breaches create obligations to pay reparations. It is silent on reparations and is generally regarded as creating a code of dispute settlement in which payment of reparations plays no part.⁵⁹

Thirdly, the CONTRACTING PARTIES did not have any power to order that a situation of breach be brought into conformity with the GATT. They can make such a recommendation but their only power, if the recommendation is not complied with, is to release other parties from obligations owing to the defaulting party.⁶⁰ It is notable that even though the power is to make a recommendation requesting compliance rather than an order requiring compliance, in the overwhelming majority of cases, the defaulting party has, in fact, complied with the recommendation.⁶¹

Fourthly, although the GATT does provide, in the event of breach, for injured parties to be released from future obligations to the defaulting party, it places significant restrictions on that right.⁶² In the case of a breach, injured parties were not released from their own

58 See Jackson (1969) at p164-165 observing that there is a multitude of clauses in the GATT which require contracting parties to consult with each other and which may result in negotiated changes to obligations.

59 In respect of the law of reparations under international law, see the statement of the law in *Chorzow Factory Case (Germany v Poland) (merits)* (1928) PCIJ Ser A, No 17 at pp46-48; and International Law Commission, *Draft Articles on State Responsibility*, Part II, Arts 6 & 7; [1984] 2 *YB Int Law Com* 19. On the absence from GATT of ordinary notions of reparations, see Petersmann, Ernst-Ulrich, "Violation-Complaints and Non-Violation Complaints in Public International Trade Law" (1991) 34 *German YIL* 175 at 183-189. The position appears to be the same after the Uruguay Round: see, in particular, Article 22 of the *Understanding on Dispute Settlement*, Annex 2 to the *Agreement Establishing the World Trade Organization* done at Marrakesh 15 April 1994 ('DSU').

60 Art XXIII (and after the Uruguay Round, the provisions of the *Understanding on Dispute Settlement*, see preceding footnote). The author believes this statement is still accurate in respect of the current law, but perhaps under the DSU the position is contentious. See, for eg, Jackson, John H., "Designing and Implementing Effective Dispute Settlement Procedures: WTO Dispute Settlement, Appraisal and Prospects" ch 5 in Anne O Krueger (ed), *The WTO as an International Organization* (University of Chicago Press, Chicago & London, 1998) pp161-180 at pp169-170.

61 See the statistics on compliance with recommendations compiled by Robert Hudec in Hudec, *Enforcing International Trade Law - The Evolution of the Modern GATT System* (Butterworths, Salem, 1991) Table 11.18 on p305.

62 GATT, Art XXIII. For a comparison of Article XXIII and the provisions of Article 60 of the *Vienna Convention on the Law of Treaties*, Vienna, adopted 22 May 1969, opened for signature 23 May 1969, in force 27 January 1980 ("*Vienna Convention*"); UN Doc A/conf 39/27; UKTS 58 (1980); 8 ILM 679: see Brand, Ronald, "Competing Philosophies of GATT Dispute Resolution in the *Oilseeds Case* and the Draft *Understanding on Dispute Settlement*" (1993) 27(6) *JWT* 117 at 133-134. Petersmann discusses the exhaustive nature of the GATT rules on countermeasures: see Petersmann, Ernst-Ulrich, "Violation-Complaints and Non-Violation Complaints in Public International Trade Law" (1991) 34 *GYIL* 175 at 193-196. Pescatore appears to take a contrary view: that the GATT legal system does not exclude the general international law of countermeasures: see Pescatore, Pierre,

obligations toward the offending party unless and until they had obtained authority of the CONTRACTING PARTIES. Between 1 January 1948 and the commencement of the WTO, such authorization was given only once.⁶³

In general, the GATT legal system's approach to breaches has always been (and still is) to re-establish the previously negotiated balance of benefits rather than the precise state of the pre-existing obligations. This is true, even though, in general, the relevant recommendation of the CONTRACTING PARTIES was to bring the relevant measure into conformity with the GATT.

3.4 THE MOST FAVOURED NATION RULE, MULTILATERALIZATION OF CONCESSIONS AND 'FIRST-DIFFERENCE' RECIPROCITY

Fundamental to the GATT is the Most Favoured Nation rule. This is provided for in Article I. It requires that every contracting party must treat the trade of every other party no less favourably than it treats the trade of any other country (of its most favoured nation'). The effect of this clause is that the benefit of every trade liberalization which is agreed between any two contracting parties (or even granted by a contracting party in favour of a non-contracting country) must be accorded in favour of every contracting party.

It is also fundamental to the GATT that parties do not have to offer the same degree of trade liberalization to other parties as other parties offer to them. Obligations are not reciprocal in that sense. Some obligations are reciprocal but obligations with respect to tariff rates are not. Obligations are expected to be reciprocal in the sense of the amount of trade liberalization exchanged. This is often called 'first-difference' reciprocity. It means that there should be some kind of reciprocity in the size of tariff cuts agreed but not necessarily in the resulting level of tariffs.

3.5 FOUR SOURCES OF FLEXIBILITY

It is important to be aware that the text of the Agreement itself and the instruments which brought it into force in 1948 gave rise to some sources of flexibility in the rules.

"The GATT Dispute Settlement Mechanism: Its Present Situation and its Prospects" (1993) 70(1) *J Int Arb* 27 at 37.

63 See "Netherlands Measures of Suspension of Obligations to the United States", determination of 8 November 1952, *BISD* 1S/32.

(a) Grandfathering

As mentioned above, under the Protocols of Provisional Application, some parts of the Agreement only applied to the extent that they were not inconsistent with existing legislation. The giving of immunity to existing legislation from compliance with the obligations under international law is called "grandfathering" the existing legislation. It is important to be mindful of which provisions were grandfathered and which were not, that is, those which applied (provisionally) only to the extent that they were "not inconsistent with existing legislation" and those which applied absolutely.

Part I: containing Articles I and II applied absolutely. It contains the Most Favoured Nation rule and also obligations relating to the negotiated tariff rates.

Part II: containing Articles III to XXIII applied to the extent that they were not inconsistent with existing legislation. It contains the rules regulating quotas⁶⁴ and subsidies,⁶⁵ the rules for temporary emergency departures from tariff obligations,⁶⁶ and also the dispute resolution provision in Article XXIII.

Part III: containing articles XXIV to XXXV applied absolutely. It contains the provisions for variation of the obligations relating to tariffs.⁶⁷

(b) Withdrawal from the Agreement

A contracting party always had the option of withdrawing from the Agreement. The Protocols of Provisional Application provided that any government could withdraw by giving 60 days notice.⁶⁸

64 Principally, Art XI.

65 Art XVI.

66 Art XIX.

67 Art XXVIII.

68 In the *Protocol of Provisional Application* of the GATT, October 30, 1947, the withdrawal provision is Art 5. Under Article XXXI of the GATT itself, parties could withdraw by giving six months notice.

(c) Exceptions in the GATT Text

The Agreement allowed for deviation from its general rules in a number of situations. Some of the exceptions were specific exceptions from particular rules. Others were general exceptions from the obligations under the Agreement. The most important exceptions for purposes of this study are mentioned later in this chapter.

(d) Waivers - Article XXV5

In the event that a contracting party wished to adopt or continue policies which did not comply with the general rules and could not be justified under any of the exceptions, then that party could apply for a waiver under Article XXV:5. Under this provision, the CONTRACTING PARTIES could waive any obligation imposed by the Agreement.⁶⁹ A two-thirds majority of the votes cast was required and that majority of votes had to contain more than half of the contracting parties.⁷⁰

4 THE RULES RELATING TO IMPORT TARIFFS

The first of the four principal policy instruments considered is the import tariff.

4.1 THE BASIC RULE - ARTICLE II SCHEDULES OF CONCESSIONS

The principal obligations concerning import tariffs are contained in Article II:1 which provides :

- (a) Each contracting party shall accord to the commerce of the contracting parties treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement.
- (b) The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided for therein.

69 Art XXV:5 "In exceptional circumstances not elsewhere provided in this Agreement, the CONTRACTING PARTIES may waive an obligation imposed upon a contracting party by this Agreement ... "

70 Art XXV:5.

As Article II contemplates, the parties' obligations relating to tariff levels apply to the products that are listed in Schedules to the Agreement. Each party to the agreement completes a Schedule which is incorporated into the Agreement by annexation to it.⁷¹ These Schedules of Concessions are comprised of lists of products for which maximum tariff rates are specified.⁷² Until the completion of the Uruguay Round, the product coverage of Schedules varied enormously from country to country. Some were almost comprehensive lists of the country's customs classifications. Others contained a very short list of products. The maximum tariff rates are described as "bound" rates. The obligation on a country not to charge more than the bound tariff rate is called a binding. The act of agreeing to a tariff binding is usually called giving a concession, so the obligations listed in a country's schedule are often referred to in the Agreement and elsewhere as "concessions".

4.2 MULTILATERALIZATION OF CONCESSIONS BY THE MFN CLAUSE

The benefits of the obligations imposed by tariff bindings are extended to all parties to the GATT. This is achieved by the provisions of Article II above and also by Article I:1 which provides, in part:

With respect to custom duties ... imposed on importation ..., any advantage, favour, privilege or immunity granted by any contracting party to any product originating in ... any other country shall be accorded immediately and unconditionally to the like product originating in ... the territories of all other contracting parties.

There are exceptions to this rule but, generally, every party automatically receives the benefit of every tariff binding given by every other party.⁷³

4.3 THE NEGOTIATION OF CONCESSIONS / BINDINGS

The contracting parties' Schedules of Concessions arise from negotiations. For a new member, its schedule arises from the negotiation for accession to the Agreement. For the original and longtime members, the schedules are the result of a series of negotiations. Those negotiations have been conducted in a few different ways. Until 1967, the Schedules

71 Art II:7.

72 Some schedules contain commitments other than tariff concessions: see the schedule items listed in GATT, *Analytical Index*, p871, fn22 & 23; and see section 11 in this chapter.

consisted of concessions resulting wholly from a process of request and offer on an item by item and country by country basis.⁷⁴ However, to some extent, the pre-Uruguay Round Schedules were also the product of across the board tariff reductions. In 1967, the Kennedy Round reductions included linear reductions on industrial products⁷⁵ and, in 1979, the Tokyo Round reductions included reductions on industrial products according to a harmonization formula which applied a larger cut to higher tariff rates.⁷⁶ The Uruguay Round applied a mixture of earlier methods including, for the first time, linear reductions on agricultural products. However, the pre-WTO Schedules relating to agricultural products were wholly the result of item by item negotiations.

In item by item negotiations, parties submit requests and offers to each other. One country may want to obtain access for a particular product to a particular country so it requests that country to cut its tariff on that item. The same country may be prepared to offer a tariff cut on another product. The process by which the final outcome of this offer and request process is reached can vary. A negotiation can be bilateral: two countries, interested in access to each others' markets, agree to give concessions to each other. This could happen where two countries exchange concession upon two products in respect of which each of the two countries is the principal supplier. Often, though, more than two countries are involved. In consequence of the MFN rule, any exchange of tariff reductions between a pair of countries would give a free ride of market access to other countries. Therefore, the first two countries would seek some concession from those other countries. In particular, they would seek some tariff concession from countries that are principal suppliers of the relevant products and that, therefore, would otherwise receive a significant benefit for nothing.⁷⁷ In general, then, a country is not prepared to negotiate a reduction of the rate on a particular product unless it receives reductions on other products from a number of other contracting parties as part of a package deal. In a number of situations that may arise under the GATT,

73 Consideration of the exceptions is mostly beyond the scope of this study. The exceptions are preferences listed in Article I:2, free trade areas and customs unions authorized under Article XXIV and non-application of the Agreement to particular parties under Article XXXV.

74 The rounds of tariff negotiations are listed in this chapter below. See the summary of tariff reduction method in Table 1.2 of Hoekman & Kostecki, *The Political Economy of the World Trading System* (Oxford University Press, Oxford, 1995) pp16-17.

75 Hoekman & Kostecki, as above.

76 Hoekman & Kostecki, as above.

77 See Jackson (1969) pp218-221.

it is important to identify who are the original parties to a particular exchange of concessions, who is a principal supplier or who is otherwise interested in a particular concession.⁷⁸ This identification is relevant to determining who has a right to participate in a renegotiation of the relevant concession. Where tariff reductions have been implemented on a formula basis, the parties have made special rules for determining initial negotiating rights.⁷⁹

4.4 ROUNDS OF TARIFF NEGOTIATIONS

Article XXVIIIbis, added to the Agreement in 1955, provides that periodically there shall be multilateral trade negotiations.⁸⁰ There have been eight rounds of multilateral trade negotiations, with the first being that conducted at the same time as the second session of the Preparatory Committee for an International Conference on Trade and Employment and the eighth being the Uruguay Round which began in 1986 and ended in 1994. The rounds of negotiation have been as follows:

The 1st Round - the Geneva Round in 1947

The 2nd Round - the Annecy Round in 1949

The 3rd Round - the Torquay Round in 1951

The 4th Round - the Geneva Round in 1956

The 5th Round - the Dillon Round in 1960-61

The 6th Round - the Kennedy Round in 1964-67

The 7th Round - the Tokyo Round in 1973-79

The 8th Round - the Uruguay Round in 1986-94

4.5 PROTECTING THE INTEGRITY OF TARIFF BINDINGS AND THE NATIONAL TREATMENT RULE

A number of additional rules prohibit government policies which can circumvent tariff bindings. Article II:1(b) prevents the limits on customs duties being circumvented by other

78 On the concepts of 'initial negotiating rights', 'principal supplying interest' and 'substantial interest', see Dam (1970) pp83-84. Important primary materials on these concepts are collected in GATT, *Analytical Index* at pp867-871.

79 Eg, with respect to the Kennedy Round, see 15S/67, and with respect to the Tokyo Round, see 26S/202. Generally see GATT, *Analytical Index*, pp868-869.

80 Art XXVIIIbis was inserted by Section X of Article I of the *Protocol Amending the Preamble and Parts II and III of the GATT*, Geneva, 10 March 1955, in force 7 October 1957; 278 UNTS 168.

charges on imports. Parties are also prohibited from using changes to tariff classifications to avoid tariff commitments.⁸¹ Article II:4 attempts to prevent parties from circumventing tariff bindings through the use of state import monopolies. Article II:4 prescribes that where a tariff concession is granted on a product that state import monopolies dealing in that product must not operate so as to “afford protection on the average in excess of the amount of protection provided for in that Schedule”.⁸² This means that the average mark-up must not exceed the bound tariff rate.

A national treatment rule in Article III prevents parties from circumventing the limits on customs duties by imposing heavier sales taxes on imported goods than on domestically produced goods.⁸³ It also prevents imposing an effective tariff through requiring imports to be used in specified proportions with domestic goods.⁸⁴ In fact, Article III prohibits the treatment of imported goods under legal regulation of any kind in a manner less favourable than the way the same regulation is applied to like domestic goods.⁸⁵ Article III does not apply only to products upon which tariff bindings have been given but to all products. In a sense, it prohibits hidden tariffs so that the import tariffs that do exist, whether bound or unbound, are transparent. There is an important exception to the national treatment rule for domestic production subsidies; if subsidies are paid “exclusively to domestic producers”, they are not prohibited by Article III.⁸⁶

4.6 THE RENEGOTIATION OF A CONCESSION / BINDING - ARTICLE XXVIII *MODIFICATION OF SCHEDULES*

After a country has placed a tariff binding in its Schedule of Concessions, it is possible for that country to alter or withdraw the concession pursuant to procedures set out in Article XXVIII. Some other provisions of the Agreement also provide for changes to obligations in various circumstances, for example, the exception for temporary emergency safeguards in Article XIX, but only Article XXVIII provides a right of renegotiation with no prerequisites.

81 Art II:3.

82 See Jackson (1969) p357 stating “...absent [a] special agreement, a tariff concession is automatically a “monopoly-protection-level” concession”.

83 See Art III:2; this is only one aspect of the national treatment provisions in Art III. There is also a de facto discrimination provision in the second sentence of Article III:2.

84 See Article III:5. On the economics of how this constitutes an effective tariff barrier, see Vousden, *The economics of protection* (Cambridge University Press, Cambridge, 1990) p40.

85 See Art III:4.

In essence, Article XXVIII provides a mechanism for parties to undo the exchange of concessions that they have previously agreed to. This reversal of the original agreement may occur where all parties agree to the reversal but it may also occur where a party wishing to undo the original agreement is unable to obtain the concurrence of the other parties. These procedures provide for permanent amendments to the Schedules of Concessions. Once the amended version of the Schedule comes into force, then the Concession that has been withdrawn is completely extinguished. Note, though, that only the particular concession which is renegotiated under Article XXVIII is erased from the Schedule. There may be one or more earlier concessions in respect of the same product that endure.⁸⁷

To explain the procedures available, I deal first with the consequences that follow where, in the absence of agreement, a contracting party simply withdraws a concession, secondly, with the negotiating procedure and, lastly, with the differences between the three slightly variant procedures available under Article XXVIII.

(a) Consequences Under Article XXVIII of Unilateral Withdrawal

Subject to an obligation to negotiate, a party could simply change its mind and withdraw a concession.⁸⁸ For example, Country A might have given a binding of a tariff on fresh apricots at a rate of 20%. If Country A fails to reach agreement on withdrawing this concession, Country A can still proceed to withdraw the concession. The withdrawal of the concession by Country A must apply to the trade of all other contracting parties. In response, certain other contracting parties are able to withdraw "substantially equivalent concessions initially negotiated with [country A]."⁸⁹

Those certain other parties, entitled to withdraw concessions in response comprise :

- parties with initial negotiating rights ('INR's), that is, parties with whom Country A initially negotiated the 20% binding on apricots ;⁹⁰

86 Article III:8(b).

87 On the layering of bindings, see Jackson (1969) pp203-204 & also McGovern, Edmond, *International Trade Regulation* (Globefield Press, Exeter, 1995-) pp5.11-3 - 5.11-4.

88 See Art XXVIII:1.

89 Arts XXVIII:3(a) and 4(d).

90 See Arts XXVIII:3(a) and XXVIII:4(d). Initial negotiating rights may arise from a specific agreement and be inscribed in a Schedule or may be 'floating INRs' arising from a decision taken in a

-
- parties determined to have a principal supplying interest in the import of apricots by Country A;⁹¹ and
 - parties determined to have a substantial interest in the import of apricots by Country A.⁹²

The concessions that can be withdrawn in response may be chosen only from those concessions that the responding party had included in its Schedule of concessions as a result of negotiations with Country A. However, the trade to which the withdrawal applies cannot be limited. The withdrawal of concessions by 'retaliating' parties must apply to the trade of all other contracting parties. These rules can make it difficult for retaliating parties to choose products for retaliation purposes because they would prefer to choose products the imports of which are supplied almost solely by the target country.

The use of the phrase "substantially equivalent concessions" implies that some value can be placed on the withdrawn concession and that it is possible to choose concessions of other parties that have "substantially equivalent" value. The Agreement does not define the concept of 'substantial equivalence' nor does it include any significant guidance on how 'substantial equivalence' or the 'value' of concessions is to be determined.⁹³ Further elucidation of these concepts is best done in the context of the negotiation procedure.

(b) The Negotiating Procedure

The above description of Article XXVIII describes the rights of the contracting parties but it does not indicate how the procedure is much more one of negotiation than of action and retaliation. The process of action and retaliation only occurs if the parties fail to reach agreement.⁹⁴ A party wishing to change its schedule must negotiate with the party with

past round that principal suppliers will automatically have INR status for the purposes of Article XXVIII (eg, see L/6367 of 15 June 1988).

91 See Arts XXVIII:3(a) and XXVIII:4(d) and Interpretative Note Ad Article XXVIII: para 1:4,5 and 6. Pre-WTO, this determination was made by the CONTRACTING PARTIES.

92 Arts XXVIII:3(a) and 4(d); See Interpretative Note Ad Article XXVIII: para 1:7. Pre-WTO, this determination was made by the CONTRACTING PARTIES.

93 There is limited guidance contained in Arts XXVIII:2, XXVIIIbis:1 & 2 and in the Interpretative Note Ad Article XXVIII.

94 Art XXVIII:3(a),3(b) and 4(d).

whom the concession was originally negotiated and with any party that has a principal supplying interest.⁹⁵ The character of the negotiation is described in Article XXVIII:2 :

In such negotiations and agreement, which may include provision for compensatory adjustment with respect to other products, the contracting parties concerned shall endeavour to maintain a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in this Agreement prior to such negotiations.

Compensatory adjustment refers to the giving of a new tariff concession to compensate for the withdrawal of an existing one. For example, Country A, wanting to increase the tariff on imports of apricots from a bound rate of 20% up to a rate of 30%, might offer to reduce the bound tariff rate on one or more other products, perhaps another fruit product or perhaps a completely different product, say, car wheels. Where compensatory adjustment is agreed, then country A can proceed with modification of its schedule without facing any withdrawal of concessions by other parties. However, it is not mandatory to reach agreement on compensation before proceeding with the withdrawal. A party can proceed with the withdrawal of the concession and continue to negotiate the compensation.

In order to determine how much compensation is appropriate, it is necessary to measure the value of the concession being withdrawn. The Agreement gives little guidance as to the appropriate measure of compensation. Article XXVIII:2 specifies the objective of the negotiation as maintaining "a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that" which existed before the change. The concepts of 'reciprocity' and 'mutual advantage' are also used in Article XXVIIIbis in describing the multilateral negotiations to be conducted from time to time. Whichever of the terms one attaches most importance to, whether it be "reciprocal", "mutually advantageous" or "not less favourable to trade", there are some difficulties in applying them to real circumstances. Some difficulties arise from uncertainty about what is being measured and others arise from the measurement itself.

Possible relevant measurements are the amount of trade that is affected by a concession, the change in price of the existing flow of imports, or the expected change in volume of the imports that flow before and after the modification of the schedule. Dam uses the term

95 Art XXVIII:1; See Dam (1970) pp83-84.

'trade coverage' to refer to the amount of trade that is affected by a concession.⁹⁶ Using this measure, the appropriate compensation for an increase in a tariff on a product for which imports are valued at \$5 million would be a new concession on some other products which constituted imports of \$5 million. As Dam comments, this approach to 'trade coverage' fails to take account of the depth of the change in tariff rate.⁹⁷ Jackson uses the same term, 'trade coverage', to refer to the change in price of the existing flow of imports.⁹⁸ Using this measure, the appropriate compensation for a 10 percentage point increase in the tariff rate on a product for which imports are valued at \$5 million would be new concessions on some other products which reduced their total import price by \$500,000. Both Jackson and Dam criticize this approach because it fails to take account of the change in the import flow that occurs in consequence of the modification to the concession.⁹⁹ If as a result of the increase, the total value of imports of apricots into country A is predicted to decrease by \$1 million, then one might argue that a negotiated outcome is "not less favourable to trade" only if it will enable the value of other imports into Country A to increase by \$1 million. Such a negotiation requires agreement upon the change in volume that will occur in response to a particular change in tariff rate.

There are also some practical difficulties with data. Generally, data on trade coverage for the previous three years is considered.¹⁰⁰ Depending on the period chosen, there may be the problem that data is not available at the time that negotiations commence.¹⁰¹ There are also obvious margins of error involved in predicting future trade flows. There may be the problem that the product is very new and there is little trade presently occurring.

In considering whether a negotiated outcome is "reciprocal and mutually advantageous", the parties may consider arguments like those discussed above involving consideration of the existing volume of trade, the depth of the tariff cut or on the changes to volumes of trade. However, there was nothing in the Agreement to determine precisely how reciprocity can be

96 See Dam (1970), pp59-61.

97 See Dam (1970), pp59-60.

98 Jackson (1969) p241; Jackson (1989) p123.

99 Jackson (1969) p241 and Jackson (1989) pp123-124; Dam (1970) p89.

100 See "Procedures for Negotiations under Article XXVIII", guidelines adopted by the GATT Council on 10 November 1980, C/113 and corr.1, BISD, 27S/26, para 2. It appears that there should be an updating of trade data as it becomes available, see L/4636, 17 May 1978.

calculated. In 1980, the CONTRACTING PARTIES adopted a set of procedures for negotiations under Article XXVIII, but it contains virtually no guidance on the valuation of concessions withdrawn and compensatory adjustments.¹⁰² Therefore, in practice, "reciprocity" means whatever the parties agree it means and a reciprocal outcome is whatever outcome the parties agree to.¹⁰³ In this sense, "reciprocity" is partly a consequence of the bargaining strength of the parties.

Article XXVIII provides that where agreement is reached then the party modifying its schedule can proceed with the modification without facing any withdrawal of concessions by other parties. In practice, though, the agreement between the parties may include some retaliatory withdrawal of concessions. Paragraph 2 of Article XXVIII refers to:

negotiations and agreement, which may include provision for compensatory adjustment with respect to other products.

These words appear to envisage a mixture of compensatory adjustments on other products and also the withdrawal of concessions which are 'substantially equivalent' to the part or whole of the withdrawn concession in respect of which adequate compensatory adjustment has not been agreed. In terms of valuation, there appears not to be any difference between concessions withdrawn, concessions given as compensation and concessions withdrawn in retaliation. Therefore, all of the uncertainties and difficulties as to valuation discussed above in relation to compensatory adjustments apply equally to retaliation.

The provision for compensatory adjustments is designed so that commitments can be modified without lessening the degree of liberalization embodied in the Schedules: that is, so that the outcome of negotiations can be "not less favourable to trade than that provided

101 See "Canada - Withdrawal of Tariff Concessions", panel report adopted 17 May 1978, BISD, 25S/42, 47-48, para 17.

102 See "Procedures for Negotiations under Article XXVIII", as above, BISD, 27S/26.

103 This statement is subject to the fact that under one of the three procedures under Art XXVIII, the CONTRACTING PARTIES may be asked to consider whether a party has "unreasonably failed to offer adequate compensation" (see Art XXVIII:4(d)). Under the other two procedures under Art XXVIII, the matter is not referred to the CONTRACTING PARTIES (See Art XXVIII:3 & 5). However, in support of the proposition, see Rhodes, Carolyn, *Reciprocity, US Trade Policy and the GATT Regime* (Cornell University Press, Ithaca & London, 1993) pp90, fn22 quoting from an interview with Jan Tumlir: "If reciprocity has uncertain economic meaning in the first place, then quantifying the equivalence of concessions is impossible. Consequently, reciprocal concession becomes a highly subjective concept based more on national negotiator's perceptions than on some universally agreed formula".

for in [the Schedules] prior to such negotiations". However, in practice, the negotiation is dominated by considerations of reciprocity because the parties that are entitled to participate in the negotiation, being either parties with initial negotiating rights, principal suppliers or parties with substantial interests, have in common that they suffer a reduction in their exports as a result of withdrawal of the original concession. Therefore, each of these parties are interested in obtaining a concession that permits a compensating increase in their own exports to the country modifying its schedule. In the event that they are only able to negotiate a lesser degree of access, these parties still wish to maintain the original sense of reciprocity in the extent of the obligations owed to each other and achieve this by unwinding some of their own obligations in retaliation. The maintenance of the original sense of reciprocity is generally referred to as maintaining the 'balance of concessions'. The concept of the balance of concessions has become very important in GATT custom and dispute settlement. The only sources of authority in the Agreement for the use of this concept of the 'balance of concessions' are the references to the possibility of withdrawal of "substantially equivalent concessions" in Article XXVIII and elsewhere in the Agreement¹⁰⁴ and the abovequoted words of Articles XXVIII:2 and XXVIIIbis referring to 'reciprocity' and 'mutual advantage'.

(c) The Three Variant Article XXIII Procedures

Article XXVIII contains not one but three procedures. The three procedures, though slightly different, are similar. The differences between the procedures hinge upon the fact that, in the ordinary course, concessions are intended to stand for a 3 year period of firm validity.¹⁰⁵ Whilst the 3 year periods of firm validity are automatically extended, it is intended that withdrawing a concession during the period of firm validity should be more difficult than withdrawing a concession at the end of the period. The three procedures are:¹⁰⁶

104 See Arts XVIII:7(b) & XIX:3(a).

105 Art XXVIII originally provided for the Schedules to until 1 January 1951. This date was extended a couple of times. Art XXVIII was amended to give the Schedules indefinite application by the *Protocol Amending the Preamble and Parts II and III of the GATT*, Geneva, 10 March 1955, in force 7 October 1957; 278 UNTS 168. Generally, see Dam (1970), p82.

106 The terminology 'Open Season Negotiations', and 'Closed Seasons Negotiations' is copied from Ryan, K, *International Trade Law* (Law Book Co, Sydney, 1975) p16-18. Dam uses the terms 'Open Season' and 'Out of Season': see Dam (1970) pp81ff.

- (1) 'Open Season Negotiations' which can be conducted at any time but can only relate to a change in a concession which is to come into force on the first day of any 3 year period;¹⁰⁷
- (2) 'Alternative Open Season Negotiations' which follow from a party giving notice that it intends to change a concession from the first day of the next 3 year period but only for the duration of that next 3 year period;¹⁰⁸
- (3) 'Closed Season Negotiations' which relate to the changing of a concession during a 3 year period.¹⁰⁹

With the first two types of negotiation, the procedure following a failure to agree is as set out above. The initiating party can proceed with the change to its Schedule and other parties can retaliate. However with the third type of negotiation (pursuant to Article XXVIII:4), two features of the procedure are different. First, the commencement of the negotiation requires the approval of the CONTRACTING PARTIES. Secondly, if the parties cannot reach agreement then the initiating party cannot proceed with the modification until the matter has been considered by the CONTRACTING PARTIES. If the CONTRACTING PARTIES decide that the initiating party has "unreasonably failed to offer adequate compensation" then the initiating party cannot proceed with the modification to its schedule.¹¹⁰

5 THE RULES RELATING TO IMPORT QUOTAS

The second of the principal policy instruments considered is the import quota.

5.1 THE BASIC RULE - ARTICLE XI GENERAL ELIMINATION OF QUANTITATIVE RESTRICTIONS

Article XI:1 provides the basic rule:

No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on

107 Art XXVIII:1

108 Art XXVIII:5

109 Art XXVIII:4

110 Art XXVIII:4(d).

the exportation or sale for export of any product destined for the territory of any contracting party.

The prohibition on quotas applies to all products whereas the prohibition on exceeding a bound tariff rate only applies to those products in respect of which a binding is given in a country's Schedule of Concessions. The obligation not to employ prohibitions or quotas applies independently of the content of each parties' Schedule of Concessions.

Prior to the WTO, a major difference between the general rule on tariffs and the general rule on quotas arose out of the operation of the Protocols of Provisional Application. As previously, noted, the general rule relating to tariffs operated absolutely but the general rule relating to quotas only operated to the extent that it was not inconsistent with existing legislation. Therefore, an import quota was not in breach of Article XI:1 if it could be justified under pre-existing legislation.¹¹¹

Apart from the pre-existing legislation exception, there were (and still are) a number of other exceptions to the general prohibition against import quotas. These are dealt with, below, after completion of the outline of the general rules and the application of the dispute settlement system to them.

5.2 NON-DISCRIMINATORY APPLICATION OF IMPORT QUOTAS - ARTICLE XIII

Quotas are in their nature discriminatory since they require discrimination against products outside the quota and where allocation is made to particular countries, necessarily involve discrimination between countries. Where import quotas are permitted under one of the exceptions, it seems that they are not subject to the MFN rule in Article I.¹¹² However, Article XIII creates particular rules on discrimination that apply to such import quotas as may be permitted under any exception to the general prohibition. The rules contained in Article XIII:2 require global quotas except where impracticable, and in the case of allocated

111 For the sake of simplicity I have deliberately avoided two of the complexities of 'grandfathering': first, that only mandatorily imposed measures are grandfathered; and, secondly, the determination of the exact date at which the pre-existing legislation must have been in existence. Both of these issues are dealt with in chapter 11 below.

112 First, the words of Article I do not mention quantitative restrictions. Second, Article XIV which allows discrimination in allocation of quotas is expressed to be an exception to Article XIII only

quotas to particular countries, the allocation of quotas must be based on the proportion supplied by the countries in a previous representative period.¹¹³ Therefore, the allocation of import quotas, although discriminatory in nature, is subject to some obligations of non-discrimination.

5.3 PROTECTING THE INTEGRITY OF THE PROHIBITION OF QUOTAS AND THE NATIONAL TREATMENT RULE

The Agreement prevents the circumvention of the prohibition of import quota through the use of internal quantitative regulations. Internal sales quotas must apply the same way to imported products as to like domestic products and, in any case, cannot be applied so as to afford protection to domestic products.¹¹⁴

There is a limited attempt to prevent the circumvention of the prohibition on import quotas through the limitation of the quantity of imports by state import monopolies. The prohibition in Article XI:1 does apply to quantitative restrictions maintained through the operation of state-trading operations.¹¹⁵ Further, Article XVII provides, inter alia, that state import monopolies must make purchases in a non-discriminatory manner solely "in accordance with commercial considerations".¹¹⁶

6 THE RULES RELATING TO EXPORT SUBSIDIES

The third of the four principal policy instruments to be considered is the export subsidy. The pre-WTO rules relating to subsidies generally and to export subsidies, in particular, evolved over 40 years. The evolution of the export subsidy rules manifested a gap between the disciplines on unprocessed agricultural products and other products. The analysis, in this thesis, of the operation of the rules over time necessarily must take account of precisely which rules were in effect at the relevant time. At the beginning of the Uruguay Round, the relevant rules derived partly from a general rule applicable to all subsidies in Article XVI:1, partly from some specific rules on export subsidies in Part B of Articles XVI that were

which infers that even without Article XIV, Article I does not apply to import quotas (This argument is made in Jackson (1969) p322).

113 See Article XIII:2. The rules contained in Article XIII are set out in Jackson, *World Trade and the Law of GATT* (Bobbs-Merril, Indianapolis, 1969) p323.

114 Article III:4 &5.

115 See Interpretative Note Ad Articles XI, XII, XIII, XIV and XVIII.

116 Article XVII:1(b).

added to the Agreement in 1955,¹¹⁷ and, for those that were parties to it, also partly from the *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement On Tariffs and Trade*, known as the "Subsidies Code" adopted in 1979 at the end of the Tokyo round.¹¹⁸ Unfortunately, not every source of rules applied to every party, so the rules were complicated by the fact that different rules applied to different parties.

An initial problem applicable to both export subsidies and domestic subsidies is the difficulty in defining what is a subsidy. In principle, subsidies can be any form of governmental assistance at all. The assistance may be in the form of cash payment but it may also be in the form of a tax concession, a sale below market price or a purchase above market price. The assistance may be given to producers of a particular product or may be given to producers of one of many inputs used to make that final product. It may not be product specific at all. For example, the government assistance may simply be given to all persons who use a particular service or who live in a particular area. Secondly, the distinction between export subsidies and other subsidies has not always been clear. Over the various changes to the rules, provisions have applied to 'subsidies which increase exports',¹¹⁹ 'subsidies on exports'¹²⁰ and 'export subsidies'.¹²¹ Part of the evolution of the rules up to and including in the Uruguay Round has been a response to these definitional problems.

6.1 EXPORT SUBSIDIES ARTICLE XVI:2 TO 5 "SECTION B - ADDITIONAL PROVISIONS ON EXPORT SUBSIDIES"

The original form of the GATT did not contain any specific provisions on export subsidies. The negotiators omitted the provisions on export subsidies in the draft ITO charter from the GATT. In 1955, concerns over the use of export subsidies resulted in the provisions in the draft ITO Charter being revisited. Agreement was reached on some prohibitions on

117 Arts XVI:2,3,4 & 5 were inserted by *Protocol Amending the Preamble and Parts II and III of the GATT*, Geneva, 10 March 1955, in force 7 October 1957; 278 UNTS 168.

118 *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement*, Geneva, 12 April 1979, in force 1 January 1980 ("Subsidies Code"); 1186 UNTS 204; BISD, 26S/56.

119 See Article XVI:1 containing the words "subsidy, ..., which operates directly or indirectly to increase exports".

120 See Article XVI:4 containing the words "subsidy on the export".

121 See Article 9 of the *Subsidies Code* containing the words "export subsidies".

particular types of export subsidies and Article XVI was augmented by the addition of Section B comprising Articles XVI:2 to 5.

In the Section B rules prohibiting certain export subsidies, a distinction was drawn between export subsidies on primary products and export subsidies on non-primary products. In respect of primary products, Article XVI:3 prohibited the application of "subsidies which operate to increase [exports] ... in a manner which results in [the subsidizing country] having more than an equitable share of world export trade" in the subsidized product. In respect of non-primary products, Article XVI:4 prohibited 'subsidies on export' that result in the sale of the subsidized product for export at a price lower than the price charged in the domestic market.¹²² Article XVI:4 only ever applied to 17 parties that accepted a declaration giving effect to its provisions.¹²³

6.2 THE *SUBSIDIES CODE* - THE AGREEMENT ON THE INTERPRETATION AND APPLICATION OF ARTICLES VI, XVI AND XXIII OF THE GENERAL AGREEMENT

For its signatories, the *Subsidies Code* applied in addition to the General Agreement. As at 31 March 1994, it had 24 signatories.¹²⁴ The rules regulating or prohibiting export subsidies and domestic subsidies were altered and extended by the *Subsidies Code* in some significant ways.

The prohibition in Article XVI:4 on export subsidies on non-primary products was made clearer by Article 9:1 of the Code. It imposed the prohibition on "export subsidies" and dropped the complication of the test in Article XVI:4 as to whether the export price was lower than the domestic price. It also extended the prohibition in Article XVI:4 to minerals which were previously covered only by Article XVI:3.¹²⁵

With respect to export subsidies on primary products, Article 10 repeated the test from Article XVI:3 relating to whether the subsidy results in the subsidizing country having "more than an equitable share of world export trade" but extended that test in two ways.

122 Article XVI:4 uses the words "subsidy on the export of any product other than a primary product".

123 "Declaration Giving Effect to the Provisions of Article XVI:4" in force 14 Nov 1962, see GATT, *Analytical Index* p457.

124 See Table VII "Acceptances of Tokyo Round Agreements" in Appendix to GATT, *Analytical Index*, pp1056-1059.

First, it stated that "more than an equitable share of world export trade" would include "any case in which the effect of an export subsidy granted by a signatory [was] to displace the exports of another signatory".¹²⁶ Secondly, Article 10 added another completely separate prohibition that applied to export subsidies on primary products. It prohibited export subsidies on primary products "to a particular market which results in prices materially below those of other suppliers to the same market."¹²⁷

There are some general provisions in the GATT and in the *Subsidies Code* which applied to both export subsidies and domestic subsidies. They are dealt with immediately below under the rules relating to domestic subsidies.

7 THE RULES RELATING TO DOMESTIC SUBSIDIES

The fourth of the four principal policy instruments to be considered is the regulation of domestic subsidies. The pre-WTO rules on domestic subsidies also changed over time, beginning with the original Article XVI (which became Article XVI:1 in the 1955 amendments) and ending with the provisions of the *Subsidies Code*.

7.1 CONSULTATIONS TO AVOID SERIOUS PREJUDICE - ARTICLE XVI:1 *SUBSIDIES, SECTION A - SUBSIDIES IN GENERAL*

Article XVI:1 obliges parties merely to enter into discussions. Contracting parties are obliged to discuss the possibility of limiting a subsidy if:

- (1) the subsidy operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory; and
- (2) the CONTRACTING PARTIES determine that the subsidy is causing or threatening serious prejudice to the interests of any other contracting party.

This provision applies to export subsidies or to domestic subsidies. The words "serious prejudice" are somewhat nebulous. Panel decisions have found that serious prejudice has been caused to a second country by export subsidies of one country which affected the

125 See the Interpretative Note Ad Article XVI:4 and also footnote 29 to Article 9 of the *Subsidies Code*.

126 *Subsidies Code*, Art 10:2(a).

127 *Subsidies Code*, Art 10:3.

competitive conditions under which the second country could export to third countries.¹²⁸ Although it was not been confirmed by any decision of the CONTRACTING PARTIES, theoretically, "serious prejudice" could also include the effect of a subsidy which enabled domestic production to displace imports or the effect of a subsidy upon products which were exported to a second country in competition with domestic products within that second country.

7.2 THE *SUBSIDIES CODE* - THE AGREEMENT ON THE INTERPRETATION AND APPLICATION OF ARTICLES VI, XVI AND XXIII OF THE GENERAL AGREEMENT

Parties to the *Subsidies Code* were obliged to limit the effects of domestic subsidies. Article 8 of the *Subsidies Code* imposed an obligation to "seek to avoid causing" certain adverse effects. Parties were obliged to seek to avoid causing:

- (a) injury to the domestic industry of another signatory,
- (b) nullification or impairment of the benefits accruing directly or indirectly to another signatory under the General Agreement, or
- (c) serious prejudice to the interests of another signatory.¹²⁹

In addition to creating an obligation to avoid causing the three adverse effects, the *Subsidies Code* also created a remedy, a right to seek authorization to retaliate, against the adverse effects. The three categories of adverse effects cover the three situations described above as falling within the meaning of serious prejudice.

8 CONSEQUENCES OF BREACHES OF THE RULES RELATING TO THE FOUR PRINCIPAL POLICY INSTRUMENTS - ARTICLE XXIII - NULLIFICATION OR IMPAIRMENT

It is not possible to understand the general rules regulating the four principal policy instruments without understanding the nature of the dispute settlement provisions of the GATT. Therefore, a description of the essence of the dispute settlement system follows in

128 See "European Communities - Refunds on Exports of Sugar - Complaint by Australia" L/4833, 6 November 1979, 26S/290 at 319, paras (g) & (h); and "European Communities - Refunds on Exports of Sugar - Complaint by Brazil" L/5011, 10 November 1980, 27S/69 at 97, paras (f) & (g).

129 This quote of Art 8:3 of the *Subsidies Code* omits the three footnotes and the references to them which are part of the text.

advance of consideration of various exceptions to the general rules.¹³⁰ The provisions described here are still in force under the GATT1994 but have been substantially modified by the *Understanding on Dispute Settlement* ('DSU'). It is stressed that this description relates to the law in force between 1948 and 1994 and it is accurate in respect of the current law only if read subject to the *DSU*.

Violations of the GATT 1947 were dealt with under the general dispute settlement provisions of Article XXIII.¹³¹ As a provision dealing with violations, Article XXIII is unusual in that a violation of the GATT "is neither a necessary nor a sufficient prerequisite to an Article XXIII action."¹³² The primary (and sufficient) prerequisite for operation of Article XXIII is that there is nullification or impairment of a benefit accruing under the Agreement. Nullification or impairment without a violation is sufficient but a violation without nullification or impairment is not (with one theoretical qualification¹³³). In

130 This description does not cover operation of panels, panel reports or the procedural aspects of the dispute settlement system. Such matters are dealt with extensively in both of Hudec's books, Hudec, Robert E., *The GATT Legal System and World Trade Diplomacy* (Butterworth, Salem, NH, 1990), Hudec, Robert E., *Enforcing International Trade Law - the evolution of the modern GATT legal system* (Butterworth, Salem NH, 1993) and also, for example, in Bael, Ivo Van, "The GATT Dispute Settlement Procedure" (1988) *JWT* 67-77; Robert E. Hudec, "GATT Dispute Settlement After the Tokyo Round: An Unfinished Business", (1980) 13 *Cornell Int.L.J.* 146; Pierre Pescatore, "The GATT Dispute Settlement Mechanism - Its Present Situation and its Prospects" (1993) *Journal of World Trade* 5-20. Plank, R, "An Unofficial Description of How a GATT Panel Works and Does Not" (1987) *Journal of International Arbitration* 101; Waincymer, Jeffrey M., "GATT Dispute Settlement: An Agenda for Evaluation and Reform" (1989) 14 *North Carolina J Int'l Law & Com Reg* 81-119; Waincymer, Jeffrey M., "Revitalizing GATT Article XXIII: Issues in the Context of the Uruguay Round" (1989) 17 *Aust Bus L Rev* 3-47. Some post-WTO works are: Palitho T.B. Kohona, "Dispute Resolution under the World Trade Organization - An Overview" (1994) 28 *JWT* 23; Ernst-Ulrich Petersmann, "The Dispute Settlement system of the World Trade Organization and the Evolution of the GATT Dispute Settlement System Since 1948" (1994) *Common Market Law Review* 1157-1244 and Young, Michael K., "Dispute Resolution in the Uruguay Round: Lawyers Triumph over Diplomats" (1995) 29(2) *The International Lawyer* 389-409.

131 Pre-WTO Interpretation of Art XXIII was affected by the following decisions: "Procedures under Article XXIII", decision of 5 April 1966, BISD, 14S/18.; "Understanding Regarding Notification Consultation, Dispute Settlement and Surveillance", adopted 28 November 1979, BISD, 26S/210 (including its Annex, the "Agreed Description of the Customary Practice of the GATT in the Field of Dispute Settlement"); Ministerial Declaration of 29 November 1982: "Dispute Settlement Procedures", BISD, 29S/13; "Action Taken on 30 November 1984; Dispute Settlement Procedures", BISD, 31S/9; "Improvements to the GATT Dispute Settlement Rules and Procedures", decision of 12 April 1989, BISD, 36S/61. The texts of these decisions are also published in GATT, *Analytical Index*, pp586-596.

132 Jackson, John H., "The Jurisprudence of International Trade: The DISC Case in GATT" (1978) 72 *Am J Int Law* 747 at 754.

133 The existence of nullification or impairment is in fact one of two alternative triggers. The other is that "the attainment of any objective of the Agreement is being impeded". However, the second trigger has never been used: Petersmann, Ernst-Ulrich, "The Dispute Settlement system of the World

practice, though, these awkward criteria were simplified by the development of a presumption under which all violations were regarded as prima facie nullification or impairment.¹³⁴ (Under the WTO Agreement, the concept of nullification or impairment appears to have little continuing importance in the case of violations.¹³⁵)

8.1 VIOLATIONS OF THE RULES ON IMPORT BARRIERS:

While there were complications in the application of Article XXIII to non-violations, its application to violations was relatively simple.¹³⁶ If a party considered that a benefit accruing to it under the Agreement was being nullified or impaired because another party was exceeding a bound tariff or was maintaining an import quota, then, after attempting to negotiate a "satisfactory adjustment", it could refer the matter to the CONTRACTING PARTIES.¹³⁷ Article XXIII provides that after investigating the matter, the CONTRACTING PARTIES "shall make appropriate recommendations ... or give a ruling ..., as appropriate".¹³⁸ In the case of a violation, the CONTRACTING PARTIES would recommend that the relevant contracting party bring the offending measure into conformity with the Agreement; that is, that it reduce its tariff rate back down to the bound level, or that it remove the offending import quota. If the offending party did not comply with the recommendation then the CONTRACTING PARTIES could:

Trade Organization and the Evolution of the GATT Dispute Settlement System Since 1948" (1994) 31 *CMLRev* 1157-1244 at 1173.

- 134 This practice was codified in the 1979 "Understanding Regarding Notification Consultation, Dispute Settlement and Surveillance", adopted 28 November 1979, BISD, 26S/210, see para 5 on p216 of the Annex beginning on p215. See Martha, Rutsel Silvestre J., "Presumptions and Burden of Proof in World Trade Law" (1997) 14(1) *Journal of International Arbitration* 67-98. (The presumption is also codified in Article 3.8 of the Uruguay Round Dispute Settlement Understanding, but this should be read in conjunction with the rest of the dispute Settlement Understanding.)
- 135 See DSU, Article 19 making the recommendation of a panel dependent upon a finding of "inconsistency". See Williams, Brett G., "Non-Violation Complaints in the WTO System" in Mengozzi, Paulo (ed), *International Trade Law on the 50th anniversary of the Multilateral Trade System* (Guiffre, Milano, 1999) pp675-797 at fn28 and accompanying text; cf Roessler, Frieder, "The Concept of Nullification and Impairment in the Legal System of the World Trade Organization" ch2 in Petersmann, Ernst-Ulrich, *International Trade Law and the GATT/WTO Dispute Settlement System* (vol 8 in *Studies in Transnational Economic Law*) (Kluwer, London, 1997) pp125-142 at 127.
- 136 The application of Art XXIII to non-violations is dealt with below in the description of the rules regulating domestic subsidies.
- 137 Article XXIII:2. The consultation process is set out in Art XXII and XXIII:1. The referral to the CONTRACTING PARTIES is provided for under Article XXIII:2.
- 138 Art XXIII:2.

authorize a contracting party or parties to suspend the application to any other contracting party or parties of such concessions or other obligations under the Agreement as they determine to be appropriate in the circumstances.¹³⁹

The only option left to the offending party was to withdraw from the Agreement.¹⁴⁰

The CONTRACTING PARTIES were given power to recommend that parties bring offending measures into conformity with the Agreement. They were not given power to order that violations be remedied. However, in practice, in the great majority of cases, parties did comply with recommendations.¹⁴¹ In fact, the parties regarded achieving conformity with the Agreement as the first priority of the dispute settlement system.¹⁴²

The sanction that lay behind the CONTRACTING PARTIES power to recommend compliance was that they had a power to authorize countermeasures: an unwinding of the Agreement with respect to the offending party. Under Article XXIII, such authorized countermeasures were to be discriminatory, that is, the retaliatory suspension of concessions or other obligations might only apply in relation to imports from the offending party.

The express terms of Article XXIII do not distinguish between violations of tariff bindings and violations of the prohibition on import quotas. In the case of a breach of either type of obligation, the CONTRACTING PARTIES had the same authority to release other parties from such concessions and obligations as they consider appropriate. Similarly, in the retaliation that can be authorized, Article XXIII does not distinguish between import tariffs and import quotas. The exact choice of obligations or concessions that may be suspended in retaliation had to be authorized by the CONTRACTING PARTIES.

There is little in the Agreement to indicate how 'appropriateness' of suspension of concessions or obligations is to be determined. There was only one case in which the CONTRACTING PARTIES authorized retaliation under Article XXIII: the Netherlands

139 Art XXIII:2.

140 The withdrawal takes effect from the expiration of the giving of 60 days notice: Art XXIII:2; cf Art XXXI and withdrawal provisions under Protocols of Provisional Application.

141 See the statistics compiled by Robert Hudec in Hudec, *Enforcing International Trade Law* (Butterworths, Salem, 1991) Tables 11.6, 11.13 & 11.18 on pp285-305.

142 This attitude was codified in the 1979 "Understanding Regarding Notification Consultation, Dispute Settlement and Surveillance", adopted 28 November 1979, BISD, 26S/210, see para 4 on p215-216 at 216 of the Annex. (It is also codified in Article 3.7 of the Uruguay Round Dispute Settlement Understanding).

complaint about United States dairy restrictions in 1952.¹⁴³ In that case, United States import quotas were having the effect of reducing Dutch exports of dairy products. The reduction of Dutch exports of Gouda and Edam cheese was estimated to be about US\$250,000 worth of trade. Reductions of other relevant Dutch exports were basically impossible to estimate because US prohibitions had prevented any trade from occurring and, therefore, there were no trade statistics upon which to base a calculation. After seeking the consent of the USA and the Netherlands to a value of trade of US\$1.1 million, the CONTRACTING PARTIES authorized the Netherlands to impose an import quota on US wheat that would reduce US imports by about US\$1.1 million.¹⁴⁴

The negotiating process was important in the resolution of disputes, perhaps more important than the above description of the parties' legal rights discloses. The CONTRACTING PARTIES only became involved in the dispute if the complainant and respondent parties were unable to reach agreement on a satisfactory adjustment of the dispute. Even after the CONTRACTING PARTIES ruled that there was a violation and recommended that a particular measure be brought into conformity with the Agreement, the disputing parties could agree that a change in the contentious measure was a satisfactory adjustment. To avoid the authorization of countermeasures, the offending party might offer compensation in the sense of alternative trade liberalization measures. Such compensation could not remedy the violation unless effected through a change to Schedules via an Article XXVIII process. Where the violation was the imposition of an import quota, compensation could remedy the violation. However, the only power given to the CONTRACTING PARTIES by Article XXIII was the power to authorize countermeasures. While, in theory any mutually agreed "satisfactory adjustment" could not involve any continuing violation of the rules,¹⁴⁵ in practice, if a complaining party decided not to seek such authorization either because it was satisfied with the compensation or, even, because it is satisfied with partial removal of the violation, then there was nothing that the CONTRACTING PARTIES could do. If there

143 "United States Import Restrictions on Dairy Products", resolution of 8 November 1952, BISD, 1S/31; "Netherlands Measures of Suspension of Obligations to the United States", determination of 8 November 1952, BISD, 3S/32.

144 Hudec (1990) pp192-193.

145 An understanding to this effect was codified in the 1989 "Improvements to the GATT Dispute Settlement Rules and Procedures", decision of 12 April 1989, BISD, 36S/61, para A2.

was a continuing violation, individual contracting parties could reactivate the dispute process.

It is stressed that, in the event of violations, the GATT did not provide any basis for:

- (1) requiring performance of an obligation; or
- (2) payment of reparations to compensate for damage caused by a violation;

The GATT only provided for recommendations that the offending party comply with the agreement. Whilst the normative force of such recommendations was high and a majority of recommendations were complied with, the only sanction was a mechanism for the unwinding of bilateral obligations. The application of that sanction by an 'injured' party was subject to prior authorization from the CONTRACTING PARTIES. Such a bilateral unwinding might be avoided by the giving of substitute obligations. The unwinding of obligations or the giving of substitute obligations was not directed to providing a remedy for any loss suffered in the past but was directed at re-establishing the balance of obligations for the future. The importance of the 'balance of obligations' concept was illustrated by response of the United States to the Netherlands suggestion of retaliation in the USA Dairy dispute. In the course of that dispute, which, as mentioned above, is the only instance where retaliation has been authorized under Article XXIII, the United States issued a statement which included the following:

We recognize the right of other contracting parties to withdraw concessions to restore the balance of the Agreement and we would have no objection to the withdrawal of concessions, which, on examination, prove to be of that kind.¹⁴⁶

The statement appears to regard retaliation as an ordinary part of the process of the unwinding of obligations that was a natural and foreseeable consequence of a breach. The statement does not evidence any regard for the retaliation as an unfriendly act nor even as an incentive to come into compliance with the Agreement. However, it is easier for a large country, like the United States, than a small one to adopt this attitude. For small countries, the threat of retaliation by large countries constituting their principal export markets is a significant incentive to bring a violating measure into conformity with the Agreement. Retaliation is generally not in the interest of the retaliating party. Note, for example, that in

146 Press Release GATT/91, 28 October 1952, p13.

the US Dairy dispute, many countries threatened retaliation but only The Netherlands actually sought authorization for it. Then, having received authorization to impose import quotas, The Netherlands did not strictly impose the retaliation that it was authorized to impose.¹⁴⁷ Presumably, the reason that The Netherlands did not strictly impose the retaliation was that it was in its commercial interest to buy additional wheat from the USA, that is, that the imposition of the retaliation was not in its best interest.

8.2 VIOLATIONS OF THE RULES ON SUBSIDIES

For purposes of considering violations, one can ignore domestic subsidies since only export subsidies could be a violation of Article XVI. If an export subsidy violated the provisions of Article XVI then Article XXIII operated in the same way as it did with respect to a violation of the rules on tariffs or quotas. The CONTRACTING PARTIES could make appropriate recommendations" or "give a ruling" as appropriate. Generally, the recommendation would be to withdraw the subsidy. However, the appropriate recommendation depended upon the precise violation. In case of violation of Article XVI:3, then the violation would have occurred not because of the existence of the subsidy but because of its results (that is, resulting in the subsidizing country having more than an equitable share in world export trade) so the appropriate recommendation could only be to cease causing that result by limiting the extent of the subsidy. As with breaches of the tariff or quota rules, if the recommendation of the CONTRACTING PARTIES were not complied with, then the CONTRACTING PARTIES could authorize other parties to "suspend the application to any other contracting party or parties of such concessions or other obligations under this Agreement".¹⁴⁸

For the signatories to it, the *Subsidies Code* provided an additional procedure for settling disputes. The Code established a Committee on Subsidies and Countervailing Measures.¹⁴⁹ If the Committee found that an export subsidy was "being granted in a manner inconsistent with the provisions of this Agreement" (the *Subsidies Code*)¹⁵⁰ then the Committee could

147 See Hudec, *The GATT Legal System and World Trade Diplomacy* (Butterworths, Salem, 1991) pp197-198 for comparison of the details of the quantities of US wheat flour that were actually imported with those permitted under the authorization.

148 Art XXIII:2.

149 *Subsidies Code*, Art 16.

150 *Subsidies Code*, Art 13:4.

make recommendations "as may be appropriate to resolve the issue".¹⁵¹ In a violation case, the recommendation could be to cease the subsidy or limit it so as to cease causing or threatening the result which made it a violation. If the recommendation were not complied with, then the Committee could authorize "countermeasures".¹⁵²

9 NON-VIOLATION NULLIFICATION OR IMPAIRMENT

As noted above, violations are not a necessary condition for the operation of Article XXIII. A perusal of the opening words of Article XXIII:1 shows that violations are only one of the fields in which Article XXIII can operate.¹⁵³ It provides:

- 1 If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of
 - (a) the failure of another contracting party to carry out its obligations under this Agreement, or
 - (b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or
 - (c) the existence of any other situation ...

Clearly, then, a case of "nullification or impairment" can exist even where there is no violation of the Agreement. Importantly, even in a case of a non-violation, the CONTRACTING PARTIES can make a recommendation and in the absence of compliance can authorize retaliation.

9.1 BENEFIT

Although there is nothing in the words of Article XXIII to limit the meaning of the words "benefit accruing to it directly or indirectly under this Agreement", in practice, they have had a limited meaning. The CONTRACTING PARTIES only ever adopted findings of non-violation nullification or impairment in cases where the relevant benefit was the benefit

151 *Subsidies Code*, Art 13:4.

152 *Subsidies Code*, Art 13:4.

153 Petersmann refers to 6 ways that Article XXIII can apply: both nullification or impairment complaints or impeding objectives of the Agreement complaints can arise in 3 ways: violations, non-violations or other situations. See Petersmann, Ernst-Ulrich, "The Dispute Settlement System of the World Trade Organization and the Evolution of the GATT Dispute Settlement System Since 1948" (1994) 31 *CMLRev* 1157-1244 at 1170-1173. In practice, there have only been two ways that the Article operates: violation nullification or impairment and non-violation nullification or impairment.

under a tariff concession of providing access to the market of the country that gave the tariff concession.¹⁵⁴

However, it is worth noting that, on a literal reading, "benefit" could embrace:

- (1) Country A's benefit of access to Country B's domestic market arising from Country B's agreement not to apply import quotas (as a separate benefit from the benefit arising from Country B's agreement to maintain a tariff binding);
- (2) Country A's benefit from the absence of certain export competition in its own market arising from Country B's agreement not to subsidize exports;
- (3) Country A's benefit from access to third country markets arising from Country B's agreement not to subsidize export to third countries and/or from tariff bindings given by third countries.

Analysis in subsequent chapters will observe that there were no instances in dispute settlement in which the CONTRACTING PARTIES extended Article XXIII to cover any of these situations except where there was a violation. The interpretation of 'benefit' was limited to benefits of access to Country B's domestic market arising from Country B's agreement to maintain a tariff binding.

9.2 NULLIFICATION OR IMPAIRMENT

Decisions of the CONTRACTING PARTIES have developed the notion of non-violation nullification or impairment so that three elements are required:

- (1) that a tariff concession was negotiated;
- (2) that a subsequent measure upsets the competitive conditions between the bound product and directly competitive products from other origins; and
- (3) that the introduction of the measure could not have been reasonably expected at the time the tariff concession was negotiated.¹⁵⁵

154 See Petersmann, Ernst-Ulrich, "The Dispute Settlement System of the World Trade Organization and the Evolution of the GATT Dispute Settlement System Since 1948" (1994) 31 *CMLRev* 1157-1244 at 1173; and GATT, *Analytical Index*, p614.

155 Petersmann, Ernst-Ulrich, "Violation-Complaints and Non-Violation Complaints in Public International Law" (1991) 34 *German YIL* 175-229 at 225.

9.3 THE REMEDY FOR NON-VIOLATION NULLIFICATION AND IMPAIRMENT

The dispute settlement procedure of Article XXIII applied to non-violations in similar fashion as it applied to violations. The post-WTO procedures have been altered slightly but the essence of the procedures has remained the same. First, the parties were to attempt to reach a satisfactory adjustment. If no satisfactory adjustment could be agreed upon then the complaining party could refer the matter to the CONTRACTING PARTIES who could make a recommendation or ruling. One should consider carefully what kind of recommendation or ruling that the CONTRACTING PARTIES could make. If there was no violation, they could not recommend the cessation of any measure. They could only recommend that the relevant policy be modified in some way that would bring an end to the nullification or impairment of benefit under the tariff concession. If the nullification or impairment was not removed and the pre-existing benefits of the tariff concession restored, then the CONTRACTING PARTIES could authorize retaliation. As noted by Hudec, in commenting on the Australian Ammonium Sulphate Subsidy case,¹⁵⁶ the effect of the nullification and impairment rule is that a non-violation can be treated exactly the same as a violation. It makes little difference that there is no actual violation. The consequences are the same; other parties can be authorized to suspend application of concessions and other obligations.¹⁵⁷

9.4 EFFECTS OF THE REGULATION OF NON-VIOLATIONS ON REGULATION OF THE FOUR PRINCIPAL POLICY INSTRUMENTS

The extent of the regulation of non-violations is not and has never been entirely clear.¹⁵⁸ Non-violation complaints have only accounted for a small number of the total number of GATT dispute settlement decisions.¹⁵⁹

156 "The Australian Subsidy on Ammonium Sulphate", GATT/CP.4/39, 3 April 1950, BISD, II/188.

157 Hudec (1990) pp165-166.

158 See Williams, Brett G., "Non-Violation Complaints in the WTO System" in Mengozzi, Paulo (ed), *International Trade Law on the 50th Anniversary of the Multilateral Trade System* (Giuffrè, Milano, 1999) pp675-797.

159 Only 15 of the 195 GATT disputes between 1948 and 1993: see Petersmann (1991). as above, at 1172.

On The Rules Relating To Import Tariffs

The non-violation nullification or impairment rule means that reasonable expectations gained from the process of tariff negotiation about the future government policy affecting competitive conditions may be protected as an integral part of the tariff binding itself.

On The Rules Relating to Import Quotas

On a literal interpretation, it might be possible for the non-violation nullification or impairment rule to be applied where policy instruments which do not violate the Agreement have the same effects that an import quota would have. Such policy instruments might include excessively strict import licensing rules or technical standards regulations, variable levies, voluntary export restraints, or the operation of government import monopolies. Arguably, such instruments nullify or impair the benefit from the absence of quotas which should result from the prohibition of import quotas. However, the CONTRACTING PARTIES never applied the non-violation nullification or impairment rule in this way.

On The Rules Relating to Export Subsidies

On a literal interpretation, Article XXIII might also apply to a non-violation export subsidy. In addition, Article 13:4 of the *Subsidies Code* could have applied to non-violation export subsidies. Article 13:4 dealt with the situations where a subsidy might be causing:

- (a) injury ;
- (b) nullification or impairment; or
- (c) serious prejudice.

If the Committee found that such a situation existed then it

[could] make such recommendations to the parties as [might have been] appropriate to resolve the issue and, in the event the recommendations [were] not followed, it [could] authorize such countermeasures as [might have been] appropriate, taking into account the degree and nature of the adverse effects found to exist ... ".¹⁶⁰

The CONTRACTING PARTIES never made findings in relation to export subsidies upon the basis of the non-violation nullification or impairment rule in Article XXIII or any of the

non-violation provisions of the *Subsidies Code*. Arguably, though, there are two theoretically possible applications in which non-violation nullification or impairment might have arisen:

- (1) The situation where subsidized exports from Country B to Country A displace domestic production from Country A's own producers;
- (2) the situation where subsidized exports from Country B to Country C displace exports from Country A to Country C.

The validity of applying the non-violation provisions to these situations is considered in chapter 12.

On The Rules Relating to Domestic Subsidies

It is in relation to domestic subsidies that the non-violation nullification or impairment rule has had the most significant effect. Clearly it is possible for a domestic subsidy to cause domestic production to displace imports. If Country A negotiates a tariff binding with Country B in circumstances where Country B has a reasonable expectation that Country A will not subsequently introduce a domestic subsidy that changes the competitive relationship between imports from Country B and domestic production in Country A, then the benefit under the tariff binding would be impaired by the new domestic subsidy. The CONTRACTING PARTIES adopted reports of working parties affirming these principles in 1955 and 1961.¹⁶¹ However, in dispute settlement, the CONTRACTING PARTIES were more cautious about confirming these principles.¹⁶² They declined to adopt a panel report based on these principles in 1985¹⁶³ but finally adopted a dispute panel report in 1989 on the basis of a limited confirmation of the validity of these principles, although not basing its

160 This quote of part of Art 13:4 omits a footnote and a reference to it.

161 See "Reports relating to the review of the Agreement - Other Barriers to Trade", report adopted 3 march 1955 (L/334 and Addendum) GATT *BISD* 3S/222 at 224, para 13; and "Subsidies - Operation of the Provisions of Article XVI" report adopted on 21 November 1961 (L/1442 & Add.1-2) GATT *BISD* 10S/201.

162 See chapter 13.

163 See "European Economic Community - Production Aids Granted on Canned Peaches, Canned Pears, Canned Fruit Cocktail and Dried Grapes" report by the panel dated 20 February 1985 (L/5778).

recommendations on them.¹⁶⁴ The validity of applying the non-violation provisions to domestic subsidies in these situations is also considered in later chapters.

10 COUNTERVAILING DUTIES

In relation to subsidies, the possibility of countermeasures or retaliation through the multilateral dispute settlement system of Article XXIII must be considered in the context of permitted unilateral countermeasures in the form of countervailing duties.

Countervailing duties are additional customs duties that may be imposed on imports to countervail against subsidies paid by other governments. Countervailing duties are permitted to be imposed upon the imports which have received the benefit of a subsidy if the subsidized imports are causing or threatening to cause material injury to an industry of the importing contracting party.¹⁶⁵ The countervailing duty may only be of such an amount as is necessary to offset the effect of the subsidy.

It is important to appreciate that countervailing duties are only effective to protect domestic industry from competition from subsidized imports. They are not effective to protect domestic industries which are losing export sales in third country markets because of competition from subsidized sales from another country to the same third country markets. In such circumstances, the country whose domestic industry is being injured can only have recourse to the general multilateral dispute settlement procedures discussed above.

11 EXCEPTIONS TO THE GENERAL RULES

The GATT contained some specific exceptions to the abovedescribed general rules. There was an agricultural programmes exception to the prohibition on import quotas.¹⁶⁶ There were also some exceptions which could justify the use of either import tariffs in excess of bindings or import quotas: a balance of payments exception, a developing country exception and an emergency safeguards exception.¹⁶⁷ Two further exceptions to the rules on tariffs relate to 'unfair' trade: that already mentioned in respect of countervailing duties and another

164 See "European Economic Community - Payments and Subsidies Paid to Processors and Products of Oilseeds and Related Animal-Feed Proteins" (L/6627) adopted 25 January 1990, GATT *BISD* 37S/86. See the more complete discussion in chapter 13 below.

165 Art VI:6.

166 Art XI:2.

in respect of anti-dumping duties. There have been changes to these exceptions in the Uruguay Round with at least some of the agricultural exceptions effectively disappearing completely.

11.1 THE AGRICULTURAL EXCEPTIONS - ARTICLE XI:2

Article XI:2 contained some specific exceptions to the prohibition on quantitative restrictions for agricultural trade. One related to restrictions on exports for the purpose of preventing or relieving shortages of foodstuffs or other essential products.¹⁶⁸ Another related to both exports and imports dealt with restrictions necessary for the application of standards for classification, grading or marketing of commodities.¹⁶⁹

The rest of the Article XI:2 exceptions related to quantitative import restrictions on agricultural or fisheries products.¹⁷⁰ The most important of these exceptions was Article XI:2(c)(i). To fit within this exception, the import restrictions had to be necessary for the enforcement of government measures which operated for the purposes of the restriction of the quantity of the product permitted to be marketed or produced. The restrictions applied to imports had to be no more restrictive than the restrictions applied to domestic production.¹⁷¹ Article XI:2(c)(i) was invoked by a number of countries to justify restrictions employed in connection with various programmes for raising the prices of agricultural products.

11.2 EXCEPTIONS FOR RESTRICTIONS TO SAFEGUARD THE BALANCE OF PAYMENTS - ARTICLES XII AND XVIII, SECTION B

There is an express exception to the no quantitative restrictions rule for restrictions that are imposed to safeguard a contracting party's balance of payments.¹⁷² The exception in Article XII is available to all contracting parties. There is a slightly more lenient balance of

167 Arts XII, XVIII and XIX respectively.

168 Art XI:2(a).

169 Art XI:2(b).

170 Arts XI:2(b)(i), (ii) and (iii).

171 See the last paragraph of Art XI:2(c).

172 Art XII:1.

payments exception in Section B of Article XVIII which is only available to certain developing countries.¹⁷³

Provisions of Articles XII and XVIII:B

Both of these provisions refer expressly to restricting the quantity of imports. They refer to restricting "the quantity or value of merchandise permitted to be imported".¹⁷⁴ In the pre-WTO GATT, they did not expressly mention the imposition of tariff surcharges on bound tariffs. However, a practice had developed under which Articles XII and XVIII:B could justify either quantitative restrictions or tariff surcharges.¹⁷⁵ Therefore, in practice, these articles provided an exception to both the general rule on import tariffs and that on import quotas.

Article XII permits a contracting party to impose restrictions "to safeguard its external financial position and its balance of payments".¹⁷⁶ However, the extent of restrictions is limited to "those necessary:

- (i) to forestall the *imminent* threat of, or to stop, a serious decline in its monetary reserves, or
- (ii) in the case of a contracting party with *very low* monetary reserves, to achieve a reasonable rate of increase in its reserves".¹⁷⁷

Article XVIII:B permits a contracting party to impose restrictions "to safeguard its external position and to ensure a level of reserves adequate for the implementation of its programme of economic development"¹⁷⁸ and the extent of such restrictions is limited to "those necessary:

- (a) to forestall the threat of, or to stop, a serious decline in its monetary reserves, or
- (b) in the case of a contracting party with *inadequate* monetary reserves, to achieve a reasonable rate of increase in its reserves".¹⁷⁹

173 Section B of Art XVIII (abbreviated XVIII:B) contains paras 8 to 12. Art XVIII:9 provides for the exception which is available to those developing countries that meet the criteria set out in Art XXVIII:4(a). See below, in this chapter, under "Exceptions - Developing Countries - Article XVIII - Governmental Assistance to Economic Development".

174 These identical words appear in both Art XII:1 and Art XVIII:9.

175 See chapter 11, *infra*, under "4.3.4 Tariffs vs Quotas in BOP Rules".

176 Art XII:1.

177 Art XII:2(a). Emphasis added.

178 Art XVIII:9.

179 Art XVIII:9. Emphasis added.

Meaning of 'Balance of Payments'

The concept of balance of payments in the sense of monetary reserves can be explained in a simplified way as follows. Consider that persons may receive payments in foreign currency every time that, in an international transaction, they either sell goods, services, or an asset, or receive a loan, a repayment of a loan, an interest payment or a dividend. Consider also that persons may need to make payments in a foreign currency every time that, in an international transaction, they either buy goods, services, or assets, or advance a loan, repay a loan, or pay an interest payment or a dividend. Such persons go to the government bank to exchange domestic currency for foreign currency.¹⁸⁰ A government's holdings of foreign exchange is called its 'monetary reserves'.¹⁸¹ When the quantity of foreign exchange that persons wish to buy from the government with domestic currency exceeds the quantity of foreign exchange that persons wish to sell to the government to obtain domestic currency, then the government is running down its monetary reserves. If this situation continues, then, with one proviso, the government will eventually run out of foreign exchange. The proviso is that this situation of running out of foreign currency holdings can only occur when the price of foreign currency (i.e. the exchange rate between domestic currency and foreign currency) is fixed by the government or, if not completely fixed, is being held by the government above the rate that the market would determine. If the exchange rate is freely floating then the exchange rate will adjust until the quantities of foreign exchange supplied and demanded match.

It is useful to consider three types of balance of payments problems:

- (1) a 'trade deficit' where receipts from exports are exceeded by payments for imports;¹⁸²

180 How this operates varies from country to country. In most countries, there is a Reserve Bank which is a government instrumentality. The Reserve Bank stands in the market to buy and sell foreign exchange. Sometimes other entities are licensed to deal in foreign exchange. A good reference to foreign exchange practices is the annual publication: International Monetary Fund, *Annual Report on Exchange Arrangements and Exchange Restrictions*, (IMF, Washington DC, 1979 -).

181 This simplification ignores holdings of gold and Special Drawing Rights ('SDR's) with the International Monetary Fund.

182 See Lindert, *International Economics* (Irwin, Homewood, Illinois, 1986) (8th ed of Kindleberger, *International Economics*) pp370-371.

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- (2) a 'current account deficit' where receipts from exports and of other income from foreigners are exceeded by payments for imports and of other income to foreigners;¹⁸³ and
- (3) an 'official balance of payments' or 'overall balance of payments' deficit where the governments holdings of monetary reserves are decreasing (receipts of foreign exchange in exchange for domestic currency are exceeded by payments of foreign exchange in exchange for domestic currency).¹⁸⁴

It is important to note that the balance of payments exceptions in Article XII and XVIII:B only apply to balance of payments problems in this third sense. These provisions only authorize a deviation from the ordinary rules on quotas and tariffs where a party has a balance of payments problem in the sense of very low or inadequate monetary reserves. These articles do not provide any exception in the circumstances where a party merely has a trade account deficit (imports exceeds exports), or a current account deficit (imports and income payments to foreigners exceed exports and income receipts from foreigners).

Secondly, it is important to note that where a country has a freely floating exchange rate, simple market operations exchanging domestic currency for foreign exchange cannot cause a running down of government monetary reserves. With a freely floating exchange rate, the exchange rate can adjust so that the quantity demanded is the same as the quantity supplied. Therefore, only abnormal dispositions of monetary reserves could cause a country with a floating exchange rate to run out of monetary reserves and, thereby, be in a position where it could qualify to impose restrictions under Article XII or Article XVIII:B.

Operation of Articles XII and XVIII:B

Parties can have recourse to Articles XII or XVIII:B without having to negotiate any compensatory concessions. However, both articles provide for consultation with the CONTRACTING PARTIES and for periodic reviews (every year under Article XII and every two years under Article XVIII).¹⁸⁵ If restrictions were not justified under the balance

183 Lindert, cited above, pp371-375.

184 Lindert, cited above, pp375-377.

185 Article XII:4(a) & (b) and Article XVIII:12(a) & (b). See also "Balance of Payments Import Restrictions - Consultation Procedures", approved by the Council, 28 April 1970, BISD, 18S/48; "Balance of Payments Import Restrictions - Procedures for Regular Consultations on Balance-of-

of payments exception, then the CONTRACTING PARTIES could recommend that the offending party should remove or modify the restrictions.¹⁸⁶ If the recommendation was not complied with then the CONTRACTING PARTIES could authorize other affected parties to suspend obligations under the Agreement in respect of the offending party.¹⁸⁷

11.3 DEVELOPING COUNTRY EXCEPTION - ARTICLE XVIII - *GOVERNMENTAL ASSISTANCE TO ECONOMIC DEVELOPMENT*

The provisions of Article XVIII provide additional exceptions for developing countries from all of the general rules. (The Agreement does not contain a definition of developing country.) Article XVIII provides four different exceptions:

- (1) the exceptions in Sections A, B and C of Article XVIII which are available to developing countries whose economies "can only support low standards of living" and are "in the early stages of development";¹⁸⁸
- (2) the exception in Section D which is available to other developing countries.¹⁸⁹

We have already dealt with Section B which provides the exception for developing countries for restrictions for balance of payments reasons. The exceptions under Sections A, C and D are limited to restrictions for the purpose of promoting the establishment of a particular industry.¹⁹⁰

Section A

Section A provides an exception from the general rules on tariffs. It provides for the renegotiation of bound tariffs in a way that is slightly more lenient than Article XXVIII.

Payments Restrictions with Developing Countries", L/3772/Rev.1, adopted 19 December 1972, BISD, 20S/47; "Declaration on Trade Measures Taken for Balance-of-Payments Purposes", L/4904, adopted on 28 November 1979, BISD, 26S/205.

186 Note that Arts XII and XVIII:B contain their own provisions for dispute settlement: Arts XII(c), (d), (e) & (f); and Arts XVIII:12(c), (d), (e) & (f). These provisions are slightly different from the general dispute settlement provision in Art XXIII. For the sake of the simplicity of this description, the question of whether the specific dispute settlement provisions exclude the general provision is not raised here.

187 This power to authorize countermeasures either derives from the specific provisions in Arts XII:4(c)(ii) or 4(d), or in Arts XVIII:12(c)(ii) or 12(d), or from the general provisions in Art XXIII:2. See the preceding footnote.

188 Art XVIII:4(a). On the meaning of these criteria, see the interpretative note Ad Article XVIII, paragraphs 1 and 4.

189 Art XVIII:4(b).

190 Arts XVIII:7(a), 13, & 22.

Sub-Articles XVIII:7(a) and (b) lay down a process of negotiation similar to the closed season negotiation under Article XXVIII:4. As under Article XXVIII:4, if the parties cannot reach agreement then the initiating party cannot proceed with the modification until the matter has been considered by the CONTRACTING PARTIES. As with Article XXVIII:4, unless the CONTRACTING PARTIES decide that the applicant has failed to make "every reasonable effort to offer adequate compensation"¹⁹¹ then the applicant may proceed with the modification of its schedule and affected parties may withdraw substantially equivalent concessions initially negotiated with the applicant.¹⁹² The important difference between Article XXVIII:4 and Article XVIII:7 is in the situation where, even though the parties are unable to agree on compensation, the CONTRACTING PARTIES find that the applicant has offered adequate compensation. In this situation, Article XVIII:7 permits the applicant to proceed with the modification to its schedule without permitting affected parties to institute any countermeasures as they might be permitted to do under Article XXVIII:4(d).

Sections C and D

Sections C and D provide mechanisms for contracting parties to seek approval of the CONTRACTING PARTIES to use measures which are not consistent with the other provisions of the GATT in order to promote the establishment of a particular industry. In theory, both of these sections of Article XVIII could operate as exceptions to all of the general rules on import quotas, on import tariffs, and on export subsidies. They could also authorize a domestic subsidy which would otherwise nullify or impair a tariff binding.

The provisions are complicated. The CONTRACTING PARTIES can release the applicant from any obligations under provisions of the Agreement as are necessary to implement the proposed measure if they

- (1) agree that there is no measure consistent with the Agreement which is practicable in order to achieve the objective;¹⁹³ and

191 Art XVIII:7(b). The words in Art XXVIII:4(d) are slightly different ("unreasonably failed to offer adequate compensation") and the 'onus of satisfaction' may be reversed.

192 Art XVIII:7(b) & Art XXVIII:4(d).

193 Art XVIII:16 in Section C & Art XVIII:22 in Section D.

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- (2) concur in the proposed measure which in the case of a measure on a product the subject of a tariff concession means that they must be satisfied that either:
- (a) agreement has been reached with other interested parties; or
 - (b) (i) the applicant "has made all reasonable efforts to reach agreement";
and
(ii) the interests of other contracting parties are adequately safeguarded.¹⁹⁴

Under both Section C and D, if the CONTRACTING PARTIES do release the applicant from such obligations under the Agreement as are necessary to implement the proposed measure, then they are able to implement the measure without facing any prospect of countermeasures from other parties. Under Section C only, if the CONTRACTING PARTIES withhold their approval then the applicant may still proceed with the proposed measure but in that case any "contracting party substantially affected" by the measure may implement countermeasures in relation to the trade of the applicant.¹⁹⁵

11.4 EXCEPTIONS - PART IV - NON-RECIPROCITY WITH DEVELOPING COUNTRIES

Part IV entitled "Trade and Development" was added to the Agreement by a Protocol which came into force in 1966.¹⁹⁶ Article XXXVI:8 varies the rules on negotiation of tariff concessions under Article XXVIIIbis and on renegotiation of tariff concessions under Articles XXVIII and XVIII:A. Article XXXVI:8 provides

the developed countries do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed countries.

194 Art XVIII:16 & 18.

195 Art XVIII:17 & 21.

196 "*Protocol Amending the General Agreement on Tariffs and Trade to Introduce a Part IV on Trade and Development*" done 8 February 1965, in force 27 June 1967, BISD, 13S/2. It was not until 1979 that all of the contracting parties had accepted the Protocol: see GATT, *Analytical Index*, p964.

11.5 THE ESCAPE CLAUSE - ARTICLE XIX - EMERGENCY ACTION ON IMPORTS OF PARTICULAR PRODUCTS

Article XIX provides for an exception to permit temporary deviations from the general rules. The exception is available to enable parties to escape from prior obligations if an unexpected surge of imports is damaging or threatening to damage a domestic industry. It can be used to justify the temporary withdrawal or modification of tariff concessions, the temporary suspension of the prohibition on import quotas in relation to particular products or the introduction of export or domestic subsidies. Article XIX is commonly called the 'escape clause' or the 'safeguard clause' and measures applied pursuant to it are commonly called 'safeguard measures'.

In respect of agricultural trade, there has been little resort to the escape clause. However, consideration of the clause is essential to a complete consideration of the way in which the Agreement leaves some scope for the pursuit of non-economic objectives.

The pre-requisites to resort to Article XIX were:¹⁹⁷

- prior consultation¹⁹⁸ (except where "delay would cause damage which would be difficult to repair"¹⁹⁹ in which case consultation must be undertaken immediately after the action is taken);
- the import of a product was causing or threatening to cause serious injury to domestic producers;²⁰⁰
- the actual or threatened injury was caused by an increase in volume of imports;²⁰¹ and
- the increase in the volume of imports was caused by:
 - (a) unforeseen developments; and
 - (b) the effect of an obligation incurred under the Agreement including under a tariff concession.²⁰²

¹⁹⁷ These pre-requisites still apply post WTO but the rules have been supplemented and to some extent modified by the *Uruguay Round Agreement on Safeguards* which is part of Annex 1A to the *Agreement Establishing the World Trade Agreement*.

¹⁹⁸ Art XIX:2.

¹⁹⁹ Art XIX:2.

²⁰⁰ Art XIX:1(a).

If the parties agreed on compensatory adjustments then the initiating party could proceed with the safeguard measures. For the situation where agreement was not reached, Article XIX laid down a procedure for temporary restrictions similar to the Article XXVIII procedure for permanent restrictions. The initiating party could proceed to implement the temporary restrictions but thereupon certain other contracting parties could retaliate by suspending "substantially equivalent concessions or other obligations under [the] Agreement".²⁰³ Whereas Article XXVIII only permitted changes to schedules of concessions, Article XIX applied to any obligation under the Agreement. Therefore, Article XIX could justify the imposition of import quotas.²⁰⁴ Similarly, in the case of retaliation, unlike the Article XXVIII procedure which was restricted to changes to tariff concessions, the retaliation could consist of import quotas as well as changes to tariff concessions.²⁰⁵ Another important difference was that under the Article XIX procedures, the CONTRACTING PARTIES were given an opportunity to veto the retaliation if it exceeded the "substantially equivalent" level.²⁰⁶

11.6 NATIONAL SECURITY AND GENERAL EXCEPTIONS

Article XX provides that the Agreement shall not prevent the adoption of any measures which are necessary for certain listed purposes. The listed exceptions includes measures necessary to protect human, animal or plant life or health, and those related to the conservation of exhaustible natural resources.²⁰⁷ Article XXI provides exceptions relating to the essential security interests of parties. Both of these exceptions can be used to justify any type of measures but envisage that the objective actually is to stop the importation of the product rather than to increase price for the benefit of domestic producers.

201 Art XIX:1(a). As well as referring to the increased quantity of imports, this article refers to the conditions of import.

202 Art XIX:1(a).

203 Art XIX:3(a).

204 Cf Art XIX:1(a) with Arts XXVIII:1,4 & 5.

205 Cf Art XIX:3(a) with Arts XXVIII:3(a),3(b), & 4(d).

206 Art XIX:3(a). See the commentary on the relevant words of Art XIX:3(a) in the Report of the Review Session working Party on "Quantitative Restrictions", L/332/Rev.1 and Addenda, adopted on 2,4 and 5 March 1955, 3S/170, 182. para 39.

207 See Articles XX (b) & (g).

11.7 ANTI-DUMPING DUTIES - ARTICLE VI

There is an exception to the rules on tariff bindings to permit tariff surcharges in response to two types of conduct that the GATT treats as unfair. We have already referred to the use of countervailing duties against subsidized imports. The other type of conduct which the GATT treats as unfair is dumping. The relevant GATT provision, Article VI, is a balance between restraining the unfair conduct and restraining retaliation against the unfair conduct. Elaborations of the anti-dumping provisions of Article VI were codified, for some GATT parties, by an additional agreement in 1979²⁰⁸ and, for all WTO Members, in a Uruguay Round agreement.²⁰⁹ However, the following general description is accurate (though incomplete) for the rules at any time since 1947 including after commencement of the WTO.

Article VI permits anti-dumping duties.²¹⁰ Dumping is defined as the selling of product in an export market at a price below that for which the goods are ordinarily sold in the exporting country's own domestic market.²¹¹ In some circumstances, the importing party is permitted to impose an anti-dumping duty equal to the difference between the two prices. As with countervailing duties, anti-dumping duties cannot be imposed unless the dumping is causing or threatening to cause material injury to a domestic industry or is retarding materially the establishment of a domestic industry.²¹²

11.8 ADDITIONAL EXCEPTIONS TO THE RULES ON SUBSIDIES

With the pre-WTO rules relating to subsidies, the non-application of the usual rules to many parties was of more importance than the exceptions to the rules.

11.8.1 Subsidy Exceptions - Non-application of Article XVI⁴

The rule in Article XVI:4 prohibiting export subsidies on non-primary products only applied to those seventeen countries that had specifically undertaken to be bound by it.²¹³

208 *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade* 12 April 1979, Geneva, BISD, 26S/171, 1186 UNTS 2.

209 *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* in Annex 1A of the *Agreement Establishing the World Trade Organization*, (1995) ATS No 8.

210 Art VI:2.

211 Art VI:1.

212 Art VI:6(a).

213 "Declaration Giving Effect to the Provisions of Article XVI:4", 19 November 1960, BISD, 9S/32; in force 14 November 1962, see GATT, *Analytical Index* (6th ed, 1994) 423.

11.8.2 Subsidy Exceptions - Effective Non-application of Article XVI3

The rule on export subsidies on primary products was so difficult to apply that it did not really have any impact at all.²¹⁴

11.8.3 Subsidies Exceptions - Non-Application of the Subsidies Code

The Subsidies Code only applied to such GATT parties as had become parties to it. As at 31 March 1994, there were 24 parties.²¹⁵

11.8.4 Subsidies Exceptions - Developing Countries - Article 14(2) of the Subsidies Code

Under Article 14(2) of the *Subsidies Code*, The rule in Article 9(1) of the *Subsidies Code* prohibiting export subsidies on non-primary products did not apply to developing countries.

12 THE OVERALL SCHEME OF REGULATION OF THE FOUR PRINCIPAL POLICY INSTRUMENTS

Having completed a description of the basic rules regulating each of the four main instruments of protection, I would like to summarize their integration into a single scheme of regulation. In particular, I would like to take an overview from which can be drawn some indication as to the way that the rules influenced choices between the different policy instruments and continue to do so.

12.1 DIFFERENT POLICY INSTRUMENTS IN NEGOTIATIONS AND RENEGOTIATIONS, IN COMPENSATION AND RETALIATION

Before setting out the summary, it is useful to note that the above description oversimplifies the role of the Schedules to some extent. The Schedules of Concessions are the mechanism by which the tariff obligations fall into place. However, in providing for the Schedules, Article II:1(a) refers to "treatment" accorded to "the commerce of other contracting parties" so the Schedules may contain undertakings on aspects of treatment of trade other than tariffs.

214 This is discussed more fully in chapter 12.

215 "Declaration Giving Effect to the Provisions of Article XVI:4" in force 14 Nov 1962, see GATT, *Analytical Index* p457.

In practice, the pre-WTO Schedules contained lists of products and import tariff rates. However, there were instances where a country Schedule contained other commitments.

Examples include commitments on:

- export duties;²¹⁶
- minimum import quotas;²¹⁷
- elimination of import permit requirements;²¹⁸
- exemptions from import quotas;²¹⁹
- exemptions from import prohibitions;²²⁰
- minimum importation and commitments to increase imports under economic plans of centrally planned economies;²²¹ and
- minimum imports by an import monopoly.²²²

Commitments relating to subsidies would have been effective if they were part of the conditions attached to the giving of a commitment on a border measure but no such commitments had appeared in Schedules before the Uruguay Round.

The earlier description of the process under Article XXVIII described it in terms of increases and decreases in tariff rates. However, even in the context of simple exchanges of higher tariff rates for lower tariff rates, it was observed that, in practice, a "reciprocal and mutually advantageous" outcome means simply the agreed outcome and that the parties can agree on anything they like.

216 The United Kingdom Schedule XIX, Section D (Malayan Union) of 30 October 1947 included a commitment on export duties on tin ore and tin concentrates, cited in GATT, *Analytical Index*, p70.

217 Eg, Schedule XXXII - Austria, Part III non-tariff concessions (1979), cited GATT, *Analytical Index*, p71, fn40.

218 Eg, Schedule LXXVII - Mexico (indication in column 7 of items to be exempt from prior import permit requirement), cited GATT, *Analytical Index*, p71, fn 41.

219 Eg, Schedule LXXXIII - Tunisia (indication of exemptions from import licensing or other quantitative restrictions for certain items), cited GATT, *Analytical Index*, p71, fn41.

220 Eg, Schedule LXXXVI - Guatemala (indication in Column 7 of items to be exempt from prohibitions, licensing and restrictive permits, and other quantitative import restrictions), cited GATT, *Analytical Index*, p71, fn41.

221 Eg, Paragraph 1 of Poland's Schedule LXV in Annex B of *Protocol for the Accession of Poland*, BISD, 15S/52, cited in GATT *Analytical Index* p70.

222 Schedule of France (Geneva 1947 & Torquay 1950) Note Ad item 235A (minimum imports of leaf tobacco and cigarettes by SEITA), cited in GATT, *Analytical Index*, p85.

It was possible then under the pre-WTO GATT for Schedules to contain a variety of commitments relating to tariffs, quotas and subsidies. In renegotiations, there was some flexibility in terms of the combination of adjustments to tariffs, quotas and subsidies that might form an eventual "reciprocal and mutually advantageous" outcome. Likewise, if the parties fail to agree, then the withdrawal of substantially equivalent concessions could be constituted by variations to commitments relating to a variety of policy instruments.

The negotiation process under Article XXIII had the same flexibility. Again "satisfactory adjustment" could mean anything that the parties could agree on and could involve adjustments to any combination of policy instruments. Similarly, the power of the CONTRACTING PARTIES to authorize suspension of "such concessions or other obligations under the Agreement as they determine to be appropriate" could have extended to authorization of various policy instruments.

12.2 SUMMARY OF THE FRAMEWORK OF RULES

The basic rules of the GATT regulating the main instruments of protection are summarized below. This summary relates to the rules as they were before commencement of the WTO. In most respects, these rules have remained unchanged by the *Agreement Establishing the World Trade Organization*. Those changes which are important for the purposes of this thesis are described in Part IV of this thesis. The pre-WTO rules were as follows :

- (1) that quantitative restrictions were prohibited (with a few exceptions, principally, for grandfathered legislation, for balance of payments purposes and also for certain agricultural management schemes);
- (2) that hidden quantitative restrictions could not be maintained by applying restrictions on internal sale in a discriminatory manner to imported goods;
- (3) that tariffs were allowed but by negotiation, could be bound and once bound could not exceed the bound rate;
- (4) that bindings on tariffs could be undone in accordance with the prescribed procedure for adjustment under which either:

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- (a) a substitute obligation binding the tariff on another product was given; or
- (b) interested parties could withdraw tariff bindings originally exchanged with the initiating party from their own Schedules affecting the trade of all other parties;
- (5) that there should be periodic negotiations to achieve lower tariffs and a higher proportion of tariffs being bound;
- (6) that hidden tariffs could not be maintained by applying internal taxes in a discriminatory manner to imported goods;
- (7) that export subsidies on non-primary products were prohibited for most industrialized contracting parties;
- (8) that export subsidies on primary products were effectively unregulated despite a formal prohibition from using them so as to result in the subsidizing country having more than an equitable share of world trade;
- (9) the parties could temporarily release themselves from any obligations that were contributing to an import surge which was causing serious damage to domestic producers;
- (10) domestic subsidies on unbound products were not regulated;
- (11) in respect of products upon which there was a tariff binding, (subject to some contention) domestic subsidies were restricted to the level in existence at the time the binding was given;
- (12) parties whose domestic industries were materially injured by subsidies could impose countervailing duties;
- (13) in the event of either a violation of any of the rules or of a domestic subsidy on a bound product being increased above the level existing at the time a binding was given, affected parties could be authorized to apply import quotas or import tariffs discriminately to the trade of the relevant party.

13 WHAT'S NEXT ?

This chapter has described the basic GATT rules regulating the four principal instruments of protection. Whilst much of what has been said is still accurate with respect to the post WTO rules, the description in this chapter is of the rules as they were between the commencement of the GATT and the commencement of the WTO.

This description provides the background for the analysis which follows in the following parts of this thesis. First, the description facilitates an analysis of the way that the rules influence choices between the four policy instruments. Second, the description facilitates the analysis in Part 3 of the thesis of the way that these rules have operated in application to agricultural trade. Third, the description lays the foundation for the description in Part 4 of the thesis of the way that the rules applying to agricultural trade were altered by the *Agreement Establishing the World Trade Organization*.

Before commencing the analysis in Parts 3 and 4 of the thesis of the past and future application of the rules to agricultural trade, it is proposed to analyze the economic and political differences between the four principal policy instruments. This is the subject of Part 2 which follows.

The Importance of Disciplining the Choice of Policy Instrument to the Effectiveness of GATT as International Law Disciplining Agricultural Trade Policies

Part 2

The Economic And Political Significance Of Distinctions Between Policy Instruments

- | | |
|-----------|---|
| Chapter 3 | Introduction To Part 2 |
| Chapter 4 | Effects Of The Four Principal Commercial Policy Instruments |
| Chapter 5 | Winners And Losers From The Four Policy Instruments |
| Chapter 6 | Comparing The Welfare Gains And Losses Of The Policy Instruments |
| Chapter 7 | Political Decision-Making Within States About The Principal Policy Instruments |
| Chapter 8 | Implications Of The Political And Economic Theory For Optimal GATT Rules - The Importance Of Regulating The Choice Of Policy Instrument |

CHAPTER 3

INTRODUCTION TO PART 2

Although this thesis is specifically directed to the problem of the application of GATT to agricultural trade, this part of the thesis is concerned with a rationale for GATT rules generally. It is concerned with what is submitted to be a determinant of the likelihood of success of GATT rules generally: the way that they distinguish between different instruments. This part of the thesis assesses the ramifications for GATT law of the differences between the principal policy instruments. How important as an objective of the GATT is regulation of the choice of instrument relative to regulation of the level of protection? ; How do these two objectives fit together?

The thesis submits that GATT rules will attract substantial compliance when they facilitate the attainment by contracting parties of two objectives:

- economic objectives; and
- non-economic objectives.

The dichotomy between economic and non-economic is problematic. Anything about which one can have a preference is economic. The problem is that some such things tend not to be reflected in market prices and it is upon this basis that the division drawn here between economic and non-economic objectives is founded. For present purposes, non-economic factors are considered to be those that are additional to those that are reflected in market prices.¹

1 The way that "non-economic objectives" can be regarded as either economic or non-economic is explained in Bhagwati, Jagdish & Srinivasan, T.N., "Noneconomic Objectives" ch24 in *Lectures on International Trade* (The MIT Press, Cambridge, Massachusetts, 1983) pp233-248 at 233-234. The terminology "non-economic" objectives is used in two influential pieces of academic writing:

The rules can help parties to achieve these two objectives if they influence parties' behaviour toward the use of policy instruments that will help them achieve the two objectives. It is necessary, then, to consider how various policy instruments affect the achievement of economic objectives and the achievement of non-economic objectives. As stated in the introduction, this thesis deal with only four principal policy instruments of trade and commercial policy.² Extrapolation of the arguments in this thesis to other policy instruments is left for subsequent work.

The current state of economic theory provides a strong argument that international trade and, hence, the removal of restrictions on it yield economic benefits. It also provides a strong argument that there are differences between different instrument of trade and commercial policy in terms of the consequential economic costs and benefits. Therefore, even when more than one policy instrument could be used to achieve a given economic objective, the choice of instrument is important because different economic costs and benefits will result from different instruments. This part of the thesis explains some propositions that are supported by modern economic theory of international trade. The propositions relate to the economic benefits of liberalizing international trade from restrictions and to the differences between the economic costs and benefits that flow from different instruments of trade and commercial policy. The explanations in this thesis are simplified. They use a partial

Johnson, Harry G., "Optimal Trade Intervention in the Presence of domestic Distortions" in Richard E. Caves, Harry G. Johnson, & Peter B. Kenen (eds), *Trade, Growth and the Balance of Payments: Essays in Honor of Gottfried Haberler* (Rand McNally and Co, Chicago, 1965) and Bhagwati, Jagdish N., "The Generalized Theory of Distortions and Welfare" ch 4 in Jagdish N. Bhagwati, Ronald W. Jones, Robert A. Mundell & Jaroslav Vanek (eds), *Trade, Balance of Payments and Growth: Papers in International Economics in Honor of Charles P. Kindleberger* (North-Holland Publishing Co, Amsterdam & London, 1971) pp69-90. See also Corden, W.M., *Trade Policy and Economic Welfare* (Clarendon Press, Oxford, 1974) pp16-17. The alternative to this distinction between economic and non-economic is to acknowledge divergences between private and public costs and benefits. Economists regards this approach as more sound. An example of this approach is in Anderson, Kym, "The standard welfare economics of policies affecting trade and the environment", ch2 in Anderson & Blackhurst, *The Greening of World Trade Issues* (Harvester Wheatsheaf, New York, 1992) pp25-48.

- 2 Discussion and analysis of other instruments may be found in many sources. Eg, in addition to the four instruments discussed within, the effects of VERs and export taxes are discussed in Blackhurst, Richard, "The Economic Effects if Different Types of Trade Measures and Their Impact on Consumers" in OECD, *International Trade and the Consumer* (OECD, Paris, 1986) pp94-111; the effects of variable levies are discussed in Sampson, G.P. & R.H.Snape, "Effects of the EEC's Variable Import Levies" (1980) 88 *Journal of Political Economy* 1026-1040; various instruments used for agricultural protection and support are discussed in McCalla, Alex F. & Timothy E.Josling, *Agricultural Policies and World Markets* (Macmillan Publishing Company, New York, 1985) ch5, esp at 110-122 and also on the large country case in ch6 and on mixtures of instruments in ch7.

equilibrium model, so called because it analyzes a part of the economy and ignores wider effects on the rest of the economy. Whilst the partial equilibrium model is inadequate in some respects, it is useful for a simple explanation of the relevant propositions of economics.

It is not the task of this thesis to explain or justify the modern theory of the economics of international trade nor to trace its development.³ This explanation draws upon that economic theory but it does not attempt to assess its validity. That is a task for others. I stress that analysis of the validity of the propositions put and of the underlying economic theory is for other scholars and is not within the scope of this thesis. No attempt is made to prove the propositions which are explained herein. Their validity is assumed.

It is interesting to take note of how much of the propositions to be explained were part of commonly known economic theory at the time the GATT was negotiated and how much would have been regarded as non-contentious at that time. In the early 1940's, it was widely accepted among economists that there were benefits from international trade.⁴ However, there were some dissident voices that were more influential than are dissident voices on the subject today.⁵ As to the different welfare effects of different policy instruments, it must be noted that much of the development of economic theory on this matter came after 1950.⁶

3 For relatively modern reviews of the state of the theory of the economics of international trade, see Jones, Ronald W. & Neary, J.Peter, "The Positive Theory of International Trade", ch1 and Corden, W.M., "The Normative Theory of International Trade" ch2 both in Ronald W.Jones & Peter B. Kenen, *Handbook of International Economics: Volume I International Trade* (North-Holland, Amsterdam, 1984), respectively pp1-62 & pp63-130.

4 For a summary of the state of economic theory of international trade at the commencement of the GATT, see Metzler, Lloyd A., "The Theory of International Trade" in Howard S. Ellis (ed) *A Survey of Contemporary Economics* (Blakiston, Philadelphia, 1949) pp210-254 reprinted as Ch1 in Metzler, *Collected Papers* (Harvard University Press, Cambridge, Massachusetts, 1973) pp1-49.

5 For an assessment of the objections to free trade see Krueger, Anne O., "Trade Policies in Developing Countries" ch11 in Ronald W.Jones & Peter B.Kenen, *Handbook of International Economics Volume I International Trade* (North-Holland, 1984) pp519-569; see also Krugman, Paul R, "Is Free Trade Passé?" (1987) 1(2) *Journal Of Economic Perspectives* 131-144.

6 The leading contributions are reviewed in Corden, W.M., "The Normative Theory of International Trade" ch2 in Ronald W.Jones & Peter B.Kenen, *Handbook of International Economics Volume I International Trade* (North-Holland, 1984) pp63-130 and also in Corden, W.M., *Trade Policy and Economic Welfare* (2nd ed, 1997). The seminal contribution was Meade, James E., *Trade and Welfare* (Volume Two in *The Theory of International Economic Policy* (Oxford University Press, London, 1955) which built on the work in Pigou, A.C., *The Economics of Welfare* (Macmillan, London, 1932). In turn, Meade's work was further developed, including in Corden, W.M., *Trade Policy and Economic Welfare* (Clarendon Press, Oxford, 1974). See also the 2nd edition of Corden, *Trade Policy and Economic Welfare* (Clarendon Press, Oxford, 2nd ed, 1997) which also contains a review of the leading contributions to this area of economic theory.

The effects of tariffs had been analyzed for over a century but it was only after 1950 that a body of work emerged comparing the welfare effects of different instruments: comparing import tariffs with import quotas, and comparing import tariffs with domestic subsidies.⁷ It was not until between 1963 and 1971 that this work formed a modern theory on choice of policy instrument to achieve a given policy objective: the general theory of distortions.⁸ The importance of the theory of distortions is perhaps most clearly enunciated in the often quoted statement of Corden that [by the theory of distortions]

*the link between the case for free trade and the case for laissez-faire has been broken.*⁹

This meant that the case for free trade did not need to establish that government intervention in the economy was inefficient and that any case for government intervention could be made without having to establish any need for trade restrictive policies.

Again, I leave for other scholars, the question of how much more modern ideas regarding the welfare effects of different policy instruments might have influenced the negotiation of the GATT. Given the quality of the economists involved in the negotiation and the availability of economic tools at the time, it would be a mistake to say that there was no knowledge on the welfare effects of different policy instruments which later crystallized into the general theory of distortions.¹⁰ However, economic theory on these matters that is influential and regarded with little contention today was not dominant thinking in 1945.

7 See the works referred to in Corden, W.M., "The Normative Theory of International Trade" in Jones & Kenen, *Handbook* (1984) at pp77-81 and pp86-96.

8 The key contributions were Bhagwati, Jagdish & Ramaswami, V.K., "Domestic Distortions, Tariffs and the Theory of Optimum Subsidy", *Journal of Political Economy*, Vol.LXXI, No.1, (February 1963) pp44-50; Johnson, Harry G., "Optimal Trade Intervention in the Presence of domestic Distortions" in Richard E. Caves, Harry G. Johnson, & Peter B. Kenen (eds), *Trade, Growth and the Balance of Payments: Essays in Honor of Gottfried Haberler* (Rand McNally and Co, Chicago, 1965); Bhagwati, Jagdish N., "The Generalized Theory of Distortions and Welfare" ch 4 in Jagdish N. Bhagwati, Ronald W. Jones, Robert A. Mundell & Jaroslav Vanek (eds), *Trade, Balance of Payments and Growth: Papers in International Economics in Honor of Charles P. Kindleberger* (North-Holland Publishing Co, Amsterdam & London, 1971) pp69-90; and Lloyd, P.J., "A More General Theory of Price Distortions in Open Economies" *Journal of International Economics* 4 (1974) 365-386. .

9 Corden, W.M., *Trade Policy and Economic Welfare* (Clarendon Press, Oxford, 1974) p4. Emphasis in the original.

10 Eg, see Meade, JE, *The Economic Basis of a Durable Peace* (George Allen & Unwin Ltd, London, 1940): whilst it contains no explicit discussion of the rankings of instruments it contains the following point, "If the individual Member States preserve the right of granting subsidies and bounties, the 'infant industry' argument is no longer a valid reason for breaking the free trade rule." (at p92).

The achievement of significant influence did not occur until some time later, at least after the publication of James Meade's *Trade and Welfare* in 1955.¹¹

The explanation of the economic effects of the principal policy instruments is arranged as follows:

Chapter 4 explains the effects of the four principal policy instruments in terms of changes to quantities of production, consumption and trade and uses these changes to explain two distinctions: that between border instruments and non-border instruments and that between price-based border instruments and quantity-based border instruments.

Chapter 5 explains the effects of each of the four principal policy instruments on welfare of various sectors of the community and for the community as a whole.

Chapter 6 explains the differences in the welfare effects between border instruments and non-border instruments and between price-based and quantity-based border instruments.

Then the thesis, in Chapter 7, explains some aspects of the governmental decision making process in relation to trade and commercial policy. It assesses factors which influence the likelihood that governments will adopt protective and industry supportive policies and also the likelihood that the political decision making process will result in the choice of particular policy instruments.

Chapter 8 notes the opposition between the conclusions reached as to the economic welfare enhancing choice of policy instruments and those reached as to the political likelihood of policy instruments being adopted. From that opposition, the thesis presents one rationale for GATT rules: to provide a constitution-like constraint on governmental decisions on the choice of trade and commercial policy instruments. As mentioned above, the thesis proposes that an appropriate influence on the choice of policy instruments is fundamental to ensuring that GATT rules are compatible with the contracting parties' dual objectives of economic benefits and non economic objectives.

11 Meade, J.E., *Trade and Welfare* (Volume Two in *The Theory of International Economic Policy*) (Oxford University Press, London, 1955).

This part of the thesis lays the foundations for Parts 3 and 4 of the thesis. Part 3 assesses whether there is a connection between deficiencies in embodying distinctions between policy instruments in the GATT and its failures in application to agricultural trade. Part 4 assesses whether the post-Uruguay round GATT appropriately embodies these distinctions between policy instruments and upon that assessment makes a prediction of the likelihood of a successful future application of the GATT to agriculture.

CHAPTER 4

EFFECTS OF THE FOUR PRINCIPAL COMMERCIAL POLICY INSTRUMENTS

INTRODUCTION

This chapter explains the changes that are caused by the imposition (or by implication, the removal) of each of the four principal instruments of protection: the import tariff, the import quota, the export subsidy and the domestic production subsidy. Our interest is in the effects within the country that imposes the policy instrument, more particularly, in the effects on price, on the quantity of consumption and production and on the quantity of imports or exports. These effects are shown by consideration of the 'before' and 'after' situation in the case of each of the four instruments. The explanation is assisted by a graphical representation. To cover all of the four instruments, it is necessary to consider both a product of which the home country is a net-importer (Product A) and a product of which it is a net-exporter (Product B).

From these explanations, some similarities and differences between the four instruments can be observed. I conclude by making two important classifications of the policy instruments.

ASSUMPTIONS

For purposes of our example, it is assumed that:¹

1 This statements of the underlying assumptions is somewhat simplified. A complete statement of the necessary assumption would also include:
(1) that all units of product are identical;
(2) that the domestic market is perfectly competitive: there are many buyers and many sellers; all participants have perfect knowledge; and transaction costs are zero;

-
- (1) For both products, the quantity that domestic producers are willing to produce and sell increases as the price increases: the higher the price, the more units they want to sell; the lower the price the less units they want to sell; and that the relationship between price and quantity supplied applies in the same proportions at any price level (the relationship is linear) so price as a function of quantity supplied can be represented as an upward sloping straight line.
 - (2) For both products, the quantity that domestic consumers want to buy decreases as the price increases: the higher the price the less units they want to buy; the lower the price, the more units they want to buy; and that the relationship between price and quantity demanded applies in the same proportions at any price level (the relationship is linear) so price as a function of quantity demanded can be represented by a downward sloping straight line.
 - (3) For both products, the world price is determined by supply and demand in the world market; Supply and demand in the domestic market is so relatively insignificant in size as not to affect the determination of the world price. This means that the quantity of the home country's imports or exports has no effect on the world price. Domestic consumers can buy as much as they like from foreigners and domestic producers can sell as much as they like to foreigners without affecting the world price. Price as a function of the quantity demanded by or supplied to the rest of the world can be represented by a horizontal straight line. Assume, in particular, that the world price is \$100 per unit.

THE 'BEFORE' SITUATION

For both the importable and the exportable good:

- (1) The equilibrium world price is \$100 per unit of product.
- (2) Since domestic producers have to compete with imports or exports which sell for \$100, then they also set their selling price at \$100.

(3) for both A and B, the world price is fixed at a stable equilibrium world price determined in a world market characterized by perfect competition (there is perfect knowledge, many sellers and many buyers).

(3) The domestic price for consumers is \$100.

The before situation for the importable product is represented in diagram 1. The downsloping line marked D representing domestic demand shows the quantity that domestic consumers will buy for any given price or alternatively the price that consumers will pay for any given quantity. The upsloping line marked S representing domestic supply shows the quantity that domestic producers will supply at any given price. Similarly, the horizontal line marked S_f representing supply from foreigners shows the relationship between price and the quantity that domestic consumers can buy from foreign sellers. In the market in the rest of the world, the price is determined at \$100 and domestic consumers can import any quantity without affecting the import price. The diagram shows the equilibrium in the domestic market at the point X with the price \$100 and the quantity demanded, 900 units. The point Y indicates the portion of the 900 units that is supplied by domestic producers. The difference between the two is the quantity of imports.

The before situation for the exportable product is represented in diagram 2. In the case of an exportable good, it is foreign demand rather than foreign supply which is represented by the horizontal line, D_f . This D_f line represents the relationship between price and the quantity that domestic producers can sell to foreign buyers. That the relationship is represented by a horizontal line indicates that at the world price, domestic producers can sell as little or as much as they like to foreign buyers without affecting the world price. The point Y indicates the quantity supplied and the point X indicates the quantity demanded in the domestic market. At the price of \$100, the quantity of domestic supply exceeds the quantity of domestic consumption by 200 units and this is the quantity of exports.

1 THE IMPORT TARIFF

If an import tariff, t , of \$20 per \$100 of value is imposed:

- (1) the equilibrium on the world market is not affected, so importers can still buy the product from foreigners for \$100;

-
- (2) the importer has to pay a tax of \$20 on each unit of product, so the importers are willing to sell to domestic consumers at a price of \$120: this is the sum of the \$100 payable to foreign sellers and the \$20 of customs duty payable to the government;
 - (3) Domestic producers have to compete with imports which sell at \$120 so they can also set their price at \$120;

Therefore, the imposition of the tariff of \$20 creates a gap of \$20 between the world price and the domestic price. The increase in the domestic price from \$100 to \$120 has an effect on the behaviour of domestic producers and of domestic consumers. These are represented in diagram 3. The \$20 increase in the effective import price is shown by the horizontal shift in the foreign supply curve, from S_f to S'_f . The new intersection between the foreign supply curve and the domestic demand curve is at the point X' indicating that the quantity demanded is 800 units. Domestic production is indicated by the point Y'. Therefore, at the new price of \$120, there is an increase in the quantity supplied by domestic producers (from 500 to 600) and a decrease in the quantity demanded by domestic consumers (from 900 to 800) so there is a corresponding decrease in the excess of domestic demand over domestic production, and in imports, from 400 to 200.

Therefore, four effects of the import tariff are:

- (1) an increase in the domestic price so that there is a gap between the world price and the domestic price equal to the amount of the tariff;
- (2) a decrease in the quantity demanded by domestic consumers;
- (3) an increase in the quantity supplied by domestic producers;
- (4) a decrease in the amount by which the quantity demanded domestically exceeds the quantity supplied domestically and a corresponding decrease in the quantity of imports.

2 THE IMPORT QUOTA

The imposition of an import quota places an absolute limit on the quantity of imports. The effects of the imposition of an import quota on the country imposing it are similar to the effects of a tariff. However, the market mechanism through which they occur is different.

Using the same example of the importable good, consider the introduction of an import quota of 200 units. After the imposition of the import quota:

- (1) the volume of imports is automatically reduced to 200 units;
- (2) at the pre-existing price of \$100 per unit, the quantity demanded exceeds the quantity produced domestically by 400 units and this excess demand is only partially met by the import of 200 units. Therefore, consumers bid the domestic price up until there is no further excess demand;
- (3) As the price increases, the total quantity demanded by consumers decreases and the total quantity supplied by producers increases. When the domestic price reaches \$120, the market reaches an equilibrium at which consumers want to buy 800 units, domestic producers want to supply 600 units and the difference is made up by 200 units of imports;
- (4) Competing against a domestic price of \$120, importers also set their price at \$120 .

These effects are shown in diagram 4. The effect on the quantity imported is an automatic consequence of the quota. The quantity imported falls from 400 to the amount permitted by the quota, 200. When at the pre-existing price of \$100, the quantity of imports is reduced to 200 units, there is an excess of domestic demand over domestic supply which bids the domestic price up from P_w (\$100) until the market reaches the point X' at which the price is P_q (\$120) and the quantity demanded is 800 units. Domestic supply is indicated by the point Y' with quantity at 600 units. Note that importers increase their price above the world price until the price of imports matches the domestic price. At the new price, P_q , the total quantity demanded by domestic consumers has decreased from 900 to 800 but the part which is supplied by domestic producers has increased from 500 to 600.

In this example, the four effects of the import tariff of \$20 and the import quota of 200 units are exactly the same:

- (1) an increase in the domestic price from \$100 to \$120 so that there is a gap of \$20 between the world price and the domestic price;
- (2) a decrease in the quantity demanded by domestic consumers from 900 to 800;
- (3) an increase in the quantity supplied by domestic producers from 500 to 600;
- (4) a decrease in the excess of the quantity demanded domestically over the quantity supplied domestically from 400 to 200 and a corresponding decrease in the quantity of imports.

The reason that these effects of the import tariff and the import quota are identical is that the reduction in imports caused by the quota was exactly the right amount required to place a gap between the domestic price and the world price of the same size as the size of the import tariff: \$20. This may not always be the case. However, it is always the case that for both an import tariff and an import quota, these same effects occur:

- (1) an increase of the domestic price above the world price;
- (2) a decrease in the quantity of imports;
- (3) a decrease in the quantity demanded domestically; and
- (4) an increase in the quantity produced domestically.

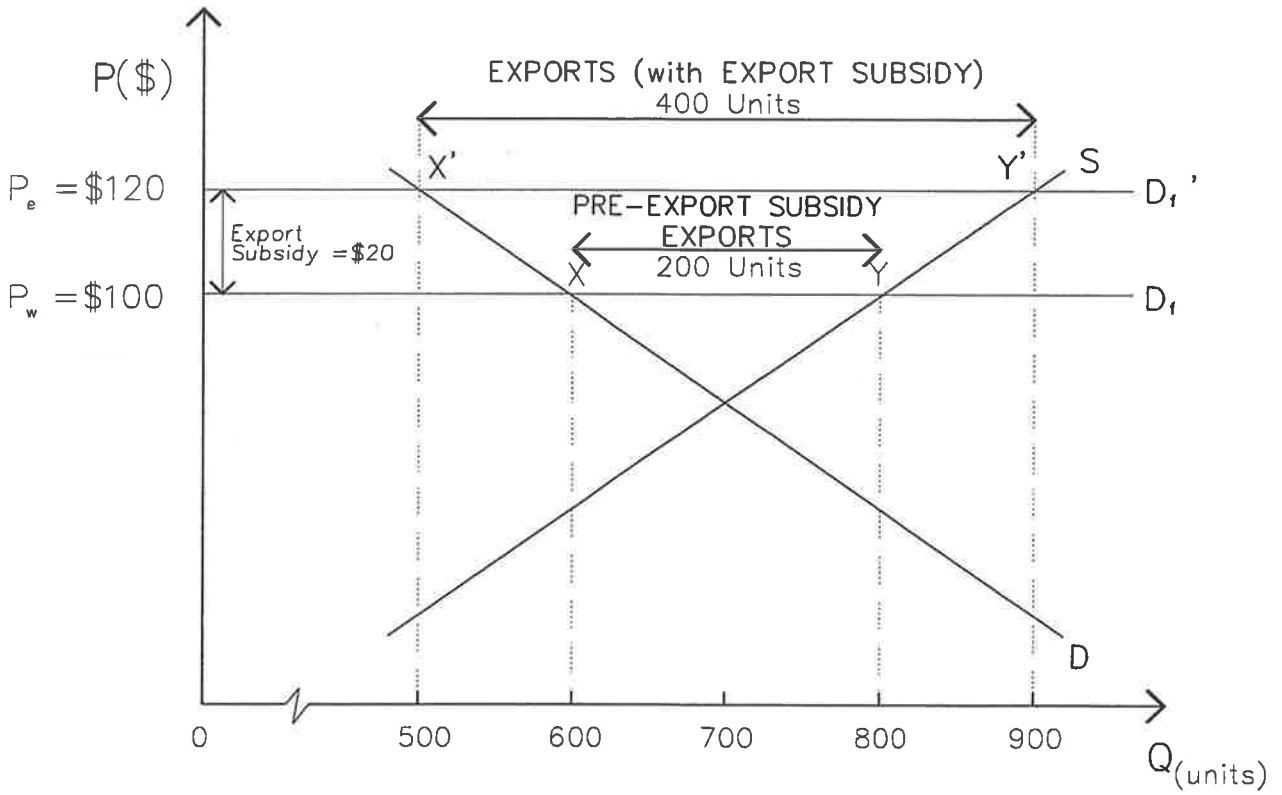
3 THE EXPORT SUBSIDY

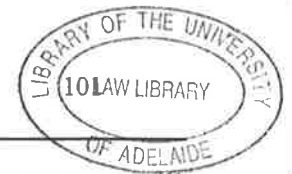
For the explanation of the import tariff and the import quota, we considered an example in which the home country was a net importer. To explain the effects of an export subsidy, we must consider the product for which the home country is a net exporter, Product B.

If an export subsidy, e , of \$20 per \$100 of value is implemented:

Diagram 5

Effects in the Home Country of an EXPORT SUBSIDY on the EXPORTABLE, Product B.





- (1) the equilibrium on the world market is not affected, so domestic producers can still sell the product to foreigners for \$100;
- (2) from each export sale, the domestic producer receives \$120 being the sum of the export subsidy of \$20 and the world price of \$100;
- (3) Domestic producers can sell as much as they like on the world market for a total receipt of \$120 so they can also set their price for sale to domestic consumers at \$120;

These effects are shown in diagram 5. After introduction of the export subsidy, from each export sale, exporters receive $P_w + e$ (\$120): the sum of the world price, P_w (\$100), and the export subsidy, e (\$20). This is represented in the diagram as an upward shift in the function for foreign demand for exports: the D_f curve shifts upward to its new horizontal position at $P_w + e$ (\$120). The point of intersection between the domestic supply curve, S , and the new foreign demand curve, D_f , indicates that at the new price, domestic suppliers supply 900 units (indicated by the point Y'). At the new price of \$120, domestic consumers demand 500 units (indicated by the point X'). In summary, there is an increase in the quantity supplied by domestic producers (from 800 to 900) and a decrease in the quantity demanded by domestic consumers (from 600 to 500) so there is an increase in the amount by which the quantity supplied exceeds the quantity demanded (from 200 to 400), which becomes the new level of exports.

The effects of the export subsidy are

- (1) an increase in the domestic price so that there is a gap between the world price and the domestic price equal to the amount of the per unit export subsidy;
- (2) a decrease in the quantity demanded by domestic consumers;
- (3) an increase in the quantity supplied by domestic producers;
- (4) an increase in the excess of the quantity supplied by domestic producers over the quantity demanded by domestic consumers and a corresponding increase in the quantity of exports.

4 THE DOMESTIC PRODUCTION SUBSIDY

The effects of domestic production subsidies are, in one major respect, different depending on whether the product subsidized is a net-importable or a net-exportable for the home country. Therefore, we will consider the effect of a production subsidy on both the before situation for the net importable and also the before situation for the net exportable. We consider a production subsidy, p , of \$20 per \$100 of value.

THE IMPORTABLE - PRODUCT A

Consider the case of the net-importable (where domestic demand exceeds supply) first. The effect of the production subsidy is that, from each sale, producers receive \$120, the sum of the market price of \$100 and the production subsidy of \$20. This is shown in diagram 6. The introduction of the production subsidy of \$20 increases the total amount received by the producer. To receive the same amount as would have been received without the subsidy, the producer can accept a lower price for any given quantity supplied. Therefore, the domestic supply function (S) shifts downward by \$20 from S to S'. Given the new supply curve, at a price of \$100 (but a total return of \$120), domestic producers increase the quantity supplied from 500 units (indicated by the point Y) to 600 units (indicated by the point Y'). Consumers are unaffected by the subsidy. They continue to demand 900 units (indicated by the point X). The excess of domestic demand over domestic supply is reduced from 400 to 300 units which is the new level of imports.

Therefore, for the importable good, the changes brought about by the domestic subsidy are:

- (1) an increase in the total effective price received by producers from \$100 to \$120;
- (2) an increase in the quantity supplied by domestic producers from 500 to 600 units;
- (3) a decrease in the excess of the quantity demanded by domestic consumers over the quantity supplied by domestic producers from 400 to 300 and a corresponding decrease in the quantity of imports.

THE EXPORTABLE - PRODUCT B

Consider, next the case of the net-exportable product for which domestic supply exceeds demand. For the exportable as for the importable, the introduction of the production subsidy of \$20 increases the total amount received by the producer so that to receive the same amount as would have been received without the subsidy, the producer can accept a lower price for any given quantity supplied. This change is shown in diagram 7. The increase in the total amount received by the producer is indicated by the downward shift in the domestic supply function (S) by \$20 from S to S'. Given the new supply curve, at a price of \$100 (but a total return of \$120), domestic producers increase the quantity supplied from 800 units (indicated by the point Y) up to 900 units (indicated by the point Y'). Domestic consumption is unchanged and is still indicated by the point X with the quantity of 600 units. The excess of quantity supplied domestically over quantity demanded domestically is increased from 200 to 300 units which is the new level of exports.

Therefore, for the net-exportable, the changes brought about by the production subsidy are:

- (1) an increase in the total effective price received by producers from \$100 to \$120;
- (2) an increase in the quantity supplied by domestic producers from 800 to 900 units;
- (3) an increase in the excess of the quantity supplied by domestic producers over the quantity demanded by domestic consumers from 400 to 300 and a corresponding increase in the quantity of exports.

Therefore, the production subsidy decreases imports in the case of a net importable and increases exports in the case of a net exportable. (There could also be the situation in which the production subsidy would be large enough to change a net importer of a product into a net exporter of the same product.) In each case, the changes arise because of changes in the effective price received by producers. In each case, whether of an importable or an exportable, domestic production subsidies have no effect on the price to domestic consumers nor on their decisions as to the quantity that they want to buy.

SIMILARITIES AND DIFFERENCES BETWEEN THE EFFECTS OF THE FOUR PRINCIPAL POLICY INSTRUMENTS

In summary, there are some significant differences between the four policy instruments and also some significant similarities. All of the four instruments have an impact on the relationship between the quantities of domestic supply and domestic demand: whether there is an excess or a deficit and of what size it is. All of the instruments have an effect on either the effective price to domestic consumers or the effective price to domestic producers or on both.

The two import barriers, the import tariff and the import quota, have similar effects though through different market mechanisms. Both have the three effects of reducing the excess of domestic demand over supply, increasing the domestic price and reducing the quantity of imports. The crucial difference is that an import tariff has a direct effect on price which has a flow-on effect on the quantity imported whereas the import quota has a direct effect on the quantity imported which has a flow-on effect on price.

It is important to notice that there is an important similarity between the effects of these import barriers and the effects of export subsidies. The key similarity between the two forms of import barriers and export subsidies is that all of these trade instruments raise the domestic price above the world price. In the case of all three instruments, the higher domestic price causes the quantity of production to increase and the quantity of consumption to decrease. These changes have the effect of decreasing imports in the case of the import barriers and of increasing exports in the case of the export subsidy.

Domestic production subsidies have similarities with and differences from each of the other instruments. Production subsidies are like the two import barriers in that where domestic demand exceeds supply, they decrease the quantity of imports. In addition, production subsidies are like export subsidies in that where domestic supply exceeds demand, they increase the quantity of exports. However, production subsidies are unlike the other three instruments in that they do not alter the price of imports or exports and thereby do not create a gap between the domestic *consumer* price and the world price (even though they do create a gap between the domestic *producer* price and the world price).

CLASSIFICATION

The above observation of similarities and differences in economic effects of these four types of policy instruments points to these two important ways of distinguishing between and classifying the four instruments.

BORDER INSTRUMENTS VS NON-BORDER INSTRUMENTS

First, there is a distinction to be drawn between, on the one hand, import tariffs, import quotas and export subsidies which create a gap between both the domestic producer price and the world price and also the domestic consumer price and the world price and, on the other hand, domestic subsidies which create a gap between the world price and the domestic producer price but not between the world price and the domestic consumer price.

Although this analysis is restricted to the four principal instruments of commercial or trade policy, this distinction could be drawn generally as the basis for a classification of all commercial policy instruments (as noted in the previous chapter, analysis of other instruments is left for other work). It would have been possible to include consumption taxes in the analysis to show that they cause a gap between the world price and the domestic consumer price but not between the world price and the domestic producer price. Other policies like voluntary export restraints, or domestic content schemes could be similarly analyzed and we could have observed how these instruments affect prices.

We can draw a general distinction between policies which create a gap between both the domestic producer price and the world price and also the domestic consumer price and the world price and, on the other hand, policies which create a gap between the world price and either the domestic producer price or the domestic consumer price but not both.² We can classify the first group as border instruments and the latter group as non-border instruments. The classification, border instruments, includes import tariffs, import quotas and export subsidies and the classification, non-border instruments includes domestic subsidies.

2 Note the same (though differently expressed) classification is adopted in Snape, Richard H., "The Importance of Frontier Barriers" in Kierzowski, Henryk, *Protection and Competition in International Trade - Essays in honour of W.M. Corden* (Basil Blackwell Ltd, London, 1987) at p215-232. Snape distinguishes between Frontier and Non-Frontier Measures on the basis of whether they "discriminate between national and foreign sources of supplies or between national and foreign destinations" (p216).

PRICE-BASED VS QUANTITY-BASED BORDER INSTRUMENTS

Secondly, there is the distinction between those border instruments which directly operate upon the price of imports or exports and those border instruments which directly operate upon the quantity of imports or exports. We have observed that import tariffs operate directly upon the price of imports and export subsidies operate directly upon the price of exports. They are classified as price-based border instruments. We have also observed that import quotas operate directly upon the quantity of imports. Therefore, import quotas (and similarly export quotas which are not discussed here) are classified as a quantity-based border instrument.

LINKING GATT'S FAILURE WITH AGRICULTURE TO THESE TWO DISTINCTIONS

These two distinctions between policy instruments are of crucial importance to this thesis because the thesis posits a link between the failure of GATT in application to agriculture and the way in which these two distinctions are embodied in GATT rules.

The next step is to determine whether the changes that we have observed in prices and quantities manifest themselves as changes in the aggregate wealth of the community and as welfare transfers between sectors of the community.

CHAPTER 5

WINNERS AND LOSERS FROM THE FOUR POLICY INSTRUMENTS

INTRODUCTION

So far we have observed only the way that the four principal instruments effect changes to prices and quantities. To understand why the changes in prices and quantities generate political motivations, it is necessary to consider who wins and who loses as a result of those changes. This chapter looks at each of the four policy instruments in turn to identify the winners and losers.

This examination of the welfare effects of each of the four principal instruments is undertaken by use of the same examples as used in the last chapter and by use of the same graphs. In the examples, the gains and losses are explained by considering whether the implementation of the policy instrument changes an entity's economic position to a more preferred position or to a less preferred position. In most cases, this is apparent from the change in money received or paid. However, in some instances, one must go beyond the changes in money flows that occur to consider the changes in real income, that is, the changes in the bundles of products that can be purchased by the entity. These real income changes can be explained by using the concept of economic surplus. This concept of economic surplus is used by economists to measure changes to economic welfare of entities. It is defined to be that which accrues to an entity in any transaction where the amount exchanged for something is less than the minimum amount which the entity would have been prepared to exchange.¹

¹ The concept of economic surplus derives from Marshall, Alfred, *Principles of Economics* (Macmillan, London, 8th ed, 1920) p124; it is explained in Ng, Yew-Kwang, *Welfare Economics*

Economic surplus is illustrated graphically by Diagram 8 which shows economic surplus accruing to consumers and producers. The consumer surplus is the difference between the amount which consumers would have been prepared to pay for each unit and the price actually required to be paid, P_e , for each unit up to Q_e . The producer surplus is the difference between the amount for which producers would have been prepared to sell each unit and the actual market price for each unit. If the price, P_e , were to change then the surplus accruing to consumers and producers would change. We could compare the before and after economic surplus to determine the change in economic surplus and we could represent the surplus gained or lost by an area of the graph.

The graphical representation of the welfare effects caused by each of the policy instruments can be regarded as representations of changes to economic surplus. However, in most cases, the graphs can also simply be regarded as representations of the changes in money flows.² By observing these changes to money flows and economic surplus, we can assess who is better off and who is worse off following the adoption of particular instruments. We can also assess whether, in aggregate, national economic welfare is improved or worsened.³ After doing that, the next chapter can take the exercise further by assessing whether the changes to economic surplus are different in the case of border and non-border instruments and also in the case of price-based and quantity-based border measures.

1 THE IMPORT TARIFF

In the example of the imposition of a \$20 import tariff on an importable (Product A), we described the following effects:

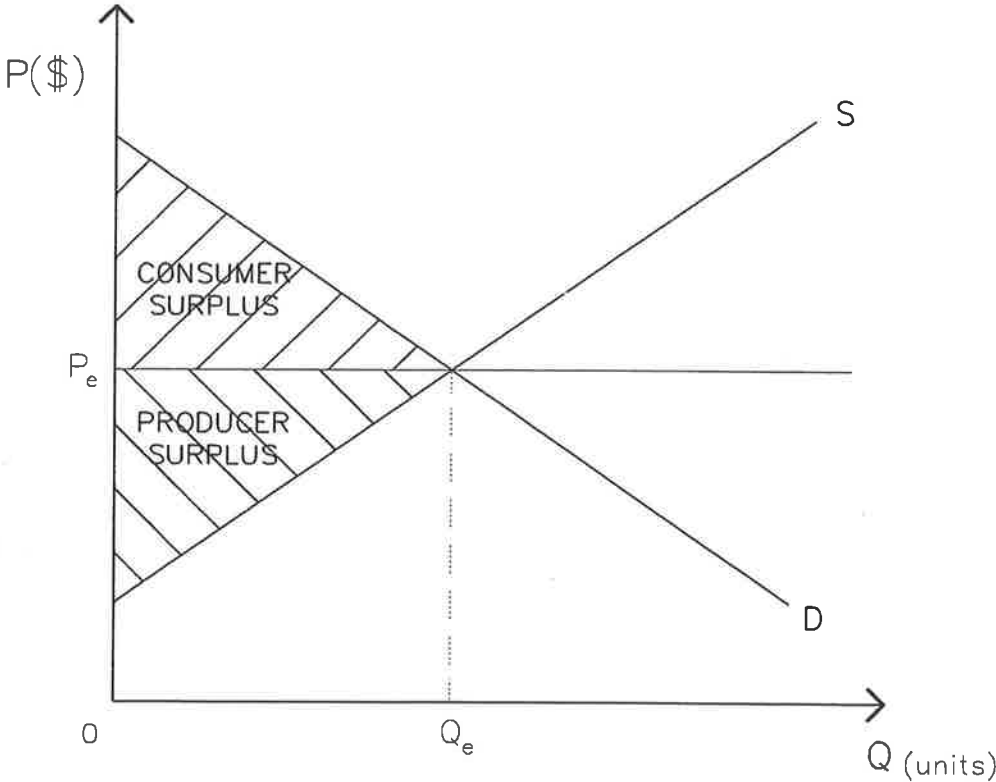
(Macmillan, London, 1979) pp84-85 and also in McCalla, Alex F. & Timothy E. Josling, *Agricultural Policies and World Markets* (Macmillan, New York, 1985) pp105-107.

2 This approach of considering changes in financial flows and then adding in changes in economic surplus matches the approach taken in McCalla, Alex F. & Timothy E. Josling, *Agricultural Policies and World Markets* (Macmillan, New York, 1985) pp104. As noted by McCalla & Josling, there is debate on the concept of surplus. Like them, I do not wish to enter the debate but to explain how the concept of surplus is used to analyze policies. On the utility of the concept of surplus, see Currie, J., Murphy, J.A. & Schmitz, A., "The Concept of Economic Surplus and Its Use in Economic Analysis" (1971) 81 *Economic Journal* 741-799 and on the limits of the tool of economic surplus, see Turnovsky, S.J., Shalit, H. & Schmitz, A., "Consumer Surplus, Price Instability and Consumer Welfare" (1980) 48 *Econometrica* 135-152.

3 This assumes any externalities or non-economic objectives have been optimally addressed.

Diagram 8

ECONOMIC SURPLUS



- (1) an increase by \$20 in the domestic price creating a divergence between the domestic price of \$120 and the world price of \$100;
- (2) a decrease in the quantity demanded domestically from 900 to 800 units;
- (3) an increase in the quantity supplied domestically from 500 to 600 units;
- (4) a decrease in the amount by which quantity demanded exceeds quantity supplied from 400 to 200 units and a corresponding decrease in the quantity of imports.

These changes allocate gains and losses to consumers, producers and the government. A graphical representation of these gains and losses is shown in Diagram 9. The diagram represents the imposition of an import tariff ($t = \$20$) by a horizontal shift in the function for supply by foreigners (from S_f to S_f') and the resulting increase in price to P_t (\$120). The post-tariff price and quantities of domestic consumption and production are represented by the points X' and Y' .

We can identify the gains and losses to different entities by looking at the different components of the quantity of consumption.

- (1) **The 500 units of consumption that are produced by domestic producers before and after the price rise:**
 - (a) producers receive an extra \$20 per unit and consumers pay an extra \$20: a transfer from consumers to producers of \$10,000. This is represented on the graph by the rectangle marked 'a'.
- (2) **The 100 units of consumption that used to be imported but are now supplied by domestic producers:**
 - (b+c) consumers pay an extra \$20 per unit: a loss of \$2000. This loss to consumers is represented by the rectangle 'b+c' (made up of the two triangles 'b' and 'c').
 - (b) These 100 units used to be supplied by importers but are now supplied by domestic producers. The domestic producers receive an extra profit equal to the amount by which \$120 exceeds the marginal cost of production. The marginal cost of production is represented by the S function since it represents the price at which

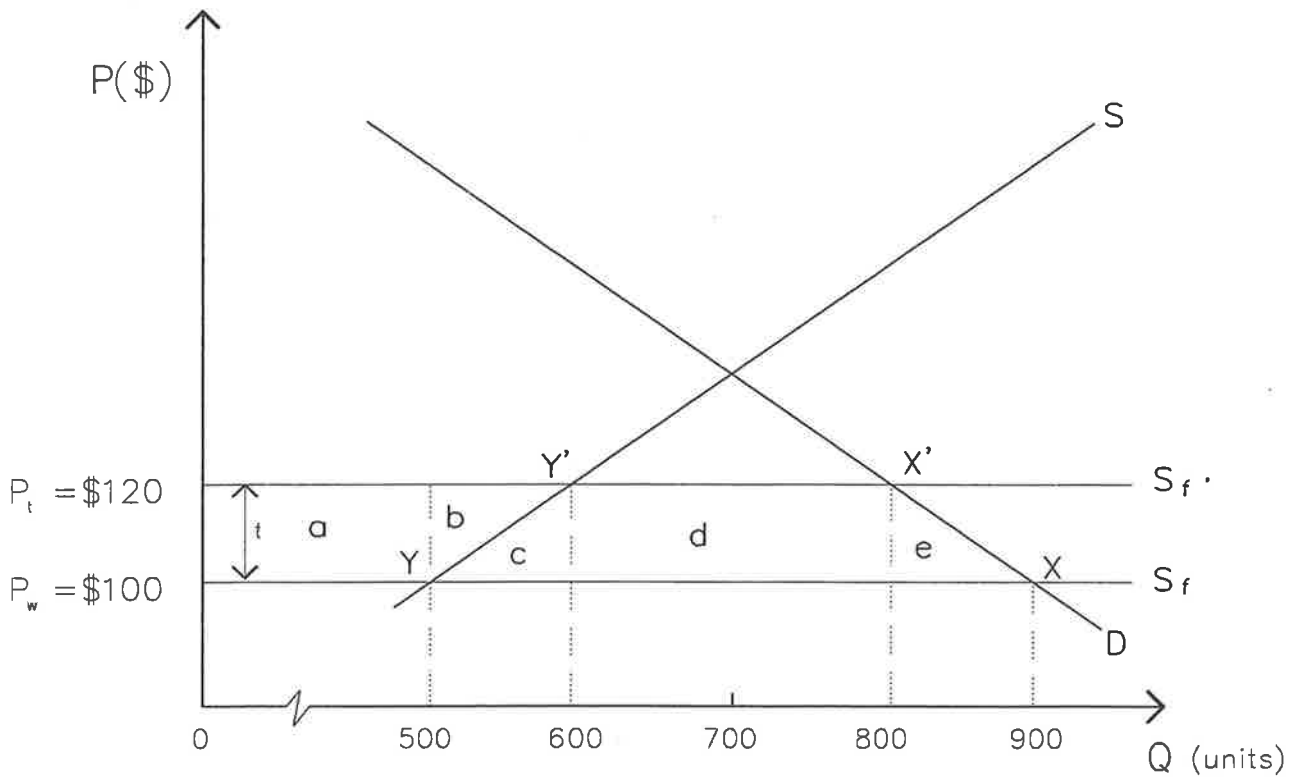
producers are willing to supply the n th unit. Therefore, the triangle marked 'b' represents the extra profit received by domestic producers from the sale of these extra 100 units. This amount (represented by the triangle 'b') is transferred from domestic consumers to domestic producers.

We can quantify the extra profit because we know that these units of production were not profitable for domestic producers at the pre-tariff price of only \$100 and since they are profitable at the post-tariff price of \$120, their marginal cost of production must be more than \$100 but less than \$120 and the profit between zero and \$20 per unit. If we assume that the marginal cost of these units increases evenly through the 100 units (as we did above⁴ and as is implicit in the fact that the S function is a straight line), then we can use an average marginal cost of \$110 and an average per unit profit of \$10, to calculate the extra profit on the 100 units as \$1,000.

- (c) The other portion of the consumers' \$20 per unit loss on these units is the amount by which their marginal cost of production exceeds \$100. This is the amount by which the cost of producing these 100 units domestically exceeds the cost at which they could have been imported. This amount is represented on the graph by the triangle marked 'c'. This portion of the loss to consumers is not transferred to anyone: a deadweight welfare loss for society.
- (3) **the 200 units of consumption that continue to be imported after the price rise:**
- (d) domestic consumers pay an extra \$20 per unit and the government receives \$20 customs duty per unit: a transfer from consumers to the government of \$4,000. This amount is represented on the graph by the rectangle marked 'd'.
- (4) **the 100 units of pre-tariff consumption that are not consumed after the price rise:**
- (e) While all of the above losses correspond to units in respect of which consumers are paying an extra \$20 per unit, this last category corresponds to the loss suffered by consumers because they choose not to buy these units at the higher price. This loss is the additional economic satisfaction that consumers are unable to attain by virtue

Diagram 9

CHANGES IN ECONOMIC WELFARE
in the Home Country caused by an
IMPORT TARIFF on an IMPORTABLE PRODUCT.



of not being able to purchase these extra units at the pre-tariff price. It is the difference between the value placed by the consumers themselves on the basket of goods that they can buy when the price of Product A is \$100 and the value placed by those consumers on the basket of good that they choose to buy when the price of A is \$120. This loss is represented in the graph by the area 'e'. The size of this loss is determined by how much value these former consumers placed on the extra units of Product A or the amount that they were prepared to pay for additional units of Product A.⁵ This amount is represented by the D function. If we assume that the consumers' willingness to pay for each marginal unit decreases evenly through the extra 100 units (as we did above⁶ and as is implicit in the D function being a straight line), then we can use an average of \$10 per unit to calculate the loss on the 100 units at \$1,000. This loss is not transferred to anyone: another deadweight loss.

We can summarize these gains and losses as follows:

Loss of economic surplus by consumers	$-(a+b+c+d+e)$
Gain in economic surplus by producers	$+a+b$
Gain in economic surplus by the government	$+d$
Net economic welfare Loss to the country	$-(c + e)$

We can also summarize the losses by adding the cash flows to show that consumers lost a total of \$17,000 of which \$11,000 was transferred to producers and \$4,000 was transferred to the government leaving a net loss of \$2,000 which was not transferred to anybody.

In summary, much of the loss suffered by consumers is transferred to either the government or to domestic producers. However, two parts of the losses to consumers, labelled c and e in the diagram, are not transferred to anyone. We call these dead weight losses. We can explain the dead weight losses in terms of the decisions of consumers and producers. The first of these, the loss labelled c, represents the amount by which the cost of producing the

4 This assumption was made at the beginning of ch4: see paragraph (1) on p96 above.

5 An expanded explanation of how this loss of real income can be measured is contained in Appendix 1.

extra 100 units domestically exceeds the cost at which they could have been imported. This portion of the deadweight loss is caused by what is known as the production effect: the price induced changes in production decisions. The other deadweight loss, labelled e, represents the loss of economic welfare sustained by consumers as a result of the decrease in their purchases from 900 to 800 units. It is the additional economic welfare that they miss out on by not being able to purchase these extra units at the pre-tariff price. This part of the deadweight loss is caused by what is known as the consumption effect: the price induced changes in consumption decisions.

The important conclusion to be drawn is that for the country imposing the import tariff, the total loss to consumers exceeds the total gains to producers and the government. The net effect on aggregate wealth is negative. We can also draw a corresponding conclusion in respect of the action of removing an existing import tariff: that the total gain to consumers exceeds the total losses to producers and to the government. While, neither the action of implementing nor removing an import tariff can be described as making some people better off without making anyone worse off, that is, as Pareto efficient,⁷ there is a significant sense in which the aggregate welfare effects are different. In the case of implementing a tariff, if the winners allocate all of their gains to compensating the losers, there will still remain an uncompensated loss. However, in the case of removing a tariff, if the winners allocate their gains to completely compensate the losers, the winners will still be left with a net gain.⁸ The net effect on aggregate wealth of removing an existing tariff barrier is positive.

2 THE IMPORT QUOTA

In the last chapter, it was shown that import quotas have the same effects as import tariffs in that they cause increases in the domestic price, a reduction in the excess of domestic demand over supply, and a reduction in the quantity of imports.⁹ With a quota, the transition to the

6 This assumption was made in chapter 4: see paragraph (2) on p96 above.

7 Pareto efficiency is used to describe any condition in which it is not possible to make one person better off without making another person worse off. See Pareto, V., *The Mind and Society*, volume 4 edited by Arthur Livingstone (Cape, London, 1935) p1466n and Ng, Yew-Kwang, *Welfare Economics* (Macmillan, London, 1979) pp30-51.

8 This is known as Kaldor-Hicks efficiency. See Ng, Yew-Kwang, *Welfare Economics* (Macmillan, London, 1979) pp59-66 including the citations of: Kaldor, N., "Welfare propositions of economics and interpersonal comparisons of utility" *Economic Journal* (1939) vol 49, 549-552 and Hicks, John R., "Foundations of welfare economics" *Economic Journal* (1939) vol 49, 696-712.

9 See diagram 2.

new equilibrium is achieved by a direct impact on the quantity of imports and an indirect effect on the price, whereas with a tariff, it is achieved through a direct impact on price and an indirect effect on the quantity of imports. The changes caused by an import quota and by an import tariff are identical when the import quota causes a gap between the world price and the domestic price that is equal to the amount of the tariff. (Quotas and tariffs are equivalent in their quantity effects if they change the gap between world price and domestic price by the same amount.)

For an import quota, the winners and losers are the same as for an import tariff with one possible difference: there is no tariff revenue from a quota. In the case of an import quota, consumers are paying more, exactly as they do with an import tariff. However, the identity of the recipient of this transfer from consumers depends on the way the quota is allocated. It can go to the government (eg, when the quota is auctioned), to the domestic importer or to the foreign seller. Apart from the transfers, an import quota imposes the same deadweight losses as an import tariff: one caused by a production effect and one caused by a consumption effect.¹⁰

3 THE EXPORT SUBSIDY

Using the example of an exportable, Product B, the previous chapter described the effects of an export subsidy of \$20 as:

- (1) an increase in the domestic price of \$20 creating a gap of \$20 between the domestic price of \$100 and the world price of \$120;
- (2) a decrease in the quantity demanded domestically from 600 to 500 units;
- (3) an increase in the quantity supplied domestically from 800 to 900 units;
- (4) an increase in the amount by which quantity supplied exceeds quantity demanded from 200 to 400 units and a corresponding increase in the quantity of exports.

These changes allocate gains and losses to consumers, producers and the government. Diagram 10 shows a graphical representation of these gains and losses. With an export subsidy, the amount received by a domestic producer from each export sale is equal to the

world price plus the export subsidy ($s = \$20$). The introduction of an export subsidy is represented in the diagram by an upward shift in the function for demand by foreigners from D_f to D_f' and an increase in price from P_w (\$100) to $P_w + s$ (\$120). The points X' and Y' indicate the post-export subsidy price and quantities of consumption and production. At the new price, the quantity supplied by domestic producers has increased from 800 to 900 and the quantity demanded by domestic consumers has decreased from 600 to 500 units so that the amount by which the quantity supplied domestically exceeds the quantity demanded domestically has increased from 200 to 400 units.

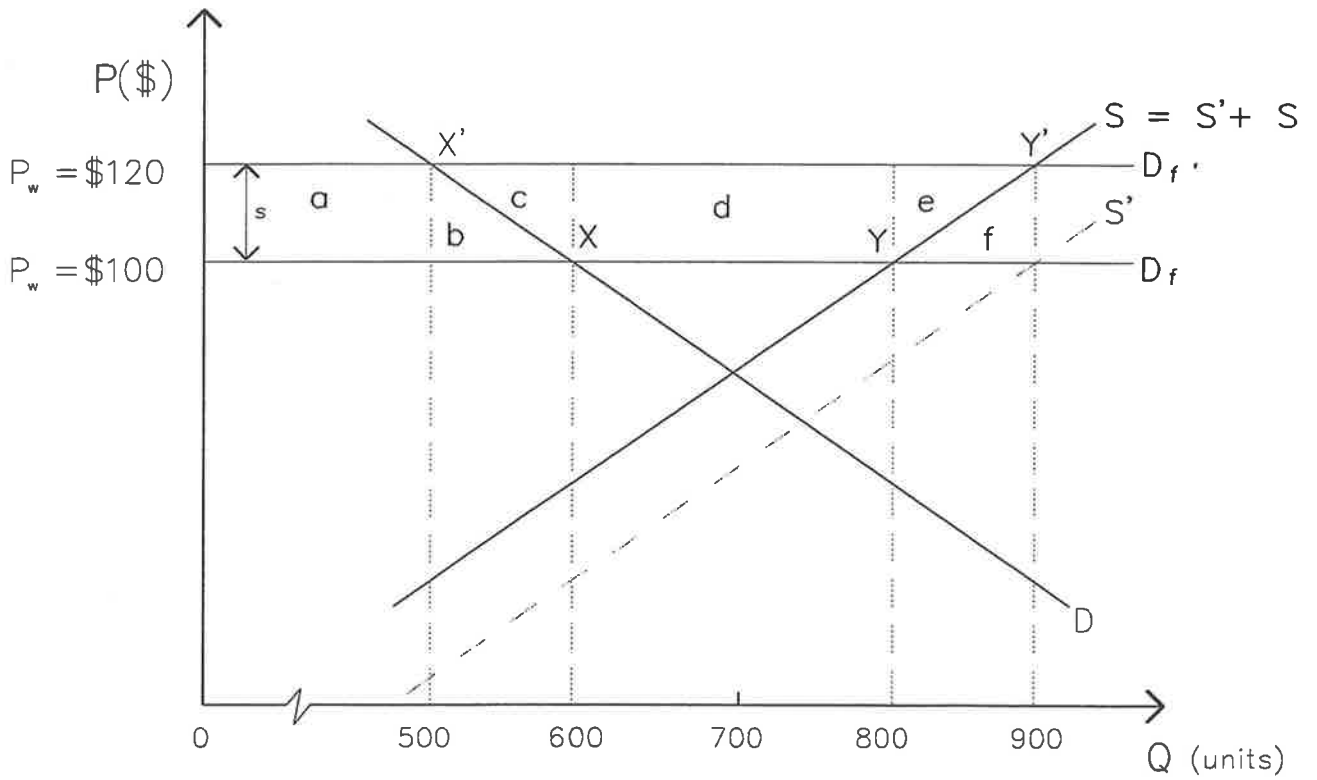
We can identify the gains and losses to different entities by looking at the different components of the quantity of production.

- (1) **The 500 units of production which are consumed by domestic consumers before and after the price rise.**
 - (a) Domestic producers receive an extra \$20 per unit and consumers pay an extra \$20: a transfer from consumers to producers of \$10,000. This is represented in the diagram by the rectangle marked 'a'.
- (2) **The 100 units of production that used to be consumed by domestic consumers but are now exported:**
 - (b+c) Domestic producers receive an extra profit of \$20 per unit and the government pays an export subsidy of \$20 per unit: a transfer from the government to producers of \$2,000. This amount is represented in the diagram by the rectangle 'b + c' (composed of the two triangles 'b' and 'c').
 - (b) In addition, for these 100 units of production, there is a loss incurred by consumers who as a result of the price increase (from \$100 to \$120) now, instead of consuming the extra units of Product B, consume other products which they prefer less than Product B. This loss is the additional economic satisfaction that consumers are unable to attain by virtue of not being able to purchase these extra units at the pre-tariff price of \$100. This loss is the same as the loss caused by the decrease in consumption caused by an import tariff. The per unit loss can be measured as the

10 This assumes that there is no additional loss in the case of the quota attributable to the expenditure of

Diagram 10

CHANGES IN ECONOMIC WELFARE
in the Home Country caused by an
EXPORT SUBSIDY on an EXPORTABLE.



amount in excess of the old price that they would have been prepared to pay for one unit. Consumers were prepared to pay between \$100 and \$120 for each of these 100 units. With an average loss of \$10 per unit, the total loss is \$1,000. This loss is represented in the diagram by the triangle 'b'.

- (3) **The 200 units of production that are exported both before and after the price rise.**
- (d) Domestic producers receive an extra \$20 per unit and the government pays an export subsidy of \$20 per unit: a transfer from the government to producers of \$4,000. This amount is represented in the diagram by the rectangle 'd'.
- (4) **The 100 new units of production.**
- (e+f) The government pays an export subsidy of \$20 per unit: a loss by the government of \$2,000. This loss is represented in the diagram by the rectangle 'e+f' (composed of the two triangles 'e' and 'f').
- (e) From the sale of these extra 100 units, producers receive an extra profit equal to the amount by which \$120 exceeds the marginal cost of production. For these 100 units, the marginal cost of production is indicated by the S function to be between \$100 and \$120 so the profit per unit is between zero and \$20 per unit. Assuming an average of \$10 per unit, the extra profit is \$1,000 (represented by the triangle 'e'). Therefore, half of the government loss on these 100 units is a transfer to producers.
- (f) The other portion of the \$20 per unit is the amount by which the marginal cost of production exceeds \$100. This is the amount by which the cost of producing these 100 units domestically exceeds the cost at which they could have been imported. This half of the loss to government is not transferred to anyone.

We can summarize these gains and losses as follows:

Loss of economic surplus by consumers	$-(a+b)$
Gain in economic surplus by producers	$+a+b+c+d+e$

resources on lobbying the government by those seeking to obtain the benefit of the import quota.

Loss in economic surplus by the government	$-(b+c+d+e+f)$
Net economic welfare Loss to the country	$-(b+f)$

We can also summarize the losses by adding the income and expenditure changes (including the change in real income which accounts for the reduction in consumption) to show that consumers lost a total of \$11,000 and that the government lost a total of \$8,000 giving total losses of \$19,000 of which \$17,000 was transferred to producers leaving a net loss of \$2,000 which was not transferred to anybody.

In summary, much of the losses suffered by consumers and by the government is transferred to domestic producers. However, two parts of these losses, labelled 'b' and 'f' in the diagram, are not transferred to anyone. These are deadweight losses. Note the similarities to the situation with a tariff. As with the import tariff and the import quota, for the export subsidy, there is a deadweight loss caused by production effects and one caused by consumption effects. The deadweight loss caused by production effects arises from domestic producers' decisions to produce more at a higher cost than would be profitable without the subsidy. This is represented by the area 'f'. It represents the amount by which the total cost to the producers and to the government of producing the additional 100 units domestically exceeds the export price which is received for them. The deadweight loss caused by the consumption effects arises from consumers' decisions to consume less of Product B (and more of something else which satisfies them less). This is the loss of economic surplus sustained by consumers as a result of the decrease in their purchases from 600 to 500. It is the economic surplus that they miss out on by not being able to purchase the 100 extra units at the pre-export subsidy price. It is represented in the diagram by the area 'b'.

We can make an observation about the relative size of the deadweight losses caused by tariffs and by export subsidies. If the per unit size of the subsidy is the same as that of the tariff then the deadweight losses are the same size.¹¹

11 Assuming that the supply and demand curves have identical slopes over the price range considered.

4 THE PRODUCTION SUBSIDY

It is necessary to deal separately with the situation of the importable, Product A, and the exportable, Product B.

THE IMPORTABLE - PRODUCT A

In the example of the importable product, the following changes brought about by the domestic subsidy were described:

- (1) no change in the price to domestic consumers;
- (2) an increase in the total effective price received by producers from \$100 to \$120;
- (3) an increase in the quantity supplied by domestic producers from 500 to 600 units;
- (4) a decrease in the excess of the quantity demanded by domestic consumers over the quantity supplied by domestic producers from 400 to 300 and a corresponding decrease in the quantity of imports.

Diagram 11 shows the gains and losses which are caused by these changes. The introduction of a production subsidy, p , is represented by a shift to the right of the domestic supply function from S to S' . The price to consumers is not affected so domestic consumption is unchanged and is still represented by the point Y . The shift in the supply function means that at the world price, P_w , producers supply the quantity indicated by the point X' , which is 600 units, an increase from 500 units. The excess of domestic demand over domestic supply falls to 300 units thereby decreasing the quantity of imports.

By looking at the different components of the quantity of domestic consumption, we can identify the gains and losses to different entities:

- (1) **The 500 units of consumption which are produced by domestic producers before and after the subsidy.**
 - (a) The government pays \$20 per unit to domestic producers: a transfer from the government of \$10,000. This is represented on the diagram by the parallelogram, marked 'a'.

(2) The 100 units of consumption that used to be imported but are now produced by domestic producers.

- (b+c) The government pays a subsidy of \$20 per unit: a loss of \$2,000. This is represented on the diagram by the parallelogram 'b+c' composed of the two triangles marked 'b' and 'c'.
- (b) Producers receive an extra profit equal to the amount by which \$120 exceeds the marginal cost of production which is represented by the S function. For each of the 100 units, there is a profit of between zero and \$20 per unit. Therefore, that part of the government's loss equal to the profit on the additional 100 units is a transfer to producers. This is represented in the diagram by the area 'b'.
- (c) that part of the government subsidy which does not accrue as extra profit to domestic producers is not transferred to anyone. It is a deadweight loss and is represented in the diagram as the area 'c'.

These gains and losses are summarized as follows:

Change in economic surplus to consumers	unchanged
Gain in economic surplus to producers	+a+b
Loss of economic surplus to the government	-(a+b+c)
Net economic welfare Loss to the country	+c.

We can also summarize the losses by adding the cash flows to show that the government pays a total of \$12,000 of which only \$11,000 is transferred to producers in extra profits leaving a net loss of \$1,000 which is not transferred to anybody.

THE EXPORTABLE - PRODUCT B

In the example of the exportable product, the changes brought about by the production subsidy were described as:

- (1) no change to the price to domestic consumers;
- (2) an increase in the total effective price received by producers from \$100 to \$120;

- (3) an increase in the quantity supplied by domestic producers from 800 to 900 units;
- (4) an increase in the excess of the quantity supplied by domestic producers over the quantity demanded by domestic consumers from 200 to 300;
- (5) an increase in the quantity of exports from 200 to 300.

These changes and the gains and losses that they cause are illustrated in Diagram 12. As with the importable, the introduction of the production subsidy is represented by a shift in the supply function from S to S'. Producers increase production from 800 to 900. The new point of production is represented by the point Y' and the point of consumption is unchanged at X. The excess of quantity supplied over quantity demanded is increased and exports increase to 300 units.

By looking at the different components of the quantity of domestic production, we can identify which of the gains and losses are transfers from one entity to another and which are deadweight losses.

- (1) **The 600 units of production consumed by domestic consumers before and after the subsidy.**
 - (a) The government pays \$20 per unit to domestic producers: a transfer from the government to producers of \$12,000. This amount is represented in the diagram by the area 'a'.
- (2) **The 200 units of production that are exported both before and after the subsidy**
 - (b) The government pays \$20 per unit to domestic producers: a transfer of \$4,000 from the government to producers. This amount is represented in the diagram by the area 'b'.
- (3) **The extra 100 units of domestic production that is exported.**
 - (c+d) The government pays a subsidy of \$20 per unit: a loss of \$2,000. This amount is represented by the area 'c + d'.
 - (c) Producers receive an extra profit equal to the amount by which \$120 exceeds the marginal cost of production (which is represented by the S function). For each of the

100 units, there is a profit of between zero and \$20 per unit. Therefore, that part of the governments loss equal to the profit on the additional 100 units is a transfer to producers. This amount is represented by the area 'c'.

- (d) That part of the government subsidy which does not accrue as extra profit to domestic producers is not transferred to anyone. It is a deadweight loss and is represented in the diagram by the area 'd'.

These gains and losses can be summarized as follows.

change in economic surplus to consumers	unchanged
gain in economic surplus to producers	+a+b+c
gain in economic surplus to the government	-(a+b+c+d)
Net economic welfare loss to the country	-d.

We can also summarize the losses by adding the cash flows to show that the government pays a total of \$18,000 of which only \$17,000 is transferred to producers in extra profits leaving a net loss of \$1,000 which is not transferred to anybody.

The net loss (represented by the area, c, in the diagram relating to the importable product and represented by the area 'd' in the diagram relating to the exportable product) represents the net additional cost of producing the units domestically over the amount that would have been incurred in importing those units. This loss is a consequence of the production decisions made in response to the grant of the subsidy. Note that a production subsidy has no effect upon the decisions of consumers. Therefore, the production subsidy causes only a production effect and no consumption effect.

CONCLUSIONS

The above analysis provides two conclusions: one about who is winning and who is losing and another about whether there is an overall loss or gain. Without detracting from the importance of these conclusions, it is useful to widen them to allow for additional considerations. Therefore, some qualifications follow the general conclusions.

CONCLUSION NO 1 - WHO IS WINNING AND WHO IS LOSING?

We have observed that all of the four policy instruments transfer wealth in favour of producers. All of the border instruments impose the cost of this transfer, at least in part, upon consumers. Import quotas and import tariffs impose the cost wholly on consumers. Export subsidies impose the cost partly on consumers and partly on taxpayers. The non-border instrument imposes the cost of the transfer upon taxpayers.

Qualification - Distinguishing between Exporters and Import Competing Producers

The partial equilibrium analysis treats domestic producers as a single group. However, the model could be improved by distinguishing between exporters and import competing producers.¹² One could consider the effect on exporters of the general level of import protection granted in favour of import competing industries and also the effect on import competing producers of the general level of export subsidization granted in favour of exporters. Although one group is not directly affected by assistance given to the other group, there is an effect caused by the change in the relative prices of the produce of the two groups. For example, as the level of import tariffs goes up then the ratio of the value of produce of exporter's to the value of produce of import competing producers goes down. In fact, it has been shown that because import barriers and export taxes have the same effect on relative prices, then the effect on exporters from import barriers is equivalent to the effect that would be caused by a tax on exports.¹³ The equivalence holds only in relation to the general level of protection. The significance of this is that we need to modify our conclusion as to the identity of the winners and losers from protection. For increases in the

12 This is achieved by the more sophisticated model called the Heckscher-Ohlin model which is based on the relative prices of products rather than the absolute price of a single product. This model was derived from the works: Heckscher, Eli, "The Effect of Foreign Trade on the Distribution of Income" *Ekonomisk Tidskrift*, Volume XXI, 1919, pp497-512 (in Swedish) first published in English translation in Howard S. Ellis & Lloyd A. Metzler for the American Economic Association (eds), *Readings in the Theory of International Trade* (Blakiston, Philadelphia, 1949) pp272; and Ohlin, Bertil, *Interregional and International Trade* (Harvard Economic Series, 1933).

13 This is called Lerner's symmetry theorem. See Lerner, A. P., "The Symmetry between Import and Export Taxes" *Economica* (1936) vol 3, 306-313. See also the explanation of the theorem in Vousden, Neil, *The Economics of Trade Protection* (Cambridge University Press, Cambridge, 1990) pp45-47. For a detailed explanation of the effects of import barriers on exporters, see Clements, Kenneth W. & Larry A. Sjaastad, *How Protection Taxes Exporters* (Thames Essay No 39, Trade Policy Research Centre, London); and also GATT, *International Trade 1981/82* (GATT, Geneva, 1982) pp15-18.

general level of import barriers, we should note that import competing producers win but exporting producers lose.

CONCLUSION NO 2 - THE OVERALL LOSS OR GAIN

The above analysis shows that the imposition of an import tariff, an import quota, an export subsidy or a production subsidy, all result in a net cost to the imposing country. The cost imposed upon consumers or taxpayers exceeds the benefit provided to producers or in the case of the import tariff, the cost imposed on consumers exceeds the benefits conferred upon producers and taxpayers. Therefore, in each case, the country considered in aggregate is better off without the protection given to producers than with the protection. For any of the measures, aggregate economic welfare is decreased by introduction of the measure and increased by its removal.

Qualification - Dispersion

Another complication which is hidden in partial equilibrium analysis is the fact that in the situation where many prices in the economy are distorted then a removal of a single price distortion may not result in a move to a more efficient allocation of resources, ie, may not cause a net benefit. Such an outcome would occur if a relatively small tariff is removed leaving a relatively large tariff in place and the resources freed from the sector which previously had the small distortion are freed to move into the sector with the large distortion. However, it has been shown that a net benefit always results from the reduction in a distortion if either:

- (1) the greatest distortion is reduced down to the level of the next highest level of distortion in the economy;¹⁴ or
- (2) all distortions are reduced by an equal percentage.¹⁵

In summary, the possibility of an efficiency decreasing tariff reduction does not occur if all tariffs are reduced in proportion or if the highest tariff is reduced. Generally, increases in

14 Lloyd, PJ, "A More General Theory of Price Distortions in Open Economics" (1974) 4 *J of Int Ec* 365-386 at proposition 6 on p 379.

15 As above at proposition 8 at p379.

the dispersion of rate of protection are welfare decreasing and decreases in the dispersion of rates of protection are welfare increasing.

Qualification - The Big Country Case

The above analysis assumed that the world price was not affected by the quantity imported or exported by the home country. In fact there may be situations, although fairly rarely, where the production or consumption of a single country is significant enough to affect the world price. An important consequence of this is that a country may actually have a net gain from the imposition of an import tariff if its reduction in quantity of imports reduces the price of those imports. However, it is important to note that the size of a tariff which offers the country implementing it a net gain is likely to be a fairly small tariff because the size of such tariff has been shown to relate inversely to the responsiveness in the rest of the world's production to the change in world price.¹⁶ There are few situations where the rest of the world does not respond to the change in price. Therefore, our conclusion that a tariff reduction always causes a net benefit must be qualified to admit that, for one or two countries, a tariff reduction in respect of a small number of products might cause a net loss. However, even for those situations, a net loss is only likely to occur where the tariff is already small.

Further, even in those limited situations in which a unilateral tariff reduction might cause a net loss, it does not follow that a multilateral tariff reduction will cause a net loss because in this multilateral situation, additional benefits are received from increased export access to other markets.¹⁷

16 For a mathematical formula for the optimal import tariff see Appendix E in Lindert, *International Economics* (Irwin, Homewood, Illinois, 1986).

17 In this situation, depending on the ranking of the payoff from different forms of behaviour, the 'prisoner's dilemma' model may be appropriate to describe the benefit from multilateral tariff reductions: see Abbott, Kenneth W., "The Trading Nation's Dilemma: the Function of the Law of International Trade", (1985) 26(2) *Harv Int LJ* 501-532.

CHAPTER 6

COMPARING THE WELFARE GAINS AND LOSSES OF THE POLICY INSTRUMENTS

INTRODUCTION

The previous chapter described the welfare effects of the four principal policy instruments, concluding that all of the four principal policy instruments have the two effects of transferring wealth to domestic producers and imposing a net loss on the community. This chapter illustrates the difference between the welfare effects of border instruments and those of non-border instruments and between the welfare effects of price-based border instruments and quantity based border instruments.

1 BORDER INSTRUMENTS VS NON-BORDER INSTRUMENTS

In the last chapter, it was shown that the effects of all of the border instruments are substantially similar. Although import tariffs and import quotas decrease imports and export subsidies increase exports, all of them:

- (1) increase the domestic price thereby creating a gap between the domestic price and the world price;
- (2) have an effect on both production and consumption decisions, increasing production and decreasing consumption;
- (3) change the gap between the quantities of domestic consumption and production and, consequently, the volume of imports or exports.

It can be shown that the size of the aggregate losses for the home country are identical for each of these three instruments if they create the same gap between the world price and the domestic price. (A quota will cause the same gap as a tariff when the price rise it causes is equivalent to the per unit tariff. An export subsidy will cause the same gap when the per unit export subsidy is of the same size as the per unit tariff.) If this condition holds then an export subsidy can be regarded as representative of the whole class of border instruments in the sense that the aggregate loss to the home country is the same.

It is desired to compare the welfare transfers and the net loss caused by a border instrument with those caused by a non-border instrument which gives the same per unit assistance to domestic producers. This can be done by comparing the effects of an export subsidy with those of a production subsidy of the same per unit amount.¹

COMPARISON OF EFFECTS OF EXPORT SUBSIDIES AND PRODUCTION SUBSIDIES

We can demonstrate the difference between an export subsidy and a production subsidy by using the same example of the exportable, Product B, shown in the diagrams used in the last two chapters. This difference between the export subsidy and the production subsidy on an exportable is illustrated by the two graphs in diagram 13.

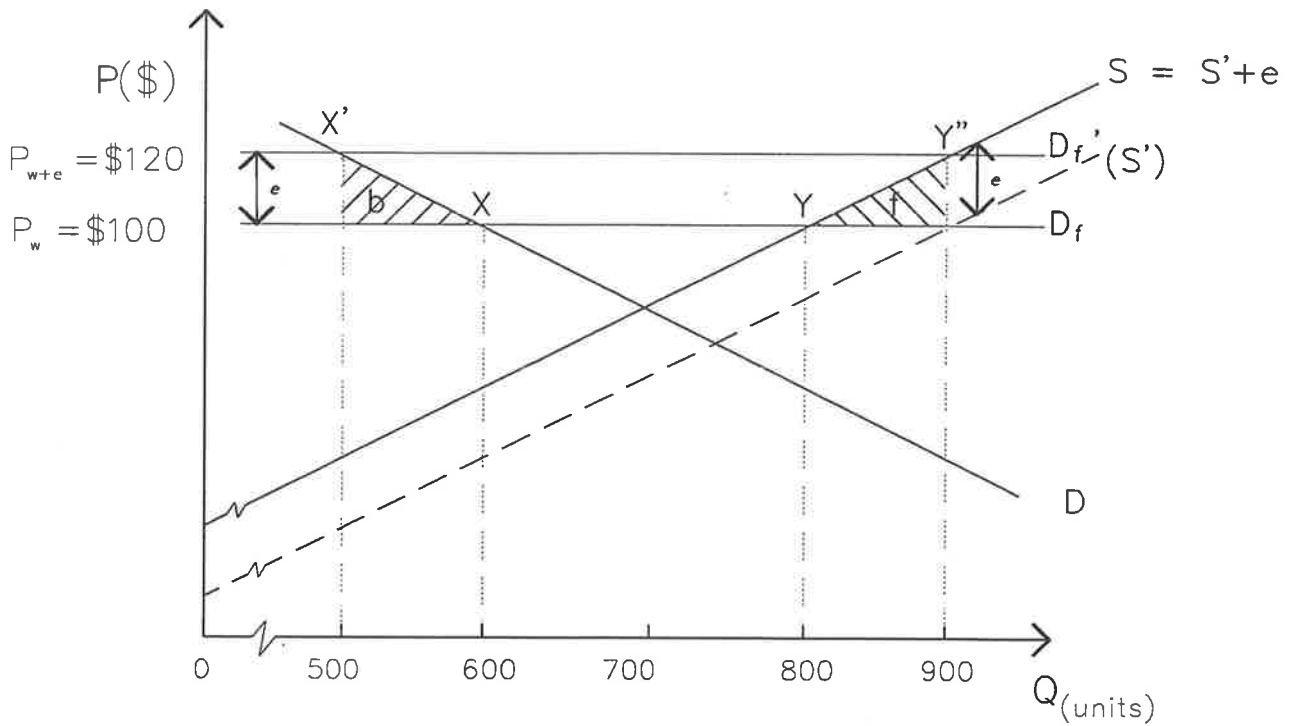
Diagram 13(a) reproduces diagram 10 showing the welfare effects flowing from the introduction of an export subsidy. As in diagram 10, the effective increase in the return on exports by the amount of the export subsidy is represented by an upward shift in the foreign demand function, from D_f to D_f' . The export subsidy changes domestic production from the quantities and price represented by the point Y to that represented by the point Y'. It changes domestic consumption from the quantities and prices represented by the point X to that represented by the point X'.

Diagram 13(b) reproduces diagram 12 showing the welfare effects flowing from the introduction of a production subsidy. As in diagram 12, the payment of the production subsidy on all units of production regardless of where they are sold is represented by a shift to the right of the domestic supply function from S to S' so that now the old supply function,

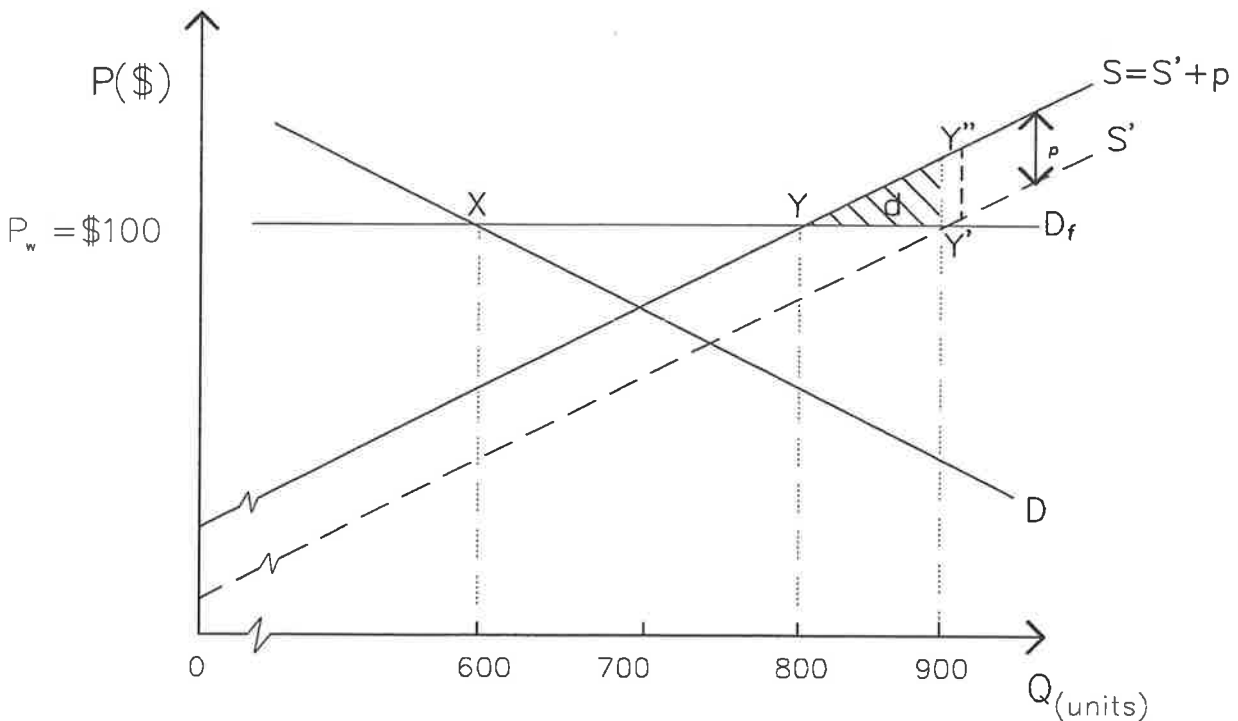
Diagram 13

BORDER INSTRUMENT Vs NON-BORDER INSTRUMENT
 COMPARISON BETWEEN WELFARE CHANGES FOR AN
 EXPORT SUBSIDY AND A PRODUCTION SUBSIDY

13. (a) EXPORT SUBSIDY



13. (b) PRODUCTION SUBSIDY



S , represents the sum of the new supply function, S' , and the subsidy, p . The production subsidy changes domestic production from the quantities and price represented by the point Y to that represented by the point Y' . The production subsidy has no effect on domestic consumption which stays at the quantity and price represented by the point X .

COMPARISON OF TRANSFERS EFFECTED BY EXPORT SUBSIDIES AND PRODUCTION SUBSIDIES

In the last chapter, the discussions of the export subsidy illustrated by diagram 10 and of the production subsidy illustrated by diagram 12 quantified the transfers to the various entities which were caused by the changes in price and quantities of consumption and production. Recall that the transfers for the export subsidy and the production subsidy on Product B were calculated as follows:

	Export Subsidy	Production subsidy
Transfer to Producers	\$17,000	\$17,000
Cost to the Government	\$8,000	\$18,000
Cost to Consumers	\$11,000	nil

Attention is drawn to the following points. First, the transfer to producers is always exactly the same for an export subsidy and a production subsidy of the same per unit size. In this case, the transfer to producers is equal to the \$20 per unit on each of the 900 units of which the \$20 per unit on the 800 units produced with or without the subsidies is wholly extra profit and the \$20 per unit on the extra units produced because of the subsidy is partly a recovery of the marginal cost of the additional units and only partly extra profit. Secondly, the cost to the government of an export subsidy is always smaller than the cost of an equivalent per unit production subsidy by the proportion that the production that is not exported bears to total production. This is because the export subsidy is paid only on that proportion of total production that is exported but the production subsidy is paid on all units of production. Finally, since a production subsidy does not increase the domestic price to

1 This exercise could also be performed by comparing the effects of a production subsidy with those of an import tariff as is done in Lindert, *International Economics*, pp150-153.

consumers, it does not impose any cost on consumers. Therefore, while the transfer to producers is the same, the production subsidy imposes all of the cost of the transfer to producers on the government whereas the export subsidy imposes part of the cost of the transfer to producers on the government but imposes the rest of the cost on consumers. All other non-border instruments impose some or all of the cost of the transfer to producers upon consumers.

COMPARISON OF DEADWEIGHT LOSSES FOR EXPORT SUBSIDIES AND PRODUCTION SUBSIDIES

In the last chapter, we noted that for both of these instruments there were some losses to consumers or to the government that were transformed into gains to producers but that there were also some losses that were not transferred to anybody, deadweight losses. We noted that both types of subsidies induced an increase in production from 800 to 900 units and that a deadweight loss resulted from this increase. The loss occurred because, on the 100 additional units, the government paid a subsidy of \$20 per unit but the producers facing a marginal cost of between \$100 and \$120 only made a profit of between zero and \$20 per unit, an average of \$10 per unit. Therefore, of the government's total loss of \$2,000, only a part was transformed into a gain to producers and the rest was not transferred to anybody. In respect of this deadweight loss caused by the production effect, that is the change in behaviour of producers, export subsidies and production subsidies are the same. These deadweight losses are represented, in the case of the export subsidy, in diagram 13(a) by the shaded area 'f' and, in the case of the production subsidy, in diagram 13(b) by the shaded area 'd'.

The other deadweight loss caused by an export subsidy is caused by the consumption effect. An export subsidy raises the price to consumers and they respond by reducing the quantity of consumption. This change in consumption represents a decrease in economic welfare for these consumers because they prefer the originally obtainable bundle of goods which included the foregone units of Product B to the bundle of goods obtainable by them when the price of Product B is increased to \$120.² This loss occurs in consequence of the export subsidy but not the production subsidy. The reason is that the export subsidy does change

the price to consumers but the production subsidy does not. The deadweight loss caused by the consumption effect is represented in diagram 13(a) by the shaded area 'b'.

Even if the production subsidy and the export subsidy are the same amount, the exact size of these deadweight losses depends upon two factors: consumers' response to price changes and producers' response to price changes. The deadweight loss caused by the production effect depends on the response of producers which depends on the marginal cost of producing additional units. However, whatever the marginal cost and whatever the size of this production effect deadweight loss, it will be exactly the same for a production subsidy and an export subsidy of the same amount. The deadweight loss caused by the consumption effect depends on the response of consumers which depends on how much more than the pre-export subsidy price is the value placed on the units not purchased after the price rise. However, whatever this value and whatever the size of this deadweight loss, it is a loss that only occurs with the export subsidy and does not occur with the production subsidy. Therefore, so long as this deadweight loss is greater than zero, that is, there is some decrease in consumption in response to a price rise, then the cost to the rest of the community of giving the same per unit assistance to producers is less with a production subsidy than with an export subsidy. This statement can be extrapolated to the other border instruments. Since the net change in welfare caused by an import tariff or an import quota is the same as that caused by an export subsidy then we can say that the difference between the net loss caused by any of the three border instruments and that caused by a production subsidy, a non-border instrument, is the deadweight loss caused by the consumption effect. In summary, the cost to the rest of the community of giving a particular per unit assistance to producers is less if it is given by a production subsidy rather than by any of the border instruments. This is an illustration of a more general principle that the cost to the rest of the community of giving a particular assistance to producers is less if it is given by a non-border instrument rather than by a border instrument.³

2 See the more detailed explanation of the consumer loss in connection with the decrease in consumption caused by an import tariff in chapter 5.

3 In the comparison between a domestic tax and a border instrument, we would find that the domestic tax causes a consumption effect but no production effect and that the difference in net loss caused by the two instruments would be the deadweight loss caused by the production effect. The more general conclusion is that regardless of whether the government objective is to adjust the quantity of consumption or the quantity of production, the total cost to the community of achieving that objective is less if non-border instruments instead of border instruments are used. However, for the sake of

CONCLUSION ON THE DIFFERENCE BETWEEN BORDER MEASURES AND NON-BORDER MEASURES

The transfer given to producers by a production subsidy and an export subsidy of the same per unit amount is the same. This is also true generally of border instruments and non-border instruments so long as they cause the same per unit increase in the price to domestic producers. However with a non-border instrument like a production subsidy, the whole of this transfer to producers is imposed on the government whereas with a border instrument some or all of the cost of the transfer to producers is imposed on consumers. Secondly, since a production subsidy does not create a gap between the domestic consumer price and the world price, it does not reduce domestic consumption. It does have a production effect but no consumption effect. Therefore, although both border instruments and non-border instruments impose a net cost on the community, for a border instrument and a non-border instrument which provide the same per unit assistance to producers, the non-border instrument imposes a lesser net cost upon the rest of the community than the border instrument.

2 PRICE-BASED BORDER INSTRUMENTS VS QUANTITY BASED BORDER INSTRUMENTS

The end of chapter 3 made the distinction between price-based border instruments and quantity based border instruments. However, so far this analysis has not discovered any significant differences in the effects of these two classes of instruments. In fact, chapters 3 and 4 showed that the effects of import tariffs and import quotas are very similar. They produce identical changes in price and quantities and depending on the method of allocation of quotas will produce exactly the same transfers of economic surplus and exactly the same deadweight loss to the economy as a whole. However, these observations are only true for a particular point in time when all relevant factors are fixed.

When one looks at the two instruments over time as various factors change then some important differences emerge. It is important to analyze the effects of changes over time to those factors which alter the size of the gap between the domestic price and the world price.

simplicity of this exposition and given that the problems of agricultural trade arise out of border instruments and subsidies, I have chosen to deal with only the four principal policy instruments and to regard production subsidies as representative of all non-border measures.

Such an alteration can arise from a change in the domestic producers' production costs or in consumers' income or tastes, or from external factors such as a change in the world price or a change in the foreign exchange rate. We can analyse these changes by comparing the effect of these changes on the welfare effects of import tariffs and import quotas.

2.1 THE EFFECT OF AN INCREASE IN DOMESTIC PRODUCTION COSTS

An increase in domestic costs might be caused by an increase in the price of an input such as materials or labour or by a decrease in productivity. Since producers maximize profit by supplying additional units until marginal cost equals marginal revenue, then the marginal cost determines the price at which producers are willing to supply any given quantity or, in other words, the quantity that they are willing to supply at any given price. Therefore, an increase in domestic costs can be represented as an upward shift in the supply function, S .

Diagrams 14 and 15 show the welfare effects of an upward shift in the supply function in the situations, respectively, in which an import tariff and an import quota are in place. In both diagrams, the original supply function is represented by S and the supply function after the cost increase is represented by S' .

Effects of An Increase in Production Costs with an Import Tariff in Force

Diagram 14 is based on diagram 10 which shows the welfare effects of an import tariff where the original supply function, S , is in place. It shows that the import tariff of \$20 causes the quantity and price of domestic production to be that represented by the point Y' instead of that represented by the point Y as it would be in the absence of the import tariff and that it causes the quantity and price of domestic consumption to be that represented by the point X' instead of that represented by the point X as it would be in the absence of the import tariff. As shown in diagram 10, the existence of these changes in price and quantity cause transfers from consumers to domestic producers and to the government but some part of the losses are not transferred to anyone. These deadweight losses caused by an import tariff are represented by the shaded triangles marked 'a' and 'b': 'a' representing the deadweight loss caused by the production effect and 'b' representing the deadweight loss caused by the consumption effect.

After the supply function has shifted to S' , the new level of domestic production which would be produced at the world price (\$120) would be the quantity indicated by the point Z' . The change in production costs would not change the level or price of domestic consumption which are still represented by the point X' . One can measure the cost of the import tariff under the new cost conditions by comparing the economic welfare of the various entities with the import tariff in place with what their economic position would be if the import tariff were not in place. With the new S' function, the existence of the import tariff is transferring resources away from consumers in favour of producers and the government because it makes the price to domestic consumers and producers \$20 higher than it would be without the import tariff. In this situation, the cost to consumers exceeds the benefits to others by the amounts represented by the two triangles 'c' and 'b': 'c' representing the deadweight loss caused by the production effect and 'b' representing the deadweight loss caused by the consumption effect. A precise measurement of these deadweight losses would show that they are of the same size as those caused by the same tariff imposed in the situation with the original level of production costs.⁴ In fact, regardless of the level of production, the import tariff always causes a gap between the world price and the domestic price equal to the size of the import tariff. Under the assumptions made here, the size of the reduction in the quantity of consumption, the size of the increase in volume of domestic production, the size of the corresponding decrease in volume of imports and, it is emphasized, the deadweight losses caused by the tariff are exactly the same regardless of the level of domestic production costs.

Effects of An Increase in Production Costs with an Import Quota in Force

Diagram 15 is based on diagram 4 showing the changes in price and quantity caused by an import quota where the original supply function, S , is in place. Diagram 4 showed that, in the example used with the original level of domestic production costs, the import quota of 200 units caused exactly the same changes in quantities and prices as did the import tariff of \$20. The import quota of 200 units causes the quantity and price of domestic production to be that represented in diagram 15 by the point Y' instead of by the point Y as it would be in

4 It necessarily flows from the facts that in both situations the difference between the price with the tariff and the price without the tariff is the same and that the S function is assumed to be a straight line, that the areas 'c' and 'a' must be the same size.

the absence of the import tariff and causes the quantity and price of domestic consumption to be that represented by the point X' instead of that represented by the point X as it would be in the absence of the import tariff. In particular, note that as with the import tariff, the import quota causes the domestic price to be \$120 instead of the \$100 that it would be in the absence of the import quota. As noted in the last chapter, the welfare effects of this import quota were almost exactly the same as for the import tariff⁵ and that the deadweight losses caused by an import tariff were exactly the same as those caused by an import tariff. These deadweight losses caused by an import quota are represented by the shaded triangles marked 'a' and 'b': 'a' representing the deadweight loss caused by the production effects and 'b' representing the deadweight loss caused by the consumption effect.

With this import quota in place, a shift in the supply function to S' means that at the market price of \$120, domestic producers are now willing to supply a lesser quantity of Product A (the quantity indicated by Z') than they were when their costs (and willingness to supply) were represented by the former supply function, S (the quantity indicated by Y'). This means that at \$120, the quantity demanded (indicated in diagram 15 by the point X') exceeds the total supply which is made up of the quantity that domestic producers are prepared to supply (indicated by the point Z') plus the 200 units permitted under the import quota. Therefore, consumers bid the price up. As the price goes up domestic producers are prepared to supply more. An equilibrium would be reached at the price and quantities of production and consumption indicated respectively by the points Z'' and X''. Under the new cost situation, the equilibrium price has increased from \$120 to \$130.

One can measure the cost of the import quota under the new cost conditions by comparing the economic welfare of the various entities with the import quota in place with what their economic position would be if the import quota were not in place. With the new supply function, S', the existence of the import quota is transferring resources away from consumers in favour of consumers and (depending how the quota is allocated) to the government because it makes the price to domestic consumers and producers \$30 higher than it would be without the import quota. Since this gap between the world price and the

5 The only difference is that the person to whom the extra cost imposed on consumers in respect of the units imported with and without the import quota can vary depending on the method of allocation of the quota.

domestic price is \$30, then the transfers from consumers to others are larger than when the gap between the world price and the domestic price was only \$20. In this situation, as in the situation for the import tariff, the cost to consumers exceeds the benefits to others because there is a deadweight loss caused by the production effect which is represented in diagram 15 by the shaded area 'A' and there is a deadweight loss caused by the consumption effect which is represented by the shaded area 'B'. It is clear from the diagram that the triangles A and B are larger than the triangles 'a' and 'b'. This is representative of the deadweight losses being larger for the same import quota when the domestic producers costs are higher.

The Difference Between the Effect of an Increase in Domestic Costs on an Import Tariff and an Import Quota

The above analysis shows that the increase in the domestic production costs had no effect on either the size of the welfare transfers or the deadweight losses caused by the maintenance of an import tariff but that the increase in domestic production costs increased the size of the welfare transfers and the deadweight losses caused by the maintenance of the import quota. The reason for the difference relates to the size of the gap between the domestic price and the world price which is caused by the import restriction. Whereas under the original production cost conditions, the import quota of 200 units caused a gap between the domestic price and the world price of \$20, under the higher production cost conditions, this gap is \$30. However, the import tariff of \$20 causes a gap between the domestic price and the world price of \$20 regardless of the level of domestic production costs. We conclude that even though the transfers and net losses imposed by an import tariff and an import quota may initially be the same, if there is a subsequent increase in production costs, then cost of maintaining the import quota increases but the cost of maintaining the import tariff stays the same.

2.2 THE EFFECT OF INCREASING DOMESTIC DEMAND

The situation of increasing domestic demand is similar to the situation of rising domestic costs. With an import tariff, as domestic demand increases, the extra demand is supplied by imports, there is no upward pressure on the domestic price and the deadweight losses caused by the tariff are unchanged. With an import quota, as domestic demand increases, given the absolute limit on imports, the extra demand is supplied by domestic producers who are able

to increase the domestic price. The gap between the domestic price and the world price increases and the size of both the transfers and the deadweight losses increases.

2.3 THE EFFECT OF A FALL IN THE WORLD PRICE

A fall in the world price can occur because of a fall in price of the particular good or it may occur because of a change in the exchange rate. If the price of foreign currency measured in terms of the domestic currency falls, then the price of the imported good measured in terms of the domestic currency also falls. Whether the price change is caused by a price fall in the goods market or in the currency market, the effect is the same: consumers can buy from foreigners more cheaply. This price reduction has a different effect if there is a tariff in place compared to that it has if a quota is in place.

Diagrams 16 and 17 are based on diagrams 3 and 4 which respectively show the situations where an import tariff of \$20 and an import quota of 200 units have had the same effects: changing the price and quantity of domestic production from that indicated by the point Y to that indicated by the point Y'; and changing the price and quantity of domestic consumption from that indicated by the point X to that indicated by the point X'; and, in particular, creating the same gap of \$20 between the world price of \$100 and the domestic price of \$120. As shown in Diagram 10, the existence of these changes in price and quantity cause transfers from consumers to domestic producers and (certainly for the tariff but also for the quota depending on the method of allocation) to the government but some part of the losses to consumers are not transferred to anyone. These deadweight losses caused by an import tariff are represented in both diagrams 16 and 17 by the shaded triangles marked 'a' and 'b': 'a' representing the deadweight loss caused by the production effect and 'b' representing the deadweight loss caused by the consumption effect.

Diagrams 16 and 17 also illustrate the impact of a fall in the world price from P_w (\$100) to P_w' (\$60) upon, respectively the situation where the tariff of \$20 is in place and the situation where the quota of 200 units is in place. In both diagrams, the fall in the world price is represented by a shift in the function for supply from foreigners from $S_f(P_w)$ to $S_f(P_w')$.

Effect of a Fall in the World Price with an Import Tariff in Force

Diagram 16 shows the impact of the fall in the world price from P_w (\$100) to P_w' (\$60) on the situation where a tariff is in place. With the world price at \$60, consumers will have to pay \$60 to foreign sellers and \$20 to the government: a total of \$80. This price that has to be paid for imports is represented by the effective foreign supply function $S_f'(P_w'+t)$. Competing against a price of \$80, domestic producers also set their price at \$80. This increase in price caused by the tariff causes the price and quantity of domestic consumption to be that represented by the point W' instead of that represented by the point W as it would be in the absence of the import tariff and it causes the price and quantity of domestic production to be that represented by the point Z' rather than that represented by the point Z as it would be in the absence of the import tariff.

One can measure the cost of the import tariff in the situation in which the lower world price prevails by comparing the economic position of the various entities with the import tariff in place with what their economic position would be if the import tariff were not in place. At the lower world price, the import tariff is still transferring resources away from consumers in favour of producers and the government because it makes the price to consumers and producers \$20 higher than it would be without the import tariff. The cost to consumers exceeds the benefits to others by the amounts represented by the two triangles 'a' and 'b': 'a' representing the deadweight loss caused by the production effect and 'b' representing the deadweight loss caused by the consumption effect. A precise measurement of these deadweight losses would show that they are of the same size as those caused by the tariff in the situation of the original level of the world price. In fact, regardless of the level of the world price, the import tariff always causes a gap between the world price and the domestic price equal to the size of the import tariff. Under the assumptions made here, the size of the reduction of the quantity of consumption, the size of the increase in volume of domestic production, the size of the corresponding decrease in volume of imports and, it is emphasized, the deadweight losses caused by the tariff are exactly the same regardless of the level of the world price.⁶ Even if the assumptions which determined that the supply and

⁶ This is a slight simplification. If the tariff is a fixed percentage of the price then the absolute amount of the tariff will depend on the price level. If the price level changes so the absolute size of the tariff changes and the absolute size of the gap between domestic price and world price changes.

demand functions are linear break down, it is still true that the size of all of the abovementioned effects is limited by the size of the gap between the world price and the domestic price which is set by the amount of the import tariff.

Effect of a Fall in the World Price with an Import Quota in Force

Diagram 17 shows the impact of the same fall in the world price on the situation where an import quota is in place. As said above, the fall in the world price is represented by a shift in the function for foreign supply from S_f to $S_f'(P_w')$. With an import quota in place, the quantity of imports necessarily stays at 200 and without any increase in imports, there is no pressure for the domestic price to fall. So the fall in the world price does not cause any reduction in the domestic price. The quantities and price of domestic production and domestic consumption stays the same at the levels represented by the points Y' and X' as they were before the fall in the world price. Most importantly, the domestic price remains at \$120 and the gap between the domestic price and the world price increases to \$60. It is emphasized that with the lower world price, the maintenance of the import quota is causing the domestic price to be \$60 higher than it would be in the absence of the import quota.

One can measure the cost of the import quota in the situation in which the lower world price prevails by comparing the economic position of the various entities with the import quota in place with what their economic position would be if the import quota were not in place. At the lower world price, the maintenance of the import quota results in a transfer of resources away from consumers and (depending how the quota is allocated) to the government because the import quota makes the price to domestic consumers and producers \$60 higher than it would be in the absence of the import quota. When this gap between the world price and the domestic price is \$60, the transfers from consumers to others are larger than when the gap between the world price and the domestic price was only \$20. In this situation, as in the situation for the import tariff, the cost to consumers exceeds the benefits to others because there is a deadweight loss caused by the production effect which is represented in diagram 17 by the shaded area marked 'A' and there is a deadweight loss caused by the consumption effect which is represented by the shaded area 'B'. It is clear from Diagram 17

Accordingly the size of the deadweight loss triangles will also change. This is not a significant change in size compared to that which occurs under a quota regime.

that the triangles 'A' and 'B' are larger than the triangles 'a' and 'b'. This is illustrative of the fact that the deadweight losses become larger for the same import quota if the world price falls.

The Difference Between the Effect of a Fall in the World Price on an Import Tariff and an Import Quota

Therefore, there is a clear difference in the effect of the change in the world price. With a tariff, the fall in the world price does cause a fall in the domestic price but with a quota the fall in the world price does not flow on at all to the domestic price. Consequently, there is also an important difference in terms of the welfare effects caused by the maintenance of the two instruments and in terms of the net deadweight losses caused by the two instruments. The above analysis shows that the fall in the world price (whether through a fall in the foreign exchange denominated price or through an appreciation in the exchange rate) had no effect on either the size of the welfare transfers or the deadweight losses caused by the maintenance of an import tariff but that the price reduction increased the size of the welfare transfers and the deadweight losses caused by the maintenance of an import quota. The reason for the difference relates to the size of the gap between the domestic price and the world price which is caused by the import restriction. Whereas, at the original world price, the import quota of 200 units caused a gap between the domestic price of \$20, at the lower world price, this gap is \$60. However, the import tariff of \$20 caused a gap between the domestic price and the world price of \$20 regardless of the level of domestic production costs. We conclude that even though the transfers and net losses imposed by an import tariff and an import quota may initially be the same, if there is a subsequent fall in the world price, then the cost of maintaining the import quota increases but the cost of maintaining the import tariff stays the same.

CONCLUSION - ON THE DIFFERENCE BETWEEN PRICE-BASED BORDER INSTRUMENTS AND QUANTITY-BASED BORDER INSTRUMENTS

The above analysis shows that the deadweight loss to an economy which adopts an import tariff is fixed regardless of any subsequent changes in factors affecting the domestic price or the world price. The analysis also shows that the deadweight loss to an economy adopting an import quota may increase as a consequence of such subsequent changes: where domestic

costs increase, domestic demand increases, the world price falls or the exchange rate appreciates. Conversely, if domestic costs decrease, domestic demand decreases, the world price rises or the exchange rate depreciates, then the protection given by a quota and the deadweight loss caused by it may decrease. This is an important difference between the two instruments. It means that when a country adopts an import tariff, there is a quantifiable limit to the size of the gains being conferred on producers and the government and on the size of the losses being imposed on consumers and crucially that there is a quantifiable limit on the total net cost to the whole country that is incurred, but when a country adopts an import quota there is no limit to these transfers and no limit to the net decrease in economic welfare.

3 SUMMARY OF CONCLUSIONS

This exposition contained in these last three chapters support some important propositions about the differences between the effects of border instruments and non-border instruments and between those of price-based border instruments and quantity-based border instruments:

BORDER INSTRUMENTS VS NON-BORDER INSTRUMENTS

1 The Net Loss

The same level of assistance to producers can be provided at a lower net cost to the rest of the community if the assistance is provided by way of a non-border instrument like a production subsidy rather than by a border instrument.

2 The Transfers

The same transfer can be given to producers by a border instrument or a non-border instrument. With a non-border instrument, the whole of the cost of the transfer to producers is incurred by the government (or taxpayers) but with a border instrument, the cost of the transfer to producers may be imposed partly on the government and is always imposed either partly or fully on consumers.

PRICE-BASED VS QUANTITY-BASED BORDER INSTRUMENTS

1 The Net Cost

If a border instrument is used to provide assistance to an import competing industry, then in the face of possible changes to domestic costs, domestic demand, world price or exchange rates, the net cost to the rest of the community is limited in size if the border instrument used is price-based like an import tariff but that cost is unlimited if it is quantity-based like an import quota. The size of the deadweight loss will increase if domestic costs increase, domestic demand increases, the world price falls or the exchange rate appreciates.

2 The Transfers

If a border instrument is used to provide assistance to an import competing industry, then in the face of the abovementioned possible changes, the transfers to producers from consumers are limited in size if the border instrument used is price-based like an import tariff but those transfers are unlimited if it is quantity-based like an import quota. The size of these transfers will increase if domestic costs increase, domestic demand increases, the world price falls or the exchange rate appreciates.

IMPORTANCE OF THE CONCLUSIONS

These conclusions provide important information relevant to considering how GATT rules should be formulated so as to be in the self interest of parties. They also provide important information as to which sections of the community have the economic incentive to support or oppose protection or assistance. This aspect is pursued in the next chapter.

CHAPTER 7

POLITICAL DECISION-MAKING WITHIN STATES ABOUT THE PRINCIPAL POLICY INSTRUMENTS

1 INTRODUCTION

The above economic analysis offers some indication of the decisions that communities might make with respect to protection of and assistance to producers.

With respect to the level of protection, the analysis shows that a decision to increase the level of protection causes a net loss to the community. Therefore, it is reasonable to expect that a government acting with the objective of maximizing the welfare of the community would be more inclined to decide to reduce protection rather than to increase it. We noted two possible exceptions to this which might apply to a specific decision on whether to grant protection in respect of a particular product: where the country is so large as to be able to influence price, in which case a positive but low level of protection might maximize national welfare; and where the decision relates to whether to grant protection in respect of a product which has a low level of protection compared to the level of protection applying to the other production of the economy, in which case the increase might have a net positive effect on welfare because it might shift productive inputs away from the heavily protected industry into the less protected industry.

With respect to the choice of instrument of protection, the analysis shows that protection imposes a larger reduction in welfare of the community if given by a non-border instrument rather than by a border instruments and an unlimited reduction in welfare if given by a quantity-based border instrument rather than a limited reduction if given by a price-based instrument. Therefore, it is reasonable to expect a government acting with the objective of maximizing the welfare of the community to provide any given level of assistance by non-border instruments rather than border instruments and, if any protection is to be given by

border instruments, to provide that protection by price-based border instruments rather than by quantity-based border instruments.

The analysis also shows that whenever any of these instruments are implemented, producers win and consumers and/or taxpayers lose. Typically, there are more people losing than winning. Therefore, one would expect that if in a national referendum on whether to adopt a particular instrument each loser voted 'no' and each winner voted 'yes', then the result would always be a 'no' vote. The median voter "(the one who makes a majority out of a minority)"¹ would always lose from protection and would vote against it.

We noted at the end of chapter 5 that the partial equilibrium analysis failed to bring out the fact that the general level of import barriers also imposed a loss on exporters. Taking this into account would reinforce our expectation that the community would not choose protection. We should also note that the partial equilibrium analysis hides some other gains and losses. The most important of these would be the possible flow on effect from protection on wage levels. The effects of protection on wages in a sector which is labour intensive and which employs a large proportion of the labour force may flow on to the level of wages in other sectors causing a loss to employer/capital owners and a gain to employees in other sectors. Assuming the number of employees to exceed the number of employers, then we would expect this overflow effect to introduce a larger number of winners than losers from the protective policy. The numbers of these additional winners and losers might even outweigh the otherwise existing majority of losing consumers and taxpayers over gaining producers. However, we could expect this factor to be significant only where the number of labourers in the sector to be protected was large enough to affect the economy wide labour market. Therefore, on the basis of this factor, we would qualify our expectation

1 Frey, Bruno S. & Weck-Hannemann, Hannelore, "The Political Economy of Protection" ch8 in David Greenaway (ed), *Current Issues in International Trade* (Macmillan Press, Houndmills, Basingstoke, Hampshire & London, 2nd ed, 1996) p154-173. Frey also makes the point that "either a majority of the electorate benefits directly, or the gains accruing to a minority can be redistributed so that a majority of the electorate is better off." (p155) However, such redistributions are exceptional. It is, in fact, the very absence of those redistributions that causes the demand for protection. However, the number of affected consumers would be larger than the number of affected producers in most cases. The absolute number of winning producers could only exceed the number of losing consumers in fairly limited situations: eg, where the product is such that it takes a large number of people to produce it but only a small number of people buy any; or where the number of domestic consumers for the product is small but export demand sustains a very large number of domestic producers (although this scenario is irrelevant to the case of import competing industries).

of political decision making based on economic gains and losses so that, generally, we would expect voters and governments to reject protection except perhaps where the sector to be protected employs a large proportion of the labour force.

This expectation that governments or voters would reject protection is not confirmed by even the most cursory observation of the extent to which countries actually do employ various protective policy instruments. Nor is the expectation that governments would choose the least costly policy instrument confirmed by observation, for border instruments are prevalent and quantitative border instruments are widespread. In particular, we can observe the peculiar feature that protection tends to be granted in favour of minority sections of the population against the apparent interest of the majority. This is at odds with the expectation that those instances where protection is chosen would be in sectors employing large proportions of the labour force. This is a prominent feature of the way governments treat the agricultural sector: for in countries where farmers are a relatively small minority of the population, governments tend to offer substantial protection and support to the agricultural sector and, conversely, in countries where farmers are a majority of the population, governments tend to tax the agricultural sector.² Further, it is countries where the farming sector is quite a small minority like Japan that there is a prevalence of the most costly instruments of protection.

Why is there such a discrepancy between the outcome that one would expect from a rational welfare maximizing choice and the actual outcome? Why is it that the political decision making process does not reach the outcome that we would expect from a referendum with voters deciding on the basis of their economic gain or loss?

Political scientists and political economists have generated theories to explain government decision making in general and also specifically in relation to trade protection decisions.³ In

2 See Anderson, Kym, "Lobbying Incentives and the Pattern of Protection in Rich and Poor Countries" (1995) 43(2) *Economic Development and Cultural Change* 401-423 and Anderson, Kym, "International Dimensions of the Political Economy of Distortionary Price and Trade Policies" in I. Goldin & L.A. Winters (eds), *Open Economies: structural adjustment and agriculture* (Cambridge University Press, Cambridge, 1992) pp290-310 at pp290-296; Anderson, Kym & Hayami, Yujiro, *The Political Economy of Agricultural Protection* (Allen & Unwin, Sydney, 1986) p1-3.

3 Two of the foundation works on political behaviour and political lobbying are Downs, Anthony, *An Economic Theory of Democracy* (Harper & Brothers, New York, 1957) and Olson, Mancur, *The Logic of Collective Action* (Harvard University Press, Cambridge, Mass., 1965). Of the writings

particular, some theories have focussed on the choice of policy instrument.⁴ Some theories deal with politics between states and others with politics within states. Like the preceding analysis of economic welfare, this exposition focuses on theories of politics within states.⁵ Models of the behaviour of governments and political decision makers have been successful to a significant degree in explaining and predicting the policies adopted by various countries. It is not intended to attempt to explain the various models and especially not the quantitative aspects of them. It is intended only to offer an explanation sufficient to give an overview of the reasons that various writers have suggested for the divergence between the actual political outcome and the outcome that would be expected on the basis of the economics set out above.

It is useful to separate two possible reasons for that divergence. Either the political decision making process is reaching the same decisions that would be made by a referendum of well informed voters voting according to whether they win or lose from the particular policy decision or it is not. If it is, then there must be some factors other than economic gain or

specifically directed to government decisions about protection, this thesis draws heavily upon Anderson, Kym, "Lobbying Incentives and the Pattern of Protection in Rich and Poor Countries" (1995) 43(2) *Economic Development and Cultural Change* 401-423; Anderson, Kym, "International Dimensions of the Political Economy of Distortionary Price and Trade Policies" in I. Goldin & L.A. Winters (eds), *Open Economies: structural adjustment and agriculture* (Cambridge University Press, Cambridge, 1992) pp290-310; Anderson, Kym, "The Political Market for Government Assistance to Australian Manufacturing Industries" (1980) 56 *Economic Record* 132-144; Baldwin, Robert E, "The Political Economy of Protectionism" in Jagdish N Bhagwati (ed), *Import Competition and Response* (University of Chicago Press, Chicago & London, 1982) p263-286; Frey, Bruno S. & Weck-Hannemann, Hannelore, "The Political Economy of Protection" ch8 in David Greenaway (ed), *Current Issues in International Trade* (Macmillan Press, Houndmills, Basingstoke, Hampshire & London, 2nd ed, 1996) p154-173; Grossman, Gene M. & Helpman, Elhanan, "Protection for Sale" (1994) 84(4) *American Economic Review* 833-850 and Vousden, Neil, *The economics of trade protection* (Cambridge University Press, Cambridge, 1990, chapter 8 "Endogenous Protection" pp177-199. For other sources, see the bibliography attached to Anderson, Kym, "International Dimensions of the Political Economy of Distortionary Price and Trade Policies" in I. Goldin & L.A. Winters (eds), *Open Economies: structural adjustment and agriculture* (Cambridge University Press, Cambridge, 1992) pp290-310. For a more extensive bibliography, see AL Hillman, *The Political Economy of Protection* (Harwood Academic, New York, 1989) and for a review of literature see p32-34 of Magee, Stephen P., *Black Hole Tariffs and Endogenous Tariff Policy* (Cambridge University Press, Cambridge, 1989).

- 4 Eg, Deardorff, Alan V., "Why do Governments Prefer Nontariff Barriers?" (1987) 26 *Carnegie-Rochester Conference Series on Public Policy* 191-216; Lloyd, Peter J. & Falvey, Rodney E., "The Choice of Instrument for Industry Protection" in Snape, R.H., *Issues in World Trade Policy: GATT at the Crossroads* (Macmillan, London, 1986) pp152-170; and Coate, Stephen & Morris, Stephen, "On the Form of Transfers to Special Interests" (1995) 103(6) *Journal of Political Economy* 1210-1235.
- 5 On theories of politics between states see Abbott, Kenneth W., "The Trading Nation's Dilemma: The Functions of the Law of International Trade" (1985) 26 *Harvard International Law Journal* 501 and

loss that would affect the decisions of voters.⁶ If it is not, then it must be that the political decision making process does not accurately transmit the wishes of voters. The first possibility requires a consideration of factors which influence voters that are not reflected in the economic analysis above: factors other than the voter's own economic gain or loss which influence the way that voters decide how to vote. The second possibility requires a consideration of the way that government decisions on protection are made and the way that those who win and lose from protective policies have input into the decision on whether to adopt the policy: the significance of the size of the wins and losses as well as the number of winners and losers, the availability and acquisition of information about the wins and losses and the role of governments, voters and lobby groups.

We will consider each of these matters generally and in our conclusions also in relation to the agricultural sector. In examining these factors, it is intended to explain not only why governments choose to give any form of protection but also why governments would choose to use any one of the four principal instruments in preference to the others: more generally, why they would use a quantity-based border instrument rather than a price-based border instrument and why they would use a border instrument rather than a non-border instrument.

2 THE IMPACT OF NON-ECONOMIC REASONS

If there is no divergence between the choices made by political decision making and by referenda and it is the case that a referendum of well informed voters would choose protection then it must be that many voters favour protection even though they lose financially from it. We need to consider why voters who will knowingly lose financially from introduction of a policy to transfer wealth from themselves to a particular sector will still vote in favour of adopting it. There are a number of possible reasons for this which are dealt with below.⁷ Although this chapter is primarily devoted to analysis of political

see the works cited in Grossman, Gene M. & Elhanan Helpman, "Trade Wars and Trade Talks" (1995) 103(4) *Journal of Political Economy* 675 at 676.

6 Implicit in this statement is that we can distinguish between economic factors and non-economic factors. Recall the discussion at the beginning of chapter 3 on the problems associated with a dichotomy between economic and non-economic matters. There, the writer proceeded on the basis that matters not reflected in market prices were non-economic.

7 Discussions of most of these arguments appear in Lindert, *International Economics* (Irwin, Homewood, Illinois, 1986) ch 7 at 143-165; in Ethier, *Modern International Economics* (WW Norton & Co, London, 1988) ch 5 at 191-218; in Anderson, Kym & Ross Garnaut, *Australian Protectionism - Extent, Causes and Effects* (Allen & Unwin, North Sydney, 1987) pp29-34; and in Blackhurst, R.,

pressures for protection generally, in some instances, attention is drawn to the relevance of a particular matter to agricultural protection.

SOME NON-ECONOMIC REASONS

Strategic Industry Development

Governments and voters may not wish to leave it to the market to determine which sectors of the economy may develop in the future and may make deliberate attempts to bring about a change in an industry's competitive position from that which is expected to occur. They may wish to establish particular industries because they are expected to be profitable industries in the future. The competitive position of a country in a particular industry may be expected to change over time and the government may take the view that the market alone will not develop the industry as quickly as is desirable. Voters may be sympathetic if they believe that the industry is one that will generate wealth for the country in the future.

National Security

There may be a view that various industries would be important to a war effort. For example, aircraft manufacturing facilities might be needed in time of war. However, the argument has also been stretched to justify protection of items of marginal relevance to security.⁸ The argument has some application to agriculture. Voters may wish to avoid the possibility of becoming dependent on other countries for food supplies which might be cut off during wartime.

Self-Sufficiency

It may be argued that the nation should have a certain level of self-sufficiency in particular production. This argument is related to the national security argument. Governments may desire not to be dependent upon external sources of supply for fear of the possible interruption in supply. For the same reasons, governments may establish emergency stocks

Marian, N. & Tumlrir J., *Trade Liberalization, Protection and Interdependence* (GATT, Geneva, 1977) pp29-40.

8 Lindert cites the "president of the Footwear Industry of America" saying "with a straight face" that "improper footwear can lead to needless casualties and turn sure victory into possible defeat". See Lindert, Peter H., *International Economics* (Irwin, Homewood, Illinois 1986) at p162 quoting from the "president of the Footwear Industry of America" as quoted in *Far Eastern Economic Review*, October 25, 1984, p70.

of some products or may try to diversify their sources of supply. This is particularly applicable to food production. It is argued that food self-sufficiency ensures that, in time of war, a country cannot be deprived of food.⁹

A Redistribution of Wealth

Voters may wish to redistribute wealth from consumers or taxpayers in favour of capital owners and labourers in a particular sector of production, even though they will have to pay higher prices or higher taxes. Sympathy may be aroused for workers in struggling industries simply because of the unemployment that they may face, particularly if the work force in that industry is above an age at which retraining is easily undertaken. Voters may be sympathetic to maintaining returns to owners of agricultural land because they perceive that these land owners make a positive contribution to the rural life of the country or to environmental care of the land. Sympathy with particular capital owners may exist where the name of the firm has an established positive reputation in the community.

Redistribution of Wealth on a Regional or Ethnic basis

A number of countries have regions within which a particular industry is the dominant supplier of employment and income. This means that a change to protection relating to such an industry may disproportionately affect the inhabitants of a particular region. This makes the identification of those losing from trade liberalization relatively easy and may increase the likelihood that other citizens are sympathetic.

This phenomenon may be compounded if the occupants of such a region are predominantly of a particular ethnic group. In this case, governments and voters may be even more sympathetic either because they identify with that ethnic group or because they wish to avoid diminishing ethnic harmony within the nation.

National and Cultural Identity

Governments and voters tend to be sympathetic to support for an industry if there is a connection between that industry and their image of their nation. Arguably, examples of these kind of connections, at various times, would be between farming and most northern

9 For an elaboration and criticism of this argument, see Winters, L. Alan, "Digging for Victory:

European countries, between motor vehicle manufacturing and the United States or between clock making and Switzerland.

Mitigating Expected Change and Avoiding the Risk of Change

Profitability is affected by a range of factors many of which are not within the control of producers. There tends to be sympathy for those who are becoming poorer as a result of changes that are not within their control. Corden called this factor the Conservative Social Welfare Function: that is, a determinant of welfare preferences of citizens which reflects a desire not to see any single group of society made worse off.¹⁰ If this tendency to act to avoid the consequences of change and to avoid initiating change which would adversely affect any group does exist, then it could account for some of the tendency toward protection.

NON ECONOMIC REASONS AND AGRICULTURE

The above arguments reflect a consistent and recurring theme: that the national interest is served by developing or maintaining particular economic sectors. In developed countries, agriculture tends to be regarded as one such sector. The agricultural sector has the distinctive feature that it produces food. It is argued, often with emotional pleas, that the national interest is served by national self sufficiency in food. For time immemorial, food has been a necessary preoccupation of humanity because the absence of food necessarily means death. Famines and food shortages loom large in the collective memories of nations. Often food shortages occur in the context of wars and there is an intuitive association between self-sufficiency in food and national security. Therefore, it is argued that nations cannot be required to become dependent on other nations for their food supply.

The distinctiveness of agriculture does not end there. Agriculture is subject to nature. Weather cannot be controlled. Little control can be exerted over the time that must pass between a tree being planted and it bearing fruit or an animal being born and it producing offspring. As a result of agriculture's dependence on nature, there are certain

10 Agricultural Policy and National Security" (1990) 13(2) *The World Economy* 170-190.
Corden, W.M., *Trade Policy and Economic Welfare* (Clarendon Press, Oxford, 1974) pp107-112 ;
See the discussion of the Conservative Social Welfare Function in Winters, L Alan, "The political

unpredictabilities about the quantity of production and certain unavoidable time lags between decisions to change production and the resulting altered production.¹¹ Therefore, it is argued, nations cannot be expected to fetter their ability to adopt appropriate policies to respond to changing conditions.

In addition, the techniques of production in agriculture have been constantly and rapidly affected by change. Naturally this has affected the competitiveness of those that do not change or are slower to change. Often such producers are able to convince the nation to provide protection to mitigate the effects of rapid changes and to allow time for modernization and adjustment.¹²

It is also argued that maintenance of the agricultural sector is important to regional development, racial harmony, employment, demographics, physical attractiveness of the country, and culture.

CONCLUSIONS ON NON-ECONOMIC OBJECTIVES

The existence of non-economic objectives can explain the apparent discrepancy between actual political decision making and the outcome that one would expect on the basis of rational maximization of economic welfare. The existence of non-economic objectives and the satisfaction gained by achieving them may mean that a majority of well informed citizens acting to maximize their own welfare would vote in favour of a grant of protection and a government making the same decision would in fact be making a welfare maximizing choice. Therefore, the existence of non-economic objectives might mean that there would not be any difference between a decision made by referendum and one made by other ordinary political processes. However, in the absence of actually holding the referendum, it is difficult to verify that the same decision is being reached.

economy of the agricultural policy of industrial countries" (1987) 14 *European Journal of Agricultural Economics* 285-304 at 292.

11 These factors are succinctly explained in Hathaway, Dale E, *Agriculture and the GATT - Rewriting the Rules* (Institute for International Economics, Washington DC, 1987) (No 20 in the series - Policy Analyses in International Economics) pp69-70.

12 See Winters, L Alan, "The political economy of the agricultural policy of industrial countries" (1987) 14 *European Review of Agricultural Economics* 285-304.

These conclusions only relate to the level of protection. A non-economic reason for increasing production in a sector or product may explain the decision to grant some assistance. However, it does not explain the choice of policy instrument. It cannot explain why many of the policy instruments that actually are used involve larger costs than are necessary.

In order to explain the choice of instrument of protection and also to explain the choice of protection in those situations in which non-economic objectives do not wholly explain decisions to grant a particular level of protection and in which a referendum (of well informed voters) would not choose that level of protection, it is necessary to analyze further the economic gains and losses from protection and the way in which they are transmitted into political decisions.

3 THE IMPACT OF TRANSFERS ON THE POLITICAL DECISION MAKING PROCESS

That national political decision making may not result in the same outcomes as would result from referendums may result from ineffectiveness in the way that citizens wishes are translated into government policy. This would be most stark in a dictatorship. Even in a democracy, though, the political process is almost always different to a referendum.¹³ That the outcomes of a referendum are different to the outcomes of the ordinary political process indicates that the voters do not have equal influence on political processes. It must be the case that those who would vote 'no' in a referendum have less influence on the political process than their numbers would indicate and that those who would vote 'yes' have more influence than their numbers would indicate.

One can begin this analysis of the political process by considering how political decision are made and how political-economy theorists have modelled the process. Political decisions are made in different ways in different countries. Some are democratic and others military

13 It is not easy to find instances of referendums on trade protection. However there are a couple of instances of elections that have been fought very substantially on this issue. Douglas Irwin analyzed the results of the British election of 1906 in which trade protection was a major issue and submits that the results are much closer to a the result that economic theory would predict than to the outcome of usual political processes: Irwin, Douglas, "The Political Economy of Free Trade: Voting in the British General Election of 1906" (1994) 37(1) *Journal of Law and Economics* 75-108. For other

dictatorships. Within democratic systems, the constitution of the parliament can be quite different. Members may be elected by majority votes in small electorates or they may be elected by proportional representation in larger ones. The important point is that the control of the government is contestable.¹⁴ To win office, a politician needs to gain support from the general populace. Even in a non-democratic system, control of the government is contestable although in a vastly different way: through obtaining support for factions within a governing party, by obtaining support from the army or at the point of revolution from those wielding the greatest force.

No doubt, some political decision makers are devoted to doing what they think is right for their country. However, successful models of political action have been based on the assumption that political decision makers are interested in their own welfare. One of the first comprehensive models of government decision making in democracies, that by Downs, is based on the assumption that the objective of political decision makers is to hold office.¹⁵ This is quite contrary to the objective of the altruistic politician whose objective is to implement policies. The altruistic politician wins office so as to be able to implement policies. The self interested politician implements or promises policies so as to win office. A second way in which the behaviour of governments has been modelled is by assuming that the self interested politician implements or promises policies in order to maximize financial contributions from constituents who in turn seek not the election of particular politicians but the implementation of policy that serves their own self interest.¹⁶ Financial contributions can be used to pay for the costs of election campaigning. In some countries and some circumstances, financial contributions from constituents directly improve the financial position of politicians or their family and friends.

examples, see Irwin's footnote 3 which refers to a study of the 1911 Canadian election on the issue of reciprocity with the United States and to another study on Swiss referenda on tariffs in the 1970s.

14 Anderson, Kym, "International Dimensions of the Political Economy of Distortionary Price and Trade Policies" in I. Goldin & L.A. Winters (eds), *Open Economies: structural adjustment and agriculture* at 290.

15 Downs, Anthony, *An Economic Theory of Democracy* (Harper & Brothers, New York, 1957) at p28: "parties formulate policies in order to win election rather than win election in order to formulate policies".

16 Grossman, Gene M. & Helpman, Elhanan, "Protection for Sale" (1994) 84(4) *American Economic Review* 833-850; Grossman, Gene M. & Helpman, Elhanan, "Trade Wars and Trade Talks" (1995) 103(4) *Journal of Political Economy* 675-708.

Whether one prefers to conceptualize the process as involving votes or financial contributions, the key factor is that politicians seek to maximize support and to minimize opposition. By the policies that they implement or promise to implement, they can attract either support or opposition. Each policy can be thought of as attracting votes and campaign funds from some constituents and losing votes and campaign funds from others.¹⁷ Models of these factors assume that votes and contributions are gained from those that benefit from particular policies and votes and contributions are lost from those that lose from those policies. It is assumed that the willingness to pay financial contributions in connection with particular policies is determined by the net per capita gain or loss that flows in consequence of the policy decision.

Therefore, this analysis focuses on the size of the economic transfers on a per capita basis so as to explain the way that these per capita transfers influence political decision making. It is reasonable to consider the size of the transfers on a per capita basis rather than in aggregate since it is the size of the per capita transfer which would motivate a given individual's political participation. It is proposed to focus on the gains and losses to various entities rather than on the deadweight losses. This is reasonable for two reasons: the sum of the transfers is much larger than the deadweight losses¹⁸ and the transfers are felt directly but the deadweight losses only indirectly.¹⁹

17 See Brock & Magee, "The Economics of Special Interest Politics: The Case of the Tariff" (1978) 68(2) *American Economic Review* 246-250; Downs, *An Economic Theory of Democracy*, pp36-74; Lindert, *International Economics*, p294.

18 This size comparison is illustrated by the example in the last chapter. The example contained contrived numbers of course but studies comparing the relative sizes of the transfers and the deadweight losses have reached the conclusion that I have stated. For example, see the comparison in table 2 in Winters, L.A., "The political economy of the agricultural policy of industrial countries" (1987) 14 *European Review of Agricultural Economics* 285-304 at 288.

19 It is possible that a voter will be influenced by a perception of the deadweight losses to vote for the common good. The influence of a desire to achieve the common good has been analyzed in, for example, Kiewiet, *Macroeconomics and Micropolitics* (Chicago University Press, Chicago, 1983) & Rohrschneider, R., "Citizens's attitudes towards environmental issues: selfish or selfless?" (1988) 21 *Comparative Legal Studies* 347-367. Whilst the author does not deny that it may be possible to incorporate this factor into political models used to predict trade policy decision so as to improve their predictive accuracy, this factor is deliberately omitted from this discussion in order to arrive at an overview of the state of political-economy theory in relation to trade and industry policy. It is reasonable to do so because of the degree of predictive accuracy that has been achieved by models which take into account the transfers but not the deadweight losses. This is probably explained by the ignorance of the deadweight losses having the effect that people do not take them into account.

Political market theory assumes that the net per capita gains and losses determine the amount of political support and opposition to a grant of protection. Political decision makers react to the support and opposition in the political market and act to maximize their net support. They would grant protection for so long as the additional support received exceeds the additional opposition generated. Therefore, the support and opposition given to politicians determines an equilibrium level and structure of protection.²⁰

This exposition deals with various factors that influence the size of per capita gains and losses and the way that they flow into the political decision making process. Initially, the analysis deals with factors that affect political decision making process generally and in relation to the level of protection. The analysis is then extended to deal with factors which would influence the way that the political decision making process might affect the choice of policy instrument.

3.1 FACTORS AFFECTING POLITICAL DECISIONS ON PROTECTION

An obvious point is that a voter's per capita gain or loss can only lead a voter to attempt to influence the government if that voter is aware of the gain or loss. Therefore, it is necessary to consider the information which is held by different winners and losers and to consider whether there is a cost involved in acquiring the information which makes possible participation in the government decision making process. Another important point is to consider the way in which voters can influence the political process. They vote in elections. They can influence the way that others vote. They can make financial contributions to politicians either as bribes or to fund political campaigns to influence the electorate. It is important to consider the costs that attach to exerting influence over government decision making.

If a person does successfully influence policy, there is only a net benefit from doing so if the per capita gain from the favourable policy decision exceeds any cost of influencing the policy decision and acquiring the information necessary to do so. Therefore, some of those whom the economic analysis indicates are net winners or losers may not be so when the

²⁰ For a graphical representation of the political market for protection, see, eg, Figure 1 and accompanying text in Anderson, Kym, "International Dimensions of the Political Economy of

costs of acquiring information and the costs of exerting influence over government policy are taken into account. Consequently, not every winner or loser has sufficient personal incentive to participate in political decision making.

Therefore, there are three matters to be considered:

- (1) factors affecting the per capita size of gains and losses;
- (2) factors affecting information held, its acquisition and its cost of acquisition;
- (3) factors affecting the exertion of influence over government decision-making and the costs of doing so;

3.1.1 The Per Capita Gains and Losses

The amount of support for and opposition to granting protection will be larger, the larger is the transfer away from consumers and/or taxpayers and in favour of producers. However, the important thing is the size of the transfer on a per capita basis. For producers, it is necessary to consider the size of the group to whom the transfer is given as well as the size of the transfer. For consumers and taxpayers, it is necessary to recognize that the transfers are ordinarily spread over a large number of people, so that even a large aggregate cost may not give any individual taxpayer or consumer sufficient incentive to vote against protection and certainly not enough to justify the cost of actively lobbying against it. The important thing is the size of the cost on a per consumer or per taxpayer basis: the price increase passed on to consumers or the tax increase passed on to taxpayers. Some important determinants of the size of the gains and losses on a per capita basis are listed below.

Magnitude of the Protection

It is obvious that the larger the magnitude of protection, the greater is the benefit that flows to producers and the larger is the cost imposed upon other sectors of the community.

Number of Producers in the Sector

The number of producers in the sector is important because the number of producers is the denominator used to calculate average per capita producer gains.

Proportion of Expenditure on the Protected Product

If protection causes an increase in the price of the product, then that amounts to a reduction in the real income of consumers of that product. If the labourers producing the protected product are also consumers of it, then they must weigh the loss from decreased real income resulting from the price increase against the possible benefit from a higher nominal wage which might be a consequence of protection. If expenditure on the product is a large enough proportion of the expenditure of the labourers then the size of the fall in real income due to the price increase may even be of a comparable size to an increase in real income due to any increase in nominal income. In that case, they have little to gain from protection.²¹ Conversely, if this proportion is low then a nominal wage increase received by workers in the protected sector in consequence of protection would hardly be diminished at all by the increased cost of buying the product for their own consumption. In that case, the prospect of a higher nominal wage may motivate the workers to participate in the political process to seek protection.

An additional factor is that if this proportion is large, then an increase in the price of this product causes a loss of real income to employees throughout the economy and places upward pressure on wage rates throughout the economy. This creates a cost for employers (capital owners) in other sectors. These employees in other sectors probably suffer a net loss although it could be a net gain if any increase in the nominal wage overcompensates for the reduction in real wage caused by the price increase. These employees might participate in the political process to oppose the grant of protection to the industry that produces the product upon which they spend a significant proportion of their income. However, it seems that these employees would be more likely to participate in the political process to achieve a higher nominal wage for themselves than to resist the grant of protection to the other sector.

21 See Anderson, Kym, "International Dimensions of the Political Economy of Distortionary Price and Trade Policies" in I. Goldin & L.A. Winters (eds), *Open Economies: structural adjustment and agriculture* (Cambridge University Press, Cambridge, 1992) pp290-310 at p293.

The reaction of the capital owners is more certain. They would have a significant financial incentive to oppose a grant of protection that would be likely to lead to demands for higher wages throughout the economy.

In conclusion, we can say that the higher is the proportion of the general expenditure basket that the protected product occupies, then the higher is the likelihood that capital owners in other industries will be politically active to oppose the grant of protection and the lower is the likelihood that labourers producing the protected product will be politically active to support the grant of protection.

The Significance of Intermediate Inputs in the Production of the Protected Product

The higher is the ratio of the cost of intermediate inputs to the final price of the product then the higher is the percentage increase in profit resulting from a given percentage increase in the price of the product and, therefore, the higher is the incentive to lobby for a price increase of a given percentage size.²²

Proportion of the Labour Force in the Protected Sector

The larger is the proportion of the labour force in the sector for which protection is granted, then the larger is the likelihood that an increase in wage rate in that sector will flow on to an increase in wage rates in the rest of the economy. Increases in wage rates in the rest of the economy confer a gain on employees and a loss much larger in per capita terms on employers (capital owners).²³ As noted in the introduction to this chapter, the group which would receive a gain from this flow on effect would be much more numerous than the group which would suffer a loss but the size of the per capita gain of the winners (the employees) would be much smaller than the size of the per capita loss of the losers (the capital owners).

22 See Anderson, Kym, "International Dimensions of the Political Economy of Distortionary Price and Trade Policies" in I. Goldin & L.A. Winters (eds), *Open Economies: structural adjustment and agriculture* at p294. This is consistent with the finding of Pincus, JJ in "Pressure Groups and the Pattern of Tariffs" (1975) 83(4) *Journal of Political Economy* 757-778. His conclusion was that industries whose inputs are subject to higher customs duties tend to be more successful in lobbying for high customs duties on imports with which their own output competes. This is not inconsistent with a more general relationship between the number and value of inputs and the size of the tariff rate on the final output.

23 See Anderson, Kym "International Dimensions of the Political Economy of Distortionary Price and Trade Policies" in I. Goldin & L.A. Winters (eds), *Open Economies: structural adjustment and agriculture* at p293.

In conclusion, we can say that the larger is the proportion of the labour force in the sector for which protection is to be granted then the higher is the likelihood that capital owners in other industries will be politically active to oppose the grant of protection.

3.1.2 Information, its Acquisition and Cost of Acquisition

Do people realize that industry protection or assistance makes them better or worse off? Lindert and also Frey and Weck-Hannemann make the comment that study of debates over trade legislation evinces a high level of awareness of the effects of protection on the part of the affected groups.²⁴ However, whatever this may indicate about those persons who do participate actively in public debate, it leaves open the question of who has sufficient knowledge to participate in public debate. This section considers the position of various groups in turn: the existing state of knowledge, the cost of acquiring additional information; and whether this position is different for different policy instruments.

Producers

Producers are reasonably likely to have knowledge of government policies that affect their profitability as producers. With some existing knowledge, they are reasonably likely to be able to acquire more information about the benefits of protection to them.

In the case of export subsidies or production subsidies, producers would necessarily be aware of the precise amount that was being paid or was to be paid to them. The state of knowledge about import tariffs and quotas would be less clear. Even if producers are unaware of the existence of an import quota or an import tariff, they will likely be aware of the price of imports and that competition from imports is being limited. If they have considered exporting then they would be aware of the price of their product in other countries. With a tariff, it seems extremely likely that producers would be aware that a margin is being added to import prices and they would be able to find out how much that margin is. If producers raised their price, the volume of imports would increase so they would probably be aware that the quantity of imports can rise or fall in response to changes in the domestic price, and would probably behave consistently with an awareness that the

24 Eg, Lindert, *International Economics*, p293; Frey & Weck-Hannemann, "The Political Economy of Protection", (1996) p155.

size of the margin of protection given by a tariff is limited. With an import quota, even if producers know the size of the quota and appreciate that a much larger flow of imports would force the domestic price down, they may not be able to guess what the domestic price would be in the absence of the quota. With a quota, producers would be aware that their own price changes do not affect the volume of imports so they need to have regard only to competition from domestic competitors.

Consumers

Consumers are unlikely to have much information about the industries whose goods they consume and are unlikely to be able to acquire information in respect of all of their roles as consumers of many different products.

There is little chance that consumers would be aware of any export subsidy or production subsidy. In the case of an export subsidy, even if consumers are aware of the subsidy, it may not be intuitively obvious that one of the effects of the export subsidy is to increase the price in the domestic market.

Consumers might not be aware of the existence of either an import tariff or an import quota. Even so, they may have some knowledge of the price of the product in other countries and, if so, would observe the difference. With an import tariff, if they actually find out the rate of the tariff then they will be accurately informed of how much extra they are paying because of the tariff. With an import quota, even if they are aware of the quota and its size, they may not have sufficient information to guess the effect of the quota on price.

Taxpayers

One could not reasonably credit taxpayers with knowledge of particular tariff revenues or quota allocation revenues (where there are any) or with the expenditure made for export subsidies or production subsidies. However, there is certainly an extent to which taxpayers are aware of how much tax they are paying and the general behaviour of taxpayers in minimizing tax lends much support to the general view that taxpayers prefer to pay less rather than more tax and, by inference, prefer the government to pay less rather than more in subsidies. The desire to pay less tax and less subsidies is transmitted through parliamentary representatives into the government budget process. The parliamentary representatives are

in a position to inform themselves about the costs to taxpayers. They do have estimates of the revenues and expenditures that flow in response to any policy and, except for some less developed countries, these estimates are fairly accurate. Therefore, even though taxpayers themselves may not be aware of the cost of subsidies, the government budget process tends to operate as if taxpayers are aware.

Exporters

Exporters might be aware of the increased costs caused by import barriers if they are importing inputs. The same would be true for any producer that is using imported inputs.

However, one might expect that there would be substantial ignorance among exporters of their losses in their capacities as consumers of other products which are protected and the effect that this has on the price of their own export product measured in terms of the prices of the goods that they consume. This kind of awareness is probably not intuitive and would only become a generally held view among exporters as a result of collective efforts at some cost to analyze the effects of import protection upon them.

Summary

Voters tend to have more information about policies that affect them as producers and less information about policies that affect them as consumers or as taxpayers, although in their capacity as taxpayers, there is at least an institutionalized process which ensure that their interests are weighed.

3.1.3 The Cost of Exerting Influence over Government

The net per capita gains and losses are affected by the cost of exerting influence over government decision making and this affects the way that different winners and losers have input into government decisions. It is useful to consider the role of voters and lobby groups.

Voters

Whilst many citizens may be concerned with the overall good of their country without particular consideration of their own welfare, successful predictive models of voter behaviour have been based upon the assumption that citizens vote and engage in political

activity so as to maximize their own welfare. In an election, unlike a referendum, voters are faced with a multitude of alternative policies. For each voter, some of these policies will have a major effect and others will have a minimal effect. It is likely that the each voter's decisions on voting and political activity is influenced most by the issues that have the biggest effect on the voter. Naturally, the same voter may have many roles in society: as producer, consumer, taxpayer, as one persuading others and one acted upon by the persuasion of others. However, it is reasonable to assume that since the income of a voter has a much bigger influence on a voter's welfare than any individual price in the market, then voters' roles as income earners rather than as consumers or taxpayers determine their voting decisions and their political activity.²⁵

Secondly, it is reasonable to acknowledge that the process of influencing government policy involves costs. The cost can be viewed in different ways: financial contributions that are necessary to sway a politician to adopt a particular policy;²⁶ financial contributions necessary to fund an election campaign by a politician who is expected to implement favourable policies; or costs of time, money and effort in exerting persuasive influence over politicians or over other voters. The costs of financial contribution are obvious. The cost of persuasion is more complicated. Acquisition of information about any policy issue requires time or money or effort. Voters are likely to be already in possession of information that affects them in their role as a producer and are likely to find it fairly easy to obtain more information about the benefits of protection to them. By comparison, voters are unlikely to have much information about the industries whose goods they consume and are unlikely to be able to acquire information in respect of all of their roles as consumers of many different products. Apart from the acquisition of information, the use of that information to influence others requires time and effort and money. Producers are likely to have in place institutional means of communicating with other producers but consumers have no institutional form of communicating. If there is no means of communication already in place then it has to be created. The cost of communication and the time and effort

25 See Downs, *An Economic Theory of Democracy* p255; Lindert, *International Economics* p295-296.

26 Eg, Grossman, Gene M. & Elhanan Helpman, "Protection for Sale" (1994) 84(4) *American Economic Review* 833-850 at 834-836.

are too much for most people. As a result of these participation costs, those who are small losers from any policy decision tend not to have any input into the decision.²⁷

Lobbying and the Free-Rider Phenomenon

To overcome the costs of acquisition of information and of exerting influence over decision making, voters can join forces to acquire information and to petition the government or candidates for governmental office in support or opposition to particular policies. The extent to which they can do so has a large bearing on whether they have any influence on government policy choice. People are more likely to be able to work together if they have the same interest, are able to communicate effectively with each other and individually perceive that their input will make a difference. People will be reluctant to pay a contribution toward the provision of something for their common benefit if they think that regardless of what they do, others will pay for the facility and they will be able to have a free ride.²⁸ This is called the 'free rider' effect. The extent to which lobbies can operate and the extent to which the free rider effect impairs their ability to do so is a significant determinant of government decision making. The smaller the free rider effect the more likely it is that a group of similarly affected people will be able to have a significant influence on government policy and visa versa. There are a number of factors which are good indicators of whether a particular group is likely to be a strong lobby group and whether it will be impaired by the free rider effect. Some of these are listed below.

- *Size of the Sector in the Economy*

Obviously, there is sector size below which political pressure cannot be substantial. However, as size increases there is an increase in the free rider effect. Therefore, on the bottom end of the range, there would be a positive relationship between size and

27 See Vousden, Neil, *The Economics of Trade Protection* (Cambridge University Press, Cambridge, 1990) p180. He describes a theory proposed by Mayer ("Endogenous Tariff Formation" (1984) *American Economic Review* Vol 74, 970-985) in which the fact that there are fixed costs of participating in the decision making process eliminates the small losers from participation.

28 A more succinct definition of *free-riders* appears in Lindert, Peter H, *International Economics* (1986) at 309. Samuelson explains the free rider problem (without using that name) as something that occurs in the case of any public good: "The dilemma is obvious - we wait for others to provide the facilities." (Paul A Samuelson, Keith Hancock & Robert Wallace, *Economics* (McGraw-Hill, Sydney, 2nd Australian ed, 1975) at p100.

effectiveness as a lobby group but after some optimum size the effectiveness of the sector as a lobby group would decrease as the size of the sector increases.²⁹

- *Geographic Concentration of the Lobby Group*

A number of writers have commented on a positive relationship between geographic concentration of an interest group and the demand for protection.³⁰ The geographic concentration of the group may affect the ease with which the members of the group can communicate with each other and the capacity to organize and lobby effectively. Studies have confirmed the influence of this factor. However, some regard should be had for the changing technology which can be utilized in communication and lobbying.

- *Final Consumption Good or Input*

Whether a protected product is a final consumption good or is an input for production of a processed product determines who is immediately disadvantaged by an increase in the price of a protected product. If the affected group is also the producer of another product then it is more likely that the group will be able to collectively lobby against protection than if the affected group is simply a group of consumers.

Conclusions on the Relationship between Per Capita Transfers and Political Decision Making

The above factors provide substantial explanation for the existence of protection.

The key points are, first, that the magnitude of the per capita gain for those that gain from protection is greater than the magnitude of the per capita loss for those that lose and, secondly, that both the acquisition of information and the exertion of influence over government decision making are not costless. Those that gain from protection are likely to

29 This is consistent with the finding of Pincus in an examination of the United States tariff rate of 1824. See Pincus, JJ, "Pressure Groups and the Pattern of Tariffs" (1975) 83(4) *Journal of Political Economy* 757-778. He had proposed that there would be a positive association between output and duty (pp761-764) but, in fact, found that this relationship was generally inverse (pp771-772). See also Vousden, *The Economics of Trade Protection* (Cambridge University Press, Cambridge, 1990) section 8.2 of chapter 8.

30 Eg, Baldwin, Robert E., "The Political Economy of Protectionism" in Jagdish N Bhagwati (ed), *Import Competition and Response* (The University of Chicago Press, Chicago & London, 1982) pp263-292 at 270. For empirical study on this point, see Pincus JJ, "Pressure Groups and the Pattern of Tariffs" (1975) 83(4) *Journal of Political Economy* 757-778 at 773.

have more information about the effect of the protection than those that lose. Also, those that gain from protection are more likely to be able to jointly finance the costs of exerting influence over government decisions. Therefore, even if consumers or taxpayers are successful in opposing a grant of protection, the cost of acquiring information and of lobbying may exceed the net gain from not having the protection granted. The consequence of this is those that would lose from protective policies either do not know that they will incur a loss or, even if they are aware of the loss, will not engage in any political action to avoid that loss (by lobbying or financial contributions). Effectively, then the small losers do not have any input into the political outcome. On the other hand, those that gain are more likely to know of the prospective gain and given the size of the per capita gain are more likely to still have a gain after allowing for the costs of political action or financial contributions.

In summary, there is a significant bias in favour of producer interests in the input into political decision making which might explain why governments tend to choose policies that impose a deadweight loss on the country and make more people worse off than better off. Quite simply a small number of people each with a large amount at stake have more influence over government policy than a large number of people each with a small amount at stake.

3.2 FACTORS AFFECTING POLITICAL DECISIONS AS TO CHOICE OF POLICY INSTRUMENT

The above discussion also reveals an explanation for the choice of border instruments over non-border instruments. This is that the institutional processes of government ensure that there is scrutiny over financial collections and payments by the government. So there is an institutional process by which the interests of taxpayers are given weight but there is no such institutional mechanism for giving weight to the interest of consumers. Therefore, the interests of producers are more likely to be able to extract transfers from consumers than from taxpayers. This explains why governments choose border instruments instead of subsidies even though they are choosing to impose a greater deadweight loss on the nation. It also explains the tendency to choose export subsidies rather than general production

subsidies. Simply, production subsidies involve a larger government outlay than export subsidies.

The above factors may also partially explain the choice of quantity-based border instruments over price-based border instruments. To the extent that consumers are more aware of the loss caused by a tariff than of that caused by a quota, then consumers may tender more opposition to a tariff than to quota. However, given the relative insignificance of consumer opposition generally, the factor of consumer ignorance and impotence alone is insufficient to explain the persistent choice of quantity-based border instruments. A better explanation is to be found in consideration of two other factors: expectations and attitude to risk. These factors also enhance the explanation of the tendency to choose border instruments over non-border instruments.

3.2.1 Expectations of the Future

Expectations of the future may affect the perception by various entities of the gain or loss that may accrue to them in the future in consequence of a particular policy decision. Consider the position of producers and consumers.

Producers

Even after protection is provided to producers, they are still exposed to a range of factors: market factors that may affect their profitability; and political factors which may also affect the willingness of the government to continue to provide the protection. These expectations may significantly affect the type of instrument of protection that producers seek from the government.

Market factors include changes in producers' own costs, in domestic demand or in the price of imports including through changes in the exchange rate. If producers expect an increase in their own cost, an increase in domestic demand or a decrease in the world price then the protection that is provided by an import quota may protect their profits in the face of such changes more effectively than an import tariff. Under a tariff, an increase in domestic demand will be shared between domestic product and imports but under a quota it becomes wholly an increase in demand for domestic product. Under a tariff, a fall in the world price (or appreciation of the exchange rate) will increase the volume of imports putting downward

pressure on the domestic price but under a quota the domestic price will be unaffected. Finally, under a tariff, an increase in production costs cannot be passed on without creating a price disadvantage in relation to imports but under a quota, such a cost increase (affecting all domestic firms) can flow through into a price increase without generating any additional volume of imports in competition. In the event of each of these contingencies, producers protected by an import quota will be better off than producers protected by an import tariff.

Producers will also consider the risk that the protection once given may be taken away. The continuance of protection will be affected by any changes in the opposition to protection.

One significant factor affecting the likelihood that protection will be removed is whether it is subject to annual review and re-approval. The position with subsidies is quite different from the position with import barriers. Subsidies are a part of the government budget and as such are subject to annual parliamentary scrutiny. Import barriers are not subject to the same sort of annual scrutiny. They involve some government revenue but no expenditure. Import competing producers will prefer to seek protection in a way that is not going to be subject to annual budget scrutiny.

A difference should be noted between export subsidies and domestic subsidies. With an export subsidy, the domestic price is raised. So there is a transfer from domestic consumers as well as from taxpayers. Therefore, for the same budget outlay, the transfer of wealth to producers is greater with an export subsidy than with a production subsidy or, alternatively, for the same transfer of wealth to producers, the required budget outlay is less with an export subsidy than with a production subsidy. Therefore, producers would optimally seek an export subsidy rather than a production subsidy.

The above discussion of the differences between import quotas and import tariffs suggests that consumers are more likely to be aware of the extra amount they are paying in consequence of a tariff than they are to be aware of an extra amount paid in consequence of a quota. Therefore, the opposition to a tariff may be greater than the opposition to an equivalent quota.

Consumers

The possibility of changes in prices of goods also affects consumers. However, for them, the effect on real income of a change in price of any single product must be considered in the context of the whole basket of goods which the income purchases. Generally, the expectation of any single price increase would not motivate them to lobby governments for a lower price. The poorer the community of consumers and the larger is the share of a product in their expenditures, then the more likely it is that expectations of price rises in respect of that product would motivate political activity to oppose price support policies.

3.2.2 Attitudes To Risk

Even in the absence of expectations either way in relation to particular variables, attitude to risk may have a bearing on policy decisions. The transfers received by various entities might become larger or smaller in the event of various changes like those referred to above. However, leaving open the possibility of a beneficial change may not be valued the same way as leaving open the possibility of a detrimental change. There might be a preference for certainty over leaving open the possibility of a change that might be beneficial or might be detrimental. As with expectations, we should consider the possibility of changes both to the political climate and to the market.

Even if producers have no particular expectations as to whether political support for a grant of protection will increase or decrease, if they are adverse to the risk of change then they will seek to be protected by the least visible instrument. Therefore, they will prefer instruments that are not subject to budget scrutiny; that is, they will prefer border instruments. Secondly, they will prefer import quotas to tariffs because quotas make it harder for consumers to see how much extra they are paying.

Similarly, even if they have no particular expectations of change in market conditions, they may be adverse to the possibility of change. Studies have shown that in some circumstances producers extract greater rewards under a tariff regime than under a quota regime but all such results are subject to the proviso that if producers place a sufficient value on avoiding

risk then they are better off under a quota regime.³¹ This may be illustrated by considering the possibility of a change in the world price. With an import quota, even if the world price goes up or down, the competition from imports does not change and there is no need for domestic producers to change their selling price. However, with an import tariff, if the world price goes up or down, the price of imports may go up and down also. Therefore, if the producers prefer certainty then they will lobby the government to provide protection by quota rather than by tariff.

4 CONCLUSION

GENERAL CONCLUSIONS

On the basis of immediate financial welfare, we would expect the majority of voters to be made worse off by protection and to vote against it. However, this expectation is not borne out by observation. The key point of this chapter is that the political decision making process is likely to choose protection and assistance to producers that would not be chosen by a referendum of well informed citizens and would not be chosen by a government seeking to maximize the overall economic welfare of the whole community. Compared to such a referendum, the political process is more likely to choose a higher level of protection and is more likely to choose policy instruments that are more costly than is necessary to achieve any given policy objective. Political economists have proposed a number of reasons for this divergence. This chapter has given an explanation of those reasons.

The Level of Protection

It is possible that a referendum of well informed voters will choose some positive level of protection. They may have concerns not directly related to their own financial welfare. Among such concerns may be a desire to shelter from expected change or from the risk of adverse changes. However, there are additional factors which make it likely that compared to a referendum of well informed citizens, the political process will choose protection in a much broader set of circumstances.

31 See Vousden, *The Economics of Trade Protection* (Cambridge University Press, Cambridge, 1990) pp192-199; Lloyd, Peter J. & Falvey, Rodney E., "The Choice of Instrument for Industry Protection" in Snape, R.H., *Issues in World Trade Policy: GATT at the Crossroads* (Macmillan, London, 1986) pp152-174.

The size of the per capita gains and losses and the costs associated with acquiring information and exerting influence over government policy substantially affect the way that the gains and losses impact upon political decision making. Effectively, those facing the largest per capita gains and losses control the policy decision with those facing small per capita gains or losses having no influence.

It is possible to predict the level of protection that a sector is likely to have by observing a number of factors: some affecting the size of the per capita gains and losses; some affecting the ease of acquisition of information; and some affecting the ease of lobbying to influence government policy.

The per capita size of gains to producers is positively correlated with:

- the magnitude of protection;
- up to a point, the size of the sector; and
- the extent of use of inputs;

and is negatively correlated with:

- the share of expenditure spent on the sector's produce.

The per capita size of losses to others is positively correlated with:

- the magnitude of protection; and
- the proportion of the labour force employed in the protected sector.

The costs associated with acquisition of information and the costs associated with exerting influence over government policy are affected by :

- the state of existing knowledge;
- the size of the group of affected producers or consumers;
- the geographic dispersion of the sector;
- whether output of the protected sector is an input for another sector of producers.

These factors determine the net per capita gains and losses which determine the support and opposition to any grant of protection which in turn determine the equilibrium level and structure of protection chosen by the government decision making process.

Therefore, even if there is a non-economic objective, meaning that some level of protection greater than zero is the optimal level, the political process will result in the choice of a higher level. We can make the same observation about the two other circumstances where an increase in protection might be welfare increasing: the big country case and the tariff increase which decreases dispersion of tariff rates. Where market power of a big country determines that some positive tariff level optimizes welfare, the process of political decision making will choose a tariff level higher than the optimal tariff. Similarly, even where there might be a welfare increase from a dispersion decreasing increase in protection for particular products, in fact, the political process tends toward increased dispersion because the producers' potential gain or loss from a policy decision is highest for those that already have the highest level of protection and, therefore, the most incentive to try to influence government policy.

The Choice of Policy Instrument

Further, we can predict which policy instruments are more likely to be chosen by the political process.

Border Instruments Vs Non-Border Instruments

It is more likely that the political process will choose border instruments than production subsidies. This is because although the small losses by consumers tend not to feed into political decision making, the small losses by taxpayers do by virtue of the institutional process of government budget scrutiny. Consumers do not effectively manifest political opposition to price increases but taxpayers do manifest significant political opposition to tax increases. The tendency to choose border instruments instead of production subsidies is reinforced by the desire of producers to maintain any grant of protection in the face of expected adverse changes in the political climate.

Price-based Border Instruments Vs Quantity-based Border Instruments

Of the border instruments, it is more likely that the political process will choose quantitative restrictions like import quotas instead of price-based restrictions like import tariffs whenever the following factors are present:

- (1) producers expect an adverse change to political support and opposition to the grant of protection;
- (2) producers expect adverse changes to market conditions;
- (3) producers are averse to risk of changes in political climate; or
- (4) producers are averse to risk of changes in market conditions.

CONCLUSIONS IN RELATION TO AGRICULTURE

Although agriculture is different in every country, the above list of features can offer useful guidance in determining whether any particular country is likely to protect agriculture. In most industrial countries, more so than in developing countries, the agricultural sector:

- (1) is not so large as to dissipate the benefits of lobbying through a large free rider effect;
- (2) does not employ so many people as to have a significant effect on wage rates throughout the economy;
- (3) produces goods which do not occupy too large a proportion of the budget of domestic consumers;
- (4) is either not too geographically dispersed or has good infrastructure for communication;
- (5) uses a large value of inputs into production in relation to the value of output.

In developing countries, these factors are a truer description of various sectors other than agriculture. This is consistent with studies which show that developing countries tend to protect agriculture and developing countries tend to tax it.³² This suggests that whatever the role of non-economic objectives in decisions to protect agriculture, the asymmetries in the

32 See above at footnote 2 in this chapter.

political decision making process are substantial determinants of decisions to protect agriculture. The theories of political-economy have provided little support for the view that agriculture requires protection because it is different from other sectors. The theory lends support to the view that the agricultural sector tends to be protected simply because it possesses most of the characteristics that most enable producer interests to override consumer and taxpayer interests in political decision making.

CHAPTER 8

IMPLICATIONS OF THE POLITICAL AND ECONOMIC THEORY FOR OPTIMAL GATT RULES - THE IMPORTANCE OF REGULATING THE CHOICE OF POLICY INSTRUMENT

"An evaluation of the potential effectiveness of international economic rules must take account of the extent to which the legal, economic and political rationales of the respective rules coincide."
Ernst-Ulrich Petersmann, *Constitutional Functions and Constitutional Problems of International Economic Law* (University Press, Fribourg, Switzerland, 1991) p84.

This part of the thesis began with questions about the relative importance for GATT rules of the regulation of the choice of instrument and the regulation of the level of protection. This chapter proposes an answer to those questions by reviewing the conclusions of the last four chapters and then expanding on those conclusions by considering what is in the long term interest of individual states and how that interest can best be embodied in the rules of the GATT so as to attract compliance with the rules. It is submitted that a high level of compliance can be achieved if the rules are congruent with two long term interests of states: the attainment of economic benefits and also the retention of a capacity to achieve non-economic goals. The crucial submission of this thesis is that in order to achieve these two objectives, it is essential that the rules distinguish appropriately between the different types of policy instruments and this chapter proposes how they should do so. This provides the basis for the following chapters which search for a connection between the way the rules distinguish between different instruments and the 'failure' of the rules in application to agriculture.

1 SUMMARY OF CHAPTERS 3 TO 7

Chapter 4 explained the effects of the four principal instruments on the price affecting domestic producers and consumers and on the quantities supplied and demanded. We noted that all four instruments have some effect on the difference between the quantities of domestic supply and domestic consumption which effect is accompanied by either a

reduction in imports or an increase in exports. We concluded that import quotas, import tariffs and export subsidies all raise the domestic price to consumers above the world price but that production subsidies do not and used this difference to arrive at a distinction between 'border instruments' and 'non-border instruments'. We also observed that two of the border instruments, the import tariff and the export subsidy operate directly through the price mechanism but that the import quota operates directly upon quantity and only indirectly on price and we used this criterion to define the difference between 'price-based border instruments' and 'quantity-based border instruments'. Thus, the four principal instruments were classified in the following way:

<i>Instruments</i>	<i>Non-Border Instruments</i>	<i>Border Instruments</i>
Price-based	Production Subsidy	Import Tariff / Export Subsidy
Quantity-based	-	Import quota

Chapter 5 explained the welfare effects of the four instruments showing the way that different entities win or lose in consequence of the imposition of each of the four instruments. We drew the conclusions displayed in the following table:

	<i>Producers</i>	<i>Consumers</i>	<i>Taxpayers</i>
Import Quota	Win	Lose	Win (possibly)
Import Tariff	Win	Lose	Win
Export Subsidy	Win	Lose	Lose
Production Subsidy	Win	No effect	Lose

In summary, all of the policy instruments transfer wealth to producers. The non-border instrument imposes the cost of the transfer upon taxpayers. The three border instruments all

impose costs upon consumers. There is some variation between the effects of the three border instruments on taxpayers. The export subsidy requires expenditure thereby imposing part of the transfer upon taxpayers. The import tariff provides revenue thereby also providing a transfer from consumers to taxpayers. To the conclusions from the partial equilibrium analysis, we added recognition of the loss suffered by exporting producers in consequence of the general level of import protection.

Chapter 5 also concluded that for each of the policy instruments the size of the losses exceeds the size of the gains: that is, there is a portion of the loss to either consumers or taxpayers that is not transferred to anyone. We called it a deadweight loss. This means that all four instruments impose a net cost on the country implementing them and the removal of every instrument provides a net benefit to the country removing it. Two qualifications were noted: the optimum tariff in the big country case and the dispersion reducing increase in protection. We noted the limits to the importance of the qualifications on the general principles: firstly, because the dispersion decreasing reductions in protection do always provide a net benefit and, secondly, because even in the rare big country case, the optimal tariff is small and reductions from a higher level down to the optimal tariff do provide a net benefit.

Chapter 6 illustrated the difference between the welfare gains and losses and, particularly, the deadweight loss component of the losses, first, in border instruments and non-border instruments, and secondly, in price-based border instruments and quantity-based border instruments.

First, it was shown that the deadweight loss caused by border instruments has two distinct parts: first, a consumption effect caused by the decisions of consumers in response to the price change caused by the policy instrument; and, secondly, a production effect caused by the decisions of producers in response to the same price change. In contrast, the deadweight loss caused by a production subsidy has only a production effect and no consumption effect. We concluded that for the same transfer to producers, the deadweight loss caused by a non-border instrument is always smaller than the deadweight loss caused by a border instrument. A most important corollary of this is that whenever it is a government objective to increase particular production or the returns to a particular sector of producers, that objective can be

achieved at a lower cost to the rest of the community with a non-border instrument than with a border instrument.

Secondly, it was shown that there is a significant difference between the welfare effects of price-based border instruments and quantity-based border instruments. For both types of instruments, the size of the transfers of wealth and of the net loss depends on the size of the gap between the world price and the domestic price. With export subsidies and import tariffs, the size of the gap between the world price and the domestic price is limited by the size of the tariff or the subsidy. Therefore, the size of the consequent transfers and of the deadweight loss is limited. However, with an import quota, the size of the resulting gap between the world price and the domestic price may change in response to changes in domestic demand, domestic production costs, or the price of imports (including through exchange rate changes). Therefore, in contrast to an import tariff or an export subsidy, with an import quota, the size of the transfers of wealth to producers and away from others is unlimited and the size of the net deadweight loss is also unlimited.

Therefore, without considering changes over time, the instruments can be ranked in ascending order of the net cost of using them to achieve the same support to particular producers :

<i>Rank</i>	<i>Instrument</i>	<i>Classification</i>
1	Production Subsidy	Non-Border Instrument
2	Import Tariff / Export Subsidy / Import Quota	Border Instruments

If changes over time are considered, then even though the cost of the price-based border instruments stays the same, the cost of the quantity-based border instrument changes over time. If citizens are sufficiently averse to adverse changes (they receive more satisfaction from removing the possibility of adverse effects than from leaving open the possibility of

positive effects), then the ranking of the instruments in ascending order of net cost changes to the following:¹

<i>Rank</i>	<i>Instrument</i>	<i>Classification</i>
1	Production Subsidy	Non-border instrument
2	Import Tariff / Export Subsidy	Price-based border instrument
3	Import Quota	Quantity-based border instrument

Chapter 7 noted that political decisions on the level and form of protection tend not to reach the outcomes that the economic theory indicates are desirable nor do they reach the outcomes that economic theory indicates would be chosen by a referendum of well informed citizens acting in accordance with their own economic gain or loss. In a way that accords with political-economy theorizing on the subject, the chapter offers an explanation of the reasons that governments tend to choose protection against their own apparent self interest and that of their constituents.

First, a large number of citizens may take into account considerations broader than their personal financial position. They may place a significant value on things that are not reflected in market prices. They may desire a high level of certain domestic production and, therefore, might wish to transfer wealth in favour of the relevant producers. Alternatively or in addition, they may wish to protect certain producers from adverse effects of changed market conditions and for that reason may wish to reallocate the effects of change by transferring wealth in favour of those producers.

¹ Rankings consistent with this table are also set out in Petersmann, Ernst-Ulrich, "International Competition Rules for Governments and for Private Business: A "Trade Law Approach" for Linking Trade and Competition Rules in the WTO" (1996) 72 *Chicago-Kent Law Review* 544-582 at 554 (in a table which also ranks border adjustment and voluntary export restraints which are omitted from this analysis) and in Roessler, Frieder, "The Constitutional Function of the Multilateral Trade Order" in Hilf, Meinhard & Petersmann, Ernst-Ulrich, *National Constitutions and International Economic Law* (Volume 8 of *Studies in Transnational Economic Law*) (Kluwer, Boston, 1993) pp53-62 at 54-56, 59.

However, even allowing for some level of protection justified upon non-economic objectives, the political decision making process tends to choose a higher level of protection than would be chosen by a referendum of well informed voters. The important considerations are the per capita costs and benefits received by the different entities within the political system. More particularly, one must consider the *net* per capita gains and losses after allowing for the costs of acquisition of information and the costs of exerting influence over government policy. We noted the positive and negative correlations between a number of factors and the size of either the net per capita gains or the net per capita losses. These net per capita gains or losses determine the support for and opposition to protective policies which in turn determine government decisions. The key factor is that grants of protection confer a relatively large transfer of wealth upon a relatively small number of producers and impose the cost of that transfer of wealth upon a large number of consumers or taxpayers (or both) who each bear a small part of the cost. If we take into account that the cost of acquiring information and of lobbying is greater than zero, then for producers there is a net benefit from successfully seeking protection but for consumers there may be a net loss from successfully opposing it. Essentially, a smaller number of people facing a large gain or loss are more likely to exert influence over a political decision than a large number of people facing a small gain or loss.

We conclude that there are significant biases in the political decision-making processes that result in a decision to grant protection in circumstances where a referendum of well-informed citizens would not. Even where a referendum of well-informed citizens, in order to achieve some non-economic objective, would choose to grant some positive level of protection, the political decision making process tends to result in the granting of a higher level of protection.

The political process is also biased in terms of which instruments will be chosen. The factors which make it unlikely that consumers will have sufficient knowledge or lobbying capacity to successfully oppose grants of protection transferring wealth from consumers to producers are remedied substantially (but not completely) in the case of transfers from taxpayers. In the case of subsidies, the lack of knowledge and political impotence are compensated for, to some extent, by institutional processes which scrutinize government

expenditure. Since there is no such institutional process by which consumer interests are protected, then it is easier for producers (and for a government) to impose the cost of economic transfers upon consumers than upon taxpayers. Therefore, there is a tendency to choose instruments that do not have a budgetary cost. To the extent that instruments with a budgetary cost are chosen, there is a tendency toward export subsidies rather than production subsidies because export subsidies require a lower budget outlay for the same per unit transfer to producers.

Therefore, the likelihood that the political process will choose an instrument to provide a given amount of assistance to producers can be ranked in ascending order:

<i>Rank of Likelihood</i>	<i>Instrument</i>	<i>Transfers from</i>
1 (least likely)	Production Subsidy	Taxpayers
2	Export Subsidy	Taxpayers and Consumers
3 (most likely)	Import Tariff / Import Quota	Consumers

That ranking does not consider attitudes to changes over time. In fact, the preference for border instruments over non-border instruments is reinforced if producers expect the political climate to become less sympathetic to them or if they are averse to the risk of it becoming less sympathetic to them. To avoid adverse changes in political climate, producers would prefer to receive protection in a way that is not subject to annual budget scrutiny or, at least, minimizes that scrutiny. This reinforces the bias toward protection by border instruments rather than non-border instruments.

The desire to be insulated from expected changes or the averseness to the risk of any adverse changes also affects the choice between price-based border instruments and quantity-based border instruments. To avoid adverse change, producers seek to be protected by the policy instruments that will withstand changes in domestic demand, domestic costs, or the price of imports including through exchange rate changes. Accordingly, to avoid the consequences

of adverse market changes, producers would seek protection by import quotas rather than import tariffs.

Therefore, if the possibility of changes over time is considered and producers are assumed to prefer to avoid the consequences of expected adverse changes or to be averse to the risk of adverse changes, then the ranking of the likelihood of choice of instruments should be amended to the following:

<i>Rank of Likelihood</i>	<i>Instrument</i>	<i>Transfers from</i>
1 (least likely)	Production Subsidy	Taxpayers
2	Export Subsidy	Taxpayers and Consumers
3	Import Tariff	Consumers
4 (most likely)	Import Quota	Consumers

Finally, chapter 7 observed that the application of the above political theory to agriculture gave a good explanation of the existence or absence of protection in the agricultural sector. In developed countries, the agricultural sector has the characteristics which the theory predicts make it likely that producers can influence political decision making at the expense of consumers and taxpayers.

2 CONCLUSIONS FROM CHAPTERS 3 TO 7

The focus on the internal economic effects and on the internal political decision making within states leads to two important conclusions:

- (1) first, in relation to the *level* of protection; and
- (2) secondly, in relation to the *choice of instrument* of protection.

2.1 THE LEVEL OF PROTECTION

The economic analysis indicates that on the basis of costs and benefits that are reflected adequately in the price mechanism, the decision to impose protection is against the interest

of the state that does so and that the unilateral removal of protection is in the interest of the state that does so. This is contrary to the view intuitive to many that the act of granting protection is in the national interest and the unilateral reduction or removal of protection is against the national interest.

Although on the basis of costs and benefits that are reflected adequately in the price mechanism, the national welfare maximizing level of protection is zero, to the extent that costs and benefits of protection are not reflected adequately in the price mechanism, and citizens place value on 'non-economic' objectives, then national welfare may be maximized by having some positive level of protection. That conclusion, though, must be viewed in the context of the asymmetries in the political decision-making process. These asymmetries of cost and benefit from supporting and opposing protection, including from gaining and using information, are biased in favour of protection and cause the political process to choose a level of protection that is above the welfare maximizing level. Therefore, even though 'non-economic' objectives may justify some level of protection, an even higher level is likely to be chosen by the political decision-making process.

2.2 THE CHOICE OF POLICY INSTRUMENT

The economic analysis indicates that the same level of assistance to particular producers can be provided at a lower cost to the rest of the community by a non-border instrument than by a border instrument. It also indicates that giving protection with an unlimited cost to the rest of the community can be avoided if quantitative border instruments are not used: that is, that if the community places a high enough value on avoiding unlimited costs then in a choice between a price-based border instrument and a quantity-based border instrument, welfare is maximized by choosing the price-based border instrument. Therefore, the economic analysis indicates that for maximizing welfare, policy instruments can be ranked in the following way:

- (1) that price-based border instruments (like import tariffs and export subsidies) are better than quantity-based border instruments (like import quotas);
- (2) that non-border instruments (like production subsidies) are better than border instruments (like import quotas, import tariffs and export subsidies).

A stark contrast to this ranking is arrived at by the analysis of the likelihood that the political process will result in the choice of any particular policy instrument. First, political factors make it more likely that governments will use border measures rather than subsidies to protect import competing industries. Secondly, to the extent that there is some value placed on avoiding the consequences of adverse market changes, then it follows from the political bias in favour of producers and against consumers, that the risk aversion of producers has a bigger effect on policy choice than the risk aversion of consumers. Therefore, it is likely that political decision-making will choose instruments that insulate producers rather than consumers from adverse market changes: that is, will choose quantity-based border instruments rather than price-based border instruments. In summary, the likelihood of particular policy instruments being chosen by the process of political decision-making can be ranked:

- (1) quantity-based border instruments are more likely to be chosen than price-based border instruments (assuming the value placed on avoiding the adverse effects of change is large enough);
- (2) border instruments are more likely to be chosen than non-border instruments.

Therefore, the rankings in order of welfare maximization and in order of political likelihood are exactly opposite.² The political process is likely to make the welfare minimizing choice of policy instrument. Economic welfare is maximized by the policy instrument that is least likely to be chosen.

3 A REASON FOR THE RULES

These observations from the preceding chapters suggest that nations can maximize their economic welfare by modifying the outcome of their political decision making processes in two ways:

- (1) to reduce the level of protection; and

² See Roessler, Frieder, "The Constitutional Function of the Multilateral Trade Order" in Hilf, Meinhard & Petersmann, Ernst-Ulrich (eds), *National Constitutions and International Economic Law* (Kluwer, Deventer, 1993) pp53-62 at 50 containing a table showing the inverse economic and political ranking of 4 policy instruments: production subsidies, import duties, import quotas and VERs.

- (2) to change the choice of instrument of protection towards more efficient measures.

Both of these functions, then, are appropriate objectives of GATT rules.³ I deal with them in turn.

3.1 REDUCING THE LEVEL OF PROTECTION

It is in the long-term interests of states to modify their internal political decision-making so that the level of protection is reduced. Rules of the GATT can facilitate this process, thereby enabling states to attain economic welfare that would have been foregone had the political process been unchanged. The GATT can operate as a constraint upon the choice of level of protection so as to help states avoid the wealth transfers and the deadweight losses caused by protection which would not be chosen by a referendum of well-informed citizens even allowing for their non-economic objectives. This can be achieved if the GATT rules make it difficult for states to increase the level of protection: to increase import tariff rates;

3 The functions and objectives of GATT rules discussed here are certainly not intended to be exhaustive. It is a necessary consequence of the focus on the function as a guide in choice of policy instrument that the thesis either completely or partly omits consideration of other functions and objectives of the GATT system such as providing a negotiating forum, preventing discrimination, providing a dispute settlement mechanism, maintaining reciprocity, contributing to stability, promoting economic goals, promoting a rule-based instead of power-based system or diffusing hegemonic aspects of international trade relations or in a broader sense, providing common norms or influencing behaviour. Generally, on the functions and objectives of the GATT, for example, see Jackson, John H., *The World Trading System: Law and Policy of International Relations* (The MIT Press, Cambridge, Mass., 1991) chapter 1 (distinguishing between rule-based and power-based systems); Findlayson, Jock A. & Zacher, Mark W., "The GATT and the regulation of trade barriers and functions" *International Organization*, 35, 4, autumn 1981 reprinted in Krasner, Stephen D. (ed) *International Regimes* (Cornell University Press, Ithaca & London) at 273-314 (identifying "interdependence norms" and "sovereignty norms" embodied in the operation of the GATT); Montana-Mora, Miguel, "International Law and International Relations Cheek to Cheek: An International Law/International Relations Perspective on the US/EC Agricultural Export Subsidies Dispute" (1993) 19 *NCJ Int'l L & Com Reg* 1-60 at 6-9 (comparing the application of the hegemonic model and the functional model to GATT); and Hizon, Ernesto M., "The Safeguard Measure/VER Dilemma: The Jeekyll and Hyde of Trade Protection" (1994) 15 *Northwestern Journal of International Law & Business* 105 at 116-121 (also discussing the rule/power or legal/pragmatism distinction and referring to the 'constitutional function' expressed by one "branch of the legalist school") & Roessler, Frieder, "The Scope, Limits and Function of the GATT Legal System" (1985) 8(3) *World Economy* 287-298 (describing GATT's functions in terms of three main principles). More generally on the role and functions of international economic treaties, see Roessler, Frieder, "Law, De Facto Agreements and Declarations of Principle in International Economic Relations (1978) *German YIL* 27-59 (discussing law in terms of models for management and cooperation) and even more generally in relation to the influence and effects of international law, see van Dijk, Pieter, "Normative Force and Effectiveness of International Norms (1987) 30 *German YIL* 9-35 (in particular at 13-19 on the force of policies, principles and rules).

to introduce import quotas or to make them smaller; or to increase export subsidies or production subsidies.

3.2 CHANGING THE CHOICE OF INSTRUMENT OF PROTECTION

On the basis of the above conclusions, it is in the long-term self-interest of states to modify their internal political decision-making so that the likelihood of adoption of policy instruments corresponds more closely with a welfare maximizing selection. By making it more difficult for the political process to choose the most costly policy instruments and less difficult to choose the least costly policy instruments, it becomes more likely that the policies actually chosen will achieve economic benefits that would have been foregone if the political processes were unrestrained. Such modification of the internal decision making process can be achieved through the application of the GATT. It can operate as a constraint upon the choice of policy instrument so as to help states avoid excessive deadweight losses; that is, deadweight losses that are larger than those caused by the least costly policy instrument that can achieve any given policy objective. This can be achieved if the GATT rules make it more difficult to provide assistance to producers by border instrument than by non-border instrument and more difficult to provide assistance by quantity-based border instrument than by price-based border instrument.

4 GATT RULES AS CONSTITUTIONAL CONSTRAINTS

There is nothing innovative about the idea of constraining government decision making. Such constraint is a fundamental basis of constitutional law. It is based on the notion that there are objectives more important than achieving the immediate will of the majority. The American constitutional law writer, Tribe, refers to the analogy of an experiment with pigeons which were offered a first key which if pecked rewarded them with a small food reinforcement and if not pecked rewarded them with a delayed but larger food reinforcement. Later a second differently coloured key was introduced. If the second key was pecked then the pigeons would not be offered the option of pecking the first key to receive the small but immediate food reinforcement. The study found that at first instance, 95% of the pigeons missed out on delayed larger food reinforcement because they were unable to resist the temptation to obtain the immediate but smaller food reinforcement. When the second key was introduced, 30% of that 95% chose to peck it thereby removing

the temptation of not being able to wait for the delayed but larger food reinforcement. Tribe notes the conclusion of the experimenters: "that even pigeons seem capable of learning to bind their "own future freedom of choice" in order to reap the rewards of acting in ways that would elude them under the pressures of the moment"⁴ and relates that conclusion to domestic constitutions by saying that constitutions provide the setting in which the later, larger reinforcement can be obtained and do so by preventing the choice of the earlier smaller reinforcement.⁵

Applying this analogy to the GATT, the smaller immediate reinforcement is the acquisition of votes and contributions as a result of transfers of wealth to certain producers and the larger delayed reinforcement is the higher level of economic welfare. The mechanism which prevents the choice of the earlier and smaller reinforcement is the bringing of international factors into the policy decision. The state's internal choice becomes linked to the policies that other states use in relation to the first state's trade. Parties must consider the advantages and disadvantages that flow from complying or not complying with GATT rules. Complying with the rules opens up access to other markets and not complying closes access. The extra layer of costs and benefits in the international arena must then be taken into consideration in policy choice and, importantly, must be taken into account in the short run (as well as the long run). By adding these international costs and benefits into the short run calculation, the GATT can influence the way that states resolve instances of conflict between short-run self-interest of political decision makers and the long-run interest of the country. In such instances, the costs and benefits on the international plane may enable GATT rules to override the short term interest thereby resulting in attainment of the long-term interest. This means choosing policies that are welfare maximizing in the long run rather than policies which, without the GATT, would be welfare maximizing for political decision makers in the short run. The tendency for the short term self-interest to become secondary to the long term self-interest may be assisted if, over time, the long term benefits become tangible. This may reinforce the level of compliance with the GATT rules. Naturally, this process depends upon the GATT rules being congruent with the long term interest.

⁴ Tribe, Lawrence, *American Constitutional Law* (The Foundation Press, Mineola, New York, 1978) p10 quoting from G.W.Ainslie, "Impulse Control in Pigeons" (1974) *J. Exper. Anal. Behaviour* 485.

This function of GATT rules has been derived not from an analysis of the economics of effects of protection between states or of the international politics of the effects of protection but from an analysis of domestic politics and economics. It relates to managing the relationships between different interests within single states rather than to managing relationships between states. By emphasizing the domestic, it is not intended to diminish the international aspects of the GATT. However, it is the domestic aspect which is deliberately being stressed here. Petersmann calls the regulation of domestic conflict the "primary" function of the GATT:

economic analysis suggests that the primary regulatory function of the GATT rules for transparent and economically efficient policy-making ... does not consist in the resolution of *international* conflicts of interests among states, but in the transparent ... and the welfare-increasing resolution of *domestic* conflicts of interests *within* GATT member countries among individual producers, importers, exporters and consumers.⁶

Similarly, Roessler writes:

The principal function of the GATT as a system of rules is to resolve conflicts of interest within, not among, countries. The function of the GATT as a negotiating forum is to enable countries to defend the national interest not against the national interest of other countries but against sectional interests within their own and other countries.⁷

Farber and Hudec, although placing more emphasis on the international relations management function of the GATT, compare the GATT with the internal free trade provision in the USA constitution and liken its role to that of the mast to which Ulysses was tied:

free trade agreements also partake in the nature of the "public-interest Ulysses" binding himself to the mast to avoid responding to the calls of the protectionist Sirens.⁸

Roessler states the same proposition:

5 As above.

6 Petersmann, Ernst-Ulrich, *Constitutional Functions and Constitutional Problems of International Economic Law* (University Press, Fribourg, Switzerland, 1991) p83 (emphasis in original). The deleted words embrace the function of GATT for "non-discriminatory foreign trade" being served by the non-discriminatory resolution of domestic conflicts of interest.

7 Roessler, Frieder, "The Scope, Limits and Function of the GATT Legal System" (1985) 8(3) *The World Economy* 287-298 at 297.

8 Farber, Daniel A & Hudec, Robert E, "Free Trade and the Regulatory State: A GATT's-Eye View of the Dormant Commerce Clause" (1994) 47 *Vanderbilt L R* 1401-1440.

The basic principles of the GATT .. should be seen as substitutes for constitutional norms;⁹

and

The GATT, although formally an international agreement among countries, is functionally part of the domestic constitutional order of each contracting party.¹⁰

In relation to international law generally, Henkin emphasizes the competing interests within states when he responds to Morgenthau's declaration of an "iron law of international relations, that legal obligation must yield to national interest"¹¹ by saying:

The issue of law observance ... is never a clear choice between legal obligation and national interest; a nation that observes law, even when it 'hurts', is not sacrificing national interest to law; it is choosing between competing national interests; when it commits a violation it is also sacrificing one national interest to another.¹²

This is at odds with the traditional view of international law as a system which regulates relations *between* states and with the traditional way of viewing the GATT. On this view, sovereignty of nations excludes interference in domestic matters except to the extent that there are direct effects on other nations:

it cannot be an appropriate function of international agreements and organisations to prevent sovereign powers from 'imposing costs' on their own residents if those powers take this action to be in their own interest and if they do not, in taking it, harm residents of third countries.¹³

However, in some areas of international law, for example, international human rights law, international environmental law and international labour law, there is an implicit acceptance of international law as regulation of relations *within* states rather than *between* them. The

9 Roessler, Frieder, "Discussion to Session IV: Competition and Trade Policies. The Constitutional Function of International Economic Law" *Aussenwirtschaft*, 41 Jahrgang (1986) Heft II/III, Grusch, Ruegger, S.467-474 at 473; See also Tumlrir, Jan, "GATT Rules and Community Law - A comparison of Economic and Legal Functions" in Meinhard Hilf, Francis G. Jacobs & Ernst-Ulrich Petersmann (eds) *The European Community and GATT* (Kluwer, Deventer, The Netherlands, 1986) pp1-22.

10 Roessler, Frieder, "The Scope, Limits and Function of the GATT Legal System" (1985) 8(3) *The World Economy* 287-298 at 298.

11 Morgenthau, Hans, *In Defence of the National Interest: a critical examination of american foreign policy* (Knopf, New York, 1951) p144 (also published as *American Foreign Policy: a critical examination* (Methuen, London, 1952)).

12 Henkin, Louis, "International Law and National Interest" (1986) 25 *Col J Trans L* 1 at 6 quoting from his own, *How Nations Behave* (Columbia University Press, New York, 2nd ed, 1979) p331.

13 Hindley, Brian, "Voluntary Export Restraints and the GATT's Main Escape Clause" (1980) 3 *World Economy* 313-341 at 330.

acceptance of international legal obligations in these areas is not universal. Often obligations are rejected by States on the ground that their sovereignty would be eroded by assuming obligations in areas traditionally in the domain of domestic sovereignty. Acceptance of international obligations in traditionally domestic areas is argued on the basis that the subject matter of the law cannot be dealt with adequately by the domestic law of states acting alone or that the subject matter tends not to be dealt with adequately in the domestic law of states because domestic law reform would not muster majority support. In the case of regulation of international trade, the political cost of reducing protection is less if other countries also reduce protection at the same time.¹⁴ Secondly, domestic constitutions tend not to contain constraints on the power of governments to restrict commerce with foreigners¹⁵ even though they do commonly constrain the power of governments to restrict commerce between citizens.¹⁶ Were such constitutional constraints to be debated in a domestic setting, producers would tender warlike opposition.¹⁷ Consequently, domestic law alone is neither able to deliver the full potential gains from international trade nor does it tend to protect the capacity of citizens to engage in commerce with foreigners. Therefore, there is a role for the GATT as a supplement to domestic constitutions in regulating relations between different interests within individual states. By focussing on the internal aspects of the economic effects of protection and of political decision-making regarding protection, one is given a powerful argument that restriction of government power to grant protection is in the national interest.

5 GATT RULES AND THE SOVEREIGNTY OF STATES

Reference has been made to 'non-economic' objectives which states may wish to achieve through trade protection and industry support. As mentioned, states may wish to transfer

14 On the increased benefits of multilateral liberalization compared to unilateral liberalization, see eg, Tyers, R. & Anderson, K., *Disarray in World Food Markets: A Quantitative Assessment* (Cambridge University Press, 1992), pp210-212.

15 See Petersmann, Ernst-Ulrich, *Constitutional Functions and Constitutional Problems of International Economic Law* (University Press, Fribourg, Switzerland, 1991) pp139-208.

16 Eg, s92 of the Constitution of the Commonwealth of Australia and Article 10(2) of the Constitution of the United States of America prevent sub national governments from restricting trade across sub-national borders. On a super-national level, see the EEC Treaty, Articles 10, 12, 30 & 34.

17 Note agreement with this view in Roessler, F., "The Constitutional Function of International Economic Law" in *Aussenwirtschaft*, 41 Jahrgang (1986) Heft II/III, 467-474 at 471.

wealth to particular sectors or to insulate them from change. They may wish to influence their industrial structure or the way that their comparative advantage evolves.

If the validity of such 'non-economic' objectives is accepted then it is necessary to accept that governments need to have a level of autonomy that enables them to achieve such objectives. It is necessary that the achievement of such objectives is not blocked by international legal obligations. This analysis of the economic effects of policy instruments within states provides valuable insight into how national sovereignty may be maintained.

First, although a reduction of protection will generally be in the interest of a state, the welfare maximizing level of protection may not be zero because of factors related to 'non-economic' objectives which are not adequately reflected in the private costs and benefits of individuals upon which they make their production and consumption decisions (or, in a big country case, because there is an optimal tariff, subject to the influence of cooperation on the maximizing of welfare). In addition, the 'non-economic' objectives may change over time. Therefore, international rules need to enable individual states to choose their level of protection but in the context of the benefits and costs associated with access to the markets of other states. Whilst assisting states to reduce their level of protection is generally in the interest of states, it is necessary that the rules can accommodate some residual level of protection and even, in some circumstances, be able to accommodate an increase in the level of protection.

Second, this analysis of the economic effects of the policy instruments indicates that assistance to particular producers may be given by a number of different instruments. Therefore, an important conclusion to be drawn from this analysis is that as long as one instrument is permitted under GATT rules then parties can retain the capacity to assist particular producers. The analysis indicates further that by choice of instrument, it is possible to minimize the cost to the rest of the community of any given measure of assistance to particular producers. The cost to the rest of the community is minimized when assistance is provided by domestic subsidy. Therefore, national sovereignty to achieve non-economic objectives involving assistance to particular producers is not impeded as long as governments are free to provide domestic subsidies. A qualification to this is that if the 'non-economic' objective is not the assistance of producers but the actual prevention of

imports (say, for health reasons), then it is necessary that states be able to use border measures to achieve such objectives.

6 COMPLIANCE WITH GATT RULES AND THE LONG TERM INTEREST OF STATES

It is submitted that in order for rules to be successful, that is, for there to be substantial and long-lived compliance with them, it is essential that the rules be in the long term self interest of the states party to them. If the rules are not in the long term self interest of the parties, then it will not be possible for the rules to override short term political pressures. Non-compliance will result and it will occur first in 'hard' areas where political pressure for protection is greatest (for example, the agricultural sector in developed countries).

GATT rules can create a framework within which short term political pressures can be overcome by the long-term self-interest of the state. To achieve this, the rules alter the political decision-making process by bringing access to other markets into consideration. This changes the package of incentives available to domestic producers. They must consider the advantages of access to other markets and the possibility of loss of access in retaliation to protective measures. These international factors must be brought to bear with sufficient weight that the short term political pressures within the individual state can be overcome. GATT rules will be in the interest of parties if they encourage both reductions in the level of protection and also choice of less costly policy instruments. To reach a situation where the less costly policy instruments are used, it is essential that the rules do influence states to adopt non-border instruments in preference to border instruments and, to the extent to which border instruments are used, do influence states to adopt price-based border instruments in preference to quantity-based border instruments.

It is necessary to acknowledge the possibility of a conflict between attainment of long-term economic welfare and the attainment of a long term non-economic objective. This conflict is different to the conflict between the long-run self-interest in welfare maximization and the short-term political pressures which would result in a high level of protection. Whereas the short-term political pressures may succumb to compliance with GATT rules where they coincide with long-run self-interest, it is less likely that GATT rules will prevail over a state's long-run self-interest. In the situation where a referendum of well-informed citizens

would choose to maximize national welfare by granting protection to achieve a 'non-economic' objective, then the political pressure to grant the protection may be substantial. If a grant of protection in these circumstances would be contrary to GATT rules, then we might expect that there would be some instances of rule breaking, perhaps sufficient instances to undermine general compliance with a particular rule or even with the rules generally.

The dilemma, then, is that GATT rules have to be strong enough to overcome short-term sectional political pressure and to achieve gains in economic welfare but must also permit genuine long term interests to direct policy without undermining the rules. It is submitted that the solution to this problem lies in the two important distinctions between the policy instruments: between quantity-based border instruments and price-based border instruments; and between border instruments and non-border instruments. As noted above, a government retains the capacity to grant assistance to particular producers for 'non-economic' purposes so long as it is able to employ at least one instrument. We have identified the ranking of instruments in terms of the cost that they impose on the rest of the community. Therefore, the two objects of accommodating the sovereignty of states to achieve 'non-economic' objectives and of achieving economic gains can be reconciled if the capacity of states to employ the least costly policy instruments, non-border instruments, is unrestrained by GATT rules.

Therefore, the two distinctions between the policy instruments are a crucially important element of GATT rules. To ensure that the rules attract a high level of compliance, the rules must be in the long term interest of individual states. That long-term interest requires that states receive economic benefits from complying and also retain national sovereignty to deal with non-economic objectives. Both criteria depend upon the rules appropriately distinguishing between different policy instruments. First, the absence of an appropriate distinction may permit parties to utilize more costly instruments in place of less costly ones thereby inflicting economic damage upon themselves. Secondly, the absence of an appropriate distinction may result in parties having to break GATT rules in order to achieve genuine long-run 'non-economic' objectives.

7 **THE DIVISION BETWEEN MATTERS OF INTERNATIONAL CONCERN AND MATTERS OF DOMESTIC CONCERN MUST EMBODY THE TWO DISTINCTIONS BETWEEN INSTRUMENTS**

The foregoing leads to a prescription of the necessary content of GATT rules in order for them to attract substantial compliance. These prescriptions set out below imply a particular way of balancing submission to international rules with national sovereignty, or as Blackhurst puts it: a way of drawing

the line between policies which a country is willing to discuss with other countries and those which are 'off-limits' to foreigners.¹⁸

Indeed, as Blackhurst continues:

The need to make such a division [between 'international' and 'national' policies] raises the question of an objective basis for classifying policies.¹⁹

It is argued that the division between matters that should be regulated by international law and matters that should be left to the domestic sphere can be made upon the basis of the instrument: that border instruments should be subject to international rules and that non-border instruments should be left to the domestic sphere; further, that international rules should constrain quantity-based border instruments more than price-based border instruments leaving greater domestic autonomy over price-based border instruments.

It would be possible to use some basis other than the instrument as the way of classifying policies as either international or domestic. Indeed, since 1948, there has been a trend away from using the 'instrument' criteria toward using a criteria of 'trade effect' of the policy.²⁰ The tendency to place emphasis on trade effect arises naturally from observation that policies traditionally regarded as domestic do have trade effects. Observation of such trade effects of domestic policies has nowhere been easier than in the agricultural sector and the incidence of argument that proper GATT rules need to regulate domestic policies has nowhere been more frequent than in relation to the agricultural sector. This thesis argues that even if there is some scope for using the 'trade effects' as a criteria for classification, it cannot be done at the expense of emphasis on the 'use of instrument' criteria. If emphasis on the 'use of instrument' criteria wanes then so also wanes the ability to perform the above

18 Blackhurst, Richard, "The Twilight of Domestic Economic Policies" (1981) 4(4) *The World Economy* 357-373 at 358.

19 At 358.

discussed constitutional function of GATT rules in a way that is compatible with national sovereignty.

8 EMBODIMENT OF THE TWO DISTINCTIONS IN GATT RULES

The culmination of this analysis is the submission that the following are necessary criteria for the successful operation of GATT rules:

- (1) GATT rules must modify political decision making so as to reduce the level of protection;
- (2) GATT rules must modify political decision making so as to make it more difficult to apply border instruments than non-border instruments;
- (3) GATT rules must modify political decision making so as to make it more difficult to apply quantity-based border instruments than price-based border instruments; and
- (4) GATT rules must leave parties substantially free to utilize non-border instruments.

It is possible to make the criteria for successful GATT rules more detailed to suggest how different instruments might be regulated:

As to the first criteria, the facilitation of reduction of protection levels, the rules should facilitate commitments to reduce protection in any form. The GATT already achieves this with import tariffs. The original GATT did not but could have also facilitated undertakings to bind and reduce export subsidies. Even on import quotas, to the extent that they are legal, it could be possible to negotiate measured undertakings to increase them. Commitments to reduce domestic subsidies should be accommodated although it is submitted that if commitments are given on border instruments then the situation would rarely arise where parties have sufficient incentive to negotiate reductions of domestic subsidies.

As to the second criteria relating to the choice of non-border instruments instead of border instruments, the reduction of the level of a border instrument should confer greater benefits than the reduction of the level of a non-border instrument and the violation of an obligation on border instruments should impose greater costs than the violation of an obligation on

non-border instruments. There should be some benefit from replacing border instruments like import tariffs or export subsidies with domestic subsidies.

As to the third criteria relating to the choice of price-based instruments instead of quantity-based instruments, it is necessary that the balance of benefits and costs flowing from different instruments favour the use of either import tariffs or export subsidies over import quotas. Even where import quotas are allowed, there should be some benefit from negotiating to replace them with import tariffs.

As to the fourth criteria relating to freedom to utilize non-border instruments, although, it would be possible to accommodate undertakings to reduce domestic subsidies, there should be a presumption that in the absence of express undertakings the ability to employ domestic subsidies remains unrestricted.

Some writers have taken the view that the pre-Uruguay GATT rules already did appropriately distinguish between different instruments.²¹ One of the functions of the next part of this thesis is to analyze whether these two distinctions between policy instruments were, in fact, satisfactorily embodied in the pre-Uruguay Round GATT rules. This leads to the chief function of the next part of this thesis which is to answer the question: If these two distinctions were not satisfactorily embodied in the rules, is there a connection between that deficiency and the inability of the GATT, in the agricultural sector, to achieve the dual objectives of economic gains and the accommodation of national economic sovereignty and, therefore, a connection between that deficiency and the lack of compliance with the rules in relation to agricultural trade.

Before commencing that analysis, there remain two matters to be addressed: Firstly, is there any reason why the general conclusions made in this chapter upon the analysis contained in

21 Dunkel, Arthur & Roessler, Frieder, "Hiérarchie Des Instruments De Politique Commerciale Dans Le Système Juridique Du GATT" in Guy Ladreit de Lacharriere et la politique juridique extérieure de la France (Masson, Paris, 1989) pp234-244 esp at 241; Petersmann, Ernst-Ulrich, "Grey Area Trade Policy and the Rule of law" (1988) 22(2) *Journal of World Trade* 23-44 at 25; Petersmann, Ernst-Ulrich, *Constitutional Functions and Constitutional Problems of International Economic Law* (University Press, Fribourg, Switzerland, 1991) p93; Roessler, Frieder, "The Constitutional Function of the Multilateral Trade Order" in Meinhard Hilf & Ernst-Ulrich Petersmann, *National Constitutions and International Economic Law* (Studies in Transnational Economic Law, Volume 8) (Kluwer, Boston, 1993) pp53-62 at 56-58; and Roessler, Frieder, "Discussion to Session IV: Competition and

this Part of the thesis should not be applicable to agricultural trade as they are applicable to any other sector of trade. Secondly, whether the limitation of this theoretical perspective to the four principal policy instruments limits its usefulness.

9 DO THESE CONCLUSIONS APPLY TO AGRICULTURE ?

An important question is whether the abovementioned necessary criteria for successful application of GATT rules are applicable to the formulation of rules to govern agricultural trade or whether agriculture is sufficiently different that perhaps these criteria are not necessary or appropriate for formulation of rules to govern agricultural trade. In particular, given that agriculture is an area where the trade effects of domestic policies are substantial, it is appropriate to consider whether rules based on the above 'essential criteria' are adequate to keep such trade effects of domestic policies down to a tolerable level.

The above submissions do not make any special provision for agricultural trade. This analysis proceeds upon the basis that it must be possible for the same set of rules to be successful for all areas; that the problems with application of the rules to agriculture must result from a defect in the rules rather than from any special characteristic of the agricultural sector. Indeed, the investigation of political theory did not support any argument that agriculture is qualitatively different from other sectors in which exist politically powerful producers and politically powerless consumers. The explanation of the internal economic and political aspects of protection offer a good explanation of the behaviour of governments in developed countries in agricultural policy. Using the political theory of general application without referring to any special characteristics of agriculture, it is possible to identify that the agricultural sector in developed countries meets the usual criteria upon which we would predict the existence of a politically powerful group of producers and a politically powerless group of consumers of agricultural products.

It should be acknowledged that the GATT's failures with agriculture have arisen largely out of disagreement over how the borderline between international jurisdiction and domestic jurisdiction should be drawn. It has been an area where there has been much contention over whether GATT rules are adequate to deal with the international effects of domestic

policies. A significant part of this controversy has related to the problem of surpluses of agricultural production. The phenomenon of large surpluses being exported and causing significant disruption on the world market has generated argument that export subsidies should be completely prohibited and that domestic subsidies, as an underlying cause of surpluses, should be subjected to international regulation. To be satisfied that a general set of rules without special rules for agriculture can be successful, it is necessary to be satisfied that the general rules can deal adequately with the problem of agricultural surpluses. For that end, it is necessary to look more closely at the causes of surpluses and to consider how regulation of border instruments affects the use of non-border instruments.

Surpluses occur when the quantity of production available for supply exceeds demand. The disequilibrium occurs when producers, in response to the price available to them, supply a given quantity which is greater than the quantity that consumers, responding to the price available to them, wish to buy. The imbalance is caused by a price gap between the prices available to producers and consumers. Commonly, the price gap is caused by government imposed border instruments which raise the domestic price above the world price. However, even domestic subsidies, although not raising the consumer price, do raise the effective price received by producers thereby leading to increased volume of production. To deal with the increased volume of production, governments have a limited number of options. First, they can do nothing and can permit the extra volume to be sold on the domestic market. However, if the government has other policies in place which are aimed at maintaining a high price, then the sale of the extra volume would lower the domestic price. If the government does not wish to undermine its pricing policy, then the government is left holding a surplus which must either be stored or exported. Since it can only export at the world price, then the export of the surplus costs the government an effective export subsidy: the difference between the domestic support price and the world price. The supply of these increased quantities onto the world market can decrease the world price causing disruption to other producers who are producing on the basis of market conditions without subsidies.

It is true that domestic subsidies can contribute to the accumulation of surpluses. However, it is paramount that one takes into account that the regulation and reduction of border

instruments, in fact, removes some of the market conditions under which domestic subsidies contribute to surpluses. In the absence of border instruments, the domestic price will be the same as the world price so any government policy to reward farmers with a higher target price will cost the government the difference between the world price and the target price. However, the government can reduce the cost of such a domestic subsidy by diminishing the gap between the world price and the target price by using a border instrument to raise the effective world price. Therefore, the reduction of border instruments makes it more expensive for governments to maintain any given target price with a domestic subsidy. This provides a financial incentive for the government to reduce the target price which has the effect of lowering the quantity supplied by domestic producers which in turn reduces any surplus. Therefore, legal constraints on the border instruments do, in fact, limit the extent to which domestic subsidies can cause exportable surpluses.²²

Particular attention needs to be given to how regulation of export subsidies can contribute to the management of the potentially disruptive effects of surpluses. This question is in effect one of how might the framers of the original GATT have decided to regulate export subsidies. (However, the answer given here will have to be revisited at the end of this work in the light of the regulation of export subsidies that has been established in the Uruguay Round.) Consider the two possible extremes of the approaches that may be applied to countries with surpluses generated by domestic policies. If export subsidies are not regulated, then the effects of the domestic policy can be unloaded onto the international market without restraint. If export subsidies are completely prohibited, then the effects of the domestic policy must be absorbed within the domestic market. Going beyond this dichotomy leads to the crux of the problem: how do we delineate the extent to which the effects of surpluses can be permitted to be shifted out of the domestic market onto the world market? It is submitted that the clearest guidance on this question can be gained from the classification of policy instruments based on the two economic distinctions. Export subsidies are classified as price-based border instruments along with import tariffs. This suggests that the regulative treatment given to export subsidies should be similar to that given to import tariffs. Similarity of treatment implies that it is not necessary to completely

22 This same point is also made in Snape, R.H., "The Importance of Import Barriers" in Henryk Kierzkowski, *Protection and Competition in International Trade: essays in honour of W.M.Corden*

prohibit export subsidies. Not prohibiting export subsidies would mean accepting that the effects of domestic surpluses need not be dealt with entirely within the domestic economy but can, at least to some extent, be spilled over onto the world market. Therefore in a world in which export subsidies are common, it is submitted that a system of quantitative bindings of the ad valorem amount of export subsidies is an appropriate way to delineate the edge at which domestic surpluses would become matters of international concern. Such bindings implicitly hold an agreement about the extent to which disposal of a surplus must be dealt with by adjustment within the domestic economy. This does leave considerably more freedom to use export subsidies than would exist under a prohibition.²³ However, it does allow for the same result through a progression toward a zero binding.

Finally, we need to consider the effects of domestic subsidies in the situation where there are no import barriers and no export subsidies. The domestic subsidy provides an incentive to increase production. The increased production may be sold domestically or may be exported. The displacement of exports in other markets would occur only if the increased volume of exports is large enough to reduce the world price in which case the domestic price would necessarily also fall. If the domestic subsidy is designed to maintain a target price for domestic producers then the budgetary cost of the subsidy will increase and political pressure to reduce that cost will also increase. Even if the domestic subsidy is fixed in amount, the budgetary cost would still increase because of the additional volume so there would still be political pressure to reduce the cost. The cost could be reduced by changing the subsidy into an export subsidy or by introducing import barriers. To the extent that those options are closed by GATT rules, then the political pressure to reduce the cost of the domestic subsidy can only be met by reducing the subsidy.

Therefore, this problem of domestic subsidy generated surpluses can largely be dealt with by rules on border instruments. If rules on border instruments are effective then domestic political pressures can be relied on to discipline domestic subsidies. In an extreme case, a country may be willing to negotiate a reduction in a domestic subsidy in exchange for a

(Basil Blackwell Ltd, London, 1987) pp217-221.

23 It might be argued that such a set of rules would not have been adequate to avoid the problem of competing export subsidies which lowered the world price. However, in such a situation, there would be an incentive for parties to exchange bindings on export subsidies just as in a situation of spiralling tariffs, there is an incentive to exchange tariff bindings.

change in another country's policies and the rules need to allow for such negotiated reductions in domestic subsidies.

Such a solution leaves parties free to use non-border instruments to achieve non-economic objectives. As stated above, that there should be freedom to use at least one policy instrument to achieve non-economic objectives is a pre-requisite to success of GATT rules. Therefore, it is submitted that a general set of rules that helps parties to achieve both economic benefits and allows some autonomy in relation to non-economic objectives does not need special modification to cope with agriculture (or other hard areas). It is on that basis that the next part of the thesis assesses whether GATT rules met the proposed criteria and how successful they were in application to agriculture.

10 THE LIMITATION OF THIS ANALYSIS TO THE PRINCIPAL POLICY INSTRUMENTS

The conclusions reached here are limited by the fact that analysis has been limited to the four principal policy instruments. In particular, the limitation of the analysis of domestic subsidies to production subsidies means that this analysis has not considered the differences between different types of domestic subsidies, has not considered the way that different types of domestic subsidies could be ranked in order of the cost of achieving particular non-economic objectives, nor the way that they could be ranked in order of likelihood that they will be chosen by political decision making processes. There is scope for GATT rules to have a role in guiding parties to adopt the particular type of domestic subsidy which addresses the non-economic objective at the lowest cost.²⁴ GATT rules can also have a role in guiding parties away from the adoption of domestic subsidies in situations in which there are no justifiable non-economic objectives, that is, there are no market failures that need correcting.²⁵ However, an extension of the theoretical analysis contained herein is not attempted here. It is nevertheless important as will become apparent after the post Uruguay

24 See Anderson, Kym, *Domestic Agricultural Policy Objectives and Trade Liberalization: Synergies and Trade-Offs* University of Adelaide Centre for International Economic Studies, Policy Discussion Paper No 98/08, October 1998 (paper presented at an OECD workshop on "Emerging Trade Issues in Agriculture", Paris 26-27 October 1998, since published at <http://www.oecd.org/agr/trade/>).

25 See Schwartz, Warren F. & Eugene W. Harper, Jr., "The Regulation of subsidies Affecting International Trade" (1972) 70(5) *Michigan Law Review* 831-858 at 834; and Malmgren, Harald B., "Negotiation of Rules on Subsidies in a World of Economic Interventionism" in Stephen J. Warnecke

Round rules have been described. Post-Uruguay round rules have created a distinction which, though more complicated, is essentially that between domestic subsidies that boost output and other types of domestic subsidies. As regulation is taken further, into regulation of particular types of domestic subsidies, then it is possible that the rules may constrain the ability of parties to use the first best instrument to achieve a particular non-economic objective. In practice, such a situation is unlikely to occur as a result of increased regulation of production subsidies for two reasons. First, the relevant non-economic objective would rarely be the increase of production but would generally relate to the use of an input or to some by-product of production. Restrictions on use of production subsidies would not restrict the ability to achieve non-economic objectives relating to inputs or by-products. Even in the case in which the non-economic objective did relate to the level of production, one must consider whether even though the use of a production subsidy might be the first best instrument to use if the country is considered in isolation, it might be possible that, in the context of the behaviour of other countries, the use of a production subsidy is not the first best policy response. One would have to consider whether there is a benefit to be achieved from all parties agreeing not to use or to limit particular types of domestic subsidies because of the adverse effects on each other when many parties use them.²⁶

The within analysis has not been extended to cover the abovementioned issues relating to classes of domestic subsidies. However, the limits of the analysis contained here do not detract from the importance of the principles described here. The principles of choosing non-border instruments over border instruments and price-based border instruments over quantity-based border instruments always provide a net benefit without in any way

(ed), *International Trade and Industrial Policies - Government Intervention and an Open World Economy* (Macmillan, London, 1987) pp210-231 at 217.

26 It may be a prisoners dilemma situation in which a third best outcome can be avoided by cooperation, see Abbott, Kenneth W., "The Trading Nation's Dilemma: the Function of the Law of International Trade (1985) 26(2) *Harv Int LJ* 501-532 (also referred to above in the context of tariff reductions of low tariff in the big country case, see ch5 under "Conclusion No 2 - The Overall Loss or Gain - Qualification - The Big Country Case").

preventing the imposing country from achieving any non-economic objective related to production, producers, inputs, or any by-product of production by the first best instrument. That benefit exists even without having to consider the behaviour of other nations.

The Importance of Disciplining the Choice of Policy Instrument to the Effectiveness of GATT as International Law Disciplining Agricultural Trade Policies

Part 3

The Application of the Pre-Uruguay Round GATT to Agriculture

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|------------|---|
| Chapter 9 | Introduction To And Outline Of Part 3 |
| Chapter 10 | Some Essential Historical Background: The USA Agricultural Waiver And The Formation Of The European Economic Community And Its Common Agricultural Policy |
| Chapter 11 | The Pre-Uruguay Round Rules On Import Barriers |
| Chapter 12 | The Pre-Uruguay Round Rules On Export Subsidies |
| Chapter 13 | The Pre-Uruguay Round Rules On Domestic Support |
| Chapter 14 | Previous Attempts To Improve The Rules |
| Chapter 15 | Summary And Conclusions From Part 3 |

CHAPTER 9

INTRODUCTION TO AND OUTLINE OF PART THREE

1 INTRODUCTION

This part of the thesis examines the application of the GATT to agriculture from 1947 until the Uruguay Round. It builds upon the description in chapter 2, above, of the framework of rules, and examines their specific application to agriculture and the series of attempts to improve the rules and their application to agriculture. The examination attempts to uncover all of the relevant legal matters that have affected the degree of success and failure in applying the rules to agricultural trade. As with the description in chapter 2, since the analysis in this part is concerned with the rules as they were over the period 1947 to 1994, then generally the past tense is used even though in many instances, statements about the rules would still be true in respect of the post-WTO GATT.¹

The analysis in this Part builds upon the way that the description of the overall framework of rules in chapter 2 highlighted the differences between the regulation of different policy instruments and the variables contained within the rules which can affect the choice between the different policy instruments. In particular, there is a focus on the matters outlined in Part 2 of this thesis: the two distinctions between border instruments and non-border instruments and between price-based border instruments and quantity-based border instruments.

¹ Note though that even where the words of the GATT 1947 have not been amended, in fact the applicable law may have changed. The provisions may be overridden by a provision of one of the specific agreements listed in Annex 1A of the *Agreement Establishing the World Trade Agreement*: see the General Interpretative Note to Annex 1A. For example, the wording of Article VI and XVI has not been altered but they are now subject to the provisions of the *Uruguay Round Agreement on Agriculture* and of the *Uruguay Round Agreement on Subsidies and Countervailing Duties*. Generally, see the discussion of the relationship of this narrative to the pre-WTO GATT and the post WTO law at the beginning of Chapter 2 above.

Part 2 argued that successful application of the rules depends upon achieving the dual goals of economic benefits and retention of capacity to achieve non-economic policy objectives, and that, for the achievement of those dual goals, it is essential that the rules appropriately distinguish between price-based and quantity-based border instruments and between border instruments and non-border instruments.

This analysis seeks to determine whether the provisions of the GATT and their application have in fact given preference to price-based border instruments over quantity-based instruments and to non-border instruments over border instruments. This part of the thesis looks for any connections between:

- (1) any deficiencies in appropriately embodying and applying the two desirable distinctions in the rules; and
- (2) the 'failures' in applying the rules to the agricultural sector.

This part concludes with an assessment of whether flaws in the way that the rules embody the two distinctions contributed to the 'failures' in the application of the rules to agriculture.

This analysis is begun with a review of the framework of rules described in Chapter 2 in the context of the two distinctions between policy instruments the importance of which has been established in Part 2.

2 CONSISTENCY OF THE RULES WITH THE TWO DISTINCTIONS BETWEEN THE POLICY INSTRUMENTS

The framework of rules described in chapter 2 exhibits some consistencies with the two distinctions and also some inconsistencies. Reviewing the general framework of rules, we can make some observations about the whether the rules actually do appropriately make the two distinctions.

2.1 PRICE-BASED VS QUANTITY-BASED BORDER MEASURES

There was significant consistency with the principle that quantity-based border instruments should be dealt with more strictly than price-based border instruments. The rules applied a complete ban to quotas but only applied a limit on the size of tariffs. The prohibition of

quotas applied, on its face, to all products whereas the limits on the size of tariffs only applied to products chosen for inclusion in a country's schedule.

However, there were also significant aspects of the rules which were not consistent with this principle. The number and extent of the exceptions for import quotas undermined the preference for price-based border instruments over quantity-based border instruments. None of the exceptions made it any easier to impose a tariff instead of a quota. In particular, the balance of payments exceptions in Article XII and Section B of Article XVIII only permitted quantitative restrictions and not tariffs.

The desirable preference for price-based measures was not reflected in the provisions for offering compensatory adjustments or for imposing retaliation. There was nothing in the rules for negotiating compensatory adjustments which assigned any preference to the removal or relaxation of an import quota. Nor was there any constraint on the CONTRACTING PARTIES power to authorize countermeasures or on any contracting party's capacity to adopt them which made it any easier to adopt a import tariff surcharge than an import quota.

The approach to regulating export subsidies was also not consistent with a desirable ranking between price-based and quantity-based border instruments. The Agreement attempted to prohibit some export subsidies rather than to regulate them in some less strict way and thereby attempted to impose the same regulatory tool upon them as was imposed upon import quotas. Such rules ranked import quotas and (some) export subsidies as equally undesirable. It would have been more consistent with a desirable ranking to have regulated export subsidies in a more flexible way.

2.2 BORDER INSTRUMENTS VS NON-BORDER INSTRUMENTS

There was substantial consistency with the principle that border measures should be more strictly regulated than non-border measures. The initial Agreement with the original version of Article XVI certainly treated subsidies more favourably than it treated import restrictions. The making of the distinction in the 1955 amendments between export subsidies and other subsidies was consistent with a delineation which treats export subsidies as a border

measure and other subsidies as non-border measures and treats border measures more strictly.

The preference for non-border measures over border measures was distorted by some aspects of the Agreement. The preference was not clearly manifested in the regulation of export subsidies and production subsidies. First, the ineffectiveness of the prohibition on export subsidies on agricultural products meant that, in practice, for agricultural products, both export subsidies and domestic subsidies were permitted. Second, the application of the nullification or impairment rule to non-violations has meant that whenever a tariff binding is given then it carries with it a parallel limit on the size of domestic production subsidies. This rule impacted upon production subsidies which decrease imports but not upon either production subsidies that increase exports or upon export subsidies.

Another distortion was introduced by the way that the exceptions from the rules on border measures did not facilitate the use of non-border measures in preference to border measures. Authorisation of border measures could be given without consideration of whether the desired result could be achieved by using a non-border measure.

3 OUTLINE OF PART 3: THE APPLICATION OF THE PRE-URUGUAY ROUND GATT TO AGRICULTURE

There is no obvious best way to arrange the material. The explanation of the rules, the key historical events, the application of the rules and the various attempts to improve the rules are all interrelated. However, I have chosen to precede the more detailed analysis with some essential historical background and to suspend description of the attempts to improve the rules until the end of this Part. The whole of this material is based on the introduction to the framework of regulation set out in chapter 2. The material is arranged in the following order:

Chapter 10 Some Essential Historical Background: the USA Agricultural Waiver and the Formation of the European Community and its Common Agricultural Policy

Some of the events and issues that arose during the early years of the GATT have had such a substantial influence on the application of the rules to agriculture that it is convenient to

explain these events and issues before embarking on the more detailed analysis of the rules and their operation.

Chapter 11 The Pre-Uruguay Round Rules on Import Barriers

Chapter 12 The Pre-Uruguay Round Rules on Export Subsidies

Chapter 13 The Pre-Uruguay Round Rules on Domestic Support

These next three chapters identify the areas of difficulty in application of the GATT rules to agriculture and assess whether there is a connection between the occurrence of these difficulties and the deficiencies in appropriately embodying the two distinctions in the rules.

The detailed analysis of the rules is divided in the same way that the Uruguay Round negotiation on agriculture was divided which is into a separate consideration of import barriers, export subsidies and domestic support. This division fits comfortably with maintaining the focus on the separate regulation of the different instruments. It also lays a foundation for comparison of the past operation of the agreement with the amended rules which have been produced in the Uruguay Round.

Chapter 14 Previous Attempts to Improve the Rules

This chapter deals separately with the series of meetings, committees and reports that have occurred over the years of the operation of the GATT in attempts to improve the application of the GATT to agriculture.

Chapter 15 Summary and Conclusions from Part 3

This summarises the problems with applying the GATT to agriculture that have been uncovered. It assesses the extent to which the rules and their application have failed to appropriately embody the two distinctions and assesses whether there is a connection between that deficiency and the problems with agriculture. This chapter also prepares for Part 4 which analyzes whether the identified deficiencies have been remedied by the Uruguay Round.

CHAPTER 10

SOME ESSENTIAL HISTORICAL BACKGROUND: THE USA AGRICULTURAL WAIVER AND THE FORMATION OF THE EUROPEAN ECONOMIC COMMUNITY AND ITS COMMON AGRICULTURAL POLICY

1 INTRODUCTION

Any review of the application of GATT rules to agriculture must refer to two significant events:

- (1) the US dairy dispute that led to the granting of the US agricultural waiver;¹ and
- (2) the formation of the European Economic Community ('EEC')² which led to the creation of its Common Agricultural Policy ('CAP').³

These two series of events set the scene for the way that GATT rules were subsequently interpreted and for the way that distortions have developed in international agricultural

1 The series of events surrounding the dairy dispute and the granting of the waiver have been described many times. This account relies most heavily upon: Jackson, John H., *World Trade and the Law of GATT* (Bobbs Merrill, Indianapolis, 1969) pp733-737; Hudec, Robert E., *The GATT Legal System and World Trade Diplomacy* (Butterworths, Salem, New Hampshire, 1990) pp181-200; GATT, *International Trade, 1955*, p158ff and the materials contained in the *BISD* footnoted within.

2 The European Economic Community ('EEC') was established under the *Treaty Establishing the European Economic Community ('EEC Treaty')* (done Rome, 25 March 1957, in force 1 January 1958, 25 UNTS 11). The body vested with the executive powers of the EEC was called the European Commission ('EC'). In 1965, the *Treaty Establishing a Single Council and a Single Commission of the European Communities ('the EC Merger Treaty')* done 8 April 1965, UKTS 15 (1979), 4 ILM 776) created a single European Commission for administering the *EEC Treaty* and also the *Treaty Establishing the European Coal and Steel Community* and the *Treaty Establishing the European Atomic Energy Community*. All three communities continued to exist after 1965 and the creation of the single European Commission. The three communities were often referred to as the European Communities or the 'EC'. In 1992, the *Treaty of European Union ('Maastricht Treaty')* (done 7 February 1992, Maastricht, in force 1 November 1993, UKTS 12 (1994), 31 ILM 247) created the European Union and changed the name of the European Economic Community to the European Community (see *Maastricht Treaty*, Article G.A(1)). In this work, all references to the European Economic Community before 1 November 1993 are to the EEC rather than to the EC except in direct quotations which refer to the EC. References to the entity after 1 November 1993 are to the EU. Any reference to the EC is a reference to the European Commission.

3 These event are well documented. This account relies most heavily upon: Hudec, Robert E., *The GATT Legal System and World Trade Diplomacy* (1990) chapter 18 esp pp211-216 and chapter 19 esp pp238-240; Talbot, Ross B. *The Chicken War* (Iowa State University Press, Ames, Iowa, 1978); Walker, Herman, "Dispute Settlement: The Chicken War" (1964) 58 *AmJIL* 671; .

trade. Rather than expand the analysis in subsequent chapters to allow for multiple references to these events, it is proposed to devote this chapter to them.

2 THE USA DAIRY DISPUTE LEADING TO THE USA'S AGRICULTURAL WAIVER UNDER ARTICLE XXV

THE USA AGRICULTURAL ADJUSTMENT ACT 1933

At the time that the GATT was negotiated, the United States had in place a number of programmes which supported the prices of agricultural products. These price support programmes had been implemented under the *Agricultural Adjustment Act* ("AAA") of 1933.⁴ Under that Act, prices were set so as to maintain purchasing power parity between farm commodities and other commodities. The Act provided for benefit payments to farmers for keeping their production volume down to a desired level.⁵ The Act also introduced the technique of 'non-recourse' loans which have been an important part of US agricultural policy ever since. Loans were made to farmers by the Commodity Credit Corporation⁶ on the security of storable agricultural commodities. The farmers were given the option of repaying the loan or handing over the stored commodity which secured the loan. The loans were non-recourse because the Commodity Credit Corporation could only enforce repayment by taking the security and could not enforce any obligation to repay the debt. Such an arrangement corresponds to a put-option. It places a floor under the selling price. The ratio of commodity required as security to size of a loan constitutes an effective price for the commodity. It is this ratio which is generally termed the 'loan rate' not to be confused with any rate of interest that applies under the loan. In 1935, the Act was amended by the addition of s22 under which the President was empowered and, arguably, in some circumstances, required to impose fees or quotas on imports whenever the imports would otherwise render ineffective, or materially interfere with, a program under the Act.⁷

Aware that unrestricted imports might undermine the effectiveness of those programmes, the USA proposed an exception to the prohibition on import quotas to permit import quotas

4 May 12, 1933, Pub L No 10, 48 Stat 31.

5 Brown, *The United States and the Restoration of World Trade*, p23.

6 See Brown, as above, p24.

7 Aug. 24, 1935, Ch641, s31, 49 Stat.773; (current version at United States Code, Title 7, s624). For an analysis of s22 and its application between 1935 and 1981, see Zedalis, Rex J., "Agricultural Trade and Section 22" in (1981-1982) 31 *Drake Law Review* 587-620.

for the purpose of maintaining the effectiveness of programmes under the *AAA*. The USA proposed Article XI:2(c)(i) which as noted in chapter 2 permits quotas if they are necessary for the operation of a domestic commodity program to restrict the quantity of a commodity marketed or produced and if the quotas do not reduce the ratio of imports to domestic produce that would have existed in the absence of the quotas.⁸ Presumably, the US administration believed that any import quota imposed under s22 of the *AAA* would fall within the exception provided by Article XI:2(c)(i).⁹

When the Protocol of Provisional Application of the GATT came into force in 1948, it was not approved by Congress nor was it implemented by statute into the domestic law of the USA.¹⁰ The works of Hudec and of Jackson have analyzed the authority of the US President to enter into the Protocol and have considered the arguments as to the way that the GATT existed in US domestic law.¹¹ There are two possibilities: either that the Protocol existed as an executive agreement made by the President under the authority of the *Reciprocal Trade Agreements Act* of 1934¹² or that it existed in US domestic law only by virtue of the Presidential proclamation of it.¹³ On the first possibility, there has been some contention as to whether the GATT, as an executive agreement not approved by Congress, would receive the benefit of Article VI(2) of the US Constitution which endows treaties with the same place in the hierarchy in US law as federal statutes. Therefore, there has been doubt as to whether the GATT would override a prior federal statute. On the second possibility, as mere executive proclamation, the GATT would not override prior legislation and would be overridden by a subsequent executive order.

8 On the negotiation of Article XI:2(c)(i), see Brown, as above, pp115-117.

9 See Gardner, *Stirling-Dollar Diplomacy in Current Perspective* (Columbia University Press, New York, 1980), p374.

10 See Jackson, John H., "The General Agreement on Tariffs and Trade in United States Domestic Law" (1967) 66 *Michigan Law Review* 250 at 253 & 265.

11 Jackson, John H., "The General Agreement on Tariffs and Trade in United States Domestic Law" (1967) 66 *Michigan Law Review* 249; Jackson, John H., "US Constitutional Law Principles and Foreign Trade Law and Policy" in Meinhard Hilf & Ernst-Ulrich Petersmann, *National Constitutions and International Economic Law* (Kluwer, Deventer, 1993) pp65-89. Hudec, Robert E., "The Legal Status of GATT in the Domestic Law of the United States" in Meinhard Hilf, Francis G. Jacobs & Ernst-Ulrich Petersmann, *The European Community and GATT* (Kluwer, Deventer, 1989).

12 As amended and extended for 3 years in 1945: 59 Stat.410; The citation for the 1934 Act is 49 Stat.943; (It was codified at 19 USC 1351). See the list of enactments of this legislation in Appendix A of Jackson, "The General Agreement on Tariffs and Trade" (1967) 66 *Michigan Law Review* 249 at 313.

13 On the first possibility, see Jackson (1967), as above, at pp253ff and on the second possibility, see the same article at 288-292.

It suffices for present purposes to say that there was doubt about where the GATT lay in the hierarchy of US domestic law and as to the relative position in that hierarchy of the GATT and the *AAA* and orders made pursuant to it. This issue was important because there was a possibility that import restrictions imposed under the *AAA* could be in violation of the GATT because the *AAA* required the imposition of import controls wherever a programme was threatened regardless of whether the programme was directed toward a reduction in domestic production. To deal with this uncertainty, the Congress acted to ensure that the President's executive power under the *AAA* did not extend to proclaiming quotas in circumstances that would be contrary to the GATT. Congress amended s22 of the *AAA* to ensure compliance with the GATT, by inserting sub-section 22(f) as follows:

No proclamation under this section shall be enforced in contravention of any treaty or other international agreement to which the United States is or hereafter becomes a party.¹⁴

This avoided the situation where the President could proclaim quotas that would be contrary to the GATT even though they would be legal under domestic law.

THE USA DAIRY QUOTA DISPUTE

Over this period and until 1951, there was a continuing debate over whether the United States should ratify the Havana treaty thereby joining the International Trade Organization.¹⁵ By the time that the Torquay round of negotiations began in September 1950, the majority of the Congress was against joining the ITO and was also somewhat hostile toward the GATT. During the Torquay Round,¹⁶ the US advised the other contracting parties that the Havana treaty would not be submitted to Congress for approval.¹⁷

In 1951, the US Congress manifested its hostility to the GATT in two enactments.¹⁸ First, in an amendment to a bill extending the *Defense Production Act* of 1950, it added s104

14 July 3, 1948, Ch827, Title I, s2, 62 Stat.261.

15 See Gardner, Richard N., *Sterling-Dollar Diplomacy in Current Perspective* (Columbia University Press, New York, 1980) pp371-378.

16 From September 1950 until April 1951.

17 USA, *Dept of State Bull*, xxiii (1950) p977. See Gardner (1980) p 378 & Jackson (1969) p50; and the references cited there.

18 See the commentary on the attitude of Congress in Warley, T.K., "Western Trade in Agricultural Products" in Andrew Shonfield (ed) *International Economic Relations of the Western World 1959-1971* (Oxford University Press, London, 1976) at p346 and in the work there cited: Leddy, J.M., "The

which required the President to impose quantitative restrictions on a range of farm products.¹⁹ Although President Truman did not veto the bill and signed it into law on 31 July 1951, he proposed a new bill to repeal s104.²⁰ However, on 31 August 1951, various import controls were imposed including import prohibitions on butter, peanuts, flax seed, rice and dried skim milk and import quotas on cheese.²¹ It was clear that the legislation was not GATT consistent. It did not meet the requirements of the exception in Article XI:2(c)(i) because it required import controls in circumstances where the relevant programmes did not seek to reduce domestic production, nor was it grandfathered because on 30 October 1947, s22 of the AAA had not applied to programmes under the *Defense Production Act*.

Secondly, the Congress amended s22(f) of the AAA so as to reverse the order of precedence between domestic and international law. The new version of s22(f) was:

No trade agreement or other international agreement heretofore or hereafter entered into by the United States shall be applied in a manner inconsistent with the requirements of this section."²²

This meant that any subsequent proclamation of quotas under the AAA would be legal under domestic law even though they might be illegal under international law.²³

The new restrictions under s104 brought complaints from the other contracting parties. The US executive did not assert that the measures were GATT consistent. Instead, the US government defended itself by referring to its ongoing attempts to have s104 repealed. When it became apparent that the US Congress would not in its current session repeal s104,²⁴ the CONTRACTING PARTIES passed the resolution of 26 October 1951. In the preamble to the operative part of this resolution, the CONTRACTING PARTIES recognized

United States commercial policy and the domestic farm program" in W.B.Kelley (ed) *Studies in United States commercial policy* (Chapel Hill, 1963) at pp202-208.

- 19 The 1951 Act is 65 Stat.131 (1951); Section 104 provided that there were to be no imports of fats and oils, peanuts, butter, cheese and other dairy products which the Secretary of Agriculture might determine would reduce domestic production below current levels or below higher production goals which might have been set, which would interfere with ordinary domestic marketing or storing of the products, or which would cause any unnecessary burden or expenditure under a price support scheme.
- 20 See Hudec, *The GATT Legal System and World Trade Diplomacy* (1990) p182.
- 21 Details of these import controls are set out in GATT, *International Trade 1952* (GATT, Geneva, 1953) p83.
- 22 June 16, 1951, Ch141, s8(b), 65 Stat.75.
- 23 See Martin, Edwin G., "The conflict between Foreign Trade Agreements and Price-Support Programs" (1951) 37 *Cornell LJ* 17-31 tracing the conflict in Congress especially at 26-28.
- 24 See Hudec, *The GATT Legal System and World Trade Diplomacy* (1990), p184.

that the quotas were in violation of Article XI, that concessions granted by the US had been nullified and impaired and that the circumstances were serious enough to justify action under Article XXIII:2.²⁵ However, curiously, the operative part of the resolution did not request the US to withdraw the quotas or to repeal s104, but instead requested the other affected contracting parties to give the US a reasonable period of time in which to effect the repeal of s104.

At the next (the seventh) session of the contracting parties in November 1952, the United States government reported that the repeal of s104 of the *Defense Production Act* had been rejected by Congress, that the legislation had been renewed until 30 June 1953 and that the restrictions remained in force although with some liberalization.²⁶ The United States also indicated that s104 was not likely to be renewed upon its expiry on 30 June 1953 but that any further restrictions would be imposed under the authority of s22 of the *Agricultural Adjustment Act*.

A number of countries objected to the continuing violation of Article XI. A smaller number advised the contracting parties that they were considering retaliatory action under Article XXIII. The Netherlands alone made a formal request for authorization of retaliatory action. It sought approval for the imposition of a quota on the Netherland's imports of wheat flour from the USA. The USA responded that it would continue to seek the removal of the offending measures. The CONTRACTING PARTIES passed two resolutions: one, which recommended that the US continue its efforts to repeal section 104,²⁷ and another which authorised the imposition by the Netherlands of a quota of 60,000 tons on wheat flour imports from the US for 1953.²⁸

At the end of June 1953, the United States allowed s104 of the *Defense Production Act* to expire. However, the same dairy quotas were proclaimed under s22 of the *Agricultural*

25 "Article XI: United states Restrictions On Dairy Products", Resolution of 26 October 1951; *BISD*, Vol.II, p16.

26 The United States reported all of the liberalizations in detail, see GATT, *International Trade 1952*, p95; and Hudec (1990), as above, at p189-190; Hudec cites GATT,L/19, Sept.10, 1952; L/19/Add.1 Oct.6, 1952. These comprised removal of quotas for some cheeses and increased quotas for others. Measures affecting butter and other milk products were not liberalized.

27 "United States Import Restrictions On Dairy Products", Resolution of 8 November 1952; *BISD*, 1S/31.

Adjustment Act. Once again, the United States did not attempt to justify the quotas under s22 as being GATT consistent, whether as justified under Article XI:2 or as made under "existing legislation".²⁹ At the eighth session in September-October 1953, the Netherlands applied for an extension of its retaliation. The CONTRACTING PARTIES, although not expressly commenting on whether the quotas under s22 were in violation of the GATT, authorized the Netherlands to impose the same quota again for the 1954 calendar year.³⁰

THE USA'S 1955 AGRICULTURAL WAIVER

During 1954, the US implemented some modifications to the programmes for which the restrictions were in place so as to limit the quantity of domestic production and thereby reduce the need for the import restrictions but did not liberalize any of the import restrictions themselves.³¹ At the ninth session³² of the contracting parties, the Netherlands applied for and was granted authorization to impose the same quota for the 1955 year.³³ The executive of the United States government was in a position where it was required to maintain the quotas thereby placing the USA in violation of Article XI.³⁴ The United States applied under Article XXV of the GATT for a waiver from its obligations under the GATT in order to remove any inconsistency between its obligations under the AAA and its obligations under the GATT.

A working party was appointed to consider the waiver. The working party's report is notable for the complete absence of any reference to the wording of Article XXV and the almost complete absence of any analysis of the legal requirements of that Article.³⁵ The

28 "Netherlands Measures Of Suspension Of Obligations To The United States", Determination of 8 November 1952; *BISD*, 1S/32.

29 See Hansen, Marc & Vermulst, Edwin, "The GATT Protocol of Provisional Application - A dying Grandfather?" (1989) 27 *Columbia J Transn'l L* 263 at 299-300; and Martin, Edwin G., "The Conflict between Foreign Trade Agreements and Price-Support Programs" (1951) *Cornell LJ* 17-31 at 26-28.

30 United States Import Restrictions on Dairy Products, resolution of 13 October 1953, GATT *BISD* 2S/28.

31 *BISD*, 3S/32 at 34.

32 October 1954 - March 1955.

33 "United States Import Restrictions On Dairy Products", Resolution of 5 November 1954, *BISD*, 3S/46.

34 There has been some contention as to the extent of the President's discretion, in particular, whether the President could make a decision contrary to the recommendation of the US International Trade Commission: See Zedalis, "Agricultural Trade and Section 22" (1981) 31 *Drake Law Review* 587 at 610-613.

35 "Import Restrictions Imposed by the United States Under Section 22 of the United States Agricultural Adjustment Act", report adopted on 5 March 1955, (L/339), *BISD*, 3S/141.

members of the working party submitted a draft waiver to the CONTRACTING PARTIES but were unable to reach agreement to recommend its adoption.³⁶

On 5 March 1955, the CONTRACTING PARTIES adopted the report of the working party and decided that:

pursuant to paragraph 5(a) of Article XXV of the General Agreement ... the obligations of the United States under the provisions of Articles II and XI of the General Agreement are waived to the extent necessary to prevent a conflict with such provisions of the General Agreement in the case of action required to be taken by the Government of the United States under Section 22. ...³⁷

They also declared that:

this decision shall not preclude the right of affected contracting parties to have recourse to the appropriate provisions of Article XXIII ...³⁸

The working party's report does not record any discussion at all about the merits of the principal US argument. The US argument was based upon an internal conflict between its executive and legislative limbs of government. The report does not record any consideration of whether such circumstances should or should not be relevant to deciding whether to give the waiver. Instead, the members of the working party in favour of giving the waiver simply accepted that the separation of the two limbs of the US government was relevant for the purposes of determining its obligations under international law. They accepted that the executive was not responsible for and could not control the acts of the legislature. The decision implicitly assumes that a waiver of some description was necessary because otherwise the US would be in violation of the GATT.

In two ways, the waiver went beyond the existing violation and extended to any possible violation that might (without the waiver) have occurred in the future. First, the waiver was not restricted to products which were actually under restriction at the time that it was given. Secondly, although the existing restrictions were quotas not tariff surcharges, the waiver was given from Article II as well as from Article XI. The US argued that since the *Agricultural Adjustment Act* required the imposition of fees or quantitative restrictions, it

36 3S/141 at 143, para 4.

37 "Waiver Granted to the United States in Connection with Import Restrictions Imposed Under Section 22 of the United States Agricultural Adjustment Act (of 1933), as amended", Decision of 5 March 1955, *BISD*, 3S/32 at 34.

38 *BISD*, 3S/32 at 35.

needed a waiver from Article II as well. If fees were imposed it would be undesirable to use the procedure under Article XXVIII for what it said would be temporary measures. The working party did not engage in any consideration of whether, in such circumstances, the US would have been able to or should have been required to comply with the usual Article XXVIII procedures.

The waiver was not given for a limited time and nothing in the waiver decision required the USA to come into conformity with the Agreement. The waiver was not conditional on the US remedying the existing violations, that is, removing the restrictions within any specified time frame. Nor was the waiver conditional on the US taking any action to remove the circumstances which made the restrictions necessary under s22, that is, to change the underlying domestic programme.

Although the waiver changed the USA measures from violations into non-violations, it did not limit the right of other parties to have recourse to Article XXIII in so far as it related to non-violation nullification or impairment. The decision declared that it

[would] not preclude the right of affected contracting parties to have recourse to the appropriate provisions of Article XXIII³⁹

Therefore, the granting of the waiver did not affect the already given authorization of the Netherlands quota for 1955. Nor did the waiver affect the right to seek authorization of countermeasures in subsequent years. In each of the following years, from 1956 to 1959, the Netherlands was given authorization to impose the quota on imports of US wheat flour.⁴⁰ After 1959, the Netherlands stopped seeking authority for countermeasures. No other country ever applied for an authorization to adopt countermeasures against these US quotas.

In 1959, import quotas under s22 were in force in relation to wheat and wheat products, cotton and cotton waste, rye and rye flour, peanuts and peanut oil, tung nuts and tung oil and a number of dairy products.⁴¹ The relevant report of the contracting parties for that year records that the US delegate

39 *BISD*, 3S/32 at 35.

40 For the calendar year of 1957, see *BISD*, 5S/28; for the calendar year 1958 see *BISD*, 6S/152 at 157; for the calendar year of 1959, see *BISD*, 7S/124 at 128.

41 *BISD*, 7S/124 at 128.

assured the Working Party that it was his government's intention to terminate the restrictions as soon as they were no longer needed to protect the operation of the agricultural programmes.⁴²

Thirty years later, after the commencement of the Uruguay Round, restrictions under s22 were still in place in relation to most of the aforementioned products, although not for wheat.⁴³ Arguably, the granting of the waiver and its longevity undermined the commitment of all contracting parties to comply with GATT rules in relation to agricultural products,⁴⁴ and also their commitment to the GATT itself.⁴⁵

It is worth examining the legality of this decision under Article XXV.

3 INTERPRETATION OF ARTICLE XXV

THE LEGAL TEST FOR WAIVERS IN ARTICLE XXV

The decision by the CONTRACTING PARTIES to grant a waiver under Article XXV must be approved by a two-thirds majority of the votes cast and that majority must comprise more than half of the contracting parties. The words of Article XXV:5 permit the CONTRACTING PARTIES to waive obligations only in "exceptional circumstances not elsewhere provided for in this Agreement". Therefore, the language of Article XXV suggests that the granting of waivers should be subject to two prerequisites:

- that the circumstances be exceptional; and
- that the exceptional circumstances not be elsewhere provided for in the GATT.

APPLICATION OF ARTICLE XXV TO THE USA AGRICULTURAL WAIVER

Were the circumstances in which the US sought its waiver "exceptional"? The mere existence of a programme to raise domestic prices was hardly exceptional. Such programmes were common and could not be categorized as exceptional. There is an

42 *BISD*, 7S/124 at 128.

43 GATT, "Trade Policy Review, United States, 1992" (GATT, Geneva, April 1991) Volume I, p87 and Table AIV.6.

44 For agreement with this view, see Warley, T.K., "Western Trade in Agricultural Products" in Andrew Shonfield (ed) *International Economic Relations of the Western World 1959-1971* (Oxford University Press, London, 1976) at p347; Jackson, *World Trade and the Law of GATT* p718 & pp736-737; and Jackson, John H. & William J. Davey, *Legal Problems of International Economic Relations* (West Publishing, St Paul, 2nd ed, 1986) p317, fn46.

45 See Dam, K., *The GATT: Law and International Organization* (1970) at p260.

argument that the conflict between the executive and legislative limbs of the US government was an exceptional circumstance. However, it seems difficult to interpret "exceptional circumstances" as extending to that situation because the possibility of conflict between different limbs of government is not rare in legal systems, and international law has a settled rule for dealing with the situation where domestic law requires an act that breaches international law, that is, that a requirement of a domestic law is not a defence or excuse for violating international law.⁴⁶

As to the second legal prerequisite, was the USA's position with respect to the *Agricultural Adjustment Act* a circumstance not elsewhere provided for in the agreement? The Agreement does deal fairly specifically with programmes to restrict the quantity of production by providing that restrictions are permissible if they are necessary to maintain such programmes. It can be argued that Article XI:2(c)(i) exhaustively covers the field of programmes which lift the domestic prices of agricultural commodities. If it does cover the field then the situation under the *AAA* where programmes operated to increase the domestic prices is a situation provided for by Article XI:2(i). It follows that the situation where programmes increase prices without being accompanied by measures to reduce production is not a situation that is "not elsewhere provided for" in the GATT.

Therefore, there are difficulties in arguing that the circumstances of the US waiver met the apparent requirements of Article XXV. Yet, the waiver was given. It is enlightening to look at how article XXV was applied before the US agricultural waiver. The most important instance was the application for a waiver by the member countries of the European Coal and Steel Community in 1952.

APPLICATION OF ARTICLE XXV TO THE EUROPEAN COAL AND STEEL COMMISSION

The formation of the European Coal and Steel Community was an important event, hopefully the closing event, in a long history of antagonism between Germany and France over the coal and iron resources which lie along their common border. It was these

46 *Treatment of Polish Nationals in Danzig* (1932) PCIJ A/B No44; *USA(Shuffeldt) v Guatemala* (1930) 2 RIAA 1083; this rule has been confirmed by Art 4 of Part 1 of the International Law Commission's draft Articles on State Responsibility [1980] 2 *YB Int Law Com* 30; and by Art 27 of the *Vienna Convention on the Law of Treaties* 22 May 1969, UN Doc A/conf 39/27, UKTS 58 (1980).

resources which had enabled Germany to manufacture the armaments used in its war effort.⁴⁷ After World War II, as Germany was passing through a transition from being under joint allied control to becoming the two new nations of West Germany and East Germany, the control of the coal and steel industry in the Saar province of Germany was also passing through a transition. From 1945, the state of the Saar had been occupied by France. In 1947, the state Parliament of the Saar adopted a constitution that called for total independence from Germany.⁴⁸ In 1948, the coal and steel industry in the Saar was assigned to Allied (excluding USSR) supervision.⁴⁹ By the time of the formation of the German Federal Republic ("GFR") in May 1949 and the incorporation of the Saar within it, the USA and UK had become less willing to exercise control over the coal and steel industry in the Saar.⁵⁰ They both had become more concerned with the security threat from the USSR and the countries dominated by it in Eastern Europe than with any possible threat from Germany. The USA was pushing for full participation for the GFR (West Germany) in the maintenance of security and stability in western Europe. However, the government of France was concerned that control of the coal and steel industry should not pass to the GFR and, in May 1950, it proposed that the entire French and German production of coal and steel be placed under a joint high authority.⁵¹ That the political security of France was a prime motivation is demonstrated by the language of the announcement which was made by the French Minister of Foreign Affairs, M. Robert Schuman. He said that the amalgamation:

will change the destiny of these regions which have long been devoted to the production of arms to which they themselves were the first to fall constantly victim. ... The community of production, which will in this manner be

47 For a brief history of the way the Saarland has passed between France and Germany: see *Encyclopaedia Britannica* (William Benton, Chicago, 15th ed, 1973) vol.16, p113. Prior to world war II, the Saar had been under the administration of the League of Nations until 1935 when following a plebiscite it was returned to Germany.

48 *Encyclopaedia Britannica* (15th ed, 1973) Vol 16, "Saarland", p113.

49 In 1948, under the Ruhr statute of 1948, the Allies assumed joint supervision over the coal and steel authority in the Saar: see P.J.G.Kapteyn & P.Verloren Van Themaat, *Introduction to the Law of the European Communities* (Kluwer Law and Taxation Publishers, Deventer/The Netherlands 1990) pp4-6.

50 Kapteyn & Van Themaat, as above, p5.

51 This brief description is drawn principally from Kapteyn & Van Themaat, *Introduction to the Law of the European Communities*, p4-5.

created, will clearly show that any war between France and Germany becomes not only unthinkable but is in fact impossible.⁵²

The plan was well received by West Germany, Italy and the Benelux countries as well as by the United States. In the following year, on 18 April 1951, France, West Germany and the Benelux countries entered into *The Treaty Establishing the European Coal and Steel Commission* ("*ECSC Treaty*").⁵³ The treaty entered into force on 25 July 1952.⁵⁴ The treaty provided for the removal of all customs duties and quantitative restrictions on the movement of coal and steel products between the six member countries.

Since the duties and restrictions applying in relation to coal and steel products from non-member countries were to remain unchanged, the treaty created a preference which was inconsistent with the Most Favoured Nation rule in Article I of the GATT.⁵⁵ For that reason the six member governments applied to the CONTRACTING PARTIES for a waiver under Article XXV. A working party was appointed to consider the waiver.

The working party report recommended that obligations under the GATT be waived to the extent necessary to permit the six governments to act for the purposes of the GATT in relation to coal and steel as if their territory constituted the territory of a single contracting party.⁵⁶ The working party observed that there was no limit to the type of obligation under the agreement that could be waived under Article XXV.⁵⁷ The working party appears to have considered it necessary that the objectives of the ECSC be consistent with the objectives of the GATT and it decided that they were.⁵⁸ However, the report does not contain any discussion of whether the circumstances were "exceptional circumstances" or whether they were "not elsewhere provided for" in the Agreement.

52 From Statement by M.Robert Schuman, Minister of Foreign Affairs of France on 9 May 1950 in S.Patijn (Ed) *Landmarks in European Unity* (A.W.Sijthoff, Leyden, 1970) p47-49 at p47.

53 *Treaty Establishing the European Coal and Steel Community (ECSC)*, 18 April 1951, Paris, 261 UNTS 140; also printed in *European Yearbook*, Vol.1, pp359-453; and in at *Encyclopedia of European Community Law*, K.R.Simmonds (ed) (Sweet & Maxwell, London, 1992) Part B2, pB2001 and following (hereafter referred to as the "*ECSC Treaty*").

54 See the entry for the ECSC Treaty in Bowman & Harris, *Multilateral Treaties Index and Current Status*, Treaty 262.

55 See Chapter 2 hereof at section 3.4.

56 See paras 5 & 7 of "The European Coal and Steel Community", report adopted by the CONTRACTING PARTIES on 10 November 1952; *BISD*,1S/85; For the decision of the CONTRACTING PARTIES, see: "Waiver Granted in connection with the European Coal and Steel Community", Decision of 10 November 1952; *BISD*,1S/17.

57 *BISD*, 1S/85 at 86, para2.

Were the circumstances "exceptional circumstances not elsewhere provided for" in the GATT? There is a reasonable argument that the status of the Saar was an exceptional circumstance that was not provided for in the GATT.⁵⁹ In 1947, the Saar was not part of Germany, nor of France, and was not an independent state. At that time, trade between the Saar and France was unrestricted and trade between the Saar and Germany was subject to post-war Allied control. Article I does permit an exception from the MFN rule for some border situations as are mentioned in Article I:2(d). However, it makes no reference to the Saar and given the history of the Saar's economic relationship with France, one might have expected that France would have proposed an Article I:2(d) exception for trade between it and the Saar. However, such a submission would have been inconsistent with an assertion that the Saar was part of France. So if the matter was considered, perhaps the French deliberately chose to remain silent. As for trade between Germany and the Saar, Germany was not a party to the negotiation of the Agreement, and when it did accede, its protocol preserved existing arrangements as to "intra-German" trade and by that time the Saar was part of Germany. So there are some reasons why the removal of barriers to trade in coal and steel between France and Germany could possibly have been regarded as occurring in "exceptional circumstances not elsewhere provided for" in the agreement. However, whilst this argument might have justified the arrangement between France and Germany, it could not have justified the inclusion of the other four countries.

Were these circumstances "not elsewhere provided for" in the Agreement? The situation corresponds to the formation of a free trade area which is limited to one sector of the economy. The formation of free trade areas and the process of regional integration are matters provided for under the Agreement, in Article XXIV. That Article provides an exception to the MFN rule for free trade areas and customs unions where, inter alia, restrictions are eliminated from substantially all trade between members. Clearly, the *ECSC Treaty* failed to meet this test because it only eliminated barriers from trade in the coal and steel sector. On one view, this was a process of integration different to that contemplated by Article XXIV and therefore not covered by it. Alternatively, it might be argued that Article

58 *BISD*, 1S/85 at 86, para3.

59 This was accepted in the later waiver decision: "Waiver Granted to France and the Federal Republic of Germany for Special Measures Applied in their Trade Relations with the Saar", Decision of 22 November 1957, *BISD*, 6S/30.

XXIV covers all the permissible impacts of regional integration upon the MFN rule and that the formation of the ECSC was a matter "provided for" under Article XXIV. On that view, it would follow that the formation of the product specific type of free trade area was not a circumstance "not otherwise provided for" in the GATT.

As mentioned above, the panel report granting the waiver does not enter into any discussion of these legal points. It simply submits a draft waiver. By the time that the CONTRACTING PARTIES considered the report, the Cold war had intensified. War had intensified in Korea. The USA and France were involved in intense disagreement over the re-arming of Germany. The six member countries of the ECSC had also moved to establish joint defence arrangements.⁶⁰ Bluntly put, the most powerful parties were more concerned with the stability of western Europe than they were with compliance with the GATT.

It seems that the two formal legal prerequisites had no influence on the decision to give the waiver for the ECSC. The same approach was taken in the consideration of the US application for its waiver on agriculture. The second decision was facilitated by the first for, by then, the prerequisites no longer existed except in words. The only relevant consideration for a decision under Article XXV was whether the required number of votes could be raised.⁶¹ It was the cumulative effect of these two decisions which has led to the most disruptive factor for international trade in agricultural products: the Common Agricultural Policy of the European Economic Community.

4 THE CREATION OF THE EUROPEAN ECONOMIC COMMUNITY AND THE IMPLEMENTATION OF THE COMMON AGRICULTURAL POLICY

THE TREATY OF ROME

After formation of the ECSC in 1952, there was a continuing process of political debate and consultation over further moves towards integration of Western Europe.⁶² This process led to the signing on 25 March 1957 of the *Treaty Establishing the European Economic*

60 On 27 May 1952, they signed the *European Defence Community Treaty* under which a European army would have been created. However the treaty was never ratified. See Kapteyn & Van Themaat, *Introduction to the Law of the European Communities*, p9-11.

61 This view is taken in Jackson (1969) at p544.

62 There is a description of the various initiatives in Kapteyn & Van Themaat, *Introduction to the Law of the European Communities*, pp11-16.

Community ("EEC Treaty") also known as the *Treaty of Rome*.⁶³ The treaty came into force on 1 January 1958.⁶⁴ The treaty established new European institutions⁶⁵ and provided for substantial economic integration of the member states: France, Italy, West Germany, The Netherlands, Belgium and Luxembourg.⁶⁶ The treaty also provided for association with the overseas countries and territories which were former colonies of Belgium, France and Germany so as to extend existing preferences (GATT legal by virtue of specific exceptions in Article I:2 to the MFN rule) to all members.⁶⁷ It provided for a transition to a situation where trade between any member state and an overseas country (now usually called "ACP countries" or "Lome countries") would be on terms such that:

- exports from a Lome country could be made to a member country on the same terms as from one member country to another; and
- exports from any member country could be made on the same terms as the Lome country gave to any one of the member countries.

The plan for economic integration envisaged the removal of internal restrictions on movement of goods, services, capital and people. With respect to trade in goods, all

63 *Treaty Establishing the European Economic Community (EEC)* 25 March 1957, Rome, 29 UNTS 11 (in force 1 January 1958); also printed in *European Yearbook*, Vol.IV, pp413-537; and in *Encyclopedia of European Law*, as above, Part B10; (hereafter referred to as the "EEC Treaty"). Also see footnote 2 in this chapter.

64 See the entry in Bowman & Harris, *Multilateral Treaties, Index and Current Status*, Treaty 343.

65 The *EEC Treaty* created four principal institutions: (1) the European Commission (Arts 155-163); (2) The European Council of Representatives (Arts 145-154); (3) The European Court of Justice (Arts 164-188); and (4) The European Parliament (Arts. 137-144).

66 Article 3 of the *EEC Treaty* is an inclusive list of the EEC's activities. The most important for the purposes of this paper are:

(a) the elimination, as between Member States, of customs duties and of quantitative restrictions in regard to the importation and exportation of goods, as well as of all other measures with equivalent effect;

(b) the establishment of a common customs tariff and a common commercial policy towards third countries;

(c) the abolition, as between Member States, of the obstacles to the free movement of persons, services and capital;

(d) the inauguration of a common agricultural policy;"

67 *EEC Treaty*, Arts 131-136. The arrangements between the members of the EEC and the colonies and territories have been set out in a series of treaties. Today, the overseas territories includes the former colonies and territories of the new EU members. The territories tend to be called Lome countries or ACP (African, Carribean and Pacific) countries. See the *Fourth ACP-EEC Convention of Lome* 15 December 1989, in force 1 September 1991, UKTS 47 (1992). See the details of the earlier treaties in the entries in Bowman & Harris, the *Third Lome Agreement* at Treaty 963, the *Second Lome Treaty* at Treaty 763 including references to earlier treaties.

restrictions were to be removed and a common external regime of restrictions was to be created over a period of 12 years. The formation of the common external tariff was to be implemented over a number of stages beginning on 1 January 1962.⁶⁸ The basic rule was that the common tariff should be the arithmetic mean of the national tariffs in force on 1 January 1957. However, for products where the divergence between national tariff rates was greatest, there were some interim steps of equalization before the adoption of a common tariff.

There was some backwardness about applying the scheme of integration to the agricultural sector. In principle, the scheme for removing restrictions was applicable to all sectors including agriculture.⁶⁹ However, Articles 39 to 46 provided for significant exceptions for agricultural products and provided for the formation of a Common Agricultural Policy ("CAP"). The *EEC Treaty* did not include detailed operation of the CAP. It only established objectives of the CAP,⁷⁰ matters to be taken into account in its formation,⁷¹ and provided for a number of forms that the CAP might take.⁷² Article 44 provided for the key exception to the general requirement to remove restrictions. It authorised the member states to set target prices for agricultural products and to prohibit agricultural imports below those

68 *EEC Treaty* Arts 18-29. Art 23:1(a) provides for the first changes to tariffs to be applied "at the end of the fourth year after entry into force of this treaty."

69 *EEC Treaty*, Art 38;

70 *EEC Treaty*, Art 39:1 "The objectives of the common agricultural policy shall be:

(a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilization of the factors of production, in particular labour;

(b) thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture

(c) to stabilize markets;

(d) to assure the availability of supplies

(e) to ensure that supplies reach consumers at reasonable prices."

71 *EEC Treaty*, Art 39(2):

"In working out the common agricultural policy and the special methods of its application, account shall be taken of:

(a) the particular nature of agricultural activity, which results from the social structure of agriculture and from structural and national disparities between the various agricultural regions;

(b) the need to effect the appropriate adjustments by degrees;

(c) the fact that in the Member States agriculture constitutes a sector closely linked with the economy as a whole."

72 *EEC Treaty*, Art 40:2 "In order to attain the objectives set out in Article 39 a common organisation of agricultural markets shall be established. This organisation shall take one of the following forms, depending on the product concerned:

(a) common rules on competition;

(b) compulsory co-ordination of the various national market organisations;

(c) a European market organisation."

targetted prices. Such minimum price restrictions could be imposed wherever the progressive liberalization of trade restrictions would meet the ambiguous standard of jeopardising the attainment of the objectives of the CAP.⁷³

THE GATT COMMITTEE REPORT ON THE TREATY OF ROME

Since the preferences created under the *EEC Treaty* were a prima facie breach of the most favoured nation rule in Article I of the GATT, the member governments of the EEC submitted the *EEC Treaty* to the CONTRACTING PARTIES for consideration under Article XXIV of the GATT. Article XXIV provides that if arrangements for free trade areas and customs unions meet certain rules then other GATT rules do not prevent the formation of such arrangements. Article XXIV:7(a) provides that parties entering into such arrangements must notify the CONTRACTING PARTIES. Article XXIV:7(b) gives the CONTRACTING PARTIES a quasi judicial function in that it provides that if the CONTRACTING PARTIES find that the arrangement does not meet the rules, then they must make recommendations to the relevant parties and that those parties must not implement or maintain the arrangement unless they modify it in accordance with the recommendations. Prior to the submission of the *EEC Treaty*, the CONTRACTING PARTIES had considered regional arrangements on three occasions.⁷⁴ In each instance, the CONTRACTING PARTIES had decided affirmatively that the relevant countries were entitled to claim the benefits of Article XXIV.

In 1957, the CONTRACTING PARTIES established a committee to examine the *EEC Treaty*. The terms of reference of the committee sought an examination of the problems likely to arise from the applications of the relevant provisions of the GATT and the *EEC*

73 *EEC Treaty*, Art 44:1 "In so far as progressive abolition of customs duties and quantitative restriction between Member States may result in prices likely to jeopardise the attainment of the objectives set out in Article 39, each Member State shall, during the transitional period, be entitled to apply to particular products, in a non-discriminatory manner and in substitution for quotas and to such an extent as shall not impede the expansion of the volume of trade provided for in Article 45(2), a system of minimum prices below which imports may be either:

- temporarily suspended or reduced; or
- allowed, but subjected to the condition that they are made at a price higher than the minimum price for the product concerned.

In the latter case the minimum prices shall not include customs duties."

74 *The customs union agreement between South Africa and Southern Rhodesia*, Decision of the CPs of 18 May 1948; *BISD*, II, 29; *The free-trade area treaty between Nicaragua and El Salvador*, Decision

Treaty.⁷⁵ For an agreement such as the *EEC Treaty* providing for a transition to a customs union, the relevant provisions of Article XXIV of the GATT require that:

- (1) restrictions on trade between the EEC members be eliminated in respect of substantially all trade;⁷⁶
- (2) in the formation of the common external tariff and trade regulation:
 - (i) any tariff increases by a member must be negotiated under the Article XXVIII procedure with account taken of tariff reductions by other members;⁷⁷
 - (ii) the duties and other restrictions in force after the Treaty comes into effect must not be "higher or more restrictive" than those which applied previously;⁷⁸
- (3) the Treaty must provide for the transition to a customs union to occur within a reasonable time.⁷⁹

Under the *EEC Treaty*, the member States were due to make the first changes of their tariff schedules toward a common tariff on 1 January 1962.⁸⁰ Since the formation of the EEC would result in some bound tariff rates of some members being increased, then the member states were required to enter into negotiations under Article XXIV:6. At the time that the committee assessed the consistency of the EEC Treaty with the GATT, the Article XXIV:6 negotiation had not even begun.

of the CP's of 25 October 1951, *BISD* II,30 and *The participation of Nicaragua in the Central American Free-Trade Area*, Decision of the CPs of 13 November 1956; *BISD*, 5S/29.

75 *The European Economic Community*, report adopted on 29 November 1957, (L/778), GATT, *BISD*, 6S/68.

76 Art XXIV:8(a)(i).

77 Art XXIV:6.

78 See Art XXIV:5 for the precise wording of this requirement. Note, in particular, the time at which the test is applied.

79 Art XXIV:5(c).

80 *EEC Treaty*, Art 23:1(b).

The Committee divided itself into 4 sub-groups, one of which dealt with agriculture. The reports of the 4 sub-groups were assembled into a single report of the Committee which identified a number of problems including:

- (1) whether in respect of agricultural trade, the use of minimum price systems and prohibitions of imports below the minimum price would be inconsistent with the GATT, in particular, Article XI;⁸¹
- (2) the problem of defining the requirements of the "substantially all" trade test and whether, given that barriers were not being removed from agricultural trade, the test requiring the removal of barriers to "substantially all" trade between members had been met;⁸²
- (3) whether in respect of agricultural trade, the use of minimum price systems would be contrary to Article XXIV because it would result in an increase in barriers to non-members;⁸³
- (4) whether they could approve a mere formula for the calculation of a common tariff rather than the common tariff itself, and if so whether a formula based on an arithmetic average was acceptable;⁸⁴
- (5) whether the CONTRACTING PARTIES could authorize the implementation of the common tariff prior to the completion of the Article XXIV:6 negotiations;⁸⁵
- (6) whether Article XXIV permitted the creation of global import quotas for the whole region in substitution for existing import quotas that were maintained by individual member countries for balance of payments purposes;⁸⁶
- (7) whether the time frame envisaged by the *EEC Treaty* for formation of the free trade area and customs union was too long to constitute a reasonable period as required by Article XXIV:8;⁸⁷ and

81 *BISD*, 6S/70 at 81, paras 1-18, in particular, para 14.

82 *BISD*, 6S/70 at 89, paras 29-36.

83 *BISD*, 6S/70 at 81, paras 1-18, in particular para.14.

84 *BISD*, 6S/70 at paras 6-8.

85 *BISD*, 6S/70 at 74, paras 12 & 13.

- (8) whether the association with the Lome countries was an extension of preferences in violation of the MFN rule which was not justified by Article XXIV.

The representatives of the six members submitted that there was no conflict between the two agreements. Generally, the representatives of the other contracting parties disagreed. In the end, the Committee did not make any particular legal recommendation to the Contracting Parties on any of the above issues. It submitted that

it would be more fruitful if attention could be directed to specific and practical problems, leaving aside for the time being questions of law and debates about the compatibility of the Rome treaty with Article XXIV of the General Agreement.⁸⁸

The CONTRACTING PARTIES arrived at the conclusion (inter alia) that the examination of the *EEC Treaty* under Article XXIV and the discussion of the legal questions involved in it "could not usefully be pursued at the present time."⁸⁹ Nor have they been usefully pursued since.

In effect, the CONTRACTING PARTIES were unable to exercise their quasi-judicial function under Article XXIV because of the disagreements among the parties. In the end, no conclusion was reached as to whether the 6 members of the EEC were entitled to claim the benefits of Article XXIV. It was clear that the integration of western Europe was going to proceed regardless of whether the arrangement was within the GATT rules.

Leaving aside the relationship with the Lome countries, the main reason why the arrangement between the 6 countries might not have been GATT consistent was the failure to subject agriculture to the same liberalization as was applied to other trade. The Committee did advert to the issue of whether excluding agriculture from the liberalization disqualified the arrangement from meeting the test of liberalizing "substantially all trade". However, the Committee (including its sub-groups) failed to assess whether the application of minimum price schemes to intra member trade would be contrary to Article XI as a restriction other than an ordinary customs duty. At the time of the examination, the EEC did

86 *BISD*, 6S/70 at 76, paras 1-13.

87 *BISD*, 6S/70 at 75-76, paras 17-18.

88 "The Treaty Establishing the European Economic Community", Action at the 13th Session, (October - November 1958) *BISD*, 7S/69 at 70.

89 *BISD*, 7S/69 at 71.

not give evidence of the mechanism by which minimum import prices would be maintained but the *EEC Treaty* did expressly provide for a power to 'suspend' or 'reduce' imports.⁹⁰ In the absence of actual implementation of the plan, it was difficult for the committee to pass judgement. The report said the majority of the Committee (excluding the 6 parties to the *EEC Treaty*) considered that even though the Treaty required the "substitution of new internal barriers in place of existing tariffs and other measures", it was not, at that time, possible to determine whether the new barriers would be consistent with the GATT.⁹¹

With aid of hindsight, this was a serious omission. It could have been argued that minimum import price regulations applying between the six members could only be maintained by an instrument other than an ordinary customs duty and that therefore the relevant instrument would be a violation of Article XI:1. A problem with dealing with such an illegal restriction was that, in practice, there was no one that would complain about it; all of the parties on whose trade it would be imposed would have consented to it. However, the unlikelihood of a complaint ought not to have prevented the CONTRACTING PARTIES from dealing with the legality of the minimum price schemes. The terms of reference of the working parties were wide enough. Having considered the legality of the import restrictions, the CONTRACTING PARTIES ought to have gone on to consider whether the establishment of new illegal barriers was in compliance with the test of eliminating barriers on substantially all trade. The 6 parties to the *EEC Treaty* submitted that 80% of trade was sufficient to meet the test. The rest of the committee members did not propose any other test. Both the definition of the test and the assessment of whether the retention of the restrictions on the agricultural sector breached the test were left unresolved.

The serious consequence of the failure to make a sensible legal ruling upon the arrangement derives not so much from the fact that the internal trade was not liberalized but rather from the fact that external trade barriers were erected. Surely, it was foreseen that it would be impossible to maintain the minimum price scheme with respect to intra-EEC trade unless an as or more restrictive regime applied to imports from non EEC members. The Report records that some members of the committee expressed that view.⁹² A clear assessment of

90 *EC Treaty*, Art 44:1.

91 *BISD*, 7S/69 at 88, para 14.

92 At 83-84, para 4.

the situation was not helped by the fact that, at the time, most of the EEC members were maintaining quantitative restrictions relating to a broad range of agricultural products upon the legal justification of the balance of payments exception. The committee did discuss the issue of whether these restrictions could be converted to EEC wide restrictions but without conclusion.⁹³

The failure to give a ruling on these matters resulted in a situation where restrictions of dubious legality were placed on internal trade. The operation of the minimum price scheme depended upon a set of EEC wide restrictions: either, quantitative restrictions the legal justification for which was dubiously founded upon the balance of payments situation of any one of the six members or the new instrument, the variable levy, the legality of which was disputed and has not been tested since.

The most significant aspect of the outcome was the situation it created. It would be impossible to remove the restrictions without rendering the intra-EEC minimum price scheme ineffective. In consequence, the failure to properly exercise the quasi-judicial function not only detracted from the authority of a number of the rules but it also facilitated the growth of a strong political lobby for agricultural protection in the EEC.

THE FORMATION OF THE COMMON AGRICULTURAL POLICY AND THE FIRST ARTICLE XXIV:6 NEGOTIATION

In the following year, 1958, at a conference in Stresa, the EEC adopted three fundamental principles for the CAP:

- (1) that there should be a single market;
- (2) that intra EEC trade should receive a price preference over imports into the EEC;
- (3) that the members states should collectively be responsible for the cost of the CAP through the establishment of a common fund (which was later established under the name of the European Agricultural Guidance and Guarantee Fund).⁹⁴

93 At 76-81, paras 2-13.

94 European Commission, *The Common Agricultural Policy and Its Reform* (European Commission, Brussels, 1987).

Agreement on these principles was the first stage in negotiations between the EEC members of the new Common Agricultural Policy. The internal negotiations between members continued while they carried on external negotiations about agricultural restriction with the CONTRACTING PARTIES.⁹⁵

In September 1960, the first Article XXIV:6 negotiation for the EEC began. It was supposed to be completed by the end of 1960 so that a new round of multilateral negotiations could then commence. However, the parties could not reach agreement, essentially, because the EEC countries had not yet agreed among themselves on the details of the CAP. The CONTRACTING PARTIES decided to commence the general round ("Dillon Round") on 29 May 1961 in the hope that the outstanding Article XXIV:6 negotiations would be completed in the course of the general round.

It was not until 14 January 1962 that the members of the EEC finally reached agreement on the regulations establishing the CAP⁹⁶ with the EEC Council of Ministers adopting decisions on the operation of the CAP in relation to five groups of products including cereals, pigmeat and poultry meat.⁹⁷ Similar decisions followed in respect of other products including rice, dairy products, beef and sugar. It was not until 4 April 1962 that the final text of the regulations governing the first five groups of products were approved by the EEC and then submitted to the CONTRACTING PARTIES.⁹⁸ During these months, the Article XXIV:6 negotiations and the Dillon Round were still proceeding. By 7 March 1962, the parties to the Article XXIV:6 negotiation had reached agreement in respect of all but 5 product groups.⁹⁹ At that stage, the EEC brought into effect the first step toward the common tariff.

95 On the internal EEC negotiations and the separate policies of the EEC countries which were the subject of negotiation, see Fearn, Andrew, "The History and Development of the CAP 1945-1985" chapter 3 in Ritson, Christopher & Harvey, David (eds), *The Common Agricultural Policy and the World Economy - Essays in Honour of John Ashton* (CAB International, Wellingford UK, 1991) pp21-70 esp pp27-43.

96 Talbot, Ross B., *The Chicken War* (Iowa State University Press, Ames, Iowa, 1978) p15.

97 See "European Economic Community - Common Agricultural Policy" report submitted to Committee II - Expansion of Trade, GATT COM.II/134, 24 Sept 1962. See also Williams, Allan M., *The European Community* (Blackwell, Oxford, 1991) p43.

98 See "European Economic Community - Common Agricultural Policy" report submitted to Committee II - Expansion of Trade, GATT COM.II/134, 24 Sept 1962.

99 Herman Walker, "Dispute Settlement: The Chicken War" [1964] 58 *AmJIL* 671 at 675.

The 5 contentious product areas were wheat, rice, corn, sorghum and poultry. For these products, the EEC was proposing to remove existing bindings completely and to introduce a system of variable duties. These variable levies would be calculated by reference to the gap between a nominated internal price and the world price. Therefore, it was not possible for the EEC to specify exactly how much the tariff rates on these items would increase. This resulted in a disagreement between the EEC and the USA as to the appropriate compensating adjustment for the purposes of Article XXVIII.¹⁰⁰ On 7 March 1962, the parties agreed to reserve the right of the US to compensation and deferred the calculation of compensation until the Common Agricultural Policy would come into force.¹⁰¹

On 1 July 1962, the common agricultural policy for poultry came into effect. The new import tariff was approximately 13.5 cents per pound. Germany had previously had a bound rate of 15% ad valorem, the approximate equivalent of 4.5 cents per pound.¹⁰² The USA reserved its rights to impose countermeasures. The disagreement between the USA and Germany over the appropriate level of compensation led to what became known as the 'chicken war'. To resolve the dispute the CONTRACTING PARTIES appointed a panel to determine the value of the suspended tariff concession under Article XXVIII.¹⁰³ In the only instance in which the CONTRACTING PARTIES made a decision as to the value of a concession, the panel decided that US\$26 million of the USA's trade was affected by the removal of the pre-existing bindings on poultry.¹⁰⁴ The EEC proceeded with the removal of the binding and the USA proceeded to unbind tariffs affecting \$US 26 million of trade.¹⁰⁵

At the end of the Article XXIV:6 negotiation and the Dillon round, the EEC countries had effectively unbound a large number of agricultural products. It is important to note that this unbinding was part of an overall package of which one part was a general tariff cut.¹⁰⁶ A part of the package that was to become very important in the future was the giving of zero or near zero bindings on a range of grain substitutes. They applied to certain oilseeds

100 As above.

101 At 680-681.

102 At 671.

103 For the text of the panel report, see *Panel on Poultry, report of panel*, (L/2088), 21 November 1963, (1963) 3 ILM 116; *BISD*, 12S/65.

104 Walker, as above, p679.

105 At p681.

including palm, soybean, rapeseed and sunflower and to oils and meals derived from them. The zero or near zero bindings also applied to other non-grain feed products including tapioca (a starchy root), corn gluten (a by-product of corn milling) and citrus pellets (made from dried citrus pulp a by product of citrus juice).¹⁰⁷ The zero or low bindings on these products would later become an important factor in EEC-USA trade relations.

The freedom from bindings gave the EEC members the flexibility they sought in the design of the CAP. Negotiation of the remaining CAP policies took a few years as the parties debated the appropriate target prices and some significant institutional issues.¹⁰⁸ In December 1963, the EEC reached agreement on the CAP for beef, veal, dairy products, and vegetable oils and fats.¹⁰⁹ However, before these mechanisms could come into force the members had to reach agreement on common prices. This took a little longer. The first product tackled was wheat. Here, the key was the difference between the high prices prevailing in Germany and the low prices prevailing in France. In December 1964, The EEC reached agreement on a common price for wheat which was higher than the weighted average of the existing price in the member states. This resulted in lower prices for German, Italian and Luxembourg wheat farmers but in much higher prices for French wheat farmers. The negotiation of prices in other products followed this pattern with the target prices being well above the pre-existing weighted averages.¹¹⁰ The CAP came into force for some products on 1 July 1967 and for most of the other products on 1 July 1968.¹¹¹ The last major policy, that for wine, was agreed on in 1970.

106 Curzon, Gerard, *Multilateral Commercial Diplomacy* (Michael Joseph, London, 1965) p100 and the table of EEC tariff rates on p101.

107 See Hathaway, Dale, *Agriculture and the GATT: Rewriting the Rules* (Institute for International Economics, Washington DC, September 1987) pp30-32 & Hathaway, Dale E., "Agriculture" ch2 in Schott, Jeffrey J. (ed), *Completing the Uruguay Round - A Results Oriented Approach to the GATT Trade Negotiation* (Institute for International Economics, Washington DC, Sept 1990) pp51-62 at 52-53.

108 The negotiation was dominated by disagreements between France and Germany as France sought to obtain access to the German market to balance the access that France had given Germany for its industrial products. France refused to accept the principle of majority decisions and refused to participate in negotiations until unanimous voting was adopted: Allan M. Williams, *The European Community*, p43.

109 Hill, Brian E., *The Common Agricultural Policy - Past, Present and Future* (Methuen, London & New York, 1984) p22.

110 Hill, Brian E., *The Common Agricultural Policy - Past, Present and Future* (Methuen, London & New York, 1984) p24.

111 Hill, Brian E., *The Common Agricultural Policy - Past, Present and Future* (Methuen, London & New York, 1984) p24.

Fundamentally the introduction of the CAP resulted in a substantial increase in the degree of protection given to the agricultural sector by import barriers. In the three key areas of cereal, meat and dairy products, the before and after levels of import protection were as follows:¹¹²

	<i>Pre CAP (1959)</i>	<i>Post CAP (1968)</i>
Cereals	13.5%	72.4%
Meat	19.0%	52.1%
Dairy Produce	18.6%	137.3%

THE OPERATION OF THE COMMON AGRICULTURAL POLICY

For present purposes, a full description of the Common Agricultural Policy is not necessary but some understanding of the basic elements is desirable.¹¹³ The following description relates to the policy for cereals. The policies for most other products are similar but not identical.¹¹⁴ The description relates to the policy as it was in 1986 at the beginning of the Uruguay Round.

The European Commission establishes the Target Price, the Threshold Price and the Intervention Price. The difference between the Target Price and the Threshold Price is approximately equal to port unloading costs and internal EEC transport costs between port

112 Hill, Brian E., *The Common Agricultural Policy - Past, Present and Future* (Methuen, London & New York, 1984) p26. See also Malmgren, H.B. & Schlechty, D.L., "Rationalizing World Agricultural Trade" (1970) 4(4) *JWTL* 515-537. .

113 For descriptions of the CAP, see European Commission, *The Common Agricultural Policy and its Reform* (European Commission, 1986); Holland, Martin, *European Community Integration* (Pinter, London, 1993) p187-191; Kerr, Anthony J.C., *The Common Market and How It Works* (Pergamon, Oxford, 1983) esp pp72-73, or Ritson, Christopher, "Introduction to the CAP" chapter 1 in Ritson, Christopher & Harvey, David (eds), *The Common Agricultural Policy and the World Economy - Essays in Honour of John Ashton* (CAB International, Wellingford UK, 1991) pp1-9 and the very succinct explanation of the variable levy system in Evans, John E., *The Kennedy Round in American Trade Policy - The Twilight of the GATT?* (Harvard University Press, Cambridge, Mass., 1971) at p83-84.

114 See Hill, Brian E., *The Common Agricultural Policy, Past, Present and Future* (Methuen, London & New York, 1984) "Appendix 3.2 Methods of Support used by the CAP" pp51-55 briefly setting the different mechanisms used for different products.

and major centres. The Intervention Price is set slightly lower than the Threshold Price. These are illustrated in the diagram "Common Agricultural Policy for Wheat".

Imports are subject to a minimum price scheme implemented by a mechanism called a variable levy. Under a variable levy, duty on imports is calculated as the difference between the actual import price and the threshold price. When unloading costs and internal EEC transport costs are added to the price, the final price should approximate to the Target Price. In each member state, an intervention board stands in the market to buy produce at the Intervention Price. This provides a minimum guaranteed price to farmers. (The farmers have to pay the cost of transporting the produce to the intervention centre.) In respect of exports, the intervention board pays the farmers an export subsidy equal to the difference between the Intervention Price and the actual export price.

Similar systems operate for sugar, milk, beef, veal, mutton and lamb.¹¹⁵ For eggs and poultry and some fruit and vegetables the protection is limited to the import levies without any intervention buying. Since the early 1980's, the EEC has limited the various intervention purchase systems by the introduction of quotas, co-responsibility levies (which effectively lower the intervention price) and conditions of purchase which require some setting aside of land or restrictions on plantings.¹¹⁶

From the outset of the CAP, the target prices have always been set significantly higher than world price levels. In fact, in order to secure the agreement of countries with the high cost producers, the target prices have been set fairly close to the prices prevailing in those countries.¹¹⁷ This has had significant consequences:

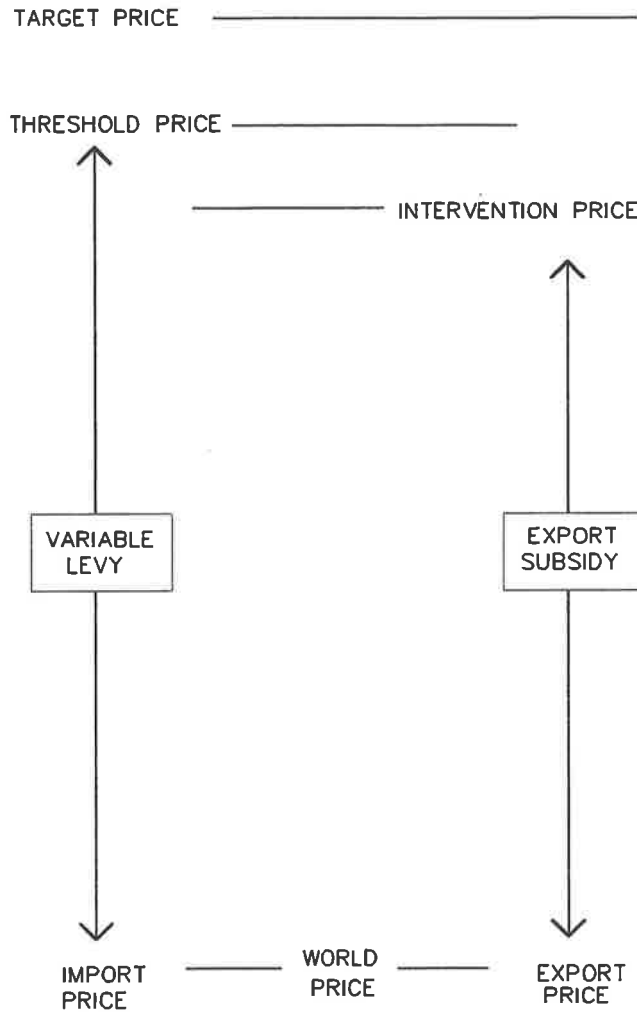
- (1) that the CAP is a high cost policy;
- (2) that there have been significant increases in quantity of production for the community as a whole;

115 For references to a number of the regulations establishing the common organization of the markets in various products, see J. Kodwo Bentil, "Attempts to Liberalize International Trade In Agriculture and the Problem of the External Aspects of the Common Agricultural Policy of the European Economic Community" (1985) 17(3) *Case Western Reserve Journal of International Law* 335-387 at 355-356, fn159-166.

116 European Commission, *The Common Agricultural Policy and Its Reform* (EC, Brussels, 1987).

117 Williams, as above, p43.

COMMON AGRICULTURAL POLICY FOR WHEAT



- (3) that surpluses have accumulated to the point where the export subsidies were introduced to dissipate the surpluses.

Both the variable levies and the export subsidies have been contentious legal issues for the GATT. Variable levies were only applied to products to which no tariff binding applies. The EEC argues that since parties are permitted to change unbound tariffs then variable levies are GATT consistent. However, the variable levy works exactly like a quantitative restriction, with the quantity determined by the threshold price. If the threshold price is set high enough, then the variable levy operates as an import prohibition. The EEC's export subsidies have been subject to legal challenges but the difficulties in applying Article XVI:3 have prevented any finding that the export subsidies are not GATT consistent.

ENLARGEMENTS OF THE EEC AND ARTICLE XXIV:6 NEGOTIATIONS

Significant effects on agricultural markets and on GATT law arose from enlargements of the EEC. The EEC was enlarged by the accessions of Denmark, Ireland and the United Kingdom in 1973, of Greece in 1981, and of Spain and Portugal in 1986.¹¹⁸ After each enlargement, the operation of the CAP was extended throughout the enlarged EEC. These enlargements of the EEC had two effects on trade in agricultural products:

- (1) if the acceding state was an exporter of a product, then the change over to CAP prices encouraged production and discouraged consumption; and
- (2) if the acceding state was an importer of the product, then after the accession, the source of imports shifted from countries outside the EEC to the existing EEC member countries.¹¹⁹

In addition to these market effects, these enlargements had a significant effect on GATT law. With each addition of new members to EEC, there has been a new Article XXIV:6 negotiation and a new set of adjustments to the external tariff and other restrictions. A

118 In relation to the Accession of Denmark, Ireland and the United Kingdom in 1973, of Greece in 1981, and of Spain and Portugal in 1986, see the references to the treaties and the working party reports listed in tables A and B of "Tables on application of Article XXIV" in GATT, *Analytical Index*, pp789-808.

119 See Donges, Juergen B. & Schatz, Klaus-Werner, "Competitiveness and Growth in an Enlarged European Community" (1979) 2 *The World Economy* 213-227 at 224.

significant impact of these adjustments arises from the fact that nullification and impairment disputes have come to revolve around the legitimate expectation of the parties at the time a binding was given. Consequently, in respect of every binding, it is important to be able to identify the date it was given. Where the EEC is enlarged and a binding previously given by existing members is extended to a new member, questions arise as to whether the date of the binding is the same for all members and whether, for the original members, the legitimate expectations associated with the tariff binding are to be assessed at the date of the original grant or at the date of the second grant under the Article XXIV:6 negotiation. The answer to this issue is not clear and will be addressed in more detail in chapter 13. It suffices at this point to say that Article XXIV:6 negotiations and their outcomes have added a significant complication into a number of disputes¹²⁰ and that this problem was central to the Oilseeds dispute which was a major barrier to progress in the Uruguay round negotiation on agriculture.¹²¹

5 IMPORTANCE OF THE HISTORICAL BACKGROUND

In a number of important ways, this historical background sets the scene for the analysis of the application of GATT rules to agriculture which follows.

The review illustrates the importance of some political factors existing in the early years of the GATT. The grant of the US waiver shows how the GATT was affected by the political balance existing when the GATT came into existence. The original hostility of the US Congress to the GATT and the bargaining strength of the US in the post war years were critical to the decision to grant the US agricultural waiver. By 1955 when the USA waiver was given, the earlier granting of the ECSC waiver had demonstrated the way that political factors relating to European security had already relegated matters of GATT legality to a position of less importance.

The review also introduces the difficulty in fitting the continued integration of the EEC within the rules of the GATT. The creation of these difficulties can be attributed to some

120 *EEC - Canned Peaches case*, report by the Panel given 20 February 1985, L/5778, which report has not been adopted by the CONTRACTING PARTIES; *EEC - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, report adopted 25 January 1990, L/6627, BISD, 37S/86.

121 The Oilseeds dispute is dealt with in chapter 13.

degree to the two earlier decisions under the waiver provision. The ECSC waiver wiped out the legal requirements of Article XXV so as to facilitate the decision on the US agricultural waiver. By the time that those decisions had been made, the supremacy of the process of European integration over the technicalities of GATT had been established and the US, by asserting the priority of its own agricultural programmes over the technicalities of the GATT, had created a precedent for the EEC.

The lasting result of these factors and events is that thirty years later, in 1986, when the Uruguay round began, the United States was still applying import quotas under s22 of the AAA and the European Community was still operating a Common Agricultural Policy which implemented minimum import regimes by the use of variable levies.

6 WHAT WAS THE RELATIVE IMPORTANCE OF THE POLITICAL FACTORS AND THE SUBSTANTIVE RULES?

It is obviously tempting to blame the inability to attract compliance with the law and spirit of the GATT on power politics both domestically and internationally. It seems that, in the face of powerful political forces, the law had to be moved aside. In both the USA and the EC, just as our analysis of political decision making would predict, the farm lobbies exerted substantial influence over agricultural policy. In the USA, they exerted enough influence to have the AAA amended in 1951 and to ensure that the executive was able to successfully refuse to yield in the dairy dispute. The support of the agricultural lobby was so strong that the USA was able to take the position that, unless it received the waiver, then it would withdraw from the GATT. In the case of the EEC, the farm lobby was strong enough to ensure that the liberalization applied to the rest of the economy did not apply to farmers. Whereas, in other industries, high cost producers were expected to adjust to competition with lower cost producers in other member states, in the agricultural sector, high cost farmers were able to influence the government to guarantee their prices and to insulate them from competition from lower cost producers in other member states. At the inception of the EEC, the concerns with European peace and security together with the attitude of the Europeans that they would not adhere to the spirit of Article XI if the USA was not going to, was sufficient to enable the demands of the agricultural sector to override the application of Article XI.

This historical and political background might be taken to suggest that the problems with applying the GATT to agriculture would have arisen regardless of the content of the GATT rules. However, whatever the attraction of an explanation in terms of power politics, the approach of this thesis is that there may be a connection between the failures with agricultural trade and the substantive content of the rules, in particular, a failure of the GATT rules to satisfactorily embody the two distinctions between border instruments and non-border instruments and between price-based border instruments and quantity-based border instruments. Therefore, this historical background is offered as a necessary part of that investigation. At this stage of that investigation, we can note that substantial problems arose in the application of the rules on import barriers to agricultural import quotas in the USA and to renegotiation of tariff and variable levies in the EEC. With the benefit of hindsight, we can also observe that this difficulty eventually resulted in large surpluses in the EEC and disruptive subsidized exports.

Therefore, it is possible at this stage to point to a few aspects of the substantive rules which contributed to these difficulties:

- (1) the agriculture exception which was inserted in the agreement to meet the requirements of the *AAA* only provided for the use of quantity-based border instruments;
- (2) the waiver provision in Article XXV did not make it less costly to seek a waiver to utilize a quantity-based border instrument instead of a price-based instrument or a non-border instrument rather than a border instrument;
- (3) Article II and Article XI seemed to have left a gap for variable levies;
- (4) The tolerance in Article II of a product by product method of tariff reduction left no mechanism for ensuring that the most protected sectors were liberalized and, similarly, the renegotiation provision in Article XXVIII did not have any mechanism to prevent increases in protection in the most protected areas.
- (5) in 1955, when the USA's export subsidies were a concern and in 1962, when the EEC whilst still a substantial net importer of agricultural products, introduced a

policy which was predictably going to result in surpluses, there was no mechanism under the GATT to negotiate a binding on export subsidies.

A more detailed analysis of the application of the GATT rules on import barriers to agriculture now follows.

CHAPTER 11

THE PRE-URUGUAY ROUND RULES ON IMPORT BARRIERS AND THEIR APPLICATION TO AGRICULTURE

1 INTRODUCTION

Chapter 9 identified some of the consistencies and inconsistencies between the framework of GATT (GATT 1947) rules described in Chapter 2 and the two desirable distinctions between policy instruments described in part two of this thesis. This chapter and the next two chapters take the description in chapter 2 into more detail and apply it specifically to agricultural trade. This chapter :

- (1) searches for defects in the way that the rules on import barriers embodied the distinctions between price and quantity based border instruments and between border and non-border instruments such as might have impaired the ability of the rules to guide parties toward achieving both economic benefits and non-economic objectives;
- (2) analyzes the way that GATT rules on import access affected trade in agricultural products between 1948 and the Uruguay Round and identifies and explains the areas of difficulties;

so as to lay the groundwork for an assessment of whether any such defects referred to in paragraph (1) contributed to the difficulties referred to in paragraph (2).

Almost every aspect of the GATT's scheme of regulation of import barriers gave rise to problems in application to agricultural trade. Although there were problems in other areas of trade, particular difficulty was encountered with agricultural trade: in application of the disciplines on tariffs, the prohibition on quantitative restrictions and the exceptions to these

rules. The application of the disciplines on tariffs was less successful in relation to agricultural products than in relation to other products simply because less bindings were given on agricultural products. The application of the prohibition on quantitative restrictions was problematic. The agricultural sector was among the sectors most affected by such quantitative restrictions.¹ One of the GATT parties' most persistent problems was the existence of quantitative restrictions that do not fit any of the exceptions. Difficulties occurred with a number of the exceptions to the prohibition: the grandfathering provision, the waiver provision, the balance of payments exceptions and the agricultural exception.

An additional problem was the existence of import barriers that were not disciplined by either the rules on tariffs or the rules on quantitative restrictions. These barriers slipped through the rules completely. Chapter 10 included a description of the variable levies used in the EEC's Common Agricultural Policy. These were a considerable disruption to agricultural trade. Another instrument affecting agricultural trade that bypassed the rules was the voluntary export restraint. This is described below in the context of an explanation of the emergency safeguards clause.

In considering the problems with application to agricultural trade of GATT rules on import access, this analysis goes through the various elements of the framework of rules on import barriers maintaining an emphasis on the way that the rules impact upon the choice of policy instrument. Note that in addition to the choice of instrument that occurs in an initial decision to grant protection, a choice must also be made whenever a party chooses compensatory liberalization or resorts to retaliatory measures. To maintain a coherent overview of the impact of different provisions on the choice between instrument, it is useful to pay attention to four variables:

- (1) whether the legal right to impose the barrier is permanent or temporary;
- (2) whether there is any need to offer compensating concessions on other products;

¹ See, eg, GATT, "Quantitative Restrictions and Other Non-Tariff Measures", report (1984) of the Group on Quantitative Restrictions and other Non-Tariff Barriers adopted on 30 November 1984", (L/5713), *BISD*, 31S/211. Para 12 notes "that the areas of agriculture, textiles and iron and steel were among those severely affected by quantitative restrictions." Para 31 records "Some delegations added that, in any event, the areas of agriculture, textiles, and iron and steel should be given particular

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- (3) whether other parties have a right to retaliatory suspensions of concessions or other obligations (and if so whether it can be discriminatory); and
 - (4) whether the maintenance of the barrier is subject to continuing procedures for consultation and review.

This analysis builds a more complete picture of the way that the rules distinguished between border and non-border instruments and between price and quantity based border instruments. This facilitates an assessment of whether there is a connection between the failures in relation to agriculture and any deficiencies in the embodiment of these distinctions in the rules.

In assessing the effects of various deficiencies in the application of the rules to agriculture, it is also necessary to appreciate that temporary failings in the rules may have consequences for the future because such failings contribute to the domestic pressures for protection in the future. Therefore, the fact that protection of agricultural trade was or is permitted to exist under one loophole for a short time may lead to political forces that encourage exploitation of another loophole at a later date.

The following material covers particular rules relating to import barriers which influenced the success or failure of the application of the GATT to agriculture between 1947 and the Uruguay Round.² It begins with an overview of the negotiation of the rules on import barriers. Next, it reviews problems with the general tariff rules and the general rule on quantitative restrictions. Then, it deals with problems that arose with some of the exceptions to the rules: grandfathering, waivers, balance of payments restrictions, the agricultural exception, the safeguards exception and the economic development exception. Clearly, those provisions resorted to most frequently deserve analysis. However, some of

attention in the context of future work on quantitative restrictions as these areas were among those severely affected by restrictions."

2 The comments made at the beginning of chapter 2 about the way this narrative applies to the pre-WTO GATT are also applicable here. The narrative will function as a basis for describing the changes made in the Uruguay Round but no attempt to describe those changes is made in this chapter. Therefore, as with chapter 2 the description is predominantly in the past tense even though some aspect of the description are still accurate in respect of the post-WTO rules. In some instances, for simplicity, the description reverts to the present tense.

the provisions not frequently resorted to are also worthy of analysis because they were and are part of the framework of rules affecting policy choice.

There are some limitations in the scope and depth of the treatment of the exceptions. Apart from a cursory reference, this study omits the exceptions in Articles XX and XXI and also omits anti-dumping duties. Articles XX and XXI relate to situations where the object of the restriction is to reduce imports rather than to protect a domestic producer. For those situations, the rules described in part 2 which dictate that a price-based instruments should be preferred to a quantity-based instrument and a non-border instrument should be preferred to a border instrument are not applicable. In fact, according to the general theory of distortions, the opposite is true.³ Anti-dumping is discussed only to the extent of distinguishing the safeguards provision from the anti-dumping provision. This omission is also a practical matter of limiting the scope of this study. In any case, antidumping duties have not been a major factor affecting trade in the principal agricultural commodities. The treatment of state trading is also very brief not because state trading has not affected agricultural trade but because the influence of GATT rules on state trading has been minimal.

2 OVERVIEW OF THE NEGOTIATION OF THE RULES ON IMPORT BARRIERS

In Chapter 2, it was observed that in the course of the negotiation of the GATT, the most important issues were the substantial reductions of tariff rates, particularly, in the USA and the elimination of Commonwealth tariff preferences. As noted there, in the end, the United Kingdom refused to give up the system of Commonwealth preferences and, instead, merely agreed to a ceiling on the level of preference.

There was also difficulty with reaching accord on a method of achieving a substantial reduction in tariff rates. The UK position was that there should be a multilateral, across the

3 See Bhagwati, "The Generalized Theory of Distortions and Welfare", ch4 in Bhagwati, Jones, Mundell & Vanek (eds), *Trade, Balance of payments and growth: Papers in International Economics in Honour of Charles P Kindleberger* (North - Holland Publishing Co, Amsterdam, London, 1971) pp69-90 at 78, and the article by Johnson there referred to: Johnson, HG, "Optimal Intervention in the Presence of Domestic Distortions" in Caves, Johnson & Kenen (eds), *Trade, Growth and the Balance of Payments* (North - Holland Publishing Company, Amsterdam, 1965)

board, tariff reduction.⁴ Meade's 1942 "Proposal for an International Commercial Union" proposed a reduction of protection to a maximum level⁵ This seems to have influenced the UK position although it appears to have evolved into a proposal for a given percentage reduction in tariffs across the board.⁶ In fact, the UK linked achievement of such a reduction to the giving up of Commonwealth preferences.⁷ This approach differed from the approach upon which the United States had previously entered into bilateral treaties pursuant to its Reciprocal Trade Agreements Act. These contained negotiated exchanges of tariff reductions on particular products or groups of products. They also contained most favoured nations clauses to multilateralize the benefits of the bilateral agreements.⁸ Whilst there was some support within the US government for an across the board reduction, by the time that the Reciprocal Trade Agreement Act was renewed in early 1945, the US government had moved to the position that such an approach would not be acceptable.⁹ However, it is noteworthy that the US Proposals for Expansion of World Trade and Employment negotiated with the UK which were published in November of that year contained broad language compatible with either approach to tariff reduction.¹⁰ However, the USA was arguing for a bilateral-multilateral approach which would consist of exchanges of tariff reductions on a country by country and item by item basis with the benefits of each reduction generalized to all other parties. This was the method of reduction that was proposed in the USA's Suggested Charter in 1946 and which was eventually embodied in the GATT.

4 Culbert, Jay, "War-time Anglo-American Talks and the Making of the GATT" (1987) 10 *The World Economy* 381-398 at 391-392.

5 James Meade, "A Proposal for an International Commercial Union", reproduced in James Meade's *War-time Proposal for a Liberal Trade Regime* (1987) 10 *The World Economy* 399-407; clause 11:3 provided that "Members would undertake ... to reduce to a defined maximum the degree of protection which they would afford to their own home producers against the produce of other members of the Union."

6 Culbert, "War-time Anglo-American Talks and the Making of the GATT" at 394.

7 Culbert, "War-time Anglo-American Talks and the Making of the GATT" at 391; and Penrose, E.F., *Economic Planning for the Peace* (Princeton University Press, Princeton, 1953) pp92-93.

8 The pre-1945 USA agreements with most favoured nation clauses are listed in the references cited in Jackson (1969) p37. Some of these earlier agreements are also referred to in Appendix A "Analysis of GATT in Relation to 1945 United States Statutory Authority, Congressional History, and Prior Trade Agreements" in Jackson, "The General Agreement on Tariffs and Trade in United States Domestic Law" (1967) 66 *Michigan Law Review* 249.

9 Brown, *The United States and the Restoration of World Trade* (The Brookings Institution, Washington DC, 1950) p51; and Culbert, p394.

10 See USA Department of State, *Proposals for Expansion of World Trade and Employment* (Department of State Publication 2411), Chapter III, Section B, Article 1.

The method of reduction that the UK argued for finds unequivocal support in the modern economic theory of distortions. We recall two propositions:

- (1) that even though it is possible that a reduction of one or more distortions in a market can result in a net welfare cost, a reduction of the greatest distortion down to the next highest level of distortion in the economy always results in a net welfare gain;¹¹ and
- (2) that even though it is possible that a reduction of one or more distortions in a market can result in a net loss in economic welfare, an equal percentage reduction of all distortions in a market always results in a net welfare gain.¹²

If the negotiators of the GATT had adopted either fixed percentage reductions or Meade's original maximum tariff proposal (which would have applied a higher percentage reduction to the highest distortions), then it would not have been possible for any one or more tariff reductions in a party's national market to result in a net welfare loss for that nation. The system, as adopted, left scope for the selection of tariff reductions in relatively less distorted industries which would permit net shifts of resources to relatively more distorted industries. Significantly, it left scope for the most distorted industries to be completely left out of the tariff reduction process. Therefore, in choosing a method for reducing tariffs, the negotiators not only failed to choose a system that would ensure that gains in economic welfare would be maximized but they chose a system that could potentially result in net losses in economic welfare.

The bilateral-multilateral method was settled on well before the First Preparatory Session and it was not in contention thereafter. There was further negotiation over the extent of reduction of preferences but the question of reverting to a multilateral across the board tariff cut was not considered.¹³ In subsequent meetings of the Preparatory Committee, there was a broad consensus that low tariffs were better than high tariffs and that a system of

11 Proposition 6 in Lloyd, PJ, "A More General Theory of Price Distortions in Open Economies" (1974) 4 *J of Int Ec* 365-386 at p379. See the discussion of this point in chapter 5 at p122.

12 Proposition 8 in Lloyd, A More General Theory of Price Distortions in Open Economies" at 381. See the discussion of this point in chapter 5 at p122.

13 Brown (1950), pp73-75.

exchanging tariff bindings was desirable.¹⁴ It seems that there was little disagreement with adopting the framework of bilateral tariff reductions in a multilateral treaty. Nor does there appear to have been major disagreement about the basic elements of the tariff binding system.¹⁵

In the negotiations in the Preparatory Committee, there was much more contention over treatment of quantitative import restrictions than over treatment of tariffs.¹⁶ Whether or not there should be a general ban on quantitative restrictions was a major point of contention in the negotiations in the Preparatory Committee.¹⁷ The consistent position of the USA was that it favoured a general ban on quotas. This was one of the basic rules included in the USA *Proposals* negotiated with Great Britain and was adopted in the USA's *Suggested Charter*.¹⁸ Note that the provision contained in the *Suggested Charter* went beyond the provision which had ordinarily been included in the USA's bilateral trade agreements. The relevant clause in earlier bilateral agreements had only applied the prohibition on quantitative restrictions to products on which a tariff binding had been given.¹⁹

There were two reasons for the USA-UK opposition to import quotas. The first was the ill consequences of discrimination and the second was the relative economic inefficiency of quotas compared with tariffs.²⁰ However the economic argument seems to have been subsidiary to the considerations of the unfairness of discrimination. The USA argued that whereas discrimination is an unavoidable consequence of a quota system, a tariff system

14 See chapter III, Section A, item 2 of *Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment ("London Session report")*, UN Doc E/PC/T/33 (London, Oct 46). See, above, chapter 2, p33..

15 Brown (1950), p73-75.

16 These observations of the negotiation are drawn principally from Brown, William Adams, *The United States and the Restoration of World Trade* (The Brookings Institution, Washington DC, 1950) and also from the other references noted in Chapter 2, fn 4.

17 Brown (1950), pp75-78.

18 See Ch III Section C-1 of the *Proposals for Consideration by an International Conference on Trade and Development, Federal Reserve Bulletin* (January 1946) pp14-19' (see above, ch2 at p31) and ; article 19 of *Suggested Charter for an International Trade Organization of the United Nations* (US Dept of State Publication no 2598, Commercial Policy series 93 (1946) (see above, ch2 at p32).

19 Eg, see Article X:1 of the *Mexico-USA Reciprocal Trade Agreement*, 23 December 1942, Washington, *Treaties and Other International Agreements of the United States of America (TIAS)* 1776-1949 Vol 9, p1109.

20 See Tumlir, Jan, "GATT Rules and Community Law - A Comparison of Economic and Legal Functions" in Hilf, Jacobs & Petersmann, *The European Community and GATT* (Kluwer, The Hague, 1986) pp1-22 at p7 (speculating as to which reason was the main motivation for the agreement to ban quantitative restrictions).

results in equal treatment of all states. It opposed allowing international trade to be determined on the basis of political negotiation rather than on the basis of price and quality. It also argued that while under a tariff system it is possible for trade flows to shift in accordance with competition on price and quality, such competition is limited under a quota system.²¹

The *Suggested Charter* did provide for some exceptions to the prohibition on quantitative restrictions. As had been agreed between the USA and Great Britain in the negotiation of the *Proposals*,²² the *Suggested Charter* contained an exception for restrictions to protect the balance of payments.²³ There appears to have been much support for the view that only quantitative restrictions were a powerful enough instrument to stop the outflow of monetary reserves in a balance of payments crisis. The *Suggested Charter* also contained an agricultural exception designed to provide legal justification for quotas under the US *Agricultural Adjustment Act*²⁴ and also an emergency safeguards exception to guard against surges of imports.²⁵

At the first Preparatory Session for the Havana Conference,²⁶ a number of countries opposed the general prohibition of quantitative restrictions. In opposition to the USA-UK view, a number of countries regarded quantitative trade restrictions as an essential policy instrument. In particular a number of developing countries including India, China and Lebanon regarded import quotas as necessary for the implementation of their economic development plans.²⁷ New Zealand offered a similar argument asserting that even in a non-planned economy it was necessary to use import quotas in order to set priorities for international trade.²⁸

India argued that, in some circumstances, quantitative restrictions are less restrictive than tariffs:

21 Brown (1950), p56 & 76.

22 Brown (1950) p56.

23 *Suggested Charter*, Art 20.

24 *Suggested Charter*, Art 19(e).

25 *Suggested Charter*, Art 29.

26 The First (London) Session of the Preparatory Committee for a United Nations Conference on Trade and Employment, 15 October 1946 - 26 November 1946, see above ch2 at p33.

27 Brown (1950), p75

28 Brown (1950), p75 & 114.

- (1) where a domestic industry supplies only a small part of domestic requirements, a tariff on the whole of these requirements would be too heavy a burden on consumers;
- (2) where, because of the smallness of domestic output, no representative cost figures are available, a tariff based on costs would be unnecessarily high;
- (3) when import prices are very unstable, tariffs have to be high enough against all contingencies, which would be more burdensome on consumers than the use of quantitative restrictions which are inherently inflexible;
- (4) some tariffs based on price may simply reduce trade, but quantitative restrictions may permit pooling arrangements in which foreign and domestic costs are averaged;
- (5) in industries important for national security, quantitative restrictions should be used because of their greater certainty.²⁹

At the first preparatory session for the Havana conference, the USA managed to keep the general rule in the agreement.³⁰ However, it was hampered by the fact that its own draft contained two exceptions in addition to the balance of payments exception: the emergency safeguards exception and the agricultural programmes exception. Both of these exceptions were the subject of significant debate at the preparatory sessions and they weakened the integrity of the USA's argument for a general ban on quantitative restrictions.

The agriculture exception was one of two areas where the members of the Preparatory Committee argued about the need to make special rules for agricultural products, the other being export subsidies. The USA administration was always quite open about its view that the charter would not be approved by the US Congress unless the existing agricultural programs could be retained and that, therefore, the agricultural exception was essential.³¹ In the preparatory sessions, the debate on the agricultural exception was mainly over suggestions for widening it.³² Chile wanted it to include manufactured products.³³ India,

29 Brown (1950), p76.

30 As above.

31 Brown (1950), p116.

32 *London Session report*, Chapter III, Section C, Item 1(d) to (h).

China and the Netherlands wanted the exception to permit quotas where necessary to protect schemes for price stabilization as well as schemes to limit production.³⁴ China and some other developing countries opposed the limitation on quotas to those that did not alter the proportion of imports in total product. They said this restriction "would perpetuate their dependence on imports and hinder their industrialization."³⁵

With respect to the safeguards exception, it was the United States that argued against narrowing the exception.³⁶ The United Kingdom wanted the safeguards exception to provide for the use of tariffs and subsidies only and not the use of quotas.³⁷ However, the USA's view prevailed³⁸ as one would have expected given the number of countries that were opposed to the general ban anyway. In fact, by the time of the second preparatory conference, the USA President's negotiating authority was subject to a requirement that any trade agreement had to include an escape clause similar to that contained in the USA-Mexico Trade Agreement which did provide for quotas as well as tariffs.³⁹

Although there was sufficient support for the United States view to retain the general prohibition of quantitative restrictions, the debate shifted to consideration of exceptions to the general rule. There was a multitude of exceptions proposed by a variety of states. The proposed exceptions included the allowance of quantitative restrictions:

- to support prices;
- to restrict imports of luxury goods;
- to protect domestic production;
- to increase national employment; or

33 Brown (1950), p116.

34 Brown (1950), p116.

35 Brown (1950), p117.

36 Brown (1950), p89.

37 Brown (1950), pp89-90; see also Hudec (1990) p17-18.

38 London Draft Charter of the ITO (see chapter 2 p9) Article 25.

39 Under executive order 9832 of February 1947; See Brown (1950) p18, Hudec (1990)17-18, Jackson & Davey *Legal Problems of International Economic Relations* (West Publishing, St Paul, Minn., 1986) p541. Subsequent enactments of the content of this order are described in Jackson & Davey (1986), p541. See Article XI of the *Mexico-United States Reciprocal Trade Agreement*, Washington, 24 December 1942, *Treaties and Other International Agreements of the United States of America 1776-1949* (USA Dept of State Publication 8615, 1972) Vol 9, p1109.

- to promote economic development.⁴⁰

Some other proposed exceptions related to goods which were subject to state monopolies, and to low tariff countries.⁴¹ In particular, there was substantial debate over whether the GATT should make special provision for developing countries and whether there should be an exception to the rules on import access for restrictions for economic development purposes.⁴² A limited exception for this purpose was included in Article 13 of the London Draft ITO Charter.

When the GATT was drafted, between the two Preparatory Conferences at the New York drafting session, the draft reflected the London draft of the ITO Charter. It did contain the general prohibition of quantitative restrictions and it did contain the exceptions for balance of payments, safeguards, agricultural programmes and economic development.

It is important to appreciate that at the Second (Geneva) Preparatory session, there were a number of negotiations going on at once.⁴³ First, the negotiation continued on the preparation of the draft charter for the proposed ITO. Secondly, the parties negotiated the details of tariff bindings and reductions. Thirdly, negotiation continued on the text of the GATT. So, importantly, the negotiations on tariff rules and the negotiation of tariff reductions proceeded even though there had not been a prior agreement on rules to maintain the integrity of commitments on tariffs, in particular, even though there had not been a prior agreement on abolishing or even to gradually remove quantitative restrictions. At this second session, in relation to quantitative restrictions, there was again significant argument over additional exceptions to the general prohibition. However, the provisions of the New York draft still formed the basis of the final draft of the GATT completed at the Second Preparatory Session. It was in this form that the Agreement came into provisional operation under the Protocol signed at the end of the Geneva session, though with the provisions on quantitative restrictions only applying to the extent not inconsistent with existing legislation.

40 Brown (1950), p77.

41 Brown (1950), p77.

42 *London Session report*, chapter III, section C, item 1(m); Brown, pp97-102; Gardner, Richard N., *Stirling-Dollar Diplomacy in Current Perspective*, (Columbia University Press, New York, 1980) p363.

43 See Jackson, John H., *The World Trading System - Law and Policy of International Economic Relations* (The MIT Press, Cambridge, Massachusetts, 1989) pp32-33.

Therefore, although when negotiation of the GATT was completed, the GATT did contain the general prohibition of quantitative restrictions this is not indicative of a universal agreement with any general principle relating to the relative merits of tariffs and quotas. It is interesting to note that this lack of consensus was confirmed at the Havana Conference. Although at the preparatory sessions, the focus had shifted from the general rule to the delineation of exceptions, at the Havana Conference, argument was reopened over the general prohibition itself. As Brown retells it:

No less than twenty-four amendments were offered on this provision, three of them providing for complete freedom to impose such restrictions for economic development.⁴⁴

The USA and also the countries that had participated in the Preparatory Sessions argued strongly in favour of the general prohibition and again the argument was shifted away from the general rule toward the scope of the exceptions, in particular, the scope of the exception for economic development.

3 THE APPLICATION OF THE RULES ON IMPORT BARRIERS TO AGRICULTURAL TRADE

3.1 THE APPLICATION OF THE RULES ON IMPORT TARIFFS

3.1.1 Review of Basic Rules

The basic rules on tariffs are described in Chapter 2. The Article II obligations depend on the parties choosing to place a binding for a particular product in their schedules. The negotiation of the binding is central to the nature of the obligation. Changes to schedules occur in the context of renegotiation of alternative bindings or a fallback to an unwinding of the original exchange of concessions. The tariff obligations are as permanent as the schedules are and once a schedule is changed then the change is not subject to any further review.

In summary, for a party to exceed a tariff binding, under the usual Article XXVIII procedure for renegotiation of a schedule, a party must either:

- (1) offer compensating liberalization; or

44 Brown (1950), p153.

-
- (2) face the risk of retaliatory measures;
- but
- (3) the renegotiation of the tariff obligation is permanent; and
- (4) the new tariff rate is not subject to further scrutiny by the other contracting parties.

This position serves as a baseline for a comparison whether other provisions of the GATT make it easier or harder to introduce import barriers than Article XXVIII. This comparison will be made in the course of dealing with some of the main areas of problems in the application of the rules to agriculture.

3.1.2 The Low Number of Bindings

A problem in the application of the tariff binding rules to agriculture was the lower proportion of agricultural products in respect of which bindings had been given.⁴⁵ A GATT Secretariat report in 1982 reported that, on average for the European Union and 9 other industrialized countries, 66% of agricultural tariff lines were bound compared to 92% of the industrial product tariff lines.⁴⁶ A World Bank study found that, in pre Uruguay Round schedules of industrial countries only 55% of agricultural tariff items were bound and, in those of developing countries, only 18% of the agricultural tariff items were bound.⁴⁷

There were a number of reasons why there had been less bindings negotiated on agricultural products. A major factor is the negotiating positions of the parties that have an interest in negotiating bindings on agricultural products. Since, in industrial countries, the removal of protection for agriculture involves a significant loss of political support, it is generally necessary that it occur in exchange for increased export access which provides an offsetting

45 See GATT, "Co-operation on Agriculture in the GATT - Note by the Secretariat" Consultative Group of 18, CG.18/W/68, 8 April 1982, p2, para 3. saying that "as shown by the table on page 6 of CG.18/W/59/Rev.1, there are generally fewer tariff concessions on agricultural than industrial products, whether calculated as a percentage of tariff lines or of trade".

46 See GATT, "Agriculture in the GATT - Note by the Secretariat" (for the Consultative Group of 18, 17th meeting, 10-12 February 1982) CG.18/W/59/Rev.1, 20 January 1982, Table headed "Importance of GATT Bindings in Countries Participating in the Tariff Study", p6. The sample comprised Austria, Canada, EEC, Finland, Japan, NZ, Norway, Sweden, Switzerland and the USA.

47 See Hathaway, Dale E. & Ingco, Merlinda D., "Agricultural Liberalization and the Uruguay Round" chapter 1 in Martin, Will & Winters, L.Alan (eds), *The Uruguay Round and the Developing Economies* (World Bank discussion paper 307) (World Bank, Washington DC, 1995) p1-24 at p1.

gain in political support. Apart from Canada, New Zealand and Australia, the countries that have the most interest in negotiating bindings on agricultural products are developing countries. It is necessary for developing countries to be able to give something in exchange for a binding on an agricultural product from an industrial country. In many cases, developing countries have not had sufficiently large import markets for products of export interest to industrial countries to be able to extract concessions in return.

The Contracting Parties attempted to rectify this asymmetry in negotiating power by modifying the tariff negotiation and renegotiation procedures. Developing countries have argued that they should not have to offer full reciprocity in exchanges of concessions. This view is manifested in the provisions of Part IV of the GATT which was added by an amendment which came into force on 27 June 1966.⁴⁸ Part IV consists of Articles XXXVI, XXXVII and XXXVIII. Article XXXVI:9 provides:

The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties.

The same idea is reiterated in the 1979 Declaration on Differential and More Favourable Treatment Reciprocity and Fuller Participation of Developing Countries.⁴⁹ The effects of these provisions are unclear. They have a potential to cut both ways. In theory, they made it legitimate for developing countries to make less than reciprocal offers but, in practice, they may have discouraged industrial countries from entering into exchanges of concessions.⁵⁰ Despite the intention of the rules, they did nothing to assist the government of an industrial country to overcome the loss of political support occasioned by granting bindings or reducing bound rates on agricultural products.

Whatever the effects of Part IV on the negotiating process, they were largely overshadowed by another factor. This was the ease with which developing countries could impose quantitative restrictions under Article XVIII, section B which is discussed later in this

48 *Protocol Amending the GATT to Introduce a Part IV on Trade and Development*, 1965, dated 8 February 1965, in force 27 June 1966, L/2314, *BISD*, 13S/2.

49 At paragraph 5 of the Decision of the CONTRACTING PARTIES of 28 November 1979, L/4903, *BISD*, 26S/203.

50 The effect of Part IV on the willingness of developed countries to exchange concessions is discussed in Hindley, Brian, "Differential and More Favorable Treatment and Graduation", ch 10 in Finger, J

chapter. Countries were unwilling to pay for a tariff concession that could easily be nullified by the subsequent introduction of a quantitative restriction.⁵¹

This factor relating to the influence of the existence of quantitative restrictions on the negotiation of tariff bindings did not only affect the bargaining power of developing countries. For any country, if a quantitative restriction exists on a product and is expected to continue then there is much less and sometimes no benefit to be received from negotiating a tariff binding. This was one reason why the European Communities and the United States had not negotiated more bindings on agricultural products with each other.

3.2 THE APPLICATION OF THE RULES PROHIBITING QUANTITATIVE RESTRICTIONS

Over the years, various GATT committees have documented the manner and extent to which agricultural trade has been plagued with quantitative restrictions.⁵² For example, a 1961 study found that, out of 33 countries surveyed, 29 maintained some kind of quantitative restriction on the imports of wheat, 26 on dairy products and 23 on meat.⁵³ The legality of some of the quantitative restrictions has been extremely tenuous.

3.2.1 Review of Article XI

Chapter 2 set out the content of the basic prohibition in Article XI:1. It applies to all "restrictions other than duties, taxes or other charges". In contrast to the tariff obligations of

Michael & Andrzej Olechowski (eds), *The Uruguay Round - A Handbook for the Multilateral Trade Negotiations* (World Bank, Washington DC, 1987) p68.

51 See Hindley, "Differential and More Favorable Treatment", as above, pp68 & 71.

52 Eg, see GATT, "Committee II - Expansion of Trade", COM.II/86/Add.7/Rev.1, 3 March 1961 (Documentation for Future Work of Committee II - Revised Estimates of the Area of International Trade Covered by Non-tariff Measures) (includes estimate for each of the commodities studied by the Committee (meat, dairy, cereals, sugar and oils) for, inter alia, the volume of trade covered by, inter alia, quantitative restrictions; GATT Secretariat, "Consolidated Summary Schedules on the Non-Tariff Measures for Agriculture" COM.II/112, 3 March 1961 (is a summary prepared by the GATT Secretariat on the non-tariff measures for 6 groups of agricultural commodities: cereals, dairy, fish, meat, vegetable oils and sugar). Information was collected again by a Committee on Agriculture in 1968, see "Agricultural committee - Programme of work of Committee" GATT, COM.AG/9, 26 January 1968. See also the work of the 1984 Review of Quantitative Restrictions: "Quantitative Restrictions - Note by the Secretariat" (for the Group on Quantitative Restrictions and Other Non-Tariff Measures NTM/6/Rev2.; and the series of documents "Information on Measures and Policies Affecting Trade in Agriculture" AG/FOR/Rev submitted to the Committee on Agriculture between 1987 and 1989.

53 "Consolidated Summary Schedules on the Non-Tariff Measures for Agriculture", GATT Secretariat, COM.II/112, 3 March 1961.

Article II:1(b) which only apply to products that are chosen by a country, the prohibition in Article XI:1 applies to all products.

3.2.2 Interpretation of restrictions other than duties, taxes or other charges

The words "restrictions other than duties, taxes or other charges" have been interpreted broadly. As well as applying to straightforward import prohibitions and import quotas, the prohibition applies to many other instruments. For example, in the *European Fruits and Vegetables* case,⁵⁴ the minimum import scheme was regarded as a "restriction" within Article XI:1. In addition, non-automatic licensing schemes,⁵⁵ and discriminatory listing requirements applicable to imported alcoholic beverages⁵⁶ have been ruled upon as falling within the prohibition.

3.2.3 Scope of Prohibitions and Exceptions

The CONTRACTING PARTIES took a consistent line that the prohibition should only be subject to those exceptions that are provided for in the agreement.

Arguments that the prohibition should be interpreted to fit in with social, political and economic requirements have been dismissed as has the particular argument that the prohibition should not be applied strictly to agriculture. In the context of a dispute about Germany's restrictions on agricultural products, part of the German argument was that

the pertinent provisions of the General Agreement relating to this important field [(agriculture)] are no longer realistic and need to be revised.⁵⁷

Although the response of the working party was not unanimous, almost all of the members rejected Germany's argument regarding it as an assertion that a party could disregard those provisions of the agreement that it regarded as unsatisfactory.⁵⁸

54 "EEC - Programme of Minimum Import Prices, Licences and Surety Deposits for Certain Processed Fruits and Vegetables" report of the Panel adopted on 18 October 1978 (L/4687) *BISD* 25S/68.

55 "Japan - Trade in Semi-Conductors", report of the panel adopted on 4 May 1988, (L/6309), *BISD*, 35S/116.

56 "Canada - Import, Distribution and Sale of Alcoholic drinks by Canadian Provincial Marketing Agencies", report of the panel adopted on 22 March 1988, (L/6304), *BISD*, 35S/37.

57 Para 3 of the German statement that was the subject of consideration by the working party is reported at "Import Restrictions of the Federal Republic of Germany", report adopted on 30 November 1957, *BISD*, 6S/53 at pp65-66.

58 *BISD* 6S/53 at 59, para 9.

In two later cases, this attitude was affirmed. In a case dealing with EEC restrictions against imports from Hong Kong,⁵⁹ the panel report rejected submissions that it should extend its consideration beyond the express provisions of the Agreement to include a consideration of social and economic conditions.⁶⁰ It also rejected a submission that the provisions of the Agreement could be regarded as having been varied by the longstanding tolerance of other quantitative restrictions.⁶¹ The other case dealt with Japanese restrictions on imports of leather.⁶² There, the panel rejected Japanese submissions that the panel should take into account certain historical, cultural and socio-economic circumstances. The panel re-affirmed that it could only consider Article XI:1 and the exceptions that were provided for in the Agreement.⁶³

3.3 THE GAP BETWEEN ARTICLES II AND XI - VARIABLE LEVIES

Another difficulty with the rules on import access was that there were some instruments of import restriction which seemed not to be regulated by either the tariff obligations in Article II or the prohibition in Article XI:1. This problem was been of particular significance to agricultural trade.

The tariff obligations are worded by Article II in terms of an exemption from:

- (1) "ordinary customs duties" in excess of those in the Schedule; and
- (2) "all other duties or charges of any kind imposed on or in connection with importation" in excess of those existing on the date of the Agreement.

The prohibition on quotas is worded by Article XI:1 in terms of

"prohibitions or restrictions other than duties, taxes or other charges".

Therefore, ordinary customs duties that are not bound are left unregulated. Apart from those, every type of import barrier should be covered by either Article II or Article XI. However, one of the problems with agricultural trade was the use of techniques of import

59 "EEC - Quantitative Restrictions against Imports of Certain Products from Hong Kong", report of the panel adopted on 12 July 1983 (L/5511), *BISD*, 30S/129.

60 30S/129 at 138.

61 30S/129 at 138-139.

62 "Panel on Japanese Measures on Imports of Leather", report of the panel adopted on 15/16 May 1984, (L/5623), *BISD*, 31S/94.

protection in respect of which there was substantial difficulty in applying the ordinary provisions of either of Articles II or XI.

A major instrument of concern was the variable levy used by the EEC in its Common Agricultural Policy. The brief overview of the CAP in chapter 10, above, included a description of the workings of a variable levy. As mentioned, the EEC relied on the argument that since there were no tariff bindings on the relevant products, then they were free to charge any rates of duty and to change them as often as was desired.⁶⁴ Another argument is that the variable levy was an instrument not contemplated by the GATT and that in the original negotiation of the EEC's common external tariff (in the Article XXIV:6 negotiation and the Dillon round), the EEC gave compensation which thereafter permitted it to use variable levies.

In subsequent GATT reviews of the process of European integration and the formation of the CAP, the question of GATT consistency of variable levies was raised but not dealt with.⁶⁵ On at least one occasion, the response of the EEC to such allegations of illegality was dismissive, treating the problem as raising a need to change the text of the GATT rather than the variable levies:

Furthermore, the representative of the EEC added that perhaps the text of the Agreement should be adapted or supplemented in the future so as to take better account of the specific characteristics of agriculture.⁶⁶

In fact, there never was a satisfactory determination of the GATT consistency of variable levies. The following discussion considers the extent to which pre-WTO GATT panel decisions made relevant determinations and considers possible arguments both on whether

63 31S/94 at 111, para 44.

64 Jackson, John H, *The World Trading System: law and policy of international relations* (MIT Press, Cambridge, Mass., 1989) p131. Curzon, Gerard, *Multilateral Commercial Diplomacy - The General Agreement on Tariffs and Trade and Its Impact on National Commercial Policies and Techniques* (Michael Joseph, London, 1965) p203. (However, see McGovern, Edmond, *International Trade Regulation* (Globefield Press, Exeter, 1986) p458, "in most cases the requirements of this clause are inapplicable because the products in question are not the subject of bindings" possibly indicating that that there were a small number of products subject to bindings to which variable levies are applied.

65 "Draft Report of Committee II on the Consultation with the European Economic Community" COM.II/139, 8 March 1965; "The Committee felt that it was not its task to go into the legal question": see para 36 on p14 (on beef), and almost identical wording in para 23 on p30 (on dairy products), and para 26 on p54 (on rice).

66 "Draft Report of Committee II on the Consultation with the European Economic Community" COM.II/139, 8 March 1965, para 36 on p14.

variable levies might have been violations of the GATT and whether they might have constituted non-violation nullification or impairment.

(a) *Are Variable Levies a Violation of the GATT?*

The essence of the problem of regulation of variable levies was that although variable levies were import duties, variable levies had the same effect as a quantitative restriction.⁶⁷ Just as is the case with a quantitative restriction, it is not possible to overcome a variable levy just by reducing one's selling price. An important legal point is whether variable levies should have been regulated by Article II or by Article XI. Treated as either "ordinary customs duties" or "other import charges" then Article II:1(b) applied but treated as "restrictions other than duties, taxes or other charges" then Article XI applied. If Article II:1(b) was the applicable provision, then since that Article is applicable only to products which are the subject of tariff bindings,⁶⁸ variable levies upon products that were unbound could not have been a violation of the GATT. If Article XI was the appropriate provision, then variable levies were a violation.

A similar question was considered in relation to a slightly different form of minimum import scheme in a 1978 dispute involving a minimum import price regime of the EEC on certain fruits and vegetables.⁶⁹ One of the measures under dispute in that case applied to tomato concentrate which was subject to a tariff binding in the EEC's schedule of concessions. The import scheme required the lodgement of a deposit at the time of application for an import licence. If tomato concentrate was imported at or above a designated minimum price, then the whole of the deposit was refunded. However, if tomato concentrate was imported at a price below the designated minimum price, then the importer forfeited that part of the deposit which was equal to the amount by which the actual import price fell below the designated minimum price.

As to whether the legality of the forfeiture scheme should be considered under Article XI or under Article II, four of the five panel members decided that the relevant provision was

67 In addition to capturing rent from consumers as an import restriction, variable levies also capture the benefit of an subsidies paid by exporting countries, see: Sampson, Gary P. & Snape, Richard H., "Effects of the EEC's Variable Import Levies" (1980) 88 *Journal of Political Economy* 1026-1040.

68 See fn 64 above referring to McGovern (1986), p458.

Article XI and that Article II was irrelevant and the other panel member decided on the opposite view. The majority said that the scheme fell within the meaning of the words "restriction other than duties, taxes or other charges" in Article XI:1 and that, therefore, the scheme was prima facie prohibited by Article XI:1. The dissenting panel member observed that under the scheme it was still possible to import at prices below the minimum price but that the scheme operated so as to impose a charge that raised the price up to the minimum price. He concluded that the scheme was not a restriction within the meaning of Article XI but was a charge within the meaning of Article II:1(b).⁷⁰

The reasoning of the majority might have been directly applicable to variable levies as used by the EC. The result of a variable levy is the same as that noted by the panel in the *EC Fruit and Vegetables* case as being the result of the forfeiture scheme: it results in an absence of imports below a minimum price.⁷¹ However, the technical difference is that with the forfeiture system, there was an undertaking not to import below a minimum price whereas with the EEC's variable levies there was no such undertaking. In practice, there is little difference between enforcing a minimum price scheme by deductions from a refundable deposit and doing so by charging a variable levy of the same amount. However, the majority's conclusion that Article XI rather than Article II was applicable relied upon an emphasis on the obligation not to import below the minimum price rather than upon the additional payment for which importers might be liable and upon a characterization of that payment as a penalty for failing to comply with the obligation rather than as a charge in respect of importation.⁷²

There was never any other panel decision relevant to the issue of whether variable levies were in breach of the Agreement. McGovern observes that there seems to have been a reluctance on the part of critics of the CAP to have a formal determination of the issue of legality of variable levies.⁷³ He refers to the way the issue was avoided in the reports of the

69 "EEC - Programme of Minimum Import Prices, Licences and Surety Deposits for Certain Processed Fruits and Vegetables", report of the Panel adopted on 18 October 1978, (L/4687), *BISD*, 25S/68.

70 Both views on this point are at para 4.9.

71 25S/68 at para 4.9.

72 25S/68 at para 4.16. Hudec discusses some unsatisfactory aspects the reasoning, see Hudec (1993) p50.

73 McGovern, (1986), p458.

panels dealing with *Uruguayan Recourse to Article XXIII* in 1963.⁷⁴ Indeed, while the *EC Fruits and Vegetables* decision seems to have paved the way for a legal challenge to variable levies under Article XI:1, such a legal challenge was never made.

(b) *Are variable levies a non-violation nullification or impairment under Article XXIII ?*

As discussed in chapter 2, the operation of the dispute settlement procedure in Article XXIII turns not upon the existence of a violation but on the existence of nullification or impairment of a benefit under the Agreement. Arguments that variable levies constituted a non-violation nullification and impairment are difficult. Possible arguments might be:

- (1) that because of the frequency of the changes to the rate of customs duty, there was an impairment of the benefit given by Article X which is an expectation that such information will be published in a usable manner; or
- (2) that there is an impairment of the benefit that should flow from having Article XI complied with.

However, there is nothing in previous dispute decisions to support either of these arguments and nor do other panel decisions assist in constructing an argument that variable levies constituted a non-violation nullification or impairment.

In the dispute, *Uruguayan Recourse to Article XXIII*, part of the case submitted by Uruguay was the argument that variable levies constituted a nullification and impairment under Article XXIII. Because the panel had decided not to make a decision on whether variable levies were violations,⁷⁵ they could only consider the question of nullification and impairment on the basis of variable levies being non-violations. The panel noted that Uruguay had not made any submissions as to which particular benefits under the Agreement were being nullified or impaired and said that, in the absence of such submissions, it could not make a decision as to whether any nullification or impairment existed.⁷⁶

74 "Uruguayan Recourse to Article XXIII", *BISD*, 11S/95, 13S/35, 13S/45. See McGovern (1986) p458 fn31 where he refers to 11S/95 at 100 and 13S/45 at 49.

75 *Uruguayan Recourse*, 11S/95 at para 17.

76 11S/95 at 100.

There have been only a few panel reports which found the existence of nullification and impairment in non-violation situations and not all of those have been adopted by the CONTRACTING PARTIES.⁷⁷ In every case but one, the finding of the panel related to the impairment of a benefit flowing from a tariff concession and in the only case which related to a benefit other than a benefit under a tariff concession, the report has never been adopted by the CONTRACTING PARTIES.⁷⁸ Therefore, the CONTRACTING PARTIES have never made a finding that non-violation nullification and impairment existed in relation to a benefit other than a benefit given by virtue of a tariff binding. It seems that variable levies were effectively unchallengeable on this point.

3.4 REGULATION OF QUOTAS AND MARK-UPS BY STATE IMPORT MONOPOLIES

State trading bodies can be used as mechanisms to impose the equivalents of import quotas or import tariffs. The essential factor to being able to do so is exclusivity. They must have a monopoly. So long as the state trading body has a monopoly on importation, then it can control imports either by restricting the quantity of imports or by imposing a high mark-up on the price. By using the latter, they can effectively limit the quantity of imports without actually having to impose any laws restricting the quantity of imports. However, an effective restriction is imposed. The state trading body simply has to decide the price at which it will on-sell imports into the domestic market. Having done so, it can then choose to buy the quantity of imports that it needs to meet the demand at the selected price.

77 Up to the coming into force of the WTO the only such reports were "The Australian Subsidy on Ammonium sulphate", GATT/CP.4.39, adopted on 3 April 1950, *BISD* II/188; "Treatment by Germany of Imports of Sardines", G/26, adopted 31 October 1952, *BISD* 1S/53; "Report of panel on EEC - production aids granted on canned peaches, canned pears, canned fruit cocktail and dried grapes" L/5778, 1984; not adopted by the CONTRACTING PARTIES: see GATT, *Analytical Index*, p612, and not reported in the *BISD*; reported in Bureau of National Affairs, 20 *US Export Weekly* 1028, 5 June 1984; "EEC - Tariff Treatment on Imports of citrus Products from Certain Countries in the Mediterranean Region", L/5776, dated 7 February 1985 (unadopted, extracted in GATT *Analytical Index*, pp614-615; European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins", report of the Panel adopted on 25 January 1990, L/6627, *BISD*, 37S/86.

78 "EEC - Tariff Treatment on Imports of Citrus Products from Certain Countries in the Mediterranean Region", L/5776, dated 7 February 1985 (unadopted), extracted in GATT, *Analytical Index*, pp614-615.

Over the life of the GATT, the use of state run import monopolies to control agricultural imports has been pervasive.⁷⁹ Hathaway, writing in 1987, spoke of estimates of 90% of world trade in wheat and 70% of world trade in course grains.⁸⁰ From the beginning, the GATT did contain provisions to govern state trading entities. However, these provisions had little impact on the extent to which such entities have been used to restrict imports. In practice, the GATT imposed little constraints on the way that state trading operations could restrict imports and parties were free to use such operations to restrict agricultural trade.

GATT Rules on Import Monopolies

It is clear from the way that the GATT rules are constructed that some care was taken so that the operation of state import monopolies would not, in itself, be inconsistent with the GATT and that parties acceding to the GATT (perhaps especially those who had elements of planned economies) would not be required to replace state import monopolies with free market arrangements. The elements of the regulation of import monopolies are as follows.

First, the GATT regulates the imposition of effective tariffs through import monopolies. As mentioned in chapter 2,⁸¹ parties are prohibited from circumventing tariff concession through the use of import monopolies. Article II:4 prohibits parties from operating import monopolies "so as to afford protection on the average in excess of the amount of protection provided for in that Schedule". This obligation can be varied by other specific provisions incorporated into the Schedule of Concessions.⁸²

Secondly, the GATT regulates the imposition of import prohibitions and import quotas through the use of import monopolies. As mentioned in chapter 2, the Article XI rule

79 See, eg, data relating to the period 1977 to 1981 collected in "Agriculture in the GATT - Note by the Secretariat" CG.18/W/59/Rev.1, 20 January 1982 at p9-10 referring to 2 countries for which state trading entities carried out all trade and a further 17 countries which reported operating 97 state trading entities of which 69 concerned agricultural products.

80 Hathaway, Dale E., *Agriculture and the GATT: Rewriting the Rules* (Institute for International Economics, Washington DC, 1987) (No 20 in the series, Policy Analyses in International Economics), p111.

81 See, above, chapter 2 under heading 4.5 "Protecting the Integrity of Tariff Bindings and the National Treatment Rule".

82 See Jackson, *World Trade and the Law of GATT* (1969), p357. Note that Interpretative Note Ad Article II:4 says it should be interpreted "in the light of" Article 31 of the Havana Charter which requires "import monopolies to "import and offer for sale such quantities of the product as will be sufficient to satisfy the full domestic demand for the imported product".

prohibiting quantitative restrictions does apply to import restrictions "made effective through state-trading operations".⁸³

Thirdly, Article XVII regulates discrimination by state import monopolies. Article XVII:4 requires import monopolies to purchase imports in a non-discriminatory manner which is defined to mean that regard is had solely to "commercial considerations".

Fourthly, a general exception was made in Article XX for any import restrictions "necessary" for "the enforcement of monopolies operated under" Articles II:4 and XVII provided that measures met the requirements of the 'chapeau' of Article XX (not being means of arbitrary or unjustified discrimination and not being disguised restrictions on international trade).

Effectiveness of the Regulation of Import Monopolies Affecting Agriculture

The principal limitation to the effectiveness of Article II:4 was the same as with the general rule in Article II. This was that there were fewer tariff bindings given in relation to agricultural products than on other products. In the absence of a tariff binding, there was no restriction of the mark-up that could be charged.⁸⁴ Whilst Article II:4 did accommodate the making of specific concessions relating to mark-ups, it appears that very few such concessions were ever given. Hoekman and Kostecki record two such instances in the period 1947-1994, in each case, the concessions only lasting for a short period of time.⁸⁵

Another significant problem with Article II:4 was the technical difficulties in proving a violation. The test to be satisfied is that the protection afforded by the import monopoly is not "on the average" in excess of the rate specified in the tariff binding. Proving an excessive rate of mark-up in a single instance is not sufficient. A complainant needed substantial information about the purchase and resale prices at which the trade of the import

83 See the Interpretative Note Ad Articles XI, XII, XIII, XIV and XVIII. This was also cited in chapter 2 under heading 5.1 "The Basic Rule - Article XI General Elimination of Quantitative Restrictions".

84 Eg, see the Complaint against the Haitian Tobacco Monopoly, GATT document L/454 (1955) (cited in Baban, Roy, "State Trading and the GATT" (1977) 11 *JWTL* 334-353 at 344-345) (where it was decided that there was no inconsistency with Article II because the relevant product was not bound).

85 See GATT, *Analytical Index - Guide to GATT Law and Practice* (GATT, Geneva, 6th ed, 1994) p85; see also Hoekman & Kostecki, *The Political Economy of the World Trading System* (Oxford University Press, Oxford, 1995) pp110-111.

monopoly had been undertaken.⁸⁶ The domestic selling price would have to be determined and any costs relating to internal taxes, transportation, or distribution would have to be excluded from the calculation.⁸⁷ To address this problem, paragraph 4 was added to Article XVII in 1957 requiring governments to submit information about state trading operations. Nevertheless, up to 1977, there had only been two rulings made in GATT dispute settlement relating to import monopolies.⁸⁸ The second of these was the challenge by Uruguay against 15 industrialized countries.⁸⁹ Among the 562 restrictions⁹⁰ complained about by Uruguay were restrictions imposed through state trading entities in 9 countries. As with the question of variable levies, the panel declined to make a legal ruling on a matter upon which Uruguay had failed to plead a legal argument. The working party did not make any finding on whether the operation of the import monopolies were in violation of Article II:4.

The interaction of the rule regulating mark-ups with the rules regulating quantitative restrictions impaired the effectiveness of the rule on mark-ups. In practice, if a country was applying a quantitative restriction, then the domestic price would be higher than the world price and possibly higher by much more than the margin established in any tariff binding. It was confirmed in a case on Korean Restrictions on Beef in 1989 that Article II:4 did not apply to the situation in which quantitative restrictions were being applied consistently with another provision of the Agreement.⁹¹

One can observe that the lack of effective regulation of the control of imports by state import monopolies was consistent with the adoption of the 'country by country' and 'item by item' system of negotiating tariff bindings. It has already been noted that the adoption of the item by item system enabled parties to avoid bindings on agricultural products. In the case

86 Generally, on this calculation, see McGovern, Edmond, *International Trade Regulation* (Globefield Press, Exeter, 1995-) p5.11-9.

87 See Kostecki, M.M., *East-West Trade and the GATT System* (Trade Policy Research Centre, London by St Martin's Press, New York, 1978) at 45 setting out the calculation of the relevant prices to determine whether there is a violation of Article II:4. An example of the application of these calculations are "Canada - Import, Sale and distribution of Alcoholic Drinks" GATT *BISD* 35S/86.

88 Baban, Roy, "State Trading and the GATT" (1977) 11 *JWTL* 334-353 at 344.

89 "Uruguayan Recourse to Article XXIII" report adopted on 16 November 1962 (L/1923) GATT *BISD* 11S/95.

90 See Hudec, Robert E., "Retaliation Against "Unreasonable" Foreign Trade Practices: The New Section 301 and GATT Nullification and Impairment" (1975) 59 *Minnesota Law Review* 461-539 at 497

91 "Republic of Korea - Restrictions on Imports of Beef - complaint by the USA" GATT *BISD* 36S/268, para126.

of state trading, the adoption of an item by item system for binding mark-ups not only enabled parties to avoid bindings on mark-ups on agricultural products but also enabled them to impose effective quantitative restrictions without actually imposing quantitative restrictions.

4 THE EXCEPTIONS TO THE GENERAL RULES ON IMPORT BARRIERS

As mentioned above, difficulties with a number of the exceptions to the general rules on import barriers adversely affected the liberalization of agricultural trade. Each of the exceptions to be discussed below were introduced in chapter 2. They are:

- (1) grandfathering of pre-existing measures;
- (2) waivers.
- (3) the balance of payments exception;
- (4) the agricultural exception;
- (5) the emergency safeguards exception;
- (6) the economic development exception.

The operation of each of these exceptions impacted upon the relative strictness of the regulation of import quotas and that of import tariffs which it is submitted in turn contributed to difficulties in regulation of agricultural trade.

4.1 GRANDFATHERING

As described in Chapter 2, the Article XI prohibition, along with the rest of part II of the Agreement, came into force only to the extent that it was "not inconsistent with existing legislation."⁹² A significant proportion of the quantitative restrictions that were justified

⁹² Article I of the *Protocol of Provisional Application*, see ch2 p37. Generally on the history of this clause and its legal application, see GATT, *Analytical Index*, pp993-1006; Curzon (1965), pp45-46; Dam (1970), pp341-344; Jackson (1969) pp60-63; Jackson (1989) pp34-37; Hansen, Marc & Edwin Vermulst, "The GATT Protocol of Provisional Application - A Dying Grandfather?" (1989) 27 *Columbia J. Transnational Law* 263-308; Knobl, Peter F., "GATT Application - The Grandfather is Still Alive - Recent Panel Recognitions and Amendment Intentions" (1991) 25(4) *JWT* 101-118;

under this grandfathering provision were maintained in respect of trade in agricultural products.⁹³

Over the years, there were some legal developments which limited the scope of the existing legislation exception but, despite the narrowing of the scope of this exception, its existence contributed to the continued existence of many quantitative restrictions on agricultural products. In the 1984 report submitted by the Group on Quantitative Restrictions, this exception was cited as one of the principal GATT provisions advanced by parties in justification of their quantitative restrictions.⁹⁴

4.1.1 Legal Interpretation of Existing Legislation

Developments in legal interpretation of the exception occurred in three areas:

- (1) the meaning of "existing", that is, the determination of the relevant date;
- (2) the question of whether executive regulation authorised by but not mandatorily required by pre-existing legislation was protected; and
- (3) whether pre-existing legislation lost the protection of the exception if it was amended.

Firstly, the meaning of "existing" was clarified to mean, for the original parties, the 30th of October 1947,⁹⁵ and, for acceding parties, the date specified in their protocol of accession.⁹⁶

Roessler, Frieder, "The Provisional Application of the GATT - Note on the Report of the GATT Panel on the "Manufacturing Clause" in the US copyright Legislation", (1985) 19 *JWTL* 289-295.

93 See "Quantitative Restrictions and Other Non-Tariff Measures, Report (1984) of the Group on Quantitative Restrictions and other Non-Tariff Barriers adopted on 30 November 1984, (L/5713), *BISD*, 31S/211 and the compilation of restrictions and their legal justifications referred to therein: GATT Doc. NTM/W/6/Rev.2.

94 "Quantitative Restrictions and Other Non-Tariff Measures", Report (1984) of the Group on Quantitative Restrictions and other Non-Tariff Barriers adopted on 30 November 1984, (L/5713); *BISD*, 31S/211,215, para 20.

95 "Protocol of Provisional Application, Date of reference for the phrase "Existing Legislation" in paragraph I(b) of the Protocol", Ruling by the Chairman on August 11, 1949; *BISD*, Vol.II, 35.

96 See, eg, the Torquay Protocol, 21 April 1951 (*BISD*, vol.1 p86) and the Annecy Protocol, 10 October 1949 (62 UNTS 122; *BISD* Vol.1 p79) which refer to the "legislation existing on the date of this Protocol". A later example of a protocol of accession which uses the same words is that of Thailand (*BISD*, 26S/3). A number of protocols of accession specify an actual date, eg, that of Switzerland which says "legislation existing on 22 November 1958" (*BISD*, 14S/6).

Secondly, the CONTRACTING PARTIES decided that the benefit of the pre-existing legislation exception extended only to 'mandatory' legislation and did not provide protection for acts which were merely authorised by pre-existing legislation.⁹⁷

Thirdly, the CONTRACTING PARTIES decided that amendment of pre-existing legislation did not necessarily deprive it of the benefit of the exception. However, the parties added an important condition to this. The legislation only retained the protection of the clause if the degree of inconsistency with the General Agreement was not increased. This rule was interpreted quite strictly in the 1984 *United States Manufacturing Clause* case.⁹⁸ In that case, certain legislation was inconsistent with Article III. An amendment had previously established a sunset date on the legislation. The amendment which was under consideration in the dispute had merely extended the expiry date of legislation. The panel decided that the extension of the duration of the legislation increased the inconsistency of the legislation.⁹⁹ The interpretation adopted in that case was significant because it adopted a 'one-way track' approach to giving the protection of the clause to amendments.

4.1.2 Origins of the Grandfathering Provision

That the existing legislation clause ever came to exist in the first place was perhaps more than anything else a manifestation of the conflict between the parties over the importance of constructing a rule to restrict tightly the use of quantitative restrictions. It is worth

97 See "Norway - Restrictions on Imports of Apples and Pears", report of the panel adopted on 22 June 1989, (L/6474), *BISD*, 36S/306; "Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes", report of the panel adopted on 7 November 1990, (DS10/R), *BISD*, 37S/200, esp paras 82 & 83; and "Canada - Distribution, and Sale of Alcoholic Drinks by Canadian Provincial Marketing Authorities" report of panel adopted 22 March 1988, *BISD* 35S/37. See also the report "Notification of Existing Measures and Procedural Questions", Report approved by the CONTRACTING PARTIES on 10 August 1949, II *BISD* 49,61 at para 99: "The working party agreed that a measure is so permitted, provided that the legislation on which it is based is by its terms or expressed intent of a mandatory character - that is, it imposes on the executive authority requirements which cannot be modified by executive action". See also the other reports cited in *GATT, Analytical Index*, pp997-1002.

98 "United States Manufacturing Clause", report of the panel adopted on 15/16 May 1984 (L/5609); *BISD*, 31S/74.

99 "US Manufacturing Clause" at paras 36ff. The panel relied on the rather equivocal authority of the "Brazilian Internal Taxes" case, report adopted by the CONTRACTING PARTIES on 30 June 1949, *BISD*, vol.II/181. In the Brazilian Internal Taxes cases, the Panel did not make a finding, but all of its members seem to have agreed that the amendment did not necessarily deprive the legislation of protection under the existing legislation clause provided that the degree of inconsistency was not increased.

examining the historical situation from which the "existing legislation" clause came into being.

Clearly, it was in the minds of negotiators that an agreement regulating tariffs would not liberalize trade unless it included regulation of quantitative restrictions. However, given the way the negotiation proceeded, it is difficult to believe that there was universal appreciation of the potential for the regulation of tariffs to be undermined if it was not accompanied by regulation of quantitative restrictions. It was noted above that, at the Geneva conference, the parties entered into negotiations for tariff reductions even though they had not settled on the provisions of the GATT.¹⁰⁰ The parties negotiated tariff reductions before completion of negotiation of the framework agreement by which those tariff reductions would come into effect. It seems that one of the reasons that the US and others encouraged the tariff negotiation to proceed without waiting for the completion of the ITO or the GATT was that the USA negotiating authority would expire in mid-1948.¹⁰¹ Once the tariff negotiations began, they built an urgency of their own. It was in the nature of such tariff negotiations that they were carried out in secret. Governments did not tell domestic industries that their protective tariffs were being reduced. That they were conducted in this manner reflects the domestic political costs that might arise if negotiations were not secret. Particular lobby groups might withdraw their support from the government. However, if the total package including the reductions by other countries is presented as a *fait accompli* then the total political gains and losses balance each other out. However, a problem with secret negotiations is that if traders find out about prospective changes, then they will alter their transactions in anticipation of more favourable tariff treatment after the changes occur.¹⁰² The longer the time delay between the negotiations and bringing them into effect, the larger the possibility that the negotiation could not be kept secret.

By the end of the Geneva conference, at which time both the negotiation of the tariff reductions and the text of the GATT had been completed, a problem arose with speedy

100 See, above, in this chapter at p253.

101 See Jackson (1989) p35. The trade legislation had been extended in 1945 for 3 years expiring on 12 June 1948: "Act to Extend the Authority of the President" under section 350 of the *Tariff Act* of 1930 as amended, and for other purposes, 5 July 1945, Pub L 79-130, 59 Stat 410.

102 See Jackson (1989) pp34-35; Roessler, "The Provisional Application of GATT" p290; Knobl, "GATT Application - The Grandfather Is Still Alive" pp103.

implementation of the GATT. Many countries indicated that they could not put the GATT into effect without parliamentary approval and that they did not wish to go through that process twice: once for the GATT and a second time for the ITO Charter.¹⁰³

Some parties wished to bring only the tariff obligations into place. However, the United States, the UK and Canada insisted that they would not bring their tariff commitments into effect unless the other provisions which prevented the circumvention of tariff commitments by other instruments also came into effect.¹⁰⁴ It was as a compromise to this dilemma that the parties agreed upon the Protocol of Provisional Application with its existing legislation clause applying to Part II of the Agreement. It allowed the parties to bring the GATT into force without putting governments in a position where they were obliged under existing legislation to violate the Agreement.

However, leaving so many quantitative restrictions undisciplined necessarily had a detrimental effect. It was unlikely that any country would ever make a concession in exchange for a tariff reduction on a product upon which a grandfathered import quota existed. Since in many cases, the grandfathered import quotas existed in relation to agricultural trade, then this was one element in a framework that made it less likely that concessions would be exchanged on agricultural products.

That the accumulation of these political factors culminated in the "existing legislation" clause was indicative of the priorities of the negotiators. Had regulation of import quotas been a higher priority than regulation of import tariffs, then the negotiators would have ensured that an agreement on regulating quotas would be implemented before commencing secret tariff negotiations.

4.1.3 Grandfathering and Agriculture

There were a couple of instances in which the grandfathering of existing legislation had a particular effect on agricultural trade.

103 See Jackson (1989) p35; Roessler, "The Provisional Application of GATT", p290

104 See Roessler, Frieder, "The Provisional Application of the GATT" at p290. See also Jackson (1969) p62 (Jackson cites UN document EPCT/TAC/1 at 24 (1947)).

(a) *The 'Consideration' Of German Agricultural Quantitative Restrictions from 1957 to 1959*

The attitude of Germany to the formation of the EEC Common Agricultural Policy and the relative importance of compliance with the GATT were foreshadowed in its attitude to maintaining quantitative restrictions in the years immediately prior to the formation of the CAP. A controversy (dispute proceedings under Article XXIII were never initiated) over German agricultural quantitative restrictions arose a few months after the signing of the *EEC Treaty* in March 1957. Following consultations in June 1957 with Germany, the CONTRACTING PARTIES adopted a report that found that Germany could no longer justify import restrictions on the basis of Article XII. After Germany issued a statement that it would move to liberalize the existing restrictions, but not to remove them nor to apply for a waiver,¹⁰⁵ the contracting parties established a working party to respond to Germany's statement.¹⁰⁶ Germany's statement was remarkable because it asserted that the GATT should not apply the prohibition on quantitative restrictions to agricultural trade.¹⁰⁷ Germany made arguments on two other grounds for retaining some of its restrictions. One of these was that the restrictions were justified under the Pre-existing legislation clause in the Protocol.¹⁰⁸ The legal issue relating to the pre-existing legislation was referred to the Intersessional Committee¹⁰⁹ to consider and report back to the 13th session. The Intersessional Committee appointed a working party to consider the arguments under the pre-existing legislation clause.¹¹⁰

The four pieces of legislation under consideration, called the Marketing Laws, dealt respectively with trade in Grains (legislation dated 24 November 1950), Sugar (5 January 1951), Milk and Fat (28 February 1951), and Cattle and Meat (25 April 1951). Under these

105 Under the 'hard core' waiver procedure which had been established to deal with restrictions formerly justified under the balance of payments exception. See this chapter under the heading 4.3.5(a) "Disinvocation under Article XII".

106 "Import Restrictions of the Federal Republic of Germany", Report adopted on 30 November 1957; (L/768), *BISD*, 6S/55;

107 "Statement by the Representative of the Federal Republic of Germany", Annex to "Import Restrictions of the Federal Republic of Germany", Report adopted on 30 November 1957; (L/768), *BISD*, 6S/55 at 63, esp 65-66.

108 The other ground was that despite the certification by the IMF, Germany still had some balance of payments problems.

109 On the Intersessional Council, see GATT, *Analytical Index*, p1015, fn32 (& see above in ch2, p14, fn 49).

laws, it was only permissible to import for the purpose of selling to an Import and Stockpiling Agency and such sales had to be at prices fixed by the government and subject to certain levies. The laws provided for Supply plans (or in the case of the Milk and Fats law for Ministerial instructions) which would estimate the quantity of imports that were required. There were no express provisions limiting the quantities that the Import and Stockpiling Agencies could buy or sell. However in order to implement the Supply plans, the German government maintained import quotas.

Germany argued that the Marketing laws were legislation existing on the date of Germany's accession to the Agreement (which was by the Torquay Protocol which was dated 21 April 1950).¹¹¹ Germany argued both that: the protocol gave protection to the quotas even if they were not mandatorily required by the legislation; and, secondly, that even if the protocol only gave protection to mandatory legislation then the quotas were mandatorily required by the Marketing laws. The working party reported some disagreement on both points and concluded by stating the majority view that the import quotas under the Marketing Laws were not justified under the existing legislation clause in the Torquay Protocol. Three members of the working party abstained including France which agreed with Germany that the other parties should accept the statement by Germany that the law was mandatory.¹¹²

The working party report was adopted by the Intersessional Committee on 2 May 1958 with the three abstentions. Note that at this time the six parties to the EEC Treaty had begun to negotiate a common agricultural policy and were due to meet for that purpose in Stresa in July 1958. After the working party report reached the Intersessional Committee, the USA moved a recommendation that the quotas be removed. However the 6 EEC members joined to vote against the motion.¹¹³ Therefore, the finding of the illegality of the German Restrictions was not adopted by the CONTRACTING PARTIES.

110 "Import Restrictions Maintained By The Federal Republic Of Germany", Report adopted by the Intersessional Committee on 2 May 1958; (L/821), *BISD* 7S/99.

111 There is no discussion in the case about the fact that the date of the Cattle and Meat law (25 April 1950) is after the date of the Protocol. For present purposes, it has not been necessary to find the answer to this anomaly.

112 The report, L/821, does not say who the other abstainers were but presumably they were the other 2 EEC countries on the working party, Belgium and Italy.

113 Hudec (1990) p268 fn11: "The vote was 21 for, 6 against, 6 abstaining. The six negative votes were the six EEC members." Hudec cites the US motion as L/817 and the proceedings at IC/SR.38.

After the Stresa conference, when the key CAP principle of an EEC wide price regime was adopted, the protection of German agriculture had become a significant issue in intra EEC negotiations and Germany was clearly very much concerned with protecting its farmers from lower prices emanating from its fellow EEC members, particularly France and also from the rest of the world. It became clear that Germany would not submit to a GATT determination of its quantitative restrictions on agricultural products except in the context of consideration of the whole CAP. The matter of the illegality of the German restrictions was resolved by a German application for a waiver which was given without prejudice to its view that the restrictions were legal.¹¹⁴

In retrospect, it is clear that the German arguments over the interpretation of the existing legislation clause were wrong, but they did serve to delay the issue from June 1957 until May 1959. It was the first of many times that GATT determinations and negotiations have had to wait until after certain progress has been made in intra EEC negotiations on the CAP. The course of the dispute offered an indication of the importance to Germany of protection for its agricultural sector. In retrospect, the course of the dispute also illustrated the importance of the French-German relationship in intra EEC politics. France was able to take sides with Germany by supporting the technical meaning of 'mandatory' which Germany argued for. However, by doing so, France avoided the necessity of supporting any of Germany's other arguments. France would have been committed to gaining export access for agricultural products to the German market and in the negotiation of the CAP would have foreseen that there would be a dispute between France wanting to set lower EEC wide prices and Germany wanting to set higher prices.¹¹⁵ France also wanted ordinary GATT rules to apply to agricultural trade but it resented the waiver granted to the USA. Germany, on the other hand, was not merely threatened by the application of GATT rules, it was threatened by the potential impact that the CAP would have on the ability of French farmers to put German farmers out of business. Therefore, given the different French and German objectives, it is not surprising that the GATT dispute could not be resolved until after France and Germany had resolved their internal EEC negotiation.

114 "German Import Restrictions", Decision of the CONTRACTING PARTIES of 30 May 1959, *BISD*, 8S/31; the report adopted by the CONTRACTING PARTIES is at 8S/160.

115 On the setting of EEC prices, see chapter 10, under the heading "The Formation of the Common Agricultural Policy and the First Article XXIV:6 Negotiation", pp231ff.

(b) *Section 22 of the USA Agricultural Adjustment Act*

Chapter 10 mentioned that, even though the USA's 1955 agricultural waiver did "not preclude the right of affected contracting parties to have recourse to the appropriate provisions of Article XXIII", no party other than The Netherlands ever applied for authorization of retaliation. The potential for arguments over the application of the "existing legislation" clause may have played a role in discouraging such applications and, therefore, in the longevity of the USA's restrictions imposed under s22 of the *AAA*.¹¹⁶

Some restrictions imposed under s22 would have been mandatorily required by existing legislation, the *AAA*, on the relevant date, 30 October 1947. In respect of those, no waiver was necessary so, surely, the waiver only applied in respect of quotas that would not have been protected by the existing legislation clause. To determine the scope of the waiver and the preservation of the right to have recourse to Article XXIII, it would have been necessary to determine the scope of application of the "existing legislation" exception. Such a determination would have had to take account of amendments to the *AAA*.¹¹⁷ The *AAA* was amended in 1948 to add programmes in respect of which quotas could be imposed under s22.¹¹⁸ It was also amended in 1948 to give the GATT precedence over the *AAA* and again in 1951 to reverse that order of precedence.¹¹⁹

Parties seeking authorization of retaliation would have had to convince the CONTRACTING PARTIES that the relevant restrictions under s22 were not justified under the existing legislation clause. To do so, they would have had to establish either

- (1) that the amendment of the *AAA* in 1948 giving priority to the GATT had brought the *AAA* into conformity with the GATT and that the amendment reversing the order of priority had introduced a new inconsistency which was not protected under the

116 These legal technicalities are considered in Hansen, Marc & Edwin Vermulst, "The GATT Protocol of Provisional Application - A Dying Grandfather?" (1989) 27 *Columbia Journal of Transnational Law* 263 at 298-304.

117 The amendments to the *AAA* are partially described in chapter 10. They are more fully described in Hansen, Marc & Edwin Vermulst, "The GATT Protocol of Provisional Application - A Dying Grandfather?" at 299-300; and in Martin, Edwin G., "The Conflict Between Foreign-Trade Agreements and Price-Support Programs" (1951) 37 *Cornell LJ* 17-31 esp at 26-28.

118 See Martin, as above, p26; 62 Stat 1247 (1948) brought programmes in respect of the Steagull Commodities within s22. The Steagull Commodities were those for which price support policies were introduced under the Steagull Amendment: 55 Stat 498..

"existing legislation" clause thereby introducing the argument that was eventually successful in the *US Manufacturing Clause* case;¹²⁰ or

- (2) that even if the protection of the legislation had survived the 1951 amendment, the quotas were in force to protect a programme which either was not subject to the protection of s22 of the *AAA* on 30 October 1947 or which were not mandatorily required under the legislation.¹²¹

Therefore, whilst other political factors may have been more important, the legal technicalities relating to grandfathering may have discouraged requests for authorization of retaliation and, thereby, contributed to the longevity of the USA agricultural quotas.

(c) *The Swiss Protocol of Accession*

A particular instance of the impact of "existing legislation" clauses on agricultural trade was the reservation in the Swiss Protocol.¹²² In addition to an "existing legislation" clause in the ordinary form specifying the relevant date as 22 November 1958,¹²³ the Swiss Protocol made the application of Article XI subject to pre-existing agricultural support laws under which import quotas could be maintained.¹²⁴

4.2 WAIVERS UNDER ARTICLE XXV5

The biggest impact of the waiver provision on agricultural trade was that flowing from the USA's agricultural waiver granted in 1955, discussed in Chapter 10. Agriculture was also affected by a number of other waivers given in respect of the provisions on import barriers.

The provisions of Article XXV:5 have already been set out.¹²⁵ To recap, the wording of Article XXV:5 requires a two thirds majority vote and appears to restrict the giving of waivers to circumstances that:

119 62 Stat 1248 (1948); Pub L No 81-579, s3, 64 Stat 261 (1951).

120 This argument is discussed in Hanson & Vermulst, "The GATT Protocol of Provisional Application - A Dying Grandfather" at 300-302.

121 These arguments are discussed in Hanson & Vermulst at 302-304.

122 "Protocol for the Accession of Switzerland" *BISD*, 14S/6.

123 *BISD*, 14S/6 at 7, para 1 of Part I.

124 *BISD*, 14S/6 at 8, para 4 of Part I.

125 See chapter 10 at p218.

- (1) are exceptional; and
- (2) are not elsewhere provided for in the Agreement.

The original waiver clause in the USA's Suggested Charter applied to any of the obligations in the draft ITO charter on commercial policy and none of the succeeding negotiations introduced any limitations.¹²⁶ The waiver power in Article XXV:5 extends to any of the obligations under the Agreement without limitation. The only contention about the width of Article XXV:5 has arisen as to whether waivers can be granted in respect of the most favoured nation obligation in Article I. It has been argued that such a waiver amounts to an amendment of the Agreement which should be dealt with under Article XXX which requires unanimity.¹²⁷ However, the CONTRACTING PARTIES have decided that Article XXV:5 can apply to any obligation under the Agreement.¹²⁸ In the absence of any such limitation on the type of obligation or of any distinction between waivers of different obligations, the Article does not make it any more difficult to obtain a waiver from the prohibition on quantitative restrictions than from the rules on tariffs or export subsidies. Therefore, the provisions of Article XXV:5 have not done anything to guide parties toward the adoption of less costly policies.

By 1 April 1994, there had been 113 waivers granted.¹²⁹ They were given for a number of different situations. Many related to deviations from the MFN rule. A significant number related to the rules on the use of border protection instruments. Some waived the provisions of Article II to permit a party's substantially revised customs tariff to come into force within a shorter time than would have been possible if ordinary Article XXVIII negotiations were required to be completed first.¹³⁰ Some waivers enabled parties in balance of payments

126 Article 55(2) of the *Suggested Charter* which provided for the establishment of criteria and procedures for waivers referred to the obligations in Part IV of the draft charter containing the commercial policy obligations. On the successor provisions, see GATT, *Analytical Index*, p826.

127 See the argument raised by Cuba in "Reports Relating to the Review of the Agreement - Schedules and Customs Administration" report adopted on 26 February 1955 (L/329), *BISD*, 3S/205, 208-209.

128 "The European Coal and Steel Community" report adopted by the CONTRACTING PARTIES on 10 November 1952 (G/35), *BISD*, 1S/85 at 86, para 2.

129 Plus some additional decisions extending or amending a prior waiver decision. See GATT, *Analytical Index*, p823 & Table "Waivers Granted By The Contracting Parties Under Article XXV:5" at pp828-839.

130 Eg: Brazil - Renegotiation of Schedule, 15S/75; Chile - Renegotiation of Schedule, 15S/83; Indonesia - renegotiation of Schedule, 20S/28; Pakistan - Renegotiation of Schedule, 24S/15; Turkey - Renegotiation of Schedule, 9S/51.

difficulties to utilize tariff surcharges instead of quantitative restrictions in circumstances where Article XII would have only permitted quantitative restrictions. However the waivers that most affected trade in agricultural products were those where the application of Article XI was waived to permit the application of quantitative restrictions to agricultural trade. Most of these are discussed below in the context of balance of payments restrictions: the hard-core waiver granted to Belgium in 1955,¹³¹ the agricultural waiver given to Luxembourg in 1955,¹³² the waiver granted to Germany in 1959,¹³³ and the most important one, the United States waiver of 1955.¹³⁴

The granting of the waiver to the United States was described in some detail in chapter 10. The US agricultural waiver is remarkable for the looseness of its terms. In particular, it was noted above:

- (1) that the waiver was not given for a limited time;
- (2) the waiver was not conditional on the US removing the restrictions within any specified time frame; and
- (3) nor was the waiver conditional on the US altering the underlying domestic programme which made the restrictions necessary.¹³⁵

The waiver did nothing to guide the USA toward less damaging policies.

In chapter 10, it was submitted that the circumstances of the US waiver did not meet the two requirements of being "exceptional" and "not elsewhere provided for in the Agreement". There, it was also submitted that these legal requirements had been effectively removed from the Agreement by the precedent set in approving the waiver for the European Coal and

131 "Waiver Granted to Belgium in Connexion with Import Restrictions on Certain Agricultural Products", Decision of 3 December 1955, *BISD*, 4S/22.

132 "Waiver Granted to Luxembourg in Connexion with Import Restrictions on Certain Agricultural Products", Decision of 3 December 1955, *BISD*, 4S/27.

133 "German Import Restrictions", Decision of 30 May 1959, *BISD*, 8S/31, panel report, *BISD*, 8S/160.

134 "Import Restrictions Imposed by the United States Under Section 22 of the United States Agricultural Adjustment Act", report adopted on 5 March 1955, (L/339) *BISD*, 3S/141; decision of the CONTRACTING PARTIES, *BISD*, 3S/32.

135 Chapter 10, p217.

Steel Commission¹³⁶ and that this precedent made it possible for the US to negotiate such loose terms for its own waiver.¹³⁷

In 1956, the CONTRACTING PARTIES made an attempt to maintain the legal content of Article XXV:5 by approving some guiding principles to be followed in considering applications for waivers of important obligations.¹³⁸ The guidelines provide that waivers should only be given where the CONTRACTING PARTIES are satisfied that the interests of other contracting parties are adequately safeguarded,¹³⁹ and that waivers should provide for "consultation on specific action taken under the waiver",¹⁴⁰ and for annual reports to the Contracting Parties.

In the important cases affecting agriculture, these consultation and reporting procedures did little to bring the actions of the relevant contracting parties into conformity with the Agreement. Both the Belgian hard core waiver and the German agricultural restrictions waiver expired without Belgium or Germany having phased out the restrictions.¹⁴¹ With regard to the US waiver, reports were submitted annually between 1956 and 1986. In some years, there had been some liberalization of the restrictions but, almost always, it took the form of a widening rather than a removal of the quotas. In chapter 10, it was pointed out that in 1986, at the beginning of the Uruguay round, restrictions under s22 of the *Agricultural Adjustment Act* were still in place in relation to cotton and cotton waste, a variety of dairy products, and also some nuts, oils, and animal feeds and chocolate.¹⁴²

136 "The European Coal and Steel Community" report adopted by the CONTRACTING PARTIES on 10 November 1952 (G/35), *BISD*, 1S/85.

137 Although note that in the two decisions in which waivers were denied, reference was made to the circumstances not being exceptional: "Greece - Preferential Tariff Quotas to the USSR", report of the Working Party adopted 2 December 1970, *BISD*, 18S/179, 181, para 6.

138 "Article XXV - Guiding Principles to be followed by the Contracting Parties in Considering Applications for Waivers from Part I or Other Important Obligations of the Agreement", Procedures adopted on 1 November 1956; *BISD*, 5S/25. For commentary, see Jackson (1969), p547.

139 *BISD*, 5S/25, para (c).

140 *BISD*, 5S/25, para (d).

141 See "German Import Restrictions" report adopted on 13 November 1962 (L/1909) *BISD* 11S/222; & "Belgian Import Restrictions on Agricultural Products", report adopted on 16 November 1962 (L/1928) *BISD* 11S/220.

142 See chapter 10, p218.

The last report on the US waiver made before the commencement of the Uruguay Round was reviewed critically.¹⁴³ The US reported changes to its Farm Bill of 1985 which were intended to reduce production. Other parties asked whether the changes would enable the US to relinquish the waiver. The US response was that the problems of world agricultural markets could not be solved by any single country acting alone and that the existing Committee on Trade in Agriculture was the appropriate forum for dealing with the problem.¹⁴⁴ For this attitude, the US was severely criticized. The other members of the working party argued that the US was making action of other parties a precondition for bringing its own legislation into line with the Agreement.¹⁴⁵ They stressed that the US should not expect to get anything in return for giving up the waiver.¹⁴⁶

In the 1987 review, after the Uruguay round had commenced, the working party criticized the US severely. The report says that members

expressed a general frustration at the lack of progress in removing the waiver, which they said was a temporary privilege, not a right, and should not be reopened.¹⁴⁷

Most members of the Panel wanted to make some recommendations to the GATT Council. The suggested recommendations included establishing a time frame for phasing out the waiver, and the substitution of GATT consistent measures in place of the quotas. The US opposed the making of any recommendations to the Council saying that the Uruguay Round was the proper forum for dealing with problems in agricultural trade.¹⁴⁸ Although no recommendations were made, the working party report records that, but for the USA's dissent, they would have been able to unanimously conclude that the continued application of the waiver by the US:

(1) "had not facilitated adjustment of the US agricultural sector";

143 "United States Import Restrictions on Agricultural Products", Report of the working Party adopted on 22 May 1986, (L/5983); *BISD*, 33S/101.

144 *BISD*, 33S/101, paras 15, 22;

145 *BISD*, 33S/100, para 37.

146 *BISD*, 33S/100, para 41.

147 "United States Import Restrictions on Agricultural Products", report of the working Party adopted on 15 July 1987, (L/6194); *BISD*, 34S/38 at 39, para 7.

148 *BISD*, 34S/38, para 54.

- (2) "had allowed the US to maintain agricultural programmes which caused excessive supply, surplus stocks and pressure for subsidized exports", and
- (3) "had been an important factor in the failure of GATT rules to operate effectively in relation to agricultural trade".¹⁴⁹

The working party report contains an unusual reference to the waiver having arisen as a result of the US's own internal legal position and its inability to ratify the Agreement.¹⁵⁰ It was pointed out to the US that it sought the waiver because it might have otherwise had to withdraw from the agreement.¹⁵¹ Perhaps this was a veiled way of offering the US the same choice again. After all, the waiver could have been revoked by a two-thirds vote and the US congress would then have had to choose between amending the legislation or violating the Agreement.

The US response that the matter should be dealt with in the course of the Uruguay round was predictable. The issue of whether the US could use the waiver as negotiating ammunition in the Uruguay round was sensitive but in practical terms, whatever the legal position, the giving up of the waiver would only be done when the US had received enough in exchange for it.

4.3 THE EXCEPTIONS FOR RESTRICTIONS FOR BALANCE OF PAYMENTS REASONS - ARTICLE XII AND ARTICLE XVIII B

4.3.1 Introduction

Chapter 2 gave a general description of the balance of payments exception in Article XII and the separate balance of payments exception for developing countries in Article XVIII B. In terms of the overall framework of rules, this exception is different from most of the other exceptions from the rules on import barriers in two ways. First, if the pre-requisites are satisfied, then the suspension of obligations can proceed without the need to offer compensatory concessions and without any prospect of other parties being able to impose retaliation. Secondly, this exception justifies restrictions across all trade not just on specific items.

149 *BISD*, 34S/38, para 57.

150 *BISD*, 34S/38 at 55, para 52.

Abuse of and breaches of the rules relating to the balance of payments exceptions contributed significantly to the lack of liberalization achieved by the GATT in agricultural trade. The unjustified maintenance of restrictions under this exception contributed to the maintenance and increase of protection of agriculture. In some countries, the resulting level of protection helped to create the strong political power of the agricultural sector which continued even after balance of payments restrictions had been removed.

That there would be a balance of payments exception seems to have been accepted from the very first negotiations between the British and the Americans.¹⁵² As Jackson points out, the existence of this understanding predates the negotiation of the IMF agreement so the negotiation of the currency parity system was predicated on an assumption that countries would be able to impose quantitative restrictions on imports for balance of payments purposes.¹⁵³

The fact that so many countries were in fact suffering from balance of payments problems after the war had a significant effect on the negotiation of both the general prohibition of quantitative restrictions and of the balance of payments exception. It enabled parties to contemplate that it would be some time into the future before they would have to comply with the general prohibition.¹⁵⁴ Nevertheless, the outcome of the negotiation was that there were quite strict rules formed both as to when and how the balance of payments restrictions could be utilized. The additional exception in Article XVIII B for developing countries was not added until 1957.¹⁵⁵

4.3.2 The Rules for BOP Restrictions

The rules as to when these exceptions could be utilized were described in part 11.2 of chapter 2 as follows.

151 *BISD*, 34S/38, para 52.

152 See the *Proposals*, Section C, Article 2; See also Brown, *The United States and the Restoration of World Trade*, p78.

153 Jackson (1969), 678.

154 Hudec (1990), p21.

155 See "Protocol Amending the Preamble and Parts II and III of the GATT", 3 October 1955, in force 10 July 1957, 278 UNTS 168.

Article XII:

- permits a contracting party to impose restrictions "to safeguard its financial position and its balance of payments."¹⁵⁶
- The extent of restrictions is limited to "those necessary:
 - (i) to forestall the *imminent threat* of, or to stop a serious decline in its monetary reserves, or
 - (ii) in the case of a contracting party with *very low monetary reserves*, to achieve a reasonable rate of increase in its reserves".¹⁵⁷

Article XVIII B:

- permits a contracting party to impose restrictions "to safeguard its external position and to ensure a level of reserves adequate for the implementation of its programme of economic development".¹⁵⁸
- The extent of restrictions is limited to "those necessary:
 - (a) to forestall the *threat* of, or to stop, a serious decline in its monetary reserves, or
 - (b) in the case of a contracting party with *inadequate monetary reserves*, to achieve a reasonable rate of increase in its reserves".¹⁵⁹

The key element is that the exceptions are tied to the level of monetary reserves. Whenever the CONTRACTING PARTIES have to decide on the state of a party's monetary reserves, they are required to accept the determination of the International Monetary Fund ('IMF').¹⁶⁰

156 Art XII:1.

157 Art XII:2(a). Emphasis added.

158 Art XVIII:9.

159 Art XVIII:9. Emphasis added.

160 Art XV:2.

The original and still operative provisions of Articles XII and XVIIB of the Agreement contain quite expansive rules as to the way in which balance of payments restrictions may be applied. These are summarized by Jackson¹⁶¹ as follows:

- (1) restrictions shall be progressively relaxed as conditions permit;¹⁶²
- (2) measures should avoid uneconomic employment of productive resources;¹⁶³
- (3) as far as possible, measures should be adopted that expand rather than contract international trade;¹⁶⁴
- (4) avoid unnecessary damage to commercial or economic interests of any other contracting parties;¹⁶⁵
- (5) allow minimum commercial quantities of each description of goods so as to avoid impairing regular channels of trade;¹⁶⁶
- (6) allow imports of commercial samples;¹⁶⁷
- (7) avoid restrictions that prevent compliance with "patent, trade mark, copyright, or similar procedures";¹⁶⁸
- (8) but imports of certain products deemed more essential may be preferred over other imports.¹⁶⁹

The Agreement provides that whenever balance of payments restrictions were implemented, the relevant party should consult with the CONTRACTING PARTIES.¹⁷⁰ In addition, the Agreement provides for a regular review process requiring parties applying balance of

161 Jackson, (1969), 685; see also the description of the rules in Hexner, Ervin, "The General Agreement on Tariffs and Trade and the Monetary Fund" (1950-51) 1 *IMF Staff Papers* 432-464.

162 Art XII:2(b).

163 Art XII:3(a).

164 Art XII:3(a).

165 Art XII:3(c)(i).

166 Art XII:3(c)(ii).

167 Art XII:3(c)(iii).

168 Art XII:3(c)(iii).

169 Art XII:3(b).

170 Arts XII:4(a) & XVIII:12(a).

payments restrictions to consult with the CONTRACTING PARTIES annually, or two-yearly for developing countries applying restrictions under Article XVIII B.¹⁷¹

Each of Articles XII and XVIII B provide for their own dispute settlement system for disputes arising either out of the regular consultations¹⁷² or from a complaint by another party.¹⁷³ Upon a finding of inconsistency with the Agreement, the CONTRACTING PARTIES can recommend removal or modification of the restrictions and failing compliance with such a recommendation can authorize retaliation by other parties in respect of the trade of the defaulting party.¹⁷⁴ Compared to the ordinary dispute mechanism of Article XXIII, these provisions are slightly more favourable to the party having resort to the restrictions and less favourable to the party complaining. It is arguable that these specific provisions were intended to exclude the application of Article XXIII from disputes over balance of payments restrictions. However, the CONTRACTING PARTIES have decided otherwise in relation to Article XVIII B¹⁷⁵ and, by implication, also in relation to Article XII.

The detail in the rules suggests that the parties were committed to limiting the use of this exception and to maintaining the efficacy of the general prohibition on quantitative restrictions. However, the history of the agreement detracts sharply from that conclusion. Problems with application of the exception arose from at least three factors:

- (1) from the premises of the Agreement that import restrictions have a larger role in the correction of balance of payments problems than they can realistically have;
- (2) from the failure of the Agreement to provide for balance of payments restrictions in the form of tariffs instead of quotas;

171 Arts XII:4(b) & XVIII:12(b).

172 Arts XII:4(c) & XVIII:12(c).

173 Arts XII:4(d) & XVIII:12(d).

174 Arts XII:4(c)(ii) & XII:4(d); Arts XVIII:12(c)(ii) & XVIII:12(d).

175 See the three parallel reports, all adopted 7 November 1989: "Republic of Korea - Restrictions on Imports of Beef - Compliant By Australia" (L/6504) *BISD*, 36S/202 at 230-231, paras 94-97; "Republic of Korea - Restrictions on Imports of Beef - Compliant By the United States" (L/6503) *BISD*, 36S/268 at 302-303, paras 116-119; "Republic of Korea - Restrictions on Imports of Beef - Compliant By New Zealand" (L/6505) *BISD*, 36S/234 at 264-265, paras 110-113.

- (3) from the failure of the legal processes and the review and consultation procedures to ensure that balance of payments restrictions were only temporary.

The three factors are considered in turn.

4.3.3 Flawed Premises as to the Role of Import Restrictions in BOP Problems

A number of writers have observed that in situations of balance of payments deficits, import restrictions are not an appropriate remedy.¹⁷⁶ Even at the commencement of the GATT, it was generally appreciated that import restrictions could only ever be, at most, a part of a remedy for a balance of payments deficit. Foreign exchange transactions involve both current transactions and capital transactions and it is not possible to check a balance of payments deficit unless there is some correction in both capital and current account flows. Further, it is not appropriate to regard import restrictions on their own as a partial solution to a balance of payments deficit. On their own, import restrictions do not create an adjustment in the size of the gap between imports and exports. The reduction in imports is accompanied by a reduction in exports and, in the long run, the gap remains unchanged. This is an application of Lerner's symmetry theorem mentioned above.¹⁷⁷

Bergsten observed in 1977 that

in every instance where trade measures were adopted by a major country, they failed to prevent a subsequent exchange-rate change.¹⁷⁸

This was true even when major nations had fixed exchange rates. With the advent of floating exchange rates, the adjustments required to remedy a balance of payments deficit can occur through adjustments in the exchange rate and there is no need for trade restrictions. However, the reality that imposition of trade restrictions is not good policy for

176 Bergsten, C. Fred, "Reforming The GATT - The Use of Trade Measures for Balance-Of-Payments Purposes" (1977) 7 *Journal of International Economics* 1-18 at 3; Eglin, Richard, "Surveillance of Balance-of-Payments Measures in the GATT", (1987) 10 *World Economy* 1-26 at 2; Frank, Isaiah, "Import Quotas, the Balance of Payments and the GATT" (1987) 10 *The World Economy* 307-317; Roessler, Frieder, "The GATT Declaration on Trade Measures Taken for Balance-of-Payments Purposes" (1980) 12 *Case W Res J Int'l L* 383-403 at 391; & Roessler, Frieder, "The Relationship Between the World Trade Order and the International Monetary System" in Ernst-Ulrich Petersmann & Meinhard Hilf, *The New GATT Round of Multilateral Trade Negotiations* (Studies in Transnational Economic Law, Vol 5) (Kluwer, Deventer, 2nd ed, 1991) pp363-386 at 375-377.

177 See chapter 5, above, fn13 and accompanying text.

178 Bergsten, CF, "Reforming The GATT: The Use Of Trade Measures For Balance-Of-Payments Purposes" (1977) 7 *Journal of International Economics* 1-18.

dealing with balance-of-payments problems has not discouraged countries from resorting to trade restrictions as if they were an essential part of remedying these problems. One needs to ask whether GATT rules need to allow for this exception to the prohibition on quantitative restrictions and if so whether the rules contain adequate restraints on the use of these restrictions. This is well summed up by Frank:

the continuing and widespread resort to such restrictions is evidence of a basic flaw in the system that cannot be remedied through procedural change. The flaw is the sanctioning in the GATT of micro-economic measures to deal with macro-economic problems. In theory, this mismatch could be best fixed by revising the GATT to outlaw patently protective measures, such as quantitative restrictions, as a means of dealing with a country's unsustainable excess of total expenditures over output.

It is now generally accepted that balance-of-payments adjustments requires some combination of demand restraint, supply-side measures to increase output and exchange-rate and other reforms to shift the pattern of output towards net exports. The reforms typically included in adjustment programmes sponsored by the World Bank and the IMF comprehend among supply-side measures *reductions* in protection based on the well recognized principle that a tax on imports is equivalent to a tax on exports. In the light of this emphasis, it is anomalous to preserve in the GATT the right to impose increases in protection in the form of quantitative restrictions to cope with balance-of-payments problems.¹⁷⁹

4.3.4 Tariffs vs Quotas in BOP Rules

On its face, Article XII is not consistent with a desirable distinction between price-based and quantity-based border instruments. One might have expected that the Article would have provided under some circumstances for the exceeding of bound tariff rates and under even more strictly delineated circumstances for an exception to the no quotas rule. However, Article XII only authorized the imposition of quotas.¹⁸⁰ It did not authorize the charging of tariffs in excess of bound rates.¹⁸¹

This problem was partly solved by a gradual evolution towards regarding tariff surcharges for balance of payments purposes as legal if they met the prerequisites for imposition of an

179 Frank, Isaiah, "Import Quotas, the Balance of Payments and the GATT" (1987) 10 *The World Economy* 307-317 at 313-314.

180 Art XII refers to restrictions on "the quantity or value of merchandise".

181 For a discussion of the various trade instruments that could be used for balance-of-payments purposes in the context of what is actually permitted by Article XII, see Bergsten, CF, "Reforming The GATT: The Use Of Trade Measures For Balance-Of-Payments Purposes" (1977) 7 *Journal of International Economics* 1-18.

import quota under Article XII. The exception for tariff surcharges for balance of payments reasons developed unofficially. Over the years, there were a number of occasions where contracting parties suffering balance of payments difficulties chose to impose tariffs in excess of bound rates either instead of or in addition to the imposition of quotas.¹⁸²

The evolution of the legal treatment of tariff surcharges for balance of payments reasons began with a dispute involving a tariff surcharge imposed by the United Kingdom. In December 1964, a GATT working party appointed to review the surcharge first consulted with the UK. By May 1966, the Working Party had still not issued a report. By that date, the UK had announced that the tariff surcharge would lapse in November 1966. When the working party next met in June 1966, it decided to delay making a report until after the surcharge had lapsed. The report made no recommendations and did not even discuss the question of whether Article XII could justify tariff surcharges.¹⁸³ The whole episode demonstrated an enormous reluctance on the part of the working party (and the contracting parties) to take any action that would have led to a declaration of the illegality of the United Kingdom's surcharge.

After the dispute over the UK restrictions, a number of parties employed tariff surcharges for balance of payments purposes. The legality was effectively resolved by a Declaration adopted at the end of the Tokyo Round in 1979.¹⁸⁴ The Declaration applied to balance of payments restrictions under both Article XII and Article XVIII B. It noted that tariff surcharges had been used in the past for balance of payments reasons and called on parties to give preference to measures which had the least disruptive effect on trade.¹⁸⁵ This

182 Jackson (1969), at p711, lists 9 cases of which 7 were balance of payments situations in which tariff surcharges were notified to the CONTRACTING PARTIES. In 5 of these cases a waiver was given under Article XXV but in the other four cases the violation was simply tolerated. Jackson & Davey (1986), p876 note 7, refer to a list of tariff surcharges coming within the cognizance of GATT published in GATT Doc.Com.TD/F/W.3,(1965).

183 "Conciliation - United Kingdom Temporary Import Charges", Report of the Working Party adopted on 17 November 1966 (L/2676), *BISD*, 15S/113.

184 "Declaration on Trade Measures Taken for Balance-Of Payments Purposes" adopted 28 November 1979 (L/4904) *BISD*, 26S/205.

185 In part the Declaration provides :*"Noting that restrictive import measures other than quantitative restrictions have been used for balance-of-payments purposes;"* and

"1 ... The application of restrictive import measures taken for balance-of payments purposes shall be subject to the following conditions in addition to those provided for in Articles XII, XIII, XV and XVIII without prejudice to other provisions of the General Agreement:

Declaration appears to have completed the creation of a de facto exception to allow for the exceeding of bound tariffs to safeguard the balance of payments.¹⁸⁶

4.3.5 Longevity of 'Temporary' Restrictions

Since 1948, there have been many instances of countries maintaining quantitative restrictions that had once been justified (or purported to be justified) under this exception but which no longer were. Until the mid 1970's, such restrictions maintained by developed countries were a major problem. Since then, the problem of temporary restrictions becoming permanent has been more of a problem with developing countries. Over the years preceding the Uruguay Round, the contracting parties tried various mechanisms to try to obtain compliance with the rules.

4.3.5(a) *Disinvocation under Article XII*

When operation of the Agreement commenced, almost all of the 23 original parties to the GATT had import restrictions which were supporting policies to maintain domestic prices of agricultural products above world prices. Since, at that time, those same countries had very low monetary reserves, then the balance of payments exception functioned as a legal cover for their agricultural restrictions. However, problems with the balance of payments exception began to show as soon as post war balance of payments situations began to improve.

Although the Agreement required the CONTRACTING PARTIES to review restrictions applied under Article XII, and although the CONTRACTING PARTIES were required to accept the determinations of the IMF, certainly in the early years there was no systematic approach to obtaining rulings from the IMF on whether balance of payments problems had ceased and then making declarations that the entitlement to utilize the Article XII exception had expired. Commenting on the procedure up to 1960, Hudec observes:

the process of disinvocation [of entitlement to utilize the Article XII exception] tended to be rather fuzzy. Governments would usually take time to think about

(a) In applying restrictive import measures contracting parties shall abide by the disciplines provided for in the GATT and give preference to the measure which has the least disruptive effect on trade".

186 For a discussion of this point, see Roessler, Frieder, "The GATT Declaration on Trade Measures Taken for Balance-Of-Payments Purposes - A Commentary" (1980) 12 *Case W. Res. J. Int'l L* 383-403 at 387-391.

the IMF reports, and then announce disinvocation of Art. XII voluntarily, and often informally.¹⁸⁷

The first country to disinvoke was Belgium in 1955. It did not immediately remove the relevant restrictions. It took the view that a sudden removal of the restrictions would cause unacceptable political, economic and social problems. In that year, at the general review of the agreement, the parties discussed the problems that might arise for industries having received lengthy protection from balance of payments restrictions from the sudden removal of those restrictions.¹⁸⁸ A working party recommended the establishment of a special procedure for granting waivers in this situation with strict conditions attached to ensure the long-term restrictiveness of the balance of payments exception.¹⁸⁹ France dissented from this suggestion.¹⁹⁰ It argued that every application for a waiver should be judged according to established precedents. Both the decision to establish the special waiver procedure for balance of payments restrictions¹⁹¹ and the decision to grant the United States agricultural waiver¹⁹² were made on the same day. There could be little doubt that France was mindful of the contrast between the two approaches being taken: the unrigorous approach that was being applied to the granting of the US waiver for restrictions that fell outside the article XI:2 exception; and the exacting and legalistic approach which was proposed for dealing with waivers for restrictions which were no longer justified under the balance of payments exception. Despite France's disagreement, the procedure was still adopted. It seems reasonable that France and perhaps some other countries might have regarded the US as receiving unfairly favourable treatment in obtaining its waiver compared with the rules they were asked to comply with to gain a waiver for their former balance of payments restrictions.

The Hard Core Waiver

187 Hudec, *The GATT Legal System and World Trade Diplomacy* (1990) p266, fn3.

188 See under the heading, "Transitional Problems connected with the Elimination of Import Restrictions maintained during a Period of Balance-Of-Payments Difficulties" in "Reports Relating to the Review of the Agreement - Quantitative Restrictions", Report adopted on 2,4 & 5 March 1955 (L/332/Rev.1 and Addenda), *BISD*, 3S/170 at pp191-195.

189 *BISD*, 3S/170 at 191-192, para75.

190 *BISD*, 3S/170 at 192.

191 "Problems Raised for Contracting Parties in Eliminating Import Restrictions Maintained during a Period of Balance-Of-Payments Difficulties", Decision of 5 March 1955, *BISD*, 3S/38.

192 3S/141 on 5 March 1955. See above, Chapter 10, p216.

The rules comprised in the decision which became known as the "hard core waiver" were quite exacting. Waivers were to be for a maximum period of 5 years¹⁹³ and were to be dependent upon the restrictions meeting certain requirements and the party making certain undertakings.

First, parties would have to establish that:

- retention of the restriction would be necessary to avoid serious injury to a domestic industry and to permit it to adjust;
- it would not be possible to achieve that result by using a measure that was consistent with the GATT;
- there was a reasonable prospect of eliminating the restriction over a comparatively short period of time.¹⁹⁴

Secondly, parties would have to undertake that:

- the quantity of imports permitted would be reasonable, not less than a 3 year average and not less than the quantity permitted as at 1 January 1955;
- the restriction would be progressively relaxed; and
- measures would be taken to ensure elimination of the restriction.¹⁹⁵

The CONTRACTING PARTIES agreed that the granting of a waiver would not preclude recourse to Article XXIII.¹⁹⁶ This meant that affected parties could still obtain an authorization from the CONTRACTING PARTIES to retaliate against parties with quantitative restrictions that had outlived their balance of payments justification. The original decision only provided for applications for 'hard core waivers' to be made until the

193 *BISD*, 3S/38 at 41, para B1.

194 *BISD*, 3S/38 at 40, para A2.

195 *BISD*, 3S/38 at 40, para A3.

196 *BISD*, 3S/38 at 41, para C.

end of 1957. However, at the end of each year from 1957 to 1961, the cut-off date for receipt of applications was extended by a further year.¹⁹⁷

Belgium was the only party ever to receive a waiver pursuant to the hard-core waiver procedure.¹⁹⁸ All of the restrictions that were the subject of the waiver were agricultural or food products.¹⁹⁹

German Agricultural Restrictions

The next country to lose the cover of the balance of payments exception was the Federal Republic of Germany when, in 1957, the IMF found that the Republic no longer had a balance of payments problem. As discussed above in connection with the "existing legislation" clause, Germany did not act to remove the restrictions. Instead, Germany made a statement to the contracting parties outlining both a program of liberalization and a number of justifications for the continued retention of some of the restrictions, particularly those related to agricultural products. One of the justifications given was that even though the IMF had certified that Germany no longer had low monetary reserves, Germany still had a balance of payment problem because of a trading deficit with the USA. In essence, Germany argued that it needed to maintain quantitative restrictions so as to be able to discriminate against trade from the United States.²⁰⁰

However, Germany's statement went further. It expressed the view that in relation to agricultural trade, it was inappropriate to regulate quantitative restrictions upon the basis of

197 See the decision "Problems Raised for Contracting Parties in Eliminating Import Restrictions Maintained During a Period of Balance-Of-Payments Difficulties", *BISD*, 6S/32, 7S/33, 8S/27, 9S/35, 10S/35.

198 "Waiver Granted to Belgium in Connexion with Import Restrictions on Certain Agricultural Products", Decision of 3 December 1955, *BISD*, 4S/22; Luxembourg was also given a waiver but its conditions did not comply with the hard core restrictions procedure: "Waiver Granted to Luxemburg in Connexion with Import Restrictions on Certain Agricultural Products", Decision of 3 December 1956 (sic - surely, it must have been 1955 since the decision was made at the Tenth Session), *BISD* 4S/27. Note that in the list of waivers in GATT, *Analytical Index*, pp828-840, only the Belgian waiver is listed as a hard core waiver.

199 It is interesting to note the reason why the panel found that Belgium could not use a GATT consistent tariff instead of the quantitative restriction. The panel observed that Belgium was not free to alter its tariffs as these were the subject of obligations under its customs union agreement with its Benelux partners. So even before the formation of the EEC, these complications of the affect of regional arrangements on various GATT rules had arisen.

200 "Statement by the Representative of the Federal Republic of Germany", Annex to "Import Restrictions of the Federal Republic of Germany", report adopted 30 November 1957 (L/768), *BISD*, 6S/55 at 64-65, para 2.

a general prohibition with a limited exception for restrictions for balance of payments purposes:

it appears more and more doubtful whether the import policy in the field of agriculture, should be considered mainly from the point of view of the balance of payments, as is done under the rules of the General Agreement. Indeed, in most cases there is no intrinsic connection between the balance of payments and the situation of agriculture.²⁰¹

Other parties wanted Germany either to remove the restrictions immediately or to apply for a hard-core waiver. However, Germany did neither. A working party was established to respond to Germany's statement. On the issue of justification under the balance of payments exception, most members of the working party considered that the particular balance with the United States was not relevant to the criteria set out in Article XII.²⁰² However, France and Brazil agreed with Germany that the regional distribution of the balance of payments was relevant.²⁰³ As discussed above in the context of grandfathering, the matter was held over to allow time to deal with the legal issue arising in connection with the existing legislation clause under Germany's Accession Protocol. Although on that issue also, a majority formed a view contrary to Germany's, as discussed above, the CONTRACTING PARTIES failed to make a recommendation that the restrictions be removed because Germany and the other five parties to the *EEC Treaty* voted against the resolution.²⁰⁴

Germany never conceded the illegality of the restrictions but eventually it agreed to request a waiver, though not on the basis of the hard-core restrictions procedure. That waiver was given in May 1959.²⁰⁵ The decision did not rule upon the legality of the restrictions. It was made upon the basis of a limited programme of liberalization which, for many products, was nothing more than an undertaking to use best endeavours to remove restrictions at the earliest possible date.²⁰⁶ There can be little doubt that the conciliatory approach taken to granting this waiver was due to the commencement of the European Community²⁰⁷ and the

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- 201 "Statement by the Representative of the Federal Republic of Germany", *BISD*, 6S/55 at 65-66, para3.
202 "Import Restrictions of the Federal Republic of Germany", report adopted 30 November 1957 (L/768), *BISD*, 6S/55 at 64-65, para2.
203 6S/55 at 58, para7.
204 IC/SR.38 (May 2, 1958), cited in Hudec (1990), p268 fn11.
205 "German Import Restrictions", Decision of 30 May 1959 *BISD*, 8S/31; report of the panel is reported at *BISD*, 8S/160.
206 "German Import Restrictions", Decision of 30 May 1959 *BISD*, 8S/31; report of the panel is reported at *BISD*, 8S/160.
207 The *EEC Treaty* had come into force on 1 January 1958.

impending commencement of the Common Agricultural Policy under which new measures would replace the existing German restrictions.²⁰⁸ The waiver was only given for three years. It was clear that, within that time, the European Community would have to negotiate its external barriers in an Article XXIV:6 negotiation. There was little point bringing the legal issue of Germany's restrictions to a legal ultimatum when the restrictions were to be replaced soon anyway.

At about the same time as the German dispute commenced, the amendments to the Agreement adopted at the 1955 review came into force. These included provision for annual consultations to begin after a review of all balance of payments restrictions.²⁰⁹ The CONTRACTING PARTIES initiated that review and then implemented the procedure for annual review of balance of payments restrictions and established the Balance of Payments Committee.²¹⁰ The initial review was adopted in 1959 at about the same time as the German waiver was given.²¹¹ The report showed that of the then 37 parties to the Agreement, 16 were applying restrictions for which they relied on legal justification under Article XII and 9 were applying restrictions for which they relied on legal justification under Article XVIII B.²¹²

Residual Restrictions

In the next two years, a number of other countries including three more of the EEC countries, Italy, the Netherlands and France, and also Great Britain and Australia were reported by the IMF to be in sound balance of payments positions.²¹³ However, none of these countries made applications for hard-core waivers.²¹⁴ Australia and the United Kingdom both announced that they would submit a list of their remaining restrictions together with proposals for removing them.²¹⁵ The USA picked up on this approach

208 See comments by Hudec, *The GATT Legal system and World Trade Diplomacy* (1990) p268.

209 Articles XII:4(b) & XVIII:12(b).

210 See "Import Restrictions - Conciliations and Review Regarding Balance-Of Payments Restrictions" report adopted 22 November 1958 (L/931), *BISD*, 7S/90, esp at 96, para 20 for the recommendation to form a Balance of Payments Committee.

211 "Review of Import Restrictions Under Articles XII:4(b) And XVIII:12(b)", report adopted by the CONTRACTING PARTIES at their fourteenth Session in May 1959 (L/1005) (GATT, Geneva, 1959).

212 L/1005, as above, p3.

213 Hudec (1990), p268.

214 Hudec (1990), p269.

215 Hudec (1990), p269.

suggesting that the CONTRACTING PARTIES formalize this procedure. A new procedure employing the term 'Residual Import Restriction' was adopted in November 1960.²¹⁶ However, the decision does not mention the submission of proposals for removing these residual restrictions but merely invites parties to submit lists of residual restrictions to the secretariat. The adoption of the 'residual restrictions' procedure effectively killed the 'hard-core waiver' procedure. In December 1961, the CONTRACTING PARTIES extended the time limit for applications for waivers under the hard-core procedure to 31 December 1962.²¹⁷ However, no further waiver applications in respect of residual balance of payments restrictions were made by any parties under that procedure or at all. The time limit for applications was not extended again.

Over 1962, a number of additional factors further detracted from the plausibility of a strictly legal approach to residual restrictions.

(i) *End of the Dillon Round & Beginning of the CAP*

In 1962, the Dillon round was being dragged out by the disagreement about the EEC's quantitative restrictions on agricultural products. The Article XXIV negotiation with the EEC had turned out not to be a successful forum for dealing with the EEC countries' non-tariff barriers on agriculture. As the Dillon round went into its final stages, culminating in the 'chicken war',²¹⁸ there was concern that the EEC members' existing restrictions, regarded by many other countries as illegal, were being permanently institutionalized in the new forms established under the CAP which were themselves of dubious legality. This gave little incentive to other parties to apply Article XII, and Article XI generally, strictly to themselves.

(ii) *US Attempts to maintain a Legal Approach*

The USA made two further attempts during 1962 to maintain the rigorous application of the law. Firstly, it sought to develop the reporting procedure into a review procedure which

216 "Procedures for Dealing with New Import Restrictions Applied for Balance-of-Payments Reasons and Residual Import Restrictions", approved on 16 November 1960, *BISD*, 9S/18 at 19-20.

217 "Waivers granted under Article XXV:5; Problems raised for contracting parties in eliminating import restrictions maintained during a period of balance-of-payments difficulties", Decision of 8 December 1961; *BISD*, 10S/35.

218 See chapter 10, at pp233.

could place pressure on parties to remove illegal restrictions. A panel had already been appointed in 1961 to review the adequacy of the reports collected.²¹⁹ In May 1962, the USA requested a working party to review the adequacy of the reporting procedure. France opposed the suggestion and it was not adopted. In October 1962, the final report of the panel reviewing the adequacy of the reports made no substantive comment on the fact that most of the parties' reports had not indicated when the reported restrictions would be removed. With that abstention, the reporting procedure had been wound back so far that not only did it lack any of the legal rigour of the hard core waiver procedure but it actually contributed to the lax attitude toward the law.

Secondly, and more importantly, the USA challenged some of the residual restrictions of both France and Italy in proceedings under Article XXIII.²²⁰ Both complaints related mostly to restrictions on agricultural products with the complaint against France concerned with residual restrictions on 43 items of which 35 were agricultural products.²²¹ The complaint against Italy faded away, being withdrawn after Italy made a better effort to comply with the notification procedure.²²² The complaint against France proceeded to a panel.²²³ The USA relied upon two arguments and sought a decision on both of them:

- that the breach of Article XI was itself a nullification of rights under the Agreement; and
- that the maintenance of quantitative restrictions which were no longer justified by any exception, on products upon which France had given tariff bindings was a nullification and impairment of the benefit that the USA should have received from the tariff bindings.²²⁴

A finding by the panel on the second argument might have helped preserve a legal approach to residual restrictions. Such a ruling would have created a fall-back position. It would

219 "Residual Import Restrictions - Adequacy of Notifications - Interim report noted by the Council on 22 February 1962" (L/1716), *BISD*, 11S/206. Paragraph 1 states that this panel was appointed by the CONTRACTING PARTIES at their 19th session (which was in November-December 1961).

220 On the Italian complaint: see Hudec (1990), p270-72 and Appendix A, item 58; on the French complaint: see Hudec (1990), p272-275 and Appendix A, item 57.

221 On the Italian complaint: see Hudec (1990), p271; on the French complaint: see Hudec (1990), p274.

222 Hudec (1990), p272.

223 "French Import Restrictions", Report adopted on 14 November 1962 (L/1921), *BISD*, 11S/94.

have meant that even though a soft approach to the Article XI prohibition was developing, it might have been possible to prevent the soft approach from applying in respect of products in respect of which a tariff binding had been given. However, the panel avoided distinguishing between the two arguments. France advised the panel that it did not contest that the restrictions were contrary to Article XI.²²⁵ The panel found that the maintenance of the restrictions inconsistent with Article XI, which had ceased to be justifiable under Article XII, did constitute nullification or impairment of benefits to which other contracting parties, including the USA, were entitled.²²⁶ Adopting the report, the CONTRACTING PARTIES recommended that France remove the restrictions and also that the United States refrain for a reasonable period from requesting the CONTRACTING PARTIES to approve any retaliation.²²⁷ Following the decision, France took little (if any) action to remove the restrictions.²²⁸ The United States did refrain from seeking approval for retaliation for much more than a reasonable period: 10 years. It was 1972 before the USA threatened to seek approval for retaliation and, in response, France finally removed the restrictions.²²⁹ In the meantime, a clear precedent was being set: that it was possible to ignore the law rendering residual restrictions illegal.

(iii) *8th Review of the USA Waiver*

On 7 November 1962, the CONTRACTING PARTIES adopted the eighth annual review of the USA waiver.²³⁰ The USA was no closer to giving up the waiver. There had been only minor liberalizations. Import quotas were still in force for wheat, cotton, peanuts and dairy products. The report is notable only for its blandness : the US was not given a hard time. It carried the same conclusion as the previous years report: that "the removal of import restrictions by the United States would be an encouragement to other countries to take similar action".²³¹

224 See Hudec (1990), p275, fn 44 where the author says that the United States agreed to the panel on the express understanding that the panel would make findings on both arguments. There Hudec cites SR.20/8 of 9 Nov 1962, p110.

225 *BISD*, 11S/94, para 3.

226 *BISD*, 11S/94-95, paras 4 & 5.

227 "French Import Restrictions", Recommendation of 14 November 1962, *BISD*, 11S/55.

228 See Hudec (1990), p257 & p275.

229 See Hudec (1990), pp257-258.

230 "United States Import Restrictions On Agricultural Products Imposed Under Section 22 of the Agricultural Adjustment Act", report adopted on 7 November 1962, (L/1895); *BISD*, 11S/235.

231 *BISD*, 11S/235, para 23.

(iv) *Final Review of German Waiver*

On 13 November 1962, the final review of the German waiver was adopted.²³² It noted that many of the restrictions still remained and that Germany had expressed its regret that it could not indicate the removal of the restrictions. The waiver expired with the end of the session in November 1962 and Germany did not apply for an extension.

(v) *Final Review of Belgian Waiver*

On 16 November 1962, the final review of the Belgian hard core waiver was adopted.²³³ It noted that the objectives of the waiver had not been achieved because there had not been an effective phasing out of the restrictions. The waiver expired on 31 December 1962 and Belgium did not apply for an extension.

1962-1984 - Politics Not Law

The cumulative effect of all these factors was that by the end of 1962, a strict legal application of Article XI to the residual restrictions had become practically impossible. The removal of residual restrictions was no longer a matter of law but had become a matter for political negotiation. Residual restrictions continued to be the subject of negotiation in a series of committees.²³⁴ The subordination of law to politics was demonstrated in 1967 when a further attempt was made to reassert the law. New Zealand made a suggestion that parties maintaining residual restrictions be required either to make a formal undertaking to remove restrictions or to request a waiver.²³⁵ Both the EEC and the Scandinavian countries opposed the suggestion. As noted by Hudec, the influential argument was that of the Scandinavians: that it would be unfair to single out the illegal residual restrictions without also dealing with the technically 'legal' restrictions including the EEC's variable levies, and measures justified under waivers and Protocols.²³⁶ For practical purposes, this sense of

232 "German Import Restrictions", report adopted on 13 November 1962, (L/1909); *BISD*, 11S/222.

233 "Belgian Import Restrictions On agricultural Products", report adopted on 16 November 1962, (L/1928); *BISD*, 11S/220.

234 For the period up to 1974, this is chronicled in Hudec at pp279-285. The committees included the Committee on Trade and Development and the committees of the 1967 Programme of work. Chapter 14, within, gives more details of the various committees that have attempted to solve problems of agricultural trade both before and after 1974.

235 Hudec (1990), p280.

236 Hudec (1990), p281.

equity between legal and illegal restrictions had replaced the written rules of the GATT to become the applicable legal rule for dealing with the residual restrictions.

The resurfacing in 1972 of the dispute over French residual restrictions did not result in a resurgence of a legal application of Article XI. In that case, the likelihood that retaliation would be authorized led to removal of most of the restrictions. However, the dispute stands alone in terms of achieving a successful resolution by legal processes.²³⁷ There was one other case brought around this time. This was by the USA challenging the United Kingdom's restrictions against bananas and a few other products from dollar area countries.²³⁸ The balance of payments justification for these restrictions had long expired. They were maintained as a form of development aid which facilitated exports of those products from certain West Indian countries to the UK. The panel requested the parties to negotiate a settlement²³⁹ which they did,²⁴⁰ obviating the need for the CONTRACTING PARTIES to decide whether to authorise retaliation.

As mentioned, after 1962, residual restrictions were dealt with by processes of review and consultation. However, the restrictions did not begin to be substantially dismantled until 1973 when the system of fixed exchange rates began to change to a system of floating rates. In the next decade, many of the residual restrictions were phased out.

1984 - Change of Attitude

After the finding against the French restrictions in 1962, there was, in fact, no decision of illegality of residual restrictions until years later, in 1984. The decision arose out of a series of disputes over Japanese quantitative restrictions on imports of leather whose balance of payments cover had ceased in 1963. The first two complaints, one in 1980 by the United

237 Hudec suggests that the only reason that France had to remove the restrictions was that there was the pre-existing decision of the 1962 panel. He suggests that were it not for the earlier finding that retaliation could be authorised, then the CONTRACTING PARTIES would not have moved to a new finding to authorise retaliation. See Hudec (1990), p257-258.

238 "United Kingdom - Dollar Area Quotas", report of the panel adopted on 30 July 1973, L/3843(dated 19 April 1973), *BISD*, 20S/230. See Hudec, Robert E., *Enforcing International Trade Law - The Evolution of the Modern GATT Legal System* (Butterworths, Salem, NH, 1991) Appendix/Part I, complaint no 68.

239 *BISD*, 20S/230 at 236, para 6.

240 "United Kingdom - Dollar Area Quotas", report of the panel adopted on 30 July 1973, L/3843(dated 20 July 1973), *BISD*, 20S/236 at 237, para 5.

States²⁴¹ and another in 1980 by Canada²⁴² were resolved by negotiation. In the final case in 1984, a complaint by the United States, negotiations could not resolve the dispute and the ensuing panel decision marked a long-overdue change in attitude toward residual restrictions.²⁴³ It was agreed that the balance of payments cover for the restrictions had expired in 1963. The United States case was based solely on a legalistic application of the provisions of the Agreement. The Japanese case was based on the longstandingness of the restrictions and social and economic considerations related to the Japanese leather industry and, in particular, to a population group known as the Dowa people. In a return to a strict application of law to residual restrictions, the panel found that there was a breach of Article XI:1, that none of the Agreement's exceptions had been invoked and that the matters raised by Japan were irrelevant.²⁴⁴

4.3.5(b) *Disinvocation under Article XVIII B by Developing Countries*

After the early 1970's, the review procedures for restrictions under Article XII was more successful but the same cannot be said for the review of restrictions imposed by developing countries under Article XVIII B. Many developing countries did not join the change to floating exchange rates and being committed to maintaining overvalued exchange rates were resistant to solving their balance of payments deficits by devaluing their currencies. Eglin offers some statistics on the number of countries having resort to Article XVIII B between 1974 and 1985.²⁴⁵ He concludes that, for developing countries, Article XVIII B was the "most widely used exception to the Article XI prohibition on the application of quantitative trade restrictions".²⁴⁶ Although developing country restrictions under Article XVIII B were not particularly concentrated on agricultural products, their restrictions across a range of products and the ease of resort to Article XVIII B may have inhibited the willingness of

241 "Japanese Restrictions on Imports of leather", complaint by the United States, report of the panel adopted on 6 November 1979, (L/4789), *BISD*, 26S/320.

242 "Japanese Restrictions on Imports of leather", complaint by Canada, report of the panel adopted on 10 November 1980, (L/5042), *BISD*, 27S/118.

243 "Panel on Japanese Measures on Imports of Leather", report of the panel adopted 15/16 May 1984, (L/5623), *BISD*, 31S/94.

244 At 111, Para 44.

245 Eglin, Richard, "Surveillance of Balance-of-Payments Measures in the GATT" (1987) 10 *The World Economy* 1-26 at 8-14, esp Table 1 on p12.

246 Eglin, as above, at 13.

developed countries to offer concessions upon the products that were of export interest to developing countries including on agricultural products.²⁴⁷

It was noted above that the developing countries' right to use the balance of payments exception goes beyond merely "safeguarding its financial position and its balance of payments" as is provided in Article XII. A developing country can impose restrictions "to ensure a level of reserves adequate for the implementation of its programme of economic development". As also observed, the wording of Article XVIII:9 is very similar to Article XII:2. Both provide that restrictions "shall not exceed those necessary:

- (i) to forestall the [imminent] threat of, or to stop, a serious decline in its monetary reserves, or
- (ii) in the case of a contracting party with [very low]{inadequate} monetary reserves, or to achieve a reasonable rate of increase in its reserves."²⁴⁸

Article XII contains the proviso that a contracting party cannot "be required to withdraw or modify restrictions on the ground that a change in"²⁴⁹ its "domestic policies directed towards the achievement and maintenance of full and productive employment or towards the development of economic resources"²⁵⁰ "would render the restrictions unnecessary."²⁵¹ A similar provision in Article XVIII says that a contracting party cannot "be required to withdraw or modify restrictions on the ground that a change in its development policy would render unnecessary the restrictions".²⁵²

Although under both Articles XII and XVIII B the CONTRACTING PARTIES are required to accept the determination of the IMF on the state of monetary reserves,²⁵³ the IMF has taken different approaches to the decision under the two Articles. The process of obtaining IMF determinations and dealing with them in the GATT Balance of Payments Committee

247 Hindley, Brian, "Differential and More Favorable Treatment - and Graduation" in J. Michael Finger & Andrzej Olechowski (eds), *The Uruguay Round - A Handbook for the Multilateral Trade Negotiations* (The World Bank, Washington DC, 1987) pp67-74 at 68.

248 The square brackets denote words contained in Article XII:2 which are omitted from Article XVIII:9 and the parentheses denotes words contained in Article XVIII:9 but not in Article XII:2.

249 Article XVIII:3(d).

250 Article XVIII:3(d).

251 Article XVIII:3(d).

252 Article XVIII:11.

has worked reasonably well with respect to countries invoking Article XII. The IMF has certified, from time to time, that the balance of payments position of a country invoking Article XII no longer meets the criteria in Article XII. However, with respect to countries invoking Article XVIII:9, the process has not worked effectively. It appears to this author that, in respect of a GATT party applying balance of payments restrictions under Article XVIII:9, there was no instance up to 1994, where the IMF made an adjudication that the balance of payments situation of the country did not meet the requirements of Article XVIII:9.²⁵⁴ Even where foreign reserves were reasonably substantial, the IMF has abstained from saying that the balance of payments justification no longer stands.²⁵⁵

A 1985 IMF Report indicates the dimensions of the problem.²⁵⁶ It records that, in 1983, "balance of payments reasons related to the process of development"²⁵⁷ was cited as the legal justification for 361 quantitative restrictions maintained by Brazil, 442 "by Ghana, 122 by India, 253 by the Republic of Korea, 330 by Nigeria, 434 by Pakistan, 492 by Tunisia and lesser numbers by other developing countries.²⁵⁸

A stricter attitude to Article XVIII:B did not emerge until, after the commencement of the Uruguay Round, there were challenges to Korea's invocation of that Article.²⁵⁹ Korea had

253 Article XV.

254 The writer acknowledges some uncertainty on this point. The reports of the IMF to the GATT are not publicly available. The deliberations of the GATT Balance-Of-Payments Committee have not been included in the published Basic Instruments and Documents since 1957. Eglin (1987) says that "the IMF appears to have been reluctant to deny balance-of-payments justification".(p19) He falls short of saying that the IMF had never certified that there was no justification under Article XVIII. He refers to some occasions where despite the absence of an express finding by the IMF, the GATT Balance-Of-Payments Committee had still proceeded to recommend removal of the restrictions. Note 3 of the same article says: "The Committee on Balance-Of-Payments Restrictions has rarely concluded that the measures in question were not justified. This last happened in the case of Spain in 1973". He does not say whether Spain had justified its restrictions under Article XII or Article XVIII, nor whether in that instance the IMF had expressly found that the restrictions were not justified under the relevant Article.

255 Eglin (1987) gives the example of Brazil in 1978 having foreign exchange reserves equal to eleven months' import cover (at p19).

256 Shailendra J. Anjara, Naheed Kirmani & Arne B. Petersen, *Trade Policy Issues and Developments* IMF Occasional Paper No 38 (IMF, Washington, 1985) Table 7.

257 Frank, Isaiah, "Import Quotas, the Balance of Payments and the GATT" (1987) 10 *The World Economy* 307-317 at 311 quoting from Anjara, Kirmani & Petersen, *Trade Policy Issues and Developments*: see immediately preceding footnote.

258 Frank, "Import Quotas, the Balance of Payments and the GATT" as above, at 311.

259 There were in fact three separate challenges by Australia, New Zealand and the United States. "Republic of Korea - Restrictions on Imports of Beef - Complaint by Australia", report of the panel adopted on 7 November 1989, (L/6504), *BISD*, 36S/202; "Republic of Korea - Restrictions on Imports of Beef - Complaint by New Zealand", report of the panel adopted on 7 November 1989,

maintained quantitative restrictions on a range of products on the basis of Article XVIII B since its accession to the GATT in 1967. Since then, it had relaxed some of the restrictions including, in 1980, the restrictions on beef. In 1984, Korea reintensified the restrictions on beef. The GATT Balance of Payments committee had consulted with the International Monetary Fund and with Korea in November 1987. The IMF had abstained from an express finding that Korea did not have a shortage of monetary reserves.²⁶⁰ Neither did the BOP Committee reach agreement on a recommendation but its report recorded that the "prevailing view was that ... import restrictions could no longer be justified under Article XVIII:B."²⁶¹ In 1988, Australia, New Zealand and the United States entered into separate negotiations with Korea relating to Korean import quotas on beef. The negotiations did not reach a satisfactory result and each party commenced a separate challenge under Article XXIII. Each panel reviewed the findings of the November 1988 Balance of Payments Committee. They also consulted again with the IMF and were advised that Korea's foreign exchange holdings were 12 billion dollars which was equivalent to 3 months of imports. Each panel made the finding that the restrictions were not justified under Article XVIII:B.

It is interesting that the differences between Article XII and Article XVIII alluded to above were not discussed in the decisions. Korea argued that the legal justification under Article XVIII B turned on whether Korea had an adequate level of monetary reserves for the implementation of its programme of economic development.²⁶² Of the three complainants, only the USA referred to the difference between Article XII and Article XVIII B and the fact that Article XVIII B permitted restrictions consistent with its programme of economic development and only New Zealand questioned Korea's standing as a developing country within Article XVIII:4. Korea's arguments are not recorded as having directly addressed the level of reserves necessary for its programme of economic development. Most of the debate focussed on whether the restrictions were actually imposed for monetary reasons or were imposed simply as a sectoral protective measure. The findings of all three panels on this

(L/6505), *BISD*, 36S/234; "Republic of Korea - Restrictions on Imports of Beef - Complaint by United States", report of the panel adopted on 7 November 1989, (L/6503), *BISD*, 36S/268.

260 The writer has implied this from the statement at *BISD*, 36S/223, para.77 : "nor had the IMF or the BOP Committee to date obliged Korea to disinvoke Article XVIII:B."

261 GATT/BOP/171 (10 December 1987) para 22; extracted at *BISD*, 36S/202, at 230.

262 In the Australian complaint, para. 67, *BISD*, 36S/220; In the New Zealand complaint, para. 75, *BISD*, 36S/254; In the USA complaint, para.82, *BISD*, 36S/292.

point are identical.²⁶³ The reports find that the restrictions exceed those permitted under Article XVIII:9.

The Panels dealt with the dispute without deciding whether:

- (a) Korea was a developing country entitled to invoke Article XVIII:B; and
- (b) whether there was a difference between the level of reserves permitted to be protected under Article XII and that which can be protected under Article XVIII:B.

Therefore, unfortunately, the case provided no new guidance to the IMF or the Balance of Payments Committees in deciding whether restrictions were justified under Article XVIII:12. However, it did signal a willingness to make findings about monetary reserves even where there was no express finding by the IMF and, for that reason alone, represented a move to a stricter application of this exception.

4.4 AGRICULTURAL EXCEPTIONS

Chapter 2 mentioned the exceptions for agricultural products in Article XI:2 and noted that the most widely used of them was that provided by Article XI:2(c)(i). In fact, as commented in a GATT Secretariat Note in 1982, it was "not possible to know the precise extent to which contracting parties [took] advantage of the exceptions under Article XI:2" because there was no obligation under Article XI:2 to notify the GATT.²⁶⁴ The extent to which Article XI:2 was relied on emerged from various exercises by the GATT to monitor non-tariff barriers and was not reliably measured until a Review of Quantitative Restrictions in 1984.²⁶⁵

Introducing this exception in Article XI:2(c)(i), Lowenfeld writes:

The prohibition on quotas was made inapplicable to agricultural products subject to price support schemes in the importing country.²⁶⁶

263 In the Australian complaint, paras.98-101, *BISD*, 36S/227-8; In the New Zealand complaint, paras.114-117, *BISD*, 36S/266; In the USA complaint, paras.120-123, *BISD*, 36S/303-4.

264 "Agriculture in the GATT" Note by the Secretariat (for the Consultative Group of Eighteen, Seventeenth Meeting, 10-12 February 1982), CG.18/W/59/Rev.1, p21.

265 See "Quantitative Restrictions and Other Non-Tariff Measures, report (1984) of the Group on Quantitative Restrictions and other Non-Tariff Barriers adopted on 30 November 1984", (L/5713), *BISD* 31S/211. See also the Secretariat report, "Quantitative Restrictions" NTM/6/Rev2.

266 Andreas F. Lowenfeld, *International Economic Law, Volume VI, Public Controls On International Trade*, (Mathew Bender, San Francisco, 2nd ed, 1983) p25.

However, it is central to Article XI:2(c)(i) that it does not apply to any programme which supports the price of agricultural products but only to those programmes that do so by restricting the quantity produced or sold. This limitation is clearly expressed in the words of Article XI:2(c)(i) which exempts from the Article XI:1 prohibition:

- (c) Import restrictions on any agricultural or fisheries product, imported in any form, necessary for the enforcement of governmental measures which operate:
 - (i) to restrict the quantities of the like domestic product permitted to be marketed or produced, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted;".

The complicated prerequisites for the invocation of Article XI:2(c)(i) are accompanied by limits on the restrictiveness of the quotas that can be imposed. They

shall not be such as will reduce the total of imports relative to the total of domestic production, as compared with the proportion which might reasonably be expected to rule in the absence of restrictions.²⁶⁷

This means that the restrictiveness of the quotas applied to imports should not exceed the restrictiveness of the instruments being used to reduce domestic production or sales.

The provision was introduced by the USA at the beginning of the negotiations on the ITO charter.²⁶⁸ It was anomalous from the beginning. It was inconsistent with the USA's demands for a general prohibition on quantitative restrictions. However, the USA administration was aware that the ITO charter would not be approved by Congress unless it provided legal cover for import restrictions employed to protect programmes under its *Agricultural Adjustment Act (AAA)*.²⁶⁹

The USA administration was in a difficult position in the drafting of this exception. It wanted to maintain the integrity of its argument for a general prohibition of quantitative

267 Second to last sentence of the last paragraph of Article XI:2(c).

268 A provision containing almost all of the elements of Article XI:2(c) appears at Paragraph 1(e) of Chapter IIIC of the USA's *Proposals*, see chapter 2, p31, and at Article 19:2(e) of the USA's *Suggested Charter*, see chapter 2 p32.

269 See Dam, *The GATT*, pp259-260; Brown, *The United States and the Restoration of World Trade*, p116.

restrictions and also to ensure that the ITO Charter would meet the approval of Congress. They perceived that the freedom to use domestic subsidies and to resort to emergency tariff surcharges in case of import surges would not be enough to satisfy the Congress. In addition, the Department of Agriculture had demanded that there be a provision permitting quantitative restrictions to protect programmes under the *AAA*.²⁷⁰ Therefore, the administration had to draft an exception which permitted the continuation of programmes under the *AAA* but did not open up too broad an exception for the USA or any other countries. The programmes under the *AAA* were not merely price stabilization programmes but were designed to maintain a certain income parity for farm incomes.²⁷¹ An exception for maintaining the integrity of price stabilization schemes would have opened up an additional exception for other countries and still might not have protected the programmes under the *AAA*. The proposal of an exception to protect dual price schemes generally would have undermined the general prohibition and the tariff reductions. In what probably appeared to be a clever move at the time, the drafters focussed on the fact the programmes under the *AAA* did involve some limitation of *domestic* production and designed the exception around that feature. The proposed exception only permitted import restrictions that were necessary to prevent imports from undermining restrictions on domestic production and which would not reduce the ratio of imports to domestic production below a baseline determined by reference to the ratio prevailing in a previous representative period.²⁷² At the London session, the baseline was changed to the ratio that would prevail in the absence of restrictions.²⁷³ In fact, at that time, the USA's domestic restrictions on some agricultural quantities were not very substantial²⁷⁴ and it must have been foreseen that restrictions that complied with this exception might not be restrictive enough to maintain the existing income parity targets. When at the Geneva Session, the United States had to defend the necessity of a special exception for agriculture, it defended the exception in terms of price stability rather than income parity:

270 Gardner, Richard N., *Sterling-Dollar Diplomacy in Current Perspective* (Columbia University Press, New York, 1980) p149.

271 See above, chapter 10, p210ff.

272 *Proposals* chapter IIIC, para 1(e); *Suggested Charter* Article 19:2(e).

273 *London Draft ITO Charter*, (see chapter 2, p33), Article 25(2)(f); "Report of the London Session", (see chapter 2, p33), Section C, para 1(f).

274 Eg, on the restrictions on sugar production, see Brown (1950) p116.

agriculture and fisheries presented particular difficulties, since there were a multitude of small and unorganized producers who were often faced very suddenly with very large crops or catches, and the government accordingly had to step in and organize them. Industrial producers did not suffer from the same disadvantage and were usually sufficiently well organized.²⁷⁵

However, it was the US programmes for providing income parity which had to be either modified or accommodated within the system of GATT rules. The rules of Article XI:2 were so tightly drawn that they could not possibly accommodate income parity programmes. In addition, the rules did little to encourage a transition away from the use of quantitative restrictions in favour of tariffs or subsidies. The goal of allowing some leniency with respect to import restrictions to deal with sudden changes in agricultural prices could have been achieved in other ways. One way would have been a more lenient provision for temporary tariff surcharges in the situation of surges of import of agricultural products. Another useful provision might have been to provide that subsidies provided through buffer stock schemes did not impair tariff bindings.

The US administration envisaged that quotas would only be used where the relevant domestic programme actually did restrict production and, as described in chapter 10, the *AAA* was amended to make it subject to the GATT.²⁷⁶ However, the tight constraints of Article XI:2 soon became apparent to Congress which chose not to conform to them. As also described in chapter 10, the Congress wished to impose quotas that did raise prices but did not limit production and the consequent tussle between the Congress and the administration resulted in the amendment of s22 of the *AAA*, and the granting of the US agricultural waiver.

Despite the tightness of all of the requirements of Article XI:2(c)(i), after the dairy dispute and the granting of the waiver, there was no challenge to measures maintained under Article XI:2(c)(i) until 1978. This can probably be explained by the general laxness relating to quantitative restrictions purportedly justified under the balance of payments exception and also to the existence of the USA's agricultural waiver. As discussed in chapter 10, in the dairy quotas dispute in the early 1950's, the USA had conceded that the import quotas were

275 UN Doc EPCT/A/PV/19, p42 quoted in GATT, *Analytical Index*, p299.

276 By enacting s22 of the *AAA* making the *AAA* subject to any international agreement. See above, chapter 10, p212.

not justified by Article XI:2. However, the illegality of the quotas was absolved by the granting of the waiver. Subsequently, there may have been a perception that any other party could also obtain a waiver for similar restrictions which protected agricultural income parity or price support schemes even though not justified under Article XI:2 and that may have dissuaded other parties from making complaints on the issue of compliance with Article XI:2. Therefore, until 1978, Article XI:2(c) had not been effective to modify agricultural policies, not even in the USA for whose agricultural policies the article had been designed.

A noteworthy feature of the cases since 1978 is the dramatic change in the legal rigour applied to analysing conformity with the requirements of Article XI:2(c)(i). The cases reflect a general trend toward a more technical application of the GATT but arguably the cases on Article XI:2 were a significant factor in causing that general trend.

By the standards of modern panel reports, the 1978 working party report on Canadian egg quotas is startling for the brevity of its legal analysis.²⁷⁷ Without recording any reasoning, the working party recorded three conclusions:

- (1) that all members except the US thought the Canadian supply management system for eggs did conform to Article XI:2(c)(i);
- (2) that they were unable to decide whether the quotas were in accord with the last paragraph of Article XI; and
- (3) that they were unable to decide whether the quotas caused a nullification or impairment of a binding.

The modern cases on Article XI:2(c)(i) bear a striking contrast to the *Canadian Egg case* in the complexity and detail of the legal analysis. Later cases established that for a restriction to meet Article XI:2(c)(i), it must meet each of seven requirements that derive from a detailed breakdown of the words of the provision. The seven requirements are:

- (1) the measure on importation must constitute an import restriction and not a prohibition;

²⁷⁷ "Canadian Import Quotas on Eggs", report of the working party adopted on 17 February 1976, (L/4279), *BISD*, 23S/91.

- (2) the import restrictions must be on an agricultural or fisheries product;
- (3) the product to which the import restrictions apply and the product to which the domestic marketing or production restriction applies must be "like" products in any form (or if there is no substantial production of the product to which the import restrictions apply, then the product to which the import restrictions apply and the product to which the domestic marketing or production restrictions apply must be directly substitutable products);
- (4) there must be governmental measures which operate to restrict the quantities of the domestic product permitted to be marketed or produced;
- (5) the import restriction must be necessary to the enforcement of the domestic supply restriction;
- (6) the contracting party applying restrictions on importation must give public notice of the total quantity or value of the product permitted to be imported during a specified future period;
- (7) the restrictions applied must not reduce the proportion of total imports relative to total domestic production, as compared with the proportion which might reasonably be expected to rule between the two in the absence of restrictions.²⁷⁸

The development of a more stringent legal approach to the interpretation of Article XI:2(c)(i) began with the case concerning the EEC's minimum price system for tomato concentrate discussed above in the context of variable levies.²⁷⁹ There the import restrictions applied to tomato concentrate and the domestic restrictions applied to fresh tomatoes directly and it was argued to tomato concentrates indirectly. The panel separated

278 These seven requirements are listed in the case of "Canada - Restrictions on Ice Cream and Yoghurt", report of the panel adopted 5 December 1989, *BISD*, 36S/68 at 85-86, para 62. They are also listed in the case of "Japan - Restrictions On Imports Of Certain Agricultural Products" report of the Panel adopted on 22 March 1988 (L/6253) *BISD*, 35S/163 at 223-226, paras 5.1.3 - 5.1.3.7, although, there, the order of the 3rd and 4th requirements listed in the Canadian Ice cream case is reversed.

279 EEC - Programme of Minimum Import Prices, Licences and Surety Deposits for Certain Processed Fruits and Vegetables", report of the panel adopted 18 October 1978, *BISD*, 25S/68. See the discussion of the case, above at pp261-263. The case is discussed in Hudec, *Enforcing International Trade Law - The Evolution of the Modern GATT System* (Butterworth Legal Publishers, Salem NH, 1991) pp47-50 & Appendix/Part 1, pp462-463, complaint no 76.

its inquiry into 4 questions which correspond to requirements 2 to 5 listed above. While it found that tomato concentrate was a form of an agricultural product, it doubted fresh tomatoes and tomato concentrate were 'like products' and while it found that import restrictions on tomato concentrate might be necessary for a programme which restricted the quantity of either fresh tomatoes or tomato concentrate, it found that the domestic programme did not constitute an effective restriction on the production or marketing of either fresh tomatoes or tomato concentrate.²⁸⁰

Failure to meet the seventh requirement was the basis of a 1980 decision arising from a complaint by Chile about EEC restrictions on the import of dessert apples.²⁸¹ The EEC had negotiated voluntary export restraints with Argentina, Australia, New Zealand and South Africa but being unable to reach agreement with Chile had imposed an import quota on import from Chile.²⁸² The panel found that the restrictions had reduced the relative size of imports as a proportion of domestic EEC production.²⁸³

When the Uruguay round began, a number of countries were justifying restrictions under Article XI:2(c)²⁸⁴ and there was a diversity of views about whether Article XI:2(c) should be abolished or reworded.²⁸⁵ The argument has been focussed by a series of complaints by the United States. The first of these complaints, made just before the Punta Del Este Declaration and for which a panel was appointed just after, dealt with Japanese restrictions on agricultural products.²⁸⁶

The dispute between the USA and Japan, commonly referred to as the '*Japanese twelve products case*' resulted in a landmark decision which firmly established the technical

280 *BISD*, 25S/68, paras 4.10 to 4.14.

281 "EEC Restrictions on Imports of apples from Chile" report of the Panel adopted 10 November 1980 (L/5047), *BISD*, 27S/98.

282 27S/98 at 100, para 2.3.

283 27S/98 at 112-113, paras 4.7-4.8.

284 See "Quantitative Restrictions and Other Non-Tariff Measures" Report (1984) of the Group on Quantitative Restrictions and other Non-Tariff Barriers adopted on 30 November 1984 (L/5713), *BISD*, 31S/211 at 215, para 20 referring to the provisions referred to in NTM/W/6/Rev.2 .

285 See the possible approaches outlined in GATT Doc AG/W/9/Rev.3 at pp6-7 and Annexes A-I to A-VI.

286 "Japan - Restrictions On Imports Of Certain Agricultural Products" report of the Panel adopted on 22 March 1988 (L/6253) *BISD*, 35S/163. See Hudec (1991) Appendix/Part I, Complaint 148. The complaint was made on 15 July 1986 (C/M/201) and the panel established 27 October 1986 (C/M/202). The Punta Del Este Declaration was made on 20 September 1986, *BISD*, 33S/19.

approach to legal analysis under Article XI:2. In its findings, the panel comprehensively set out the provisions and the relevant interpretative note and referred to the drafting history.²⁸⁷ Then, the panel stated that each import restriction must meet each and every one of the seven requirements which are described above.²⁸⁸ The panel made some general comments on each of the requirements before separately examining the restrictions on each of the twelve products in the light of the seven requirements and its earlier comments in relation to them.²⁸⁹ Some of the restrictions were found to infringe the first requirement because they were prohibitions rather than restrictions.²⁹⁰ Some of the restrictions were found to infringe the fourth requirement because there were not any relevant domestic measures to restrict production.²⁹¹ A number of the restrictions were held not to meet the requirements because the products to which the import restrictions applied were not "agricultural products, imported in any form".²⁹² This term "agricultural products, imported in any form" was interpreted quite strictly by reference to the interpretative note to extend only to the fresh product and forms of the fresh product "in an early stage of processing and still perishable, which compete directly with the fresh product and if freely imported would tend to make restriction on the fresh product ineffective."²⁹³ Other restrictions failed to meet the fifth requirement that the restrictions be necessary to the enforcement of the domestic measures.²⁹⁴ Many restrictions were found to fail on the sixth criteria because a sufficiently specific public notice had not been given.²⁹⁵ Others still were found to fail to meet the seventh requirement because Japan had not been able to establish that the restrictions did not reduce the relative sizes of imports and domestic production.²⁹⁶ None of the restrictions on any of the products fulfilled all of the seven requirements.

287 *BISD*, 35S/163 at 221-223, paras 5.1 - 5.1.2.

288 *BISD*, 35S/163 at 223, para 5.1.3.

289 *BISD*, 35S/163 at 223-227, paras 5.1.3.1 - 5.1.3.7.

290 *BISD*, 35S/163 at 230-231, para 5.3.1.2 & at 244, para 6.4.

291 *BISD*, 35S/163 at 244, para 6.5. Note that third requirement on the listing made in the Canadian Ice Cream and Yoghurt case is listed as the fourth requirement in the Japanese Twelve Products case.

292 *BISD*, 35S/163 at 244, para 6.6.

293 Interpretative note Ad Article XI, paragraph 2(c); *BISD*, 35S/163 at 244, para 6.6.

294 *BISD*, 35S/163 at 244, para 6.7.

295 *BISD*, 35S/163 at 244, para 6.8.

296 *BISD*, 35S/163 at 244, para 6.9.

After, the *Japanese twelve products case*, the USA successfully challenged restrictions maintained by Canada on ice cream and yoghurt,²⁹⁷ by the EEC on apples²⁹⁸ and Chile successfully challenged restrictions maintained by the EEC on dessert apples.²⁹⁹ In each case, the panel referred to the seven requirements established by the Japanese twelve products case.³⁰⁰ Therefore, it became extremely difficult to justify restrictions under Article XI:2(c)(i). However, the use of restrictions to support various price support policies persisted until the end of the Uruguay round even though there was generally no legal justification for them.

The compromise embodied in Article XI:2 requiring that import restrictions be no more restrictive than domestic restrictions, clearly, was not a successful provision. It was too stringent for nations to comply with and did little to guide them into less distorting policy instruments. Clearly, it was desirable that nations use policies other than quotas to manage short term surpluses including subsidies and buffer stocks (subsidized, if necessary). To the extent that programmes were disrupted not by changes in domestic supply but by surges in imports then consideration could have been given to accommodating temporary tariff surcharges through the safeguards exception or a variation of it. To the extent that programmes were disrupted by fluctuations in domestic supply then perhaps some additional safeguard provision could have permitted tariff surcharges in a way that encouraged the use of domestic subsidies instead of import barriers. By allowing quotas, the rules did not encourage the use of subsidies instead of border instruments or tariffs instead of quotas.

4.5 EMERGENCY SAFEGUARDS - ARTICLE XIX

The emergency safeguards provision in Article XIX is an important part of the overall scheme of GATT rules. The impact of the safeguards clause on agriculture cannot be considered merely in terms of the instances of resort to Article XIX in respect of agricultural

297 "Canada - Import Restrictions on Ice Cream and Yoghurt", report of the panel adopted by the CONTRACTING PARTIES on 5 December 1989 (L/6568), *BISD*, 36S/68.

298 "European Economic Community Restrictions on Imports of Apples Complaint by the United States", Report of the panel adopted on 22 June 1989, L/6513, *BISD*, 36S/135.

299 "European Economic Community Restrictions on Imports of Dessert Apples Complaint by Chile", Report of the panel adopted 22 June 1989, (L/6491), *BISD*, 36S/93.

300 In the Canadian icecream and yoghurt case, *BISD*, 36S/68, para 62; in the EEC-Chile dessert apples case, para.12.3; in the EEC-USA apples case, *BISD*, 36S/135, para.5.3.

products or even in terms of instances of circumvention of Article XIX. One must also consider the place of the Article XIX in the overall scheme of rules and the effect that it has had on the choice between different instruments and different legal justifications for them. In addition to a fairly small number of instances of actual resort to Article XIX in relation to agricultural products and a larger, but still fairly small, number of instances in relation to agricultural products of resort to safeguard measures which evade the application of Article XIX, this provision has also impacted on agricultural trade by being too restrictive so as to:

- (1) provide a disincentive to offer tariff bindings on various products including agricultural products; and
- (2) provide a disincentive to give up legal cover for quantitative restrictions under other provisions.

Chapter 2 described the provisions of Article XIX as one of the exceptions to the general rules on import barriers.³⁰¹ There, I described the prerequisites for resort to the Article:

- (1) that there is actual or threatened serious injury to domestic producers;
- (2) the actual or threatened injury is caused by an increase in the volume of imports;
- (3) the increase in the volume of imports is caused by both
 - (i) unforeseen circumstances; and
 - (ii) the existence of an obligation under the GATT.

Utilization of the Safeguard Provision

The safeguard provision has been credited with a significant role in the process of giving tariff concessions. It is argued that parties are more willing to offer tariff concessions if they know that they can withdraw that same tariff concession if it causes a surge of imports that damages domestic industry.³⁰² While that argument may be correct, the history of the pre-WTO GATT shows that Article XIX was invoked only in a small number of the many

301 Above, ch2 at pp80-81.

302 Eg, see the statement of the United States delegate to the London preparatory session (UN doc EPCT/C.II/PV.7, at 3, 1946 quoted in Jackson (1969) at pp554-555). See also Dam (1970) p99.

instances in which parties have reimposed protection for industries affected by imports. Until the end of 1993, there had been only 150 cases where parties had sought to utilize Article XIX by giving notice to the CONTRACTING PARTIES.³⁰³ Most of them, however, involved products other than agricultural products and, in fact, the amount of trade protected by resort to Article XIX has usually been small.³⁰⁴

Despite the very limited resort to Article XIX, it is still important in a consideration of the framework of rules, of defects in the way that framework embodied the two distinctions between, first, price and quantity based border instruments and, secondly, border and non-border instruments, and the way in which any such defects contributed to problems in applying the rules to agricultural trade.

In considering the position of the safeguards clause in the overall framework of pre-WTO rules, it is important to consider the possible ways of providing additional protection when certain imports were causing serious injury to a domestic industry. In that situation, the general rules prohibited imposition of a quota, increasing a bound tariff and, for bound items, introducing or increasing production subsidies. If the imports were priced below the 'normal' price of sale in the exporting country, then a bound tariff could be augmented by an anti-dumping duty.³⁰⁵ In fact, in that situation, anti-dumping duties would be the first choice of instrument because they could be imposed on the imports of a product from a particular country. It would only be where below 'normal' price sales could not be established that parties would have sought to have recourse to the safeguards clause.

If resort to Article XIX was possible, then parties were permitted to introduce quotas or tariffs or subsidies. Article XIX did not distinguish between the different instruments. It failed to specify any preference for non-border measures over border measures and it failed to specify any preference for price based measures over quantity based measures.

303 See "Notifications to the Secretariat of Action Under Article XIX" (as at 1 December 1993) in GATT, Analytical Index, pp500-516. See also Table 19 which is headed "Article XIX actions, 1950-86" in Sampson, Gary, "Safeguards", Chapter 19 in J. Michael Finger and Andrzej Olechowski (eds), *The Uruguay Round - A Handbook for the Multilateral Trade Negotiations* (World Bank, Washington DC, 1987) pp143-152 at 147.

304 Eg, see the statistics quoted in Sampson, "Safeguards" (pp145-146) from a list of measures notified under Article XIX circulated by the GATT Secretariat in March 1982. The notifications referred to trade valued at \$1.6 million. In that year world trade was about \$2,000 billion.

305 See Article VI for the definition of 'normal' price.

Throughout the course of negotiation of the GATT, the relevant drafts of the safeguards clause did not distinguish between different instruments and neither did the provision that came into force.³⁰⁶ Brown records that in respect of the permitted retaliation in response to safeguard measures, some countries were opposed to permitting quantitative restrictions.³⁰⁷ However, none of the negotiating drafts nor the final provision restrict the type of instrument that can be used in retaliation. Therefore, in respect to the retaliation also, the article failed to reflect either of the two preferences.

Circumvention of the Safeguards Provision

Rather than resort to the safeguards clause, parties often chose to give protection to domestic industries under threat from imports by using methods of restraining imports that were not explicitly dealt with in the Agreement. These involved direct negotiation with the exporting country or even with the exporting firms that were the source of the increased flow of imports so as to arrive at an undertaking that exports would be restricted. Such export restraints imposed by an exporting country at the request of an importing country were commonly called "Voluntary Export Restraints" (VERs).³⁰⁸ With such arrangements, there was no illegal measure imposed by the importing country since it did not impose any measure at all. The restraint imposed by the exporting country may have been an infringement of Article XI if it was imposed by the government rather than by the relevant firms but, generally, there would not be any affected party who was likely to complain. The use of VERs became quite prevalent, certainly much more common than resort to Article XIX. Just in September 1986, there were at least 96 VERs in operation.³⁰⁹ The most common importing countries requesting VERs were the USA and the EEC (together accounting for 85 of the 96).³¹⁰ The most common targets were the exports of Japan (25

306 See *Suggested Charter*, Art 29; *London ITO draft*, Art 34; *New York draft of the ITO Charter*, Art 34; *New York draft of the GATT*, Art 34, *Geneva draft of the ITO Charter*, Art 40.

307 Brown, *The United States and the Restoration of World Trade*, p90.

308 Other common terms are "Export Restraint Agreement" (ERA), "Orderly Marketing Agreement" (OMA), "Voluntary Restraint Agreement (or Arrangement)" (VRA): Jackson, (1989), p177.

309 This was the number identified by the GATT Secretariat in a report entitled "Developments in International Trading System (28 November 1986) quoted in Sampson, "Safeguards", pp144-145 including table 19.1 at p145. See also the statistics cited in Petersmann, Ernst-Ulrich, *Constitutional Functions and Constitutional Problems of International Economic Law* (University Press, Fribourg, Switzerland, 1991) pp106-107.

310 Sampson, as above.

VERs) and South Korea (14).³¹¹ VERs were resorted to most often for steel, motor cars and clothing. Of the 96 referred to, 39 affected steel products and only 15 affected agricultural products.³¹²

It seems that, instead of resorting to Article XIX, parties preferred to justify safeguard measures under other provisions or in some other ways. The reluctance to utilize Article XIX may have arisen from difficulties in meeting the prerequisites to invoking Article XIX, or in the costs in terms of compensation or exposure to retaliation.

Was Invocation of Article XIX Difficult?

Whilst the pre-requisites to invocation of Article XIX appear to have been stringent, their application removed much of the stringency.

- (1) The requirement that there must be an increase in imports was interpreted (in what Sampson has called "a rather extraordinary determination"³¹³) not to be limited to an absolute increase but also to include the situation where there is a relative increase, that is, imports stay the same but domestic production declines.³¹⁴
- (2) The requirement that the increase in imports must be caused by unforeseen developments has been interpreted in such a way that the increase in imports itself can be regarded as evidence of the existence of an unforeseen development. In the *Hatters' Fur case*,³¹⁵ which was concerned with safeguards imposed by the USA on hatters' fur, the panel found that although the nature of the changed circumstance

311 As above.

312 As above.

313 Sampson, as above, p143.

314 In a decision of a GATT working party adopted in September 1948; *BISD*, vol II, 39, 44-45. The working party adopted an interpretation that was not adopted in Article XIX but was consistent with Article 40 of the Havana charter: see GATT, *Analytical Index* pp479-480 & also Jackson (1969) p558 citing U.N.Doc.E/conf.2/C.3/37 at 3 (1947-1948).

315 "Report on the Withdrawal by the United States of a Tariff Concession under Article XIX of the General Agreement on Tariffs and Trade" (GATT/CP/106), adopted 6 February 1951, GATT/CP.6/SR19, Sales No GATT/1951-3 ('Hatters' Fur report') extracted in Jackson & Davey, *Legal Problems of International Economic Relations* (West Publishing Co, St Paul, 1986) pp556-559.

was foreseeable, the extent of the change in competitive conditions caused by that circumstance was not foreseeable.³¹⁶

- (3) The requirement that the increase in imports also be caused by "the effect of an obligation" is not a constraint at all since every product is subject to the obligation in article XI;³¹⁷ although in effect the clause is only invoked where there is a tariff binding because if there is no tariff binding then additional protection can be obtained by simply raising the tariff rate without any need to meet any requirements under the Agreement.
- (4) The requirement that the serious injury must be caused by the "unforeseen development" and the "effect of an obligation" has been dramatically loosened by the "reversal of what would appear to be the logical burden of proof"³¹⁸ in the decision in the *Hatters' Fur case*. There, the USA was held not to have breached Article XIX because Czechoslovakia had not proved that the injury was not "serious".³¹⁹

Given the judicial loosening of the rules, it seems unlikely that the pre-requisites to invoking Article XIX have constituted a substantial barrier to utilizing it.

The Costs of Invoking Article XIX

Once invoked, however, there were some costs involved in using Article XIX. Parties applying the safeguard either had to offer a concession on another product³²⁰ or had to face the possibility of discriminatory retaliation by affected parties.³²¹ Since the safeguard

316 The panel said "the degree to which the change in fashion affected the competitive situation, could not reasonably be expected to have been foreseen by the United States' authorities in 1947": the *Hatters' Fur Report* p13, para 12 quoted in GATT, *Analytical Index*, p479 & in Jackson (1969) at p561.

317 See Jackson (1969), p559; Lowenthal, *Public Controls on International Trade* (1983), p218; Hudec (1989) p161.

318 Dam (1970), p102.

319 *Fur Hatters report*, p23. The panel found that imports from Czechoslovakia had caused some injury but that it was not established that the injury was serious.

320 Articles 2 and 3(a) imply that there will be a negotiation over compensation but there is no specific reference to it.

321 Articles 3(a) and 3(b).

measure could not be instituted selectively against a particular exporting country,³²² parties applying the safeguard may have had to offer an alternate concession to more than one party which might involve concessions on more than one product. If they could not find concessions with which the affected parties agree, then they could be subject to retaliatory discriminatory withdrawal of obligations by more than one affected party.

If a party was comfortably able to find alternative concessions, then instead of using Article XIX to obtain temporary protection, the party could use Article XXVIII to obtain permanent protection. If alternative concessions could not be offered, then under Article XXVIII, affected parties could only withdraw concessions that were originally negotiated with the initiating party and could do so only on a MFN basis. Therefore, it was in the interest of a party that wanted to apply a safeguard in the form of an increased tariff to run an unsuccessful Article XXVIII negotiation rather than an unsuccessful Article XIX negotiation. In effect, it was more advantageous to apply for a permanent tariff increase than a temporary one.

In addition, the article offered nothing to invoking parties in the way of a softening of the compensation that they would have to give under Article XXVIII and actually exposed them to wider possibilities of retaliation than a failed Article XXVIII negotiation would. Given that position, it is not surprising that in all those situations where a renegotiation under Article XXVIII was not desired, parties chose to invent new instruments that sidestepped Article XIX rather than to invoke it formally.

Contention over the adequacy of Article XIX has centred around the issue of whether discriminatory safeguards or VERs should be permitted by the rules and be regulated by them³²³ rather than on the factors relating to choice of instrument outlined above.³²⁴ An

322 See an argument to the contrary proposed by Jackson that Article XIX might authorize suspension of the MFN obligation in Article I. However, Jackson leans toward the view that Article XIX measures only permits non-discriminatory measures: Jackson (1969) pp564-565; This view was confirmed in "Norway - Restrictions on Imports of Certain Textile Products", Report of the panel adopted 18 June 1980 (L/4959), *BISD*, 27S/119. See also the discussion of the role of the MFN principle in Article XIX in Burnett, Robin, "Article XIX in the New GATT Trade Negotiations: Same Problems, Fresh Approaches" [1987] *Lawasia* 1-34 esp at 2-5, 9 & 24-26.

323 See, eg, Hindley, Brian, "Voluntary Export Restraints and the GATT's Main Escape Clause" (1980) 3 *World Economy* 313-341; Hizon, Ernesto M, "The Safeguard Measure / VER Dilemma: The Jekyll and Hyde of Trade Protection" (1994) 15 *Nw J Int'l & Bus* 105; Curzon Price, Victoria, "Surplus Capacity and What The Tokyo Round Failed to Settle" (1979) 2 *World Economy* 305-318.

argument for lenient treatment of VERs can be made upon the basis that a VER allocates the 'rent' from the restriction to the exporter thereby providing some compensation for the restriction.³²⁵ However, this argument is firmly based on a view of GATT as a regulator of relations between countries rather than within them. If one gives some importance to internal effects, then a VER is even more self-harming than an import quota because the home government cannot collect the 'rent' from the restriction. If one of the functions of GATT rules is to prevent self-harming choices, then avoidance of VERs is even more important than avoidance of most other quantity-based border instruments.³²⁶ The important point is that nothing in Article XIX had the effect of guiding nations toward a choice of policy instrument which was in their self interest. The use of VERs was not the only manifestation of inadequacy in Article XIX. It was also manifested in the reluctance to give up the legal cover for import quotas under other provisions and in the reluctance to give tariff bindings. Both of these effects had an influence over agricultural trade and it is submitted that more tariff bindings may have been given and less cover taken under other exceptions if Article XIX had not been so costly to use. It should be easier to use than Article XXVIII requiring less compensation and giving less exposure to retaliation with the extent of the safeguard measure permitted being linked to non-border policies to adjust for the change in comparative advantage.³²⁷ There should be easy resort to temporary production subsidies even on bound products and active encouragement of subsidies that do not encourage the pre-existing level of production.³²⁸

324 However, the choice of instrument to be permitted in safeguard measures is dealt with in Hoekman, Bernard M. & Michael P. Leidy, "Policy Responses to Shifting Comparative Advantage: Designing a system of Emergency Protection" (1990) 43 *Kyklos* 25-51; in that article also see the description of some of the practical disadvantages of allowing discriminatory protection: pp28-29.

325 See, eg, Hindley, "Voluntary Export Restraints and the GATT's Main Escape Clause" at p327 & Hoekman & Kostecki, *The Political Economy of the World Trading System* (1995), p168-169.

326 For a treatment of VERs against a framework of a constitutional function for the GATT, see: Petersmann, Ernst-Ulrich, "Grey Area Trade Policy and the Rule of Law" (1988) 22 *JWT* 23.

327 Substantial agreement with this view can be found in Hoekman, Bernard M. & Michael P. Leidy, "Policy Responses to Shifting Comparative Advantage: Designing a System of Emergency Protection" (1990) 43 *Kyklos* 25-51; although Hoekman & Leidy take a very cautious view of policies to encourage subsidies or government intervention; their preferred recommendation is to allow temporary resort to import quotas.

328 See the discussion of alternative policies to deal with changing market conditions in Corden, W Max, "Policies Toward Market Disturbance" in RH Snape, *Issues in World Trade Policy: GATT at the Crossroads* (Macmillan, London, 1986); on the different effects of output subsidies and other types of subsidies, see Hindley, as above, at p325.

It is not intended to offer a comprehensive assessment of all of the recommendations that have been made as to the reform of Article XIX³²⁹ which in any case cannot be wholly separated from recommendations made as to reform of the provisions on anti-dumping dumping duties. Rather, it is intended to draw attention to the fact that Article XIX did not in any way embody the two desirable distinctions between policy instruments. The pre-Uruguay Round Article XIX did not guide parties into adoption of least cost commercial policy instruments. Parties attempted to achieve non-economic objectives in ways that have maximized rather than minimized the economic cost. The defects in the safeguard provision affected agricultural trade in a number of ways:

- (1) providing a disincentive to offer tariff bindings;
- (2) providing a disincentive to give up legal cover for quantitative restrictions under other provisions;
- (3) providing an incentive to resort to VERs which are even more self-harming than import quotas.

Consequently, the safeguard clause has failed to help parties to simultaneously achieve the dual goals of economic benefits and freedom to achieve non-economic objectives relating to the agricultural sector.

4.6 THE EXCEPTION FOR ECONOMIC DEVELOPMENT

Chapter 2 described the exceptions for developing countries under Article XVIII:

Section A consisting of Article XVIII:7 dealing with tariff surcharges for infant industries;

Section B consisting of Article XVIII:8 to XVIII:12 dealing with quantitative restrictions for balance of payments purposes;

Section C consisting of Article XVIII:13 to XVIII:21 dealing with quantitative restrictions for infant industries; and

329 Eg, see Tumlrir, "A Revised Safeguard Clause for GATT" [1973] *JWTL* 404; Burnett, "Article XIX in the New GATT Trade Negotiations: Same Problems, Fresh approaches" [1987] *Lawasia* 1-34 .

Section D consisting of Article XVIII:22 to XVIII:23 dealing with tariffs and quantitative restrictions for developing countries that are ineligible to invoke Sections A,B or C.³³⁰

Of these, only Section B has been utilized enough to have directly had a substantial effect on agricultural trade. Section D has never been invoked and there have only been a small number of invocations of Sections A or C.³³¹ The exception provided for in Section B has already been described above, along with the more general balance of payments exception in Article XII. The ease of resort to Section B is probably, one of the reasons for the low number of instances of resort to Sections A and C. However, despite the very limited invocation of these exceptions, it is useful to analyze them in order to assess the place of the economic development exception in the overall rules, and the general influence of the overall rules on choice of policy instrument.

The present version of Article XVIII does distinguish between different policy instruments. It deals with increasing tariffs in Section A and with implementing other instruments in Section C. Section A is a modified version of Article XXVIII and Section C permits other instruments that would be inconsistent with the Agreement.

The antecedent provisions of Article XVIII and their negotiation

This exception for developing countries was, in fact, one of the most contentious issues in the negotiation of the GATT. The issue of instrumentation did arise in the negotiation in the preparatory committee as is reflected in the following description by Brown:

A strong drive was made to incorporate in the Charter the principle that underdeveloped countries are entitled to use any and all forms of protection in the interest of their programs of economic development. Many of these countries demanded not only freedom to use quantitative restrictions for this purpose but also freedom to raise tariff rates even though bound by negotiation under the General Agreement. A general argument by the United Kingdom in favor of subsidies and tariffs as a better means of promoting development than quantitative restrictions was strongly resisted by Australia, Chile, Colombia, and India. These countries were not willing to agree that the same commercial

330 See chapter 2, pp77-79.

331 Invocation under Section A are listed in GATT, *Analytical Index*, p465. The invocations under Section C are listed in the index of the *BISD*, eg see 39S/487-488. The index to the *BISD* does not show any annual review of measures under sections C since the 21st session (in 1968). On invocation under Section C, see also: GATT, *Analytical Index*, p472.

policy rules should apply to countries in all stages of economic development, and India asserted that in underdeveloped countries all industries are infant industries.³³²

A compromise was reached on the original Article XVIII which did enable deviations from other rules, but which was available for all contracting parties. The original Article XVIII³³³ provided for exceptions in the interest of a contracting party's "programme of economic development or reconstruction".³³⁴ The procedure distinguished between measures to be imposed on products which were the subject of tariff bindings and those to be imposed on unbound products.³³⁵ If there was a tariff binding, the CONTRACTING PARTIES could authorize the measure but only after the party had reached substantial agreement on compensatory concessions with other substantially affected CONTRACTING PARTIES.³³⁶ If there was no applicable tariff binding, the CONTRACTING PARTIES could authorize the measure without there having been any negotiation or agreement with other parties,³³⁷ and they were required to give the authorisation if it was established that the measure would be no less restrictive than a tariff increase, and was the most suitable measure.³³⁸ The developing countries were not satisfied with this article and, as more developing countries acceded to the agreement, pressure to change it swelled.

The amended Article XVIII which was inserted into the Agreement after the Havana Conference³³⁹ also distinguished between measures on products that were the subject of tariff bindings and those on other products.³⁴⁰ For products with a tariff binding, substantial agreement on compensating concessions was still required³⁴¹ but the possibility of retaliation was introduced where agreement was incomplete.³⁴² For products without a

332 Brown, *The United States and the Restoration of World Trade*, p98, describing the London session of the Preparatory Committee.

333 GATT, *Final Act*, Geneva, 55 UNTS 194, 252 (1947).

334 *Final Act*, Article XVIII:2(a).

335 *Final Act*, Article XVIII:3(a) referred to "any proposed measure, ..., which would be inconsistent with any obligation that the applicant contracting party has assumed under Article II, or which would tend to nullify or impair the benefit to any other contracting party or parties of any such obligation ...". Article XVIII:4 referred to measures other than those referred to in paragraph 3(a).

336 *Final Act*, Article 3(a)-(c).

337 *Final Act*, Article XVIII:4(a).

338 *Final Act*, Article XVIII:4(b).

339 Jackson, 1969, p639.

340 "Protocol Modifying Part II and Article XXVI of the GATT", 1948; adopted at the Second session of the Contracting Parties in September 1948, 62 U.N.T.S.90-102.

341 GATT 1948, Article XVIII:3(b).

342 GATT 1948, Article XVIII:4(c).

tariff binding, the new rules still permitted the CONTRACTING PARTIES to authorise the measure even if there had not been any agreement among the parties on compensating concessions.³⁴³ The circumstances in which the CONTRACTING PARTIES were obliged to concur were enlarged.³⁴⁴ Finally, for measures on products without a tariff binding, there was no possibility of retaliation.

The Current Provisions of Article XVIII

The existing Article XVIII was negotiated in the course of the 1955 review³⁴⁵ and came into effect in 1957.³⁴⁶ Of many changes, two were most important. First, the amendment created a differentiation between parties giving some developing countries the three additional sources of exemptions contained in Sections A,B and C. The right to invoke these paragraphs is determined according to criteria of low standard of living and early stage of development.³⁴⁷ All countries with economies in a process of development are eligible to invoke the exception in Section D of Article XVIII. The second major change was the creation of Section B giving developing countries a significant variation of the Article XII exception for balance of payments restrictions.

Each of Sections A, C and D is expressed to be available for the purpose of promoting the establishment of a particular industry.³⁴⁸ However, in 1979, this was broadened by a decision of the CONTRACTING PARTIES to include virtually any economic development objective.³⁴⁹

343 GATT 1948, Article XVIII:8.

344 GATT 1948, Article XVIII:7(a)(i)-(iv).

345 On the drafting of Articles XVIII:B,C & D, see "Reports Relating to the Review of the Agreement - Quantitative Restrictions" report adopted 2,4 & 5 March 1955 (L/332/Rev 1 & Addenda) *BISD*, 3S/170, 179-189; On the drafting of Article XVIII:A, see "Reports Relating to the Review of the Agreement - Schedules and Customs Administration" report adopted on 26 February 1955 (L/329), *BISD*, 3S/205, 215.

346 It came into effect by virtue of the "Protocol Amending the Preamble and Parts II and III of the GATT", dated 3 October 1955, in force 10 July 1957, 278 UNTS 168.

347 Article XVIII:4; and interpretative note ad Article XVIII paragraphs 1 and 4.

348 Article XVIII:7(a),13 and 22.

349 "Safeguard Action For Development Purposes", Decision of 28 November 1979 (L/4897), *BISD*, 26S/209.

Section A - Modifying or Withdrawing Tariff Concessions

Section A deals with increasing bound tariff rates in schedules of concessions. It corresponds to the generally available procedure for renegotiation of tariff bindings under Article XXVIII:4. In similarity to Article XXVIII:4, in the event that agreement on compensation cannot be reached, the party invoking Article XVIII A can proceed with the modification of the concession if the CONTRACTING PARTIES find that it has "made every reasonable effort to offer adequate compensation".³⁵⁰ (The CONTRACTING PARTIES are not required to find that substantial agreement has actually been reached on compensation as was required under the 1948 version of Article XVIII:3.) To reiterate the point made in chapter 2, the important difference between Article XXVIII:4 and Article XVIII:A is that, under Article XVIII:A, if the CONTRACTING PARTIES find that the applicant has offered adequate compensation, then the applicant can proceed with the modification to its schedule without facing retaliation from affected parties as would be the case under Article XXVIII:4(d).

Up to March 1994, Section A had only been invoked nine times and only once since 1965.³⁵¹

Section C - Other Restrictions

The imposition of quantitative restrictions is dealt with under Section C of Article XVIII. Section C distinguishes between the imposition of quantitative restrictions on products upon which a tariff binding has been given and products upon which tariffs are unbound.

With bound products, the concurrence of the CONTRACTING PARTIES is required and they are not required to find that agreement has been reached on compensation but only the invoking party has "made all reasonable efforts to reach an agreement and that the interests of other contracting parties are adequately safeguarded."³⁵² An interpretative note indicates that in satisfying themselves of this standard, the CONTRACTING PARTIES may authorise

350 Article XVIII:7(b). As noted in chapter 2, pp78, the words of Article XVIII7(b) are slightly different to Article XXVIII:4(d) and the 'onus of satisfaction' appears to be reversed.

351 GATT, *Analytical Index*, p465.

352 Article XVIII:18.

parties with whom agreement has not been reached to take some retaliatory measure.³⁵³ However, none of the decisions on Article XVIII:C have authorised any retaliation.³⁵⁴ The Agreement does not give other parties a right to retaliation once the CONTRACTING PARTIES have concurred in the measure.³⁵⁵

Measures in respect of products upon which no tariff concession has been given are dealt with in Section C at Article XVIII:13 to 17. The concurrence of the CONTRACTING PARTIES is not necessary but if it is not given then other parties may retaliate.³⁵⁶ The CONTRACTING PARTIES can concur if they are satisfied that the imposition of a tariff would not be sufficient for the purpose.³⁵⁷

The Economic Development Exceptions in Aggregate and as Part of the Overall Framework of Rules

If a developing country wishes to increase protection, it can increase a tariff under either Article XXVIII or XVIII:A and if it wishes to impose an import quota it can do so under either Article XVIII:B or XVIII:C.

It seems that Article XVIII:B is the easiest provision to resort to; it requires no compensation and is unlikely to attract retaliation. Article XVIII:C is less attractive because it requires negotiation of compensation and, generally, prior approval is required in order to gain immunity from retaliation.

The two provisions permitting increases of bound tariffs are reasonably similar. Article XVIII:A offers to developing countries favourable treatment compared to Article XXVIII in one way but is unfavourable in another. Using Article XXVIII:4, even where there is no agreement on the tariff change and compensation, the developing country can proceed with the tariff change unless the CONTRACTING PARTIES find that the developing country

353 Interpretative Note Ad Article XVIII, Paragraphs 18 & 22.

354 A check of the instances listed in the Index in the 38th Supplement under the heading "Economic Development - action under Article XVII:C" shows no instances of retaliatory suspensions of concessions or obligations. The list includes a few instances where the giving of compensating tariff concessions were recorded. (Eg, see Ceylon, II *BISD* 21).

355 Article XVIII:21 which gives a right of retaliation only applies to measures applied under Article XVIII:17 which only applies to situations where the CONTRACTING PARTIES have not concurred in the measure.

356 Article XVIII:17 & 21.

357 Article XVIII:16.

"has unreasonably failed to offer adequate compensation".³⁵⁸ Using Article XVIII:A, in the absence of agreement, the developing country can proceed if the CONTRACTING PARTIES find either that the developing country has offered adequate compensation or that it has "made every reasonable effort to offer adequate compensation".³⁵⁹ Although the difference is a fine one, whereas, under Article XXVIII:4, the onus for establishing reasonableness in the negotiation of compensation is on the parties opposing the tariff increase, under Article XVIII:A, the onus is on the developing country seeking to increase its tariff. On the other hand, the developing country procedure is more favourable than the Article XXVIII procedure in that if the CONTRACTING PARTIES do find that the developing country has offered adequate compensation then other parties cannot retaliate.

Which provision a developing country chooses to utilize and which instrument is imposed is probably determined by the ability to offer compensation, assuming in all circumstances that the absence of retaliation is preferred:

- (1) If developing country, A, can offer compensation which others will agree to, then it can:
 - (a) impose a quota under Article XVIII:C; or
 - (b) increase the tariff:
 - (i) under Article XVIII:A; or
 - (ii) under Article XXVIII.
- (2) If A cannot offer sufficient compensation to obtain agreement but can convince the CONTRACTING PARTIES that A has offered adequate compensation, then it can increase the tariff under Article XVIII:A.
- (3) If A cannot offer sufficient compensation to obtain agreement, cannot convince the CONTRACTING PARTIES that it has offered adequate compensation but can convince the CONTRACTING PARTIES that A has made reasonable efforts to

358 Article XXVIII:4(d).

359 Article XVIII:7(b).

reach an agreement and that the interests of other parties are safeguarded, then it can impose a quota under Article XXVIII:C.

- (4) If A cannot offer sufficient compensation to obtain agreement then it can impose an import quota under Article XVIII:B without the necessity of any prior finding from the CONTRACTING PARTIES (and can wait to see if any other party challenges the legal justification).

Looking at the overall scheme, one might expect that developing countries would tend to adopt a quota under either Article XVIII:B or XVIII:C instead of using the tariff renegotiation procedures under Article XXVIII or XVIII:A. It is instructive to count the number of instances of utilization of the different Articles.:

- (1) Twenty four (24) developing countries resorted to Article XVIII:B at least once just during the years between 1974 and 1986 and each use has affected a large range of items (over 3000 in total);³⁶⁰
- (2) Article XVIII:C had been invoked by 9 developing countries;³⁶¹
- (3) Up to March 1994, Article XVIII:A had been invoked a total of 9 times by 5 developing countries;³⁶² and
- (4) Fifteen (15) developing countries renegotiated tariff bindings under Article XXVIII a total of 31 times.³⁶³

Therefore, of all of the options for increasing the level of protection, Article XVIII:B has been resorted to the most. Use of Article XVIII:A has also been less frequent than the developing countries' use of Article XXVIII. That may indicate that developing countries have been able to comply with Article XXVIII so had no need to resort to Article XVIII:A.

360 See Hoekman & Kostecki, *The Political Economy of the World Trading System*, p164, Table 7.1.

361 See Hoekman & Kostecki, *The Political Economy of the World Trading System*, p164, Table 7.1 refers to 9 countries have been granted a release under Article XVIII:A; see also GATT, *Analytical Index*, p472, which refers to only 4 countries having been granted a release (the index to *BISD* 39S lists 16 decisions relating to those four countries) and to some other countries which have relied on Article XVIII:C without having been granted a release under the article.

362 See GATT, *Analytical Index*, p465.

363 This figure was extracted from Table "Use of Article XXVIII:1, 4 and 5: Summary Table: Status as of 30 March 1994" in GATT, *Analytical Index*, p892; by counting the developing country statistics.

However, it might also indicate that, wherever developing countries have been unable to meet the compensation requirements of Article XXVIII, they have decided to resort to quotas under Article XVIII:B rather than a tariff increase under Article XVIII:A.

Therefore, although it was intended to give developing countries additional flexibility in choosing protection to suit their development requirements, the additional accommodations given in Article XVIII have not done so in a way that encourage the use of import tariffs instead of import quotas. The exceptions have made it easier to use a quantitative restriction than to negotiate a tariff increase.

This situation must have had some effect on the liberalization achieved in the agricultural sector. First, developing countries find it easier to place quantitative restrictions on agricultural products than to bind them with tariffs. Secondly, and more importantly, the ease with which developing countries have been able to impose import quotas on any products, particularly under Article XVIII:B has almost certainly increased the difficulty that developing countries have in negotiating concessions from industrial countries on products of export interest to developing countries, including agricultural products. This may be part of the reason why the developed countries have given less bindings on agricultural products than on other products.

It remains only to comment on the policy behind the economic development exception. In the light of the discussion in Part II of this thesis, of the arguments for GATT rules as constitutional constraints, one should consider whether there is any justification for allowing any additional leeway to developing countries to impose import barriers. Why should developing countries have more freedom than developed countries to transfer wealth from consumers to producers and to do so in ways that maximize the net cost to their own economies? This issue depends essentially upon the validity of the 'infant industry' argument for protection. On the basis of the comparison between the welfare effects of policy instruments conducted in chapter 9, the non-economic objective of establishing new industries can be achieved at a lower cost through subsidies than through any trade barrier. This conclusion is equally applicable to developing countries as it is to developed countries. One difference, though, is that some developing countries have very underdeveloped taxation systems which are not capable of raising sufficient public funds to pay subsidies.

This argument may justify some increased leniency toward the use of border instruments over non-border instruments. However, it is stressed that this argument does not justify any increased use of quantity-based border instruments over price-based border instruments. It does not justify any extra accommodation of import quotas.

4.7 OTHER PROVISIONS AFFECTING AGRICULTURE

The analysis in sections 3 to 7 above has summarized most of the problems in applying the GATT rules on import barriers to agriculture. The areas selected for analysis do, in fact, account for most of such problems. In addition, these areas do represent a large enough proportion of the overall framework of rules to facilitate an assessment of whether there is a connection between the way that the framework of rules affects the choice between policy instruments and the problems that have arisen in application to agriculture.

It is worth mentioning that some other aspects of the rules have affected agricultural trade:

Anti-Dumping Duties

The use of anti-dumping duties is one of the most important issues affecting the GATT legal system. Anti-dumping duties are another way of imposing protection when imports are damaging domestic producers. The special feature of anti-dumping duties that distinguishes them from the safeguards exception is that anti-dumping duties do not have to be imposed in respect of all imports of the relevant product but may be imposed solely on the imports of the product from a particular source. Consideration of the anti-dumping duties exception raises the important questions of the relationship of this exception with the safeguards exception, its relationship with other aspects of the regulation of predatory pricing and the primacy of the most favoured nation clause. However, a study of this aspect of the system is beyond the scope of this study.

It suffices to say that, over the period from the beginning of the GATT until the Uruguay Round, anti-dumping duties did not have a significant impact upon trade in any of the major agricultural commodities.³⁶⁴ Generally, they were only employed in relation to some vegetables and fruits, and cut-flowers.³⁶⁵

³⁶⁴ Also see "Agriculture in the GATT - Note by the Secretariat" CG.18/W/59/Rev.1, 20 January 1982, p21 (noting that it difficult to measure the extent to which anti-dumping duties had affected

Health and Sanitary Regulations

Some of the health and sanitary regulations imposed on agricultural trade under Article XX had little relationship to health or sanitation and were merely disguised trade restrictions. As noted at the beginning of this chapter, in these situations, the object of the restriction is to stop imports rather than to protect a domestic producer and, given that, the prescription given in Part 2 that a price-based quantity instrument is preferable to a quantity-based border instrument does not apply. In these situations, the objective is best achieved by prohibiting the import of the undesirable product. Therefore, analysis of this area is not relevant to determining whether there is a link between any failure to appropriately embody the distinctions between instruments in the rules and the problems with applying the rules to agriculture. Issues arise in assessing the genuineness of the health or sanitary objective. These formed the basis of a particular part of the Uruguay Round negotiation on agriculture and resulted in the adoption of a separate agreement. However, these issues are not dealt with in this study.

5 SUMMARY

The drawing of conclusions from this chapter is left to the final chapter of this part of the thesis. That final chapter draws conclusions from the analysis of all aspects of the application of the pre-Uruguay round GATT to agriculture: import barriers, export subsidies and domestic support.

However, a preliminary summary and a few observations are made here with respect to both of the threads of this analysis:

agricultural trade because parties were not required to notify the Secretariat, but reporting that a cursory examination of actions reported [under the 1968 Anti-dumping Code] indicate[d] that the majority of anti-dumping and countervailing duties [were] levied on non-agricultural products. Two other reports prepared by the Secretariat on problems of applying the GATT to agriculture do not mention anti-dumping duties at all: "Cooperation on Agriculture in the GATT - Note by the Secretariat" CG.18/W/68, 8 April 1982; and "Recommendations; Draft Elaboration - Note Prepared by the Secretariat in consultation with the chairman" (for the Committee on Trade in Agriculture) AG/W/9/Rev.3, 4 June 1986. See Palmeter, N. David, "Agriculture and Trade Regulation - Selected Issues in the Application of US Antidumping and Countervailing Duty Laws" (1989) 23(1) *JWT* 47-68 at 49 (saying that the legal issues in US anti-dumping law had "arisen not in the commodity trade, but in the involving vegetables, flowers, and fruits").

365 See Palmeter, as above.

- (1) Identification of the major problems with applying the rules on import barriers to agricultural trade; and
- (2) Identification of any deficiencies in the way that the rules on import barriers embody appropriate distinctions between border and non-border instruments and price-based and quantity-based border instruments.

5.1 SUMMARY OF PROBLEMS IN APPLYING THE RULES ON IMPORT BARRIERS TO AGRICULTURE

The key problems with the application of the GATT rules on import barriers on agriculture were:

- (1) the low number of tariff bindings on agricultural products;
- (2) the gap between the rules on tariffs and those on quotas which permitted the EEC to use variable levies extensively;
- (3) the dependence of the regulation of mark-ups on state import monopolies upon the giving of tariff concessions;
- (4) grandfathering of pre-existing legislation which played a historical role in the failures to deal with German and EEC restrictions and with the US *Agricultural Adjustment Act* restrictions and a continuing role in Swiss agricultural restrictions;
- (5) the bad precedent set by the USA's 1955 agricultural waiver;
- (6) the failure to enforce the provisions of the Article XII exception for balance of payments restrictions until the mid to late 1970's;
- (7) the continuing failure to enforce the provisions of the Article XVIII B exception for balance of payments restrictions;
- (8) the failure to enforce the provisions of the agricultural exception until only a few years before the Uruguay round began;

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- (9) the fact that the safeguards exception was not perceived to give adequate safeguard leading to the use of VERs to circumvent Article XIX;
 - (10) the fact that the most frequently used exception for developing countries was the balance of payments exception.

5.2 EMBODIMENT OF DISTINCTIONS BETWEEN POLICY INSTRUMENTS IN THE RULES ON IMPORT BARRIERS

The analysis of the framework of rules revealed some deficiencies in the embodiment in the rules of the two distinctions between policy instruments. It revealed some inconsistencies with a policy of encouraging parties to adopt least costly policy instruments. Some of these deficiencies or inconsistencies arose from conflicts in the negotiation of the GATT over the relative strictness of regulation that should apply to import quotas and import tariffs and from negotiated compromises over exceptions to the prohibition on quantitative restrictions.

The notable deficiencies were:

- (1) the disincentive to negotiating tariff bindings caused by the existence of quantitative restrictions;
- (2) the tolerance of virtual quantitative restrictions in the form of variable levies on unbound items;
- (3) the granting of permanent grandfathered rights for existing import quotas instead of arranging for a transition toward the use of tariffs instead of quotas;
- (4) the absence of any incentive in the waiver provision in Article XXV:5 to encourage parties to resort to subsidies instead of import restrictions and to tariffs instead of quotas;
- (5) the failure of the balance of payments provisions to dissuade parties from maintaining quantitative restrictions after their justification had expired; and the failure of the balance of payments provisions to discourage the use of trade policies in ways that were not part of an overall macroeconomic policy to deal with the balance of payments deficit;

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- (6) the failure to provide in the agricultural exception for any incentives to shift from protecting farm incomes by dual price systems supported by import barriers toward protecting them in less costly ways such as buffer stocks, production subsidies and other types of subsidies;
 - (7) the failure to fit the safeguards provision into the overall framework of rules so that parties would be encouraged, by immunity from retaliation or exemption from having to provide compensation, to adjust to changing import flows by using tariffs and subsidies instead of quotas or instruments having the effect of quotas;
 - (8) similarly, with the economic development exception, a failure to fit the exception into the framework of rules so that developing countries would be encouraged, by immunity from retaliation or exemption from having to provide compensation, to support infant industries by using the less costly policy mixtures of tariffs, export subsidies and production subsidies rather than import quotas.

5.3 LINKS BETWEEN THE DISTINCTIONS BETWEEN INSTRUMENTS AND THE PROBLEMS WITH AGRICULTURAL IMPORT BARRIERS

The thesis submits that the abovementioned deficiencies in the embodiment of the two distinctions between policy instruments were, in fact, a part of the causes of the abovementioned problems in the application of the rules on import barriers to agriculture.

This thesis proposes a similar connection in respect of the rules on export subsidies and those on domestic support. The causal connections in respect of the overall framework of rules including all three areas is argued in chapter 15.

CHAPTER 12

THE PRE-URUGUAY ROUND RULES ON EXPORT SUBSIDIES

Both in the years of plenty and in years of scarcity, therefore, the bounty necessarily tends to raise the money price of corn somewhat higher than it would otherwise be in the home market

Adam Smith on the subject of export subsidies in *Wealth of Nations* Book IV, Vol II, p9

A bounty on the exportation of corn tends to lower its price to the foreign consumer, but it has no permanent effect on its price in the home market.

David Ricardo, in the opening of word of Chapter XXII entitled "Bounties on Exportation, and Prohibition of Importation" in *The Works and Correspondence of David Ricardo* (edited by Piero Sraffa) Vol I *On the Principles of Political Economy and Taxation* (Cambridge University Press, Cambridge, 1951) (originally published 19 April 1817)

To date the GATT has been unable to satisfactorily resolve issues surrounding export subsidies, so that the GATT resolution process does not appear to present a viable solution to the US-EEC quarrel.

William H. Boger III, "The United States-European community Agricultural Export Subsidies Dispute" (1984) 16(1) *Law & Policy in Int'l Bus* 173-238 at 179.

1 INTRODUCTION

From the above quotations, it seems plausible that even Adam Smith and David Ricardo might have disagreed about the effects of export subsidies and the desirability of regulating them. Was it or is it a failure on the part of the parties to the GATT to agree on such fundamental ideas that is at the core of the inability of the GATT (referred to in the quote from Boger) to "resolve issues surrounding export subsidies ?

This chapter continues the more detailed analysis of the pre-Uruguay round rules commenced in the last chapter. This chapter analyzes the way the rules relating to export subsidies have affected trade in agricultural products.

In fact, difficulties with the application of the export subsidy rules have been most pronounced in relation to agricultural trade. These difficulties have arisen from fundamental differences in attitudes among countries as to the extent to which subsidies should be

regulated. These differences have been most stark in relation to subsidies on agricultural products and they have repeatedly emerged to make the rules an ineffective discipline on export subsidies on agricultural products.

In assessing the problems with export subsidies on agricultural trade, this analysis builds a more complete picture of the framework of GATT rules presented in chapter 2 and maintains the focus begun in that chapter on the differences between the way that the GATT rules regulate different policy instruments. Therefore, this chapter:

- (1) analyzes the way that the GATT rules on export subsidies have operated in relation to trade in agricultural products and identifies and explains the areas of difficulties; and
- (2) searches for defects in the way that the rules on export subsidies embody the distinctions between price and quantity based border instruments and between border and non-border instruments;

so as to be able to make an assessment of whether any such defects referred to in paragraph (2) contributed to the difficulties referred to in paragraph (1). Recall that it was submitted in Chapter 8 that the scheme of the rules should permit some industry support but should do so in a way that is more tolerant of export subsidies than of quantitative restrictions whether on exports or imports and less tolerant of export subsidies than of non-border policy instruments like domestic production subsidies. The rules should also prefer less export subsidies to more and should facilitate a movement from larger export subsidies to smaller export subsidies.¹

The fact that export subsidies are dealt with separately deserves comment. The rules on export subsidies are part of a scheme of rules regulating subsidies generally. Originally, the GATT made no distinction between export subsidies and other subsidies. However, since the amendments to the Agreement in 1955, the Agreement has treated export subsidies and other subsidies differently. The making of this distinction has been accompanied with controversy and difficulties. Even in the Uruguay Round negotiation on agriculture, there was disagreement over how to divide the subject matter. The EEC proposed that

commitments should be made in terms of a global level of support, arguing that specific commitments on export subsidies were unnecessary because export subsidies are a consequence of the level of support however it is provided. The USA proposed separate commitments in the three areas of import access, export subsidies and domestic support.² That is the approach adopted in the Dunkel text and in the final Agriculture agreement.³ This work follows that same division and deals separately with the existing rules on export subsidies and those on domestic subsidies even though they are both part of the one scheme of regulation of subsidies. Nevertheless, a significant amount of what follows applies to subsidies generally not only to export subsidies. Therefore, as well as analyzing the rules on export subsidies, this chapter also serves as a basis for the analysis of domestic subsidies in the next chapter. As with the last chapter, the description relates to the pre-WTO law and necessarily relates to the law as it was at the relevant time.

2 THE TWO TRACK DISCIPLINE OF SUBSIDIES

The outline of the framework of GATT rules contained in Chapter 2 included an outline of the rules relating to export subsidies, to domestic subsidies, and to countervailing duties.⁴ It outlined two ways that the GATT rules regulate the use of subsidies generally, that is, including export subsidies and also subsidies other than export subsidies. The rules provide for two ways in which one party may respond to another party's subsidies upon goods that are exported:

- (1) first, in some circumstances, GATT parties are permitted unilaterally to apply tariff surcharges (to impose customs duties in excess of bound rates) upon imports from a particular country, the government of which has paid a subsidy in respect of those goods;
- (2) secondly, in some circumstances, GATT parties can apply for authorization⁵ to apply tariff surcharges or import quotas upon imports from a particular country (or in fact

1 See above, ch8 pp183-184 & 193-194.

2 See below, ch17 under the heading "4. Opening Proposals of the EEC and the USA".

3 See below, ch19 under the heading "2. The Dunkel Text on Agriculture".

4 Above, Ch 2 pp56-59 (on export subsidies), pp59-60 (on domestic subsidies) & p72 (on countervailing duties).

5 Under Article XXIII of the pre-Uruguay Round GATT, authorization was to be obtained from the CONTRACTING PARTIES. Under Article 13:4 of the Tokyo Round *Subsidies Code*, authorization

to be released from any obligation under the Agreement) the government of which has paid a subsidy in respect of those goods or in respect of other goods.

These two responses are commonly referred to as track I and track II.⁶

Track I relates to countervailing duties to offset the amount of the subsidy received in respect of the traded product. Generally, under Article VI, countervailing duties are not permitted unless the subsidized imports are causing material injury to a domestic industry in the importing country. However, for much of the duration of the GATT, the most prolific exponent of countervailing duties, the United States was free from the requirement of having to show any material injury because the United States' countervailing duties legislation, which did not contain any injury requirement, was 'grandfathered' under the Protocol of Provisional Application.⁷

Track II relates to the usual dispute resolution processes of Article XXIII of the GATT that can be invoked if any measure violates the provisions of the GATT or, in fact, if any measure, whether or not a violation of the GATT, nullifies or impairs a benefit under the Agreement. Chapter 2 outlined these provisions together with the particular provisions relating to subsidies in Article XVI of the GATT and the Tokyo Round *Subsidies Code*.⁸ Under these provisions, parties may resort to Article XXIII dispute resolution seeking a ruling that the subsidizing party should cease to grant the subsidy or should modify it and, in the absence of compliance with such a ruling, may request authorization to retaliate against the subsidizing party.

Therefore, the regulation of export subsidies consists of the joint effect of Tracks I and II and this review of the application of the rules to agriculture must consider both tracks. The review gives considerable support to the view that neither Track I, Track II nor their

was to be obtained from the Committee on Subsidies and Countervailing Duties. Under Article XXIII of the post-Uruguay Round GATT, authorization is to be obtained from the Dispute Settlement Body. In addition to Article XXIII, see GATT 1994, Article 2(b) and *Understanding on Dispute Settlement* Articles 2 & 22.

6 An example of the use of this terminology is Jackson, John H., *The World Trading System - Law and Policy of International Economic Relations* (The MIT Press, Cambridge, Massachusetts, 1989) p258. An earlier example is Barcelo, John J., "Subsidies, Countervailing Duties and Antidumping After The Tokyo Round" (1980) 13 *Cornell Int'l LJ* 257.

7 See, below, chapter 2 p42 & chapter 11 p268ff.

cumulative effect have been successful in disciplining export subsidies on agricultural products. The review is intended to be comprehensive in relation to Track II but, given that a detailed analysis of countervailing duties is beyond the scope of this work, the coverage of Track I is intentionally limited to providing the context for the analysis of Track II.⁹

To review the pre-Uruguay round rules, it is necessary to trace their chronological evolution. There were three stages in this process:

- (1) the creation of the original rules in the 1947 agreement;
- (2) the amendments of 1955;¹⁰ and
- (3) the 1979 *Subsidies Code*.¹¹

The following analysis deals with the negotiation of the rules at each stage and with their application. The material is arranged under the following headings:

- Negotiating Background to the Original 1947 Provisions;
- The 1947 Rules
- The 1955 General Review
- The Rules Following from the 1955 General Review
- Operation of the Rules Between 1955 and the Tokyo Round
- The Rules Following from the 1979 *Subsidies Code*
- Operation of the Rules Between the Tokyo Round and the Uruguay Round
- The Export Subsidy War of the 1980's.

8 On the dispute resolution procedures under Article XXIII and their application to Article XVI, see chapter 2, see pp60-72 and on the Tokyo Round *Subsidies Code*, see chapter 2 pp58-60.

9 A detailed analysis of countervailing duties would require analysis of the rationale for countervailing duties and consideration of schools of thought that regard countervailing duties as anti-distortion measures or as entitlements in response to injury. On these matters, see the collection of articles in (1979) 21 *Law and Policy in International Business*. Although, countervailing duties have had some impact on regulation of agricultural trade and although the framework of analysis employed here could be fruitfully applied to countervailing duties, consideration of the proper embodiment of the distinctions between border and non-border measures in the countervailing duty rules is left for later work and not substantially dealt with in this study.

10 *Protocol Amending the Preamble and Parts II and III of the GATT* 3 October 1955, in force 10 July 1957; 278 UNTS 168.

11 *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade*, dated 12 April 1979, came into force between initial signatories on 1 January 1980 ("*Subsidies Code*"), 1186 UNTS 204, *BISD* 26S/56.

3 NEGOTIATING BACKGROUND TO THE ORIGINAL 1947 PROVISIONS

3.1 TRACK I - NEGOTIATION OF THE COUNTERVAILING DUTIES RULES

In the negotiation of the original provisions on countervailing duties ('CVD's), the question of distinguishing between export subsidies and other subsidies appears not to have arisen in any significant way and may not have arisen at all. The earliest draft provision on countervailing duties is Article 11 of the *Suggested Charter*.¹² It envisaged that CVDs could be permissible in the case of production subsidies as well as export subsidies. It provided that CVDs should not be more than

an amount equal to the estimated bounty or subsidy ascertained to have been granted, directly or indirectly, on the *production or export* of such product in the country of origin or exportation.¹³

The question of CVDs was one of several matters held over at the London Session.¹⁴ At the New York drafting session, the absence of any distinction between export subsidies and other subsidies was confirmed with the words "production or export" being changed to "manufacture, production or exportation" in both the draft ITO Charter and the draft of the GATT. It appears that there was never any question of CVDs being limited to export subsidies.

The aspect of CVDs which did attract attention in the negotiation was the question of whether the existence of injury to a domestic industry should be a pre-requisite to the imposition of CVDs.¹⁵ The CVD law of the United States existing at the time did not have any injury requirement.¹⁶ The final form of Article VI of the GATT did and still does contain an injury requirement. However, under the provisions of the Protocol of Provisional Application, Article VI, being contained in Part II, came into force only to the extent that it

12 *Suggested Charter*, see ch2, p32 & fn21. The 1945 USA *Proposals* (See ch2, p31 & fn16) contained only an agreement to agree on a definition of circumstances in which countervailing duties could be applied (in Section A, para 3). James Meade's *Proposals* (see above, ch2, p6 & fn12) contained no mention of CVDs at all.

13 *Suggested Charter* Article 11. Emphasis added.

14 See *London Draft Charter* (UN Doc E/PC/T/33, see above, ch2, p33, fn24) Article 17 is a blank under the heading "Antidumping and Countervailing Duties" which is asterisked to a footnote saying that these matters are to be considered further and drafted at a later date.

15 See Wilcox, *A Charter for World Trade* (1949) pp78-79.

16 USA, *Tariff Act* of 1930, s303 PL 71-361 (codified as 19 USC §1303 1976).

was not inconsistent with pre-existing legislation. Therefore, the United States was not obliged to insert an injury requirement into its CVD law.

3.2 TRACK II - NEGOTIATION OF THE ORIGINAL ARTICLE XVI.

The opening of negotiations on ITO provisions on subsidies indicated both concerns with reducing and restricting the international effects of subsidies and also respect for a role for governments to pay subsidies as an appropriate element of their sovereignty over domestic economic and commercial policy. The objective of negotiations was to find a way of drawing the line:

between justifiable government policies, on the one hand, and policies that constitute a dangerous and improper attempt to export one's own problems at the expense of foreign nations, on the other hand.¹⁷

Initial negotiations gave promise that a clear distinction between export subsidies and other subsidies might be an important part of balancing this tension between protecting domestic sovereignty and submitting to international rules for common benefit. However, particularly as a result of disagreement over how to treat agricultural subsidies, the parties had difficulty reaching agreement on the formulation of appropriate rules and the emphasis on the distinction between export subsidies and other subsidies in balancing that tension faded.

Together with the agricultural exception in Article XI:2, export subsidies was one of two areas in the negotiation of the GATT in which special treatment for agriculture was a major issue. In negotiating a rule to restrain export subsidies, there was some contention as to whether any generally applicable rule should be applicable to agricultural products and commodities. This distinction between agricultural and non-agricultural products arose, in fact, out of contention over the critical issue of whether there should be a difference in principle between the regulation of export subsidies and the regulation of other subsidies.

The early proposals of the United States and the United Kingdom envisaged a clear distinction between export subsidies and other subsidies. As discussed in Chapter 2, the earliest British proposals were substantially influenced by James Meade's *A Proposal for an International Commercial Union*. That document suggested a quantitative limit on export subsidies:

Members would undertake not to impose open or hidden taxes or subsidies of more than, say, 10 per cent, on exports to any country whether a member of the Commercial Union or not.¹⁸

This compared to the regulation that he suggested for tariffs and domestic subsidies:

members would be forbidden to give a preference (whether by means of taxes, subsidies, preferential prices offered by state organisations, or other means) in the prices offered to their home producers which was more than, say, 25 per cent greater than the price offered to similar goods produced by other members of the Union.¹⁹

There are three notable aspects of Meade's proposal:

- (1) that the suggested regulation of export subsidies was much stricter than that proposed in relation to other subsidies;
- (2) that the suggested regulation of export subsidies was to apply to all products without exception; that is, he did not suggest that primary products or agricultural products deserved special treatment;
- (3) that the suggestion was to agree upon a maximum percentage export subsidy; that is, he did not advocate a complete prohibition on export subsidies but merely the imposition of a maximum.

These second and third aspects of Meade's proposal on export subsidies corresponded to his proposal for across the board reductions of import tariffs down to a defined maximum.²⁰

While the across the board tariff reduction proposal was neither adopted nor rejected by the non-committal language of the USA's *1945 Proposals for Expansion of World Trade and Employment*,²¹ it was rejected in the US *Suggested Charter* in favour of product by product

17 Jackson, *World Trade and the Law of GATT*, (1969) p367.

18 Paragraph 13(viii) of James E Meade, "A Proposal for an International Commercial Union" (25 July 1942) reproduced in "James Meade's War-time Proposal for a Liberal Trade Regime" (1987) 10 *The World Economy* 399-407.

19 James E. Meade, "A Proposal for an International Commercial Union" paragraph 13(iv).

20 James E. Meade, "A Proposal for an International Commercial Union" paragraph 11(iii).

21 United States, Department of State, *Proposals for Expansion of World Trade and Employment* (November 1945) (Department of State Publication 2411) (*Proposals*) Section B, para 1; the language of which appears to have been drawn to conform to the prior agreement in Article VII of the *Mutual Aid Agreement* without compromising the arguments of either the UK or the USA as to how the reductions should be arrived at.

negotiated tariff reductions.²² The suggestion for an across the board ceiling on export subsidies was rejected even earlier and was replaced in the 1945 *Proposals* with a much more complicated approach which was less clear about the distinction between export subsidies and other subsidies and which distinguished between commodities and other products. That approach formed the basis of subsequent drafts of the Charter for the ITO and eventually for the amendments to the GATT in 1955.

The *Proposals* introduced an obligation to discuss limitation of the quantity of product subsidized by "any subsidy which operates to increase exports or reduce imports" where such subsidy threatened serious injury to international trade.²³ The application of the obligation was clearly not restricted to export subsidies. The *Proposals* also contained a prohibition on export subsidies which was worded in terms of:

not taking any action which would result in the sale of a product in export markets at a price lower than the comparable price charged for the like product in the home market.²⁴

The provision allowed for a lag of three years before the prohibition would come into effect but after that time any derogation from it would require approval from the ITO.²⁵

The prohibition on export subsidies was made subject to an exception for commodities that were or were "likely to become in burdensome world surplus".²⁶ For those commodities, members were to consult together to agree on methods of removing the surplus including by negotiating an intergovernmental commodity arrangement in accordance with principles set out in Chapter V of the *Proposals*. It was only if such consultations failed to reach their object within a reasonable time, that the relevant product would be exempted from the application of the prohibition on export subsidies (and also from the obligation to discuss limitation of any subsidy threatening serious injury to international trade).²⁷ In respect of export subsidies on commodities to which the exemption applied, an additional rule was formulated:

22 See ch11 pp246-248.

23 *Proposals* Section D para 1.

24 *Proposals* Section D para 2.

25 As above.

26 *Proposals* Section D para 3a & 3b.

27 *Proposals* Section D para 3b.

no member should employ [export] subsidies so as to enlarge its share of the world market, as compared with the share prevailing in a previous representative period.²⁸

Once the exemption applied, it would continue to apply until an agreement was reached to end the exemption. Of paramount importance was the fact that the clause did not require any prior approval or agreement among the parties as a prerequisite to invocation of the exemption. This was the aspect of the provisions which was most controversial in subsequent negotiations and which led to the specific provisions on export subsidies being left out of the original form of the GATT.²⁹

In the *Suggested Charter*, Article 3(b) of Section E provided that resort to the exemption from the prohibition on export subsidies was available

[i]f it is determined that the measures provided for in subparagraph (a) of this paragraph [to deal with the actual or imminent burdensome world surplus] have not succeeded, or do not promise to succeed, within a reasonable period of time, in removing, or preventing the development of, a burdensome world surplus of the product concerned ...

As to how such a determination would be made, the draft *Suggested Charter* contained a very imprecise provision which referred to procedures yet to be established and implied that members having "an important interest in the trade in the product concerned" would have more influence over such determinations than other members.³⁰ It appears that the United States contemplated that it would have sufficient control over the making of these determinations to ensure that it would be able, if necessary, to exempt its own export subsidies on agricultural products from the prohibition on export subsidies.

At the 1st (London) Session of the Preparatory Committee, provisions very similar to the above provisions of the *Suggested Charter* were included in the *London Draft of the Charter for an International Trade Organization*.³¹ In the *London Draft*, the exemption was expressed to apply to "primary commodities". With respect to the making of the

28 *Proposals* Section D para 3c.

29 Brown, *The United States And The Restoration of World Trade* (The Brookings Institution, Washington DC, 1950) pp117-119 and Wilcox, *A Charter For World Trade* (Macmillan, New York, 1949) pp44-45.

30 *Suggested Charter*, Article 55(6).

31 *London Draft of the Charter for an International Trade Organization* Article 30(4)(b) contains the exemption for primary commodities from the prohibition on export subsidies which is in Article 30(2). Article 66(6) contains the provision regarding the making of determinations under Article 30.

determination that the exemption would apply, the provisions in the *London Draft* were no more precise than those in the *Suggested Charter*. The Report of the Session does not record any conflict over the provision but records only the suggestion that the Drafting Committee consider ways to simplify the provisions.³² The carrying forward of the provision without change from the *Suggested Charter* probably indicates that no progress was made on this issue at the London Session and that the other parties had not been able to reach agreement with the United States on a method of determining when the exemption would apply.

At the New York drafting session, the participants not only had the task of improving the draft of the charter for the ITO but also had the task of negotiating a General Agreement on Tariffs and Trade. For the second task, the United States submitted a negotiating draft of the GATT which omitted the whole of the *London Draft* charter's provisions on export subsidies which being linked to the provisions on dealing with surpluses of commodities, could not stand alone without substantial amendment.³³ Brazil and New Zealand wanted to include the export subsidy obligations in the draft of the GATT, but the United States resisted their efforts.³⁴ With respect to the content of the export subsidy provisions in the draft charter, no clarification was achieved. The export subsidy provisions in the *New York Draft* are virtually identical to those in the *London Draft*.³⁵ The words defining the determination of the right to avail of the exemption for export subsidies on primary commodities from the general prohibition were unchanged from the imprecise words contained in the *London Draft*.³⁶ Presumably, the absence of any progress on the formulation of the way that the determination would be made, was part of the reason that the

32 See UN, *Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, para 1(d)(xii) calls for the drafting committee to consider the texts with a view to simplifying them.

33 On the omission of the export subsidy provisions from the USA's first negotiating draft of the GATT, see Hudec, *The GATT Legal System and World Trade Diplomacy* (1990) p55 fn 19 and accompanying text. There, Hudec cites the original USA draft as E/PC/T/C.6/W.58.

34 Hudec (1990) p55.

35 Article 30 of the *New York Draft*. (Draft Charter in "Report of the Drafting Committee of the Preparatory Committee of the United Nations Conference on Trade and Employment (20 January to 25 February 1947) Lake Success, New York, UN Doc E/PC/T/34/Rev.1 (29 May 1947) (UN Publications Sales No: 1947.II.3.).

36 Articles 30(4)(b), 30(6) & 66(4) of the New York Draft Charter are the successors, respectively, to Articles 30(4)(b), 30(5) & 66(6) of the London Draft Charter.

United States insisted that the export subsidy provisions had to be left out of the draft of the GATT.

When the drafts from the New York drafting session were presented for adoption at the second preparatory session in Geneva, the dispute over treatment of export subsidies on primary products widened so as to threaten the distinction made between export subsidies and other subsidies. The abovedescribed lack of progress made on the export subsidy provisions between the *Suggested Charter* and the *New York Draft* and their omission from the draft of the GATT indicated that the United States was uneasy about subjecting its ability to pay export subsidies on agricultural products to the two step process of multilateral commodity negotiations and, failing those, to an approval process under the ITO. At the Geneva meeting, Canada proposed further constraints upon the exemption for primary products. It proposed that the right to utilize the exemption from the prohibition on export subsidies should only be given if the ITO determined that "the subsidy was necessary, would not stimulate exports unduly, and would not injure other members."³⁷ The counter proposals of the United States indicated that the United States negotiators, in their efforts to ensure that the USA could continue to pay export subsidies on agricultural products, had lost sight of the importance of the in-principle distinction between export subsidies and other subsidies that had been made in the original *Proposals* and in the *Suggested Charter*. The United States resisted Canada's proposal by pointing out that the constraints on export subsidies would not solve the problem of burdensome surpluses because it would not limit the payment of domestic subsidies which caused either import replacement or exports.³⁸ The United States objected to having the form of subsidy that it used being subject to such rigorous pre-requisites when other subsidies would be unregulated.³⁹ In addition, the United States made a counter proposal which further undermined the distinction between export subsidies and other subsidies. It proposed that the undertaking not to use export subsidies so as to increase a country's share of world trade in a product be applied to all subsidies rather than only to export subsidies.⁴⁰

37 Brown (1950), p118.

38 Brown (1950), p118.

39 Brown (1950), p118-119.

40 Brown (1950), p118.

In the negotiation over export subsidies, as in the negotiation over import restrictions, the USA hampered its ability to argue for its own 'in-principle' position by its insistence that there be an exception to cover its own particular programmes, in particular, those relating to agriculture. Just as the United States' insistence that there be exceptions for balance of payments restrictions, emergency safeguards and agricultural restrictions impaired the integrity of the US argument for the general prohibition on quantitative restrictions, so here the insistence of the United States that there be no prior approval requirement for export subsidies on primary products impaired the integrity of its original proposals for regulation of export subsidies.

In the end, the United States was isolated on this issue and the meeting adopted a draft ITO charter to which the USA made a reservation with respect to the provisions on export subsidies.⁴¹ The Geneva draft, then, retained the requirement for prior approval by the ITO to invoke the exception from the prohibition on export subsidies.⁴² The criteria for the granting of the exemption were extended in accordance with the Canadian proposal. It should be noted, though, that the provisions on how the ITO should reach decisions were far from final.⁴³ In fact, they contained three alternative provisions relating to voting.⁴⁴ Therefore, there was still some lack of finality about the provisions for prior approval for export subsidies on primary products.

Despite the USA's loss in the negotiation over the provisions in the draft ITO charter, the USA did manage to hold its desired position that the export subsidy provisions of the draft charter be left out of the GATT. At Geneva, as in New York, there was some disagreement with this position but the USA's view prevailed.⁴⁵ Therefore, due to the United State's refusal to accept a requirement of prior approval for export subsidies on primary commodities, the provisions on subsidies in the Geneva text of the ITO charter were

41 See the footnote to Article 27(3) in the *Report of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment* (UN Doc E/PC/T/186, 10 September 1947) p27.

42 *Geneva Draft Charter*, in the Report of the Second Session (see preceding fn) Article 27(3).

43 *Geneva Draft Charter*, Articles 72-74.

44 *Geneva Draft Charter*, Article 72.

45 See Hudec, *World Trade Diplomacy and the Law of GATT* (1990) p55 fn19. Hudec cites the record of the discussion in E/PC/T/TAC/PV/11 (5 Sept 1947) pp13-18.

weakened so that the GATT contained no prohibition on any type of export subsidy and no distinction between export subsidies and domestic subsidies.

It is not really surprising that the USA wavered from its original in-principle distinction between export subsidies and other subsidies. At that time (as mentioned above), the United States countervailing duty law required only that there be a product subsidized by another government. It did not require proof of any injury to domestic industry. Therefore, the practical fallback position for the United States, in the event of being unable to reach agreement on export subsidy provisions, was that it would not face any restrictions on its own subsidies but that it would be well able to deal with imports into the USA of subsidized products. That left only the problem of subsidies displacing USA exports to third markets. With respect to that problem, the USA probably would have anticipated that there were no countries that would engage in a subsidy war with the USA and, in any case, negotiations on the Charter were continuing.

4 THE 1947 RULES

4.1 TRACK 1 - COUNTERVAILING DUTIES

The countervailing duty provision from the New York draft was carried over into the GATT with little change. Its scope was expanded even more in Article VI:3 of the GATT, with subsidies on "the manufacture, production or export" being specified to include "any special subsidy to the transportation of a particular product".

However, the scope of the above wording is limited by Article VI:4. While, in theory, Article VI:3 might apply to any exemption, remission or rebate of tax, Article VI:4 provides that countervailing duties cannot be levied on a product by reason of the exemption from or the refund of indirect taxes.⁴⁶ As already mentioned in chapter 2, under Article VI, countervailing duties are also limited by an injury test. They can only be imposed where

⁴⁶ Article VI:4 provides that a countervailing duty may not be applied to a product "by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes".

the effect of the ... subsidization ... is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry.⁴⁷

The Article contemplated that countervailing duties could also be levied by one country in the situation where a third country's exports were being displaced by subsidized exports. In that situation, the CONTRACTING PARTIES could waive the satisfaction of the injury requirement in relation to the domestic industry of the country imposing the CVD so long as the injury requirement was satisfied in relation to the domestic industry of the third country.⁴⁸

4.2 TRACK 2 - THE ORIGINAL ARTICLE XVI

In the original agreement of 1947, the only provision dealing directly with subsidies was Article XVI which, after the 1955 amendments, became Article XVI:1. This provision remains without amendment in the post-WTO GATT. It does not impose any prohibition on the granting of any kind of subsidies.

Article XVI:1 requires parties to notify the CONTRACTING PARTIES of any subsidies they provide. Where the CONTRACTING PARTIES find that a subsidy causes or threatens "serious prejudice" to another contracting party, the subsidizing party is required to "discuss the possibility of limiting the subsidization". Article XVI:1 is expressed to operate upon:

any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory

The provision expressly recognizes that subsidies may exist and it merely provides a mechanism for discussing "the possibility" of limiting them.

47 GATT, Article VI.

48 See Article VI:6 in the version of the Agreement dated May 1952 in *BISD* Vol 1, p13 at 23.

4.3 APPLICATION OF ARTICLE XXIII DISPUTE SETTLEMENT TO THE ORIGINAL ARTICLE XVI

Article XXIII1(a) - Violation Nullification or Impairment

Since under the original Article XVI, there was no such thing as a violation export subsidy, there could not have been any application of paragraph (a) of Article XXIII to export subsidies.

Article XXIII1(b) - Non-Violation Nullification and Impairment

Article XXIII does allow for, at least, a theoretical application of the dispute settlement mechanism to non-violation export subsidies. Article XXIII states that its procedures may follow not only from a violation but also from:

- (b) the application by another contracting party of any measure whether or not it conflicts with the provisions of this Agreement, or
- (c) the existence of any other situation...

The Article states that the procedures may follow where the measure or the situation either nullifies or impairs a benefit under the Agreement or impedes the attainment of any objective of the Agreement.

As part of the introduction to the rules on subsidies, Chapter 2 (at para 9.4) introduced the possible application of Article XXIII dispute settlement resolution to measures which are not violations of the Agreement. Two situations were mentioned:

- (a) where subsidized exports from Country B to Country A displace domestic production from Country A's own producers; and
- (b) where subsidized exports from Country B to Country C displace exports from Country A to Country C.

Consider, in each situation, whether Country A would have a remedy under Article XXIII in respect of a non-violation nullification or impairment of a benefit accruing under the Agreement.

- (a) *where subsidized exports from Country B to Country A displace domestic production from Country A's own producers*

The application of the non-violation nullification or impairment principle in this situation is academic because in most situations in which the argument might be made, it would be possible to apply countervailing duties. If a countervailing duty can be applied unilaterally then it is not likely that parties will seek authorization to retaliate against a nullification or impairment from a non-violation export subsidy. Nevertheless, the theoretical possibility is considered below.

In this situation, Country A would need to establish that the deterioration of the competitive position of the domestic producers in Country A in relation to imports from Country B is an impairment of a benefit accruing under the Agreement. There is no relevant benefit under a tariff concession. Even if Country B has given a tariff concession on the product upon which it is paying the export subsidy, the benefit which accrues to Country A from Country B's tariff concession does not include any beneficial effects on the competitive relationships between Country A's domestic producers and importers of that product in Country A. So the effects of the export subsidy could be not impairing any benefit of Country B's tariff concession.

Therefore, any possible argument that a benefit is being impaired would have to relate to some benefit other than a benefit under a tariff concession. It seems that the only possible relevant benefit might be a benefit deriving from the obligation in Article XVI:1 to discuss the limitation of subsidies that cause serious prejudice to other contracting parties. Country A might argue that the obligation to discuss the possibility of limiting subsidies implies an obligation to attempt to avoid granting subsidies which cause serious prejudice to other parties and that it follows that the competitive situation that exists in the absence of seriously prejudicial export subsidies is a benefit accruing under the Agreement. However, the argument is not strong. It seems unreasonable to imply an obligation to avoid serious prejudice from the mere obligation to enter into discussions. Given that the CONTRACTING PARTIES have never adopted a finding of non-violation nullification or

impairment relating to a benefit other than a benefit accruing under a tariff concession,⁴⁹ it seems unlikely that this arguably implied obligation could be regarded as a giving rise to a benefit for the purposes of Article XXIII.

(b) *where subsidized exports from Country B to Country C displace exports from Country A to Country C.*

Can Country A argue that the export subsidy by Country B impairs the benefit received by Country A from a tariff concession granted by Country C?

In theory, if Country C gives a tariff binding on, say, apricots, then both Countries A and B receive a benefit being the enhanced competitive positions that they can both enjoy for exporting apricots to Country C. If after Country C has given the tariff binding, Country B introduces an export subsidy that results in an increase in exports of apricots from Country B to Country C displacing exports from Country A, then for Country A the competitive environment for its export of apricots to Country C is worsened. So, for Country A, a benefit received under the Agreement is being impaired.⁵⁰

In practice, third-party rights have not been recognized. There has been a tendency to view the GATT as a collection of bilateral obligations rather than as multilateral obligations.⁵¹ This view tends to exclude the idea of third party rights. In the leading cases on export subsidies, there was no argument made on the basis of third party nullification and impairment.⁵² In the trade dispute that led to the EEC-Japan Semi-conductors case, arguably the EEC could have brought a third party nullification or impairment case. Arguably, the action of the USA in negotiating an agreement with Japan to discourage sales

49 The only case in which a panel made a finding of non-violation nullification or impairment in relation to a benefit other than a benefit accruing under a tariff concession was the case of "EEC - Tariff Treatment on Imports of Citrus Products from Certain Countries in the Mediterranean Region" (L/5776, dated 7 February 1985, extracted in GATT, *Analytical Index*, pp614-615). The panel report in that case has never been adopted.

50 See the argument made by Barcelo in relation to domestic subsidies which stimulate exports. He argues that "It is reasonable to expect that profitable access to an export market would not be eliminated by production subsidies in a foreign competitor nation" and that, therefore, this situation should be regarded as a nullification or impairment of a benefit under the Agreement. The argument would apply, a fortiori, to export subsidies. See Barcelo, "Subsidies and Countervailing Duties - Analysis and a Proposal" (1977) 9 *Law & Policy in International Business* 779-853 at 847.

51 See, eg, Kingery, John C., "The US-Japan Semiconductor Arrangement and the GATT: Operating in a Legal Vacuum" (1988-89) 25 *Stanford Journal of International Law* 467 at 471.

52 *EC - Refunds of Sugar*, complaint by Australia, *BISD*, 26S/290 and *EC - Refunds of Sugar*, complaint by Brazil, *BISD*, 27S/69.

of semiconductors at dumped prices constituted an impairment of a benefit that accrued to the EEC as a result of Japan complying with Article XI:1. However, the EEC made its challenge against Japan only.⁵³ Whatever the theoretical position, there were no decisions of the CONTRACTING PARTIES that applied Article XXIII to a third party situation like that described.

4.4 SUMMARY OF ORIGINAL 1947 RULES ON EXPORT SUBSIDIES

In summary, the original 1947 rules did not prohibit any type of export subsidy nor any type of subsidy at all. Where an export subsidy caused "serious prejudice" to the interest of another party, there was an obligation to discuss the possibility of limiting the subsidy but the agreement did not provide any other remedy for such "serious prejudice". Arguably, the Track II dispute settlement procedure could be applied to certain non-violation export subsidies. However, it was not applied in that way in the early years of the GATT, nor, in fact, at any time since.

Track I countermeasures were permitted under Article VI in response not merely to export subsidies but to any type of subsidy.

5 THE GENERAL REVIEW OF THE AGREEMENT

In October 1953, the parties decided to conduct a general review of the Agreement.⁵⁴ One of the perceived problems with the Agreement was the absence of any regulation of export subsidies. In June 1954, the United Kingdom and West Germany issued a joint statement calling for the abolition of export subsidies.⁵⁵ In particular, some concern had arisen about the USA's use of export subsidies upon agricultural products. The GATT report for 1954, described the various programmes employed by the USA to subsidize the disposal of agricultural surpluses.⁵⁶ Therefore, by the time of the General Review in 1955, a number of parties sought the introduction of stricter disciplines on subsidies and this became one of the most significant aspects of the Agreement considered at the review. The review process was

53 Japan - Trade in Semiconductors, report of the Panel adopted on 4 May 1988 (L/6309) *BISD* 35S/116.

54 See "Arrangements for a Review of the General Agreement" decision of 24 October 1953 *BISD* 2S/28.

55 GATT, *International Trade 1954*, p106.

56 GATT, *International Trade 1954*, p107.

undertaken by four separate working parties reporting to the ninth session of the Contracting Parties between October 1954 and March 1955. The committee on "Other Barriers to Trade" considered subsidies together with state trading and disposal of surpluses.⁵⁷ It reviewed the provisions of Article XVI on subsidies and also the provisions of Article VI on countervailing duties and anti-dumping duties.

5.1 TRACK 1 - 1955 REVIEW OF COUNTERVAILING DUTIES PROVISIONS

Review of the countervailing duty provisions resulted in little change to Article VI.

Before the committee, the Netherlands raised the lack of effective discipline over the effects of subsidies in displacing exports in third country markets. The Netherlands proposed that it should be possible to require contracting parties to impose countervailing duties against subsidized imports from a second country where such subsidized sales cause injury to one or more other parties.⁵⁸ The suggestion was not adopted.

The only proposal that was adopted was one relating to the provision described above for the imposition of countervailing duties without proof of injury to the imposing country's domestic industry in circumstances where a third country's domestic industry is being injured. The waiver of proof of injury to the domestic market was made automatic in some circumstances and unnecessary in others. It would be automatic if the CONTRACTING PARTIES made a finding that there was actual or threatened material injury to a third country's domestic industry.⁵⁹ The waiver would be unnecessary if the injury to the third country industry might be difficult to repair.⁶⁰

5.2 TRACK 2 - THE 1955 REVIEW OF ARTICLE XVI

A number of countries submitted suggestions for amendments to Article XVI.⁶¹ Interestingly, the United States waited until other parties had made their submissions and the

57 See "Other Barriers to Trade" report adopted on 3 March 1955 (L/334 and addendum) *BISD* 3S/222 at 222, para 1.

58 See "Reports Relating to the Review of the Agreement - Other Barriers to Trade", report adopted on 3 March 1955 (L/334 and addendum), *BISD* 3S/222 at 224, para 11.

59 See the second paragraph of Article VI:6(b).

60 See Article VI:6(c).

61 See the list of proposals and statements in favour of strengthening the subsidy provisions in "Subsidies" W.9/20, 18 November 1954 (submitted to Working Party III on Barriers to trade other than quantitative restrictions or tariffs).

review sub-committee had considered them before making its own suggestions in December 1954.⁶²

The deliberations of the committee brought to the surface again the fundamental issue about the extent to which international regulation should restrict sovereignty over domestic economic and commercial policy. Again, the international effects of export subsidies, particularly the USA's agricultural subsidies, brought the matter onto the GATT agenda and, again, the parties had difficulty reaching agreement on the formulation of appropriate rules to balance the tension between protecting a right to subsidize and submitting to international rules to govern the international effects of subsidies. This tension was acknowledged by the Canadian delegate who, acknowledging that surplus stocks and pressure to dispose of them "arose out of internal policies of countries", said

while no contracting party wished to interfere in the internal policies of others, there was no doubt that the CONTRACTING PARTIES had to concern themselves with these policies when they gave rise to difficulties of an international character.⁶³

No doubt the primary concern of the Canadian delegate was the export subsidies of the United States. The USA defended its price support and export subsidy programmes, putting the arguments that:

- subsidized prices were welcomed by some consumers;
- export subsidies expanded consumption in areas where under-consumption existed; and
- export subsidies retrieved markets "lost because of barriers of different kinds".⁶⁴

Even in the statements of Australia and New Zealand which argued for regulation of domestic subsidies as well as export subsidies, there are acknowledgements of a right to subsidize, though qualified. The Australian delegate recognized

that reasonable protection of agriculture was unavoidable, and was willing to entertain measures providing some flexibility from agreed rules on this matter

62 See "Article XVI - Subsidies - Proposed draft presented by the United States Delegation" W.9/103, 15 December 1954 (submitted to Review Working Party III on Barriers to Trade other than Restrictions on Tariffs - Sub-Group III(A) - Subsidies).

63 The Statement of Mr Isbister (delegate of Canada), "Summary Record of the Seventeenth Meeting" (of the Contracting Parties, 9th session) GATT, SR.9/17, 16 November 1954.

64 The statement of Mr Brown (delegate of the USA), SR.9/17, 16 November 1954.

in the same manner that they hoped to have a similar flexibility with respect to quotas and tariffs.⁶⁵

and the New Zealand delegate, before continuing to argue for regulation of domestic subsidies, said:

There could be no outright prohibition of domestic subsidies because they should be available as an alternative protection measure to tariffs.⁶⁶

However, most countries (including Australia and New Zealand) took the view that such rights to control domestic policy had to be balanced against the need to avoid the difficulties that arose from the international effects of subsidies. In particular, the South African delegate took issue with the USA's position that price support policies were a matter of domestic concern only. The report of his statement records:

it was the price support programmes which were the root of the problem. He realized that these were matters of domestic policy and appreciated from his own personal knowledge the difficulty of resisting pressures from influential agricultural groups. The United States, however, played such an important part in the world economy that their actions had repercussions well beyond the borders of the country.⁶⁷

After the chairman of the committee submitted a progress report on the discussions, the Brazilian delegate responded by arguing for a right to subsidize, referring to:

the normal responsibility, and in fact duty of all governments to take measures necessary to place their exports in a position to compete fairly on world markets. The important question before the CONTRACTING PARTIES was the limit to be placed upon this right and duty.⁶⁸

The Brazilian statement placed great stress on leaving governments free to achieve 'non-economic objectives' (as I have previously called them⁶⁹). The statement continued:

There was frequently a disequilibrium between the profits accruing to industry and agriculture and governments must have the possibility of correcting this situation. Where such activities caused damage to other contracting parties, then and only then the CONTRACTING PARTIES should have a right to intervene. The notion of subsidies not as a right but as a duty was insufficiently developed in the Chairman's progress report.

65 The statement of Mr.Crawford (delegate of Australia), SR.9/17, 16 November 1954.

66 The statement of Mr.Johnson (delegate of New Zealand), SR.9/17, 16 November 1954.

67 The statement of Mr Louw (delegate of the Union of South Africa), SR.9/17, 16 November 1954.

68 The statement of Mr.Machado (delegate of Brazil), "Summary Record of the Twenty-third Meeting" (of the contracting parties, 9th session) GATT, SR.9/23 at p8.

69 Note the caution on this terminology above in ch3 at fn 1 and accompanying text.

This drew a response from the Indian delegate who criticized the assertion of a right to subsidize:

Referring to the comments by the delegate of Brazil to the effect that a country had the right to subsidize exports, he remarked that the question was whether it was in the interest of the contracting parties to accept a limitation of their rights in this field. Clearly, if competitive export subsidies were resorted to, the countries with limited financial means would lose, and such countries might do well to hesitate before asserting their rights to subsidize exports.⁷⁰

Despite these disagreements, it appears that there was a wide consensus that subsidies were distorting trade and that it was desirable to reduce the incidence of at least some subsidies. Of all of the statements of the contracting parties recorded⁷¹ or referred to in the Secretariats summary,⁷² only that of Indonesia does not include a call for either banning or reducing at least some subsidies.⁷³

It is less easy to extract from the records of the negotiation a clear consensus on the issue of whether the rules should differentiate between export subsidies and domestic subsidies. Some countries including Germany, Denmark, Belgium,⁷⁴ Greece,⁷⁵ appear to have wanted to restrict the use of export subsidies only. The statements of the delegates of Italy, Canada, France, New Zealand and South Africa expressed concern with domestic subsidies as well as export subsidies.⁷⁶ Also, the Dominican Republic was particularly concerned with domestic subsidies which caused import replacement thereby limiting the Dominican Republic's exports. The New Zealand delegate made the clearest distinction between export subsidies and domestic subsidies. He argued that export subsidies should be prohibited or at least severely restricted whereas domestic subsidies should be subject to strict rules but should be permitted "as an alternative protection measure to tariffs."⁷⁷

Despite these differences, as the negotiation proceeded, its focus became the adoption of additional restrictions on export subsidies. The provisions on export subsidies from the

70 The statement of Mr. Jha (delegate of India), "Summary Record of the Twenty Fourth Meeting" (of the contracting parties) GATT, SR.9/24 at p102.

71 In SR.9/17, SR.9/23.

72 In "Subsidies" W.9/20, 18 November 1954.

73 See the statement of Mr Makatuta (delegate of Indonesia) SR.9/17.

74 SR.9/17.

75 SR.9/23.

76 SR.9/17.

77 Statement of Mr. Johnson (the New Zealand delegate), SR.9/17.

draft ITO Charter became the basis for negotiations. Thus, even though there may not have been an explicit consensus on a clear distinction between export subsidies and domestic subsidies (that is, between border instruments and non-border instruments), the negotiation proceeded to a significant extent upon the basis of that distinction. Perhaps that simply reflected the consensus on tightening regulation of export subsidies and the lack of consensus on tightening regulation of domestic subsidies. Therefore, the outcome of the negotiation was that export subsidies should be regulated more strictly than domestic subsidies.

The question of whether export subsidies as price-based border measures should be treated less strictly than quantity based border measures, appears not to have been raised at all in the debates in either the pre-1948 debates or at the 1955 general review. Apart from the maximum rate of export subsidy referred to in Meade's 1942 proposal, there appears not to have been any proposals for agreeing to reductions of export subsidies or setting maximum rates. It seems that only a prohibition was discussed. As at the sessions of the Preparatory Committee, at the 1955 review, the debate focused on the delineation of the type of export subsidies that would be regulated: whether export incentives other than direct subsidies should be included; whether export subsidies on agricultural products should be treated differently from those on manufactured products; and whether only export subsidies that result in sales below the domestic price in the subsidizing country should be regulated.⁷⁸ However, aside from these matters relating to the scope of regulation of export subsidies, the records of the debate do not evidence any consideration of any other type of regulation other than a prohibition. All of the submissions contemplate a prohibition like that applied to quantitative import restrictions.

With respect to agricultural products, the debate that had occurred in negotiating the ITO Charter was reopened in the 1955 Review session. Some countries wanted to exclude agricultural products from the ban on export subsidies. The drafts submitted by the USA excepted agricultural products from the general ban.⁷⁹ The drafts submitted by both the United Kingdom and Canada followed the Havana Charter provisions closely, recommending a general ban without distinction between types of products but with an

⁷⁸ See "Progress Report By the Chairman of Working Party III" W.9/122, 18 December 1954, p2-3.

exception for systems for the stabilization of prices of primary products (or of returns to primary producers).⁸⁰

Greece,⁸¹ France and India⁸² strongly opposed applying one set of rules to manufactured products and another to agricultural products. France said that "the same regime should apply to all goods whether industrial or agricultural."⁸³ Remember that the General Review took place before the creation of the EEC and the CAP. France did not then have the surpluses that it would later have, so it was less interested in protecting the right to subsidize agriculture than in protecting its export markets from competition from subsidy generated surpluses from the USA. France's resistance to creating separate export subsidy rules for agriculture would partly have stemmed from its view of the unfairness that was emerging from GATT treatment of the United States' agricultural policies. It had already been established in the ongoing US-Netherlands dairy dispute that the USA's import barriers to support programmes under its *Agricultural Adjustment Act* agricultural support programmes were not GATT consistent.⁸⁴ However, the United States had applied for a waiver to enable it to continue to apply those import restrictions.⁸⁵ It was foreseeable that the existence of those import restrictions in the United States would continue to result in agricultural surpluses. If the proposed prohibition on export subsidies were not to apply to agriculture, then the United States would be able to use export subsidies to deal with the surplus production that was a consequences of its own GATT-inconsistent import restrictions.

The existence of surpluses in the USA was crucial to the outcome of the negotiation. In opposing the application of an export ban to agricultural products, the USA refused to be placed in the

position of being the ultimate residual supplier, after all other countries had disposed of their production,⁸⁶

79 GATT, W.9/103, 15 December 1954, paragraph 2.

80 UK proposal, GATT, W.9/104, 16 December 1954; Canadian proposal, GATT, W.9/119, 17 December 1954.

81 Statement of Mr. Bitsos (delegate of Greece); SR.9/23.

82 Statement of Mr. Jha (delegate of India); SR.9/24, p.102.

83 Statement of Mr. Philip (delegate of France); SR.9/23 at p.7-8.

84 GATT *BISD*, Vol II, p16. See, within, chapter 10, pp213-214.

85 GATT *BISD* 3S/32.

86 Statement of Mr. Brown (delegate of the USA); SR.9/17.

which was the position it saw itself as being in if it was prohibited from using subsidies to dispose of its surpluses. This argument bears a striking similarity to the attitude later used by the EEC in the Uruguay round.⁸⁷ It denies the argument that since the problem of surpluses was caused by the USA's own policies, that the burden of the effects of the surpluses should fall upon the USA. The US delegate went on to say that the surpluses had to be liquidated "in a manner which would avoid injury to the competitive position of producing countries"⁸⁸ but when other parties argued for an amendment to the agreement to formalize this commitment, the USA opposed it.⁸⁹ The final report of the working party (Review Working Party III) reported that no agreement had been reached on an amendment for disposal of surpluses.⁹⁰

The final report did submit an amendment of Article XVI.⁹¹ The amendment was close to the USA's position.⁹² The amendment did distinguish between primary and non-primary products. The exemption of primary products from the general prohibition was not made subject to the obtaining of any approval from other parties. During the debate which adopted the report, Australia, New Zealand, Denmark, Cuba, Burma, South Africa, Italy and France all denounced the distinction and the consequent soft treatment of export subsidies on agricultural products.⁹³

However, the parties did adopt a provision limiting the effects of agricultural export subsidies similar to the provisions that had been included in the Geneva Draft ITO charter and the Havana Charter. Parties' freedom to subsidize the export of agricultural products was to be limited to the extent that the subsidies did not result in the subsidizing party achieving more than an equitable share of world export trade. The "equitable share" criterion was subjected to considerable criticism. Australia criticized the adoption of the "concept that subsidies that did not result in more than an equitable share were all right".⁹⁴

87 See below, ch17, at sections 4.2, 4.2 & 6.4.

88 Statement of Mr Brown (delegate of the USA), SR.9/17.

89 "Report Relating to the Review of the Agreement, Other Barriers to Trade", report adopted on 3 March 1955 (L/334, and Addenda), *BISD*, 3S/222 at 229, para 30-32.

90 At 229, para 32.

91 At 226, para 17.

92 Report of Review Working Party III (L/334 and Corr.1 and Add.1)

93 Summary Record of the Forty-First Meeting, SR.9/41, 15 March 1955, Aust. at p3, NZ at p2 & 5, Denmark at p4, Cuba at p4-5, South Africa at p5, Italy at p5, and France at p6.

94 Statement of Mr.Crawford (delegate of Australia), SR.9/41 at p4.

Canada was concerned that the provision should not be interpreted to mean that an exporting country which used export subsidies on primary products "but had not gained more than an equitable share of world trade was not therefore to blame."⁹⁵

That the threshold of unlawful trade effects was set as high as "more than an equitable share of world export trade" was also criticized. A number of countries argued that "equitable share of individual markets" would have been more appropriate because the greatest danger of damage was in individual markets.⁹⁶ Australia proposed and subsequently withdrew an amendment to refer to individual markets. Then France and Uruguay proposed the same amendment but it was not adopted, principally because the USA said it was unnecessary. When the report was adopted the French delegation (with the support of Uruguay, the Dominican Republic, Canada, Australia and Italy) expressed the view that

the regulations relating to agricultural export subsidies, weak as they were, would lose all value if they did not prevent such subsidies from destroying the position of another exporter in individual markets. The amendment had been opposed on the grounds that it was unnecessary since the text adopted was clear. His delegation would have preferred that the point be made explicit but would be satisfied if the record shows that his delegation accepted the paragraph only on the understanding that "world markets" included the concept of "individual markets" and that the CONTRACTING PARTIES as a whole accepted that interpretation.⁹⁷

However, the USA refused to insert an agreed interpretation into the record.

The final result of the negotiation was that the distinction between export subsidies and domestic subsidies was severely compromised by the pressure to make special allowance for the USA's agricultural price support programmes.

95 Statement of Mr.Larre (delegate of Canada), SR.9/41 at p6.

96 Statement of Mr.Crawford (delegate of Australia) SR.9/41 is recorded as, "Moreover, by referring to equitable "shares of world trade" and not of "individual markets" the Article sought to solve the problem of primary products from the wrong end, since the danger of export subsidies was greatest in individual markets. It was possible to argue that notwithstanding damage being done by subsidization in individual markets a country's total share of world exports was not being increase. Mr. Crawford would forecast considerable difficulty in securing any limitation of subsidies on primary products with this formula."

97 Record of statement of Mr.Larre (France), SR.9/41, p.6.

The position of the parties at this stage in the history carries some irony into consideration of their positions at later times, during the Tokyo round and the Uruguay round.⁹⁸ It is worth noting that in 1955: it was the United States that wanted a wide freedom to subsidize and France, Germany and Italy that wanted to limit it; it was the United States that was the principal instigator of special treatment for export subsidies on agricultural products; it was the United States that sought the wide standard relating to world trade instead of individual markets and France and Italy that wanted to protect their particular export markets from the USA's surpluses; it was the European countries asking the United States not to inflict the consequences of the USA's surpluses on the rest of the world and the USA refusing to take all of the burden itself.

6 THE RULES FOLLOWING FROM THE 1955 GENERAL REVIEW

6.1 TRACK 1 - ARTICLE VI - COUNTERVAILING DUTIES

As mentioned above, the General Review did not result in any major change to the countervailing duty provisions in Article VI. The changes made it easier to impose countervailing duties where a third country was injured. However, none of the provisions deriving from the original agreement were removed. There was still no distinction as to the type of subsidy that could trigger the use of countervailing duties: importantly, no distinction between export subsidies and other subsidies.

6.2 TRACK 2 - ARTICLE XVI SECTION B - ADDITIONAL PROVISIONS ON EXPORT SUBSIDIES

The outcome of the negotiation at the General Review was the insertion of Section B into Article XVI.⁹⁹ The existing Article XVI became Article XVI:1, the sole content of Section A of Article XVI headed "Subsidies in General". New paragraphs 2 to 5 became Section B of Article XVI, headed "Additional Provisions on Export Subsidies". Paragraph 2 is only a policy statement and paragraph 5 is only an obligation to review. The substantive provisions are in paragraph 3 on primary products and paragraph 4 on non-primary products.

98 See the similar observation in Montana-Mora, Miguel, "International Law and International relations Cheek to Cheek: an International Law/International Relations Perspective on the US/EC Agricultural Export Subsidies Dispute" (1993) 19 *NCJ Int'l L & Com Reg* 1-60 at 15-16.

99 See *Protocol Amending the Preamble and Parts II and III of the General Agreement on Tariffs and Trade*, done 10 March 1955, in force 7 October 1957, TIAS No 3930; 278 UNTS 168.

Primary/Non Primary Products

The distinction upon the basis of product was made not upon the basis of agricultural and non-agricultural products but rather upon the basis of primary and non-primary products. The adoption of the term "primary" meant that not only agricultural but also mineral products were exempt from the general ban on export subsidies.¹⁰⁰ The term "primary" included not only products in their natural form but also products which have "undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade".¹⁰¹

The Rule on Export Subsidies on Primary Products - Article XVI:3

As discussed above, with respect to export subsidies on primary products, Article XVI:3 fell short of imposing a prohibition.¹⁰² Instead, Article XVI:3 contains an obligation "to seek to avoid the use of subsidies on the export of primary products" and, as discussed above, it imposes a restriction on the extent to which those export subsidies can be utilized, judged according to their effects. They cannot be applied

in a manner which results in [the subsidizing] party having more than an equitable share of world export trade in [the subsidized] product".

The provision provides some guidance as to the meaning of the word 'equitable'. It says that, in determining what is an equitable share, account should be taken of

- (1) shares of world trade in previous representative periods; and
- (2) special factors that have been or are affecting trade in the product.¹⁰³

An interpretative note establishes that a party can establish an equitable share of world trade even if it has not exported any of that product in previous periods.¹⁰⁴ Clearly, however, the

100 See Interpretative Note to Article XVI, Section B, para 2.

101 See Interpretative Note to Article XVI, Section B, para 2.

102 The text of Article XVI:3 is: "Accordingly, contracting parties should seek to avoid the use of subsidies on the export of primary products. If, however, a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product."

103 Article XV:3.

104 Interpretative Note Ad Article XVI paragraph 3 clause 1.

adoption of "more than an equitable share" as the defining criterion for a violation introduced an element of uncertainty into the provision.

The 1955 Working Party report, recommending the insertion of Article XVI:3, itself acknowledged the difficulties in determining what was an equitable share and recorded the agreement of the Working Party that

in determining what are equitable shares of world trade the CONTRACTING PARTIES should not lose sight of:

- (a) the desirability of facilitating the satisfaction of world requirements of the commodity concerned in the most effective and economic manner, and
- (b) the fact that export subsidies in existence during the selected representative period may have influenced the share of the trade obtained by the various exporting countries.¹⁰⁵

The second paragraph reflects a concern that the previous representative period should not be a period during which the share of the country whose export subsidies were under scrutiny had been inflated by those same export subsidies. However, the parties had declined to insert any interpretative note in the agreement to that effect.

The adoption of a rule based on the effects of policies rather than simply on the type of policy instrument introduced two other legal problems. First, it necessitated the determination of a question of causation; whether the share of world export trade had "resulted" from the subsidy. Secondly, it introduced some imprecision as to what recommendation the CONTRACTING PARTIES could make in the event that they found a violation of Article XVI:3. The adoption of the "more than an equitable share" standard implied that the CONTRACTING PARTIES could authorize countermeasures if the party in breach failed to reduce export subsidies to the extent sufficient to reduce its share of world export trade to an equitable share. One wonders whether it was expected that the CONTRACTING PARTIES would be able to nominate levels of export subsidies which would result in equitable shares of world trade.

105 "Other Barriers to Trade" report of the Review Session Working Party adopted by the CONTRACTING PARTIES on 3 March 1955, GATT *BISD* 3S/222 at 226, para 19.

The Prohibition on Export Subsidies on Non-Primary Products - Article XVI:4

With respect to non-primary products, Article XVI:4 applied a prohibition on export subsidies that result in the sale of the product "at a price lower than the comparable price charged for the like product in the domestic market." The two price criterion is often called the two-price or dual price test. In practice, this test adds little. Generally, an export subsidy whose payment is contingent on export will infringe the two-price test but a production subsidy whose payment is not so contingent will not. Arguably then, the adoption of the two-price test was an imprecise way to adopt a definition of export subsidy.¹⁰⁶ The prohibition is absolute in the sense that it applies regardless of the size, scope or effects of the subsidy programme.

The Asymmetry of Articles XVI:3 and XVI:4 in Practice

Looking only at the texts of the two rules, one sees a strict rule applying to non-primary products and a lax rule applying to primary products. However, the practical application of the two rules was quite different to that.

Since some parties did not intend to apply the export subsidy ban to non-primary products until a similar ban was introduced for primary products, Article XVI:4 was drawn to become binding on parties "as from 1 January 1958 or the earliest practicable date thereafter." Because of the delay of the commencement date, the paragraph also included a standstill obligation not to introduce new subsidies or extend old ones in the interim period. The standstill obligation was worded to apply until 31 December 1957. This standstill obligation lapsed at the end of 1957. This was remedied by a series of annual declarations extending the expiry date through to the end of 1960.¹⁰⁷ However, these Declarations were only accepted by 16 of the contracting parties. Finally, to remove the need for further extensions and to remove the uncertainty as to which parties were bound, some of the

106 See Hufbauer & Erb, *Subsidies in International Trade* (Institute for International Economics, Washington DC 1984) pp46 & 47; and Rivers & Greenwald, "The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences" (1979) 11 *Law & Policy in International Business* 1447-1495 at 1461. Some export subsidies may not be caught by this two price test if the producers have some monopolistic control over prices: see Snape, R.H., "International Regulation of Subsidies" (1991) 14(2) *The World Economy* 139-164 at 149 fn 1.

107 "Extension of Standstill Provisions of Article XVI:4", Declaration of 30 November 1957, *BISD*, 6S/24; "Extension of the Standstill Provisions of Article XVI:4", Proces-Verbal of 22 November 1958, *BISD*, 7S/30; and Proces-Verbal of 19 November 1959, 8S/25.

parties entered into a "Declaration Giving Effect to the Provisions of Article XVI:4".¹⁰⁸ However, only a small group of industrialized countries became parties to the declaration.¹⁰⁹ To pick up parties that had not brought Article XVI:4 into effect, the standstill obligation was extended a few more times by various instruments. The last extension which ran to the end of 1967 was signed by only one party. When it expired, only 17 parties had put Article XVI:4 into effect.¹¹⁰

All of the industrialized countries that were in accord with the distinction between primary and non-primary products became parties to the Declaration. Those of the industrial countries that were exporters of primary products and had opposed the distinction also became parties to the declaration. However, the developing countries, all of which opposed the different treatment of primary and non-primary products did not become parties to the Declaration and neither did any subsequently acceding state except Switzerland.¹¹¹ Those countries that were not parties to the declaration had effectively deferred indefinitely the assumption of the obligations of Article XVI:4.

In consequence, the pre-Uruguay Round Article XVI rules on export subsidies had an operation which was not only asymmetrical but was quite different to the operation that the text would suggest. In practice:

- in relation to non-primary products, industrial countries were prohibited from subsidizing exports but developing countries were free to do so; and
- in relation to primary products, both industrial and developing countries were free to subsidize exports (subject to the not more than equitable share constraint).

The practical variation of the rules occurred because there had not been a consensus for the differentiated treatment of primary and non-primary products.

108 "Declaration Giving Effect to the Provisions of Article XVI:4 of the GATT", declaration of 19 November 1960, 9S/32.

109 The original parties were Austria, Belgium, Canada, Denmark, France, Federal Republic of Germany, Italy, Luxembourg, the Netherlands, Norway, Sweden, Switzerland, United Kingdom and the United States of America. Later, Japan, New Zealand and Zimbabwe (at the time called Southern Rhodesia) became parties. Source: *GATT Status of Legal Instruments* p11-4.1ff. See also GATT, *Analytical Index* pp422-423.

110 See GATT, *Analytical Index*, pp423. See also Jackson, (1969), p.372-375.

111 Jackson, (1969), p.375-6.

Export Subsidies and Domestic Subsidies

It is worth pausing to note the way these two provisions incorporated the important distinctions between export subsidies and other subsidies.

The original Article XVI which became Article XVI:1 applies broadly to any type of subsidy which operates either to reduce imports or to increase exports and regardless of whether it does so directly or indirectly. The range of application of Section B is more limited. Article XVI:3 is expressed in terms of

any form of subsidy which operates to increase the export of any primary product

and Article XVI:4 is expressed in terms of

any form of subsidy on the export of any product other than a primary product.

It seems that the wording of Article XVI:4 could only apply to a subsidy paid contingent on export and not to a domestic subsidy which results in a surplus which is exported. The wording of Article XVI:3, however, is not as clear and it, arguably, could apply to a domestic subsidy which results in a surplus that is exported.¹¹²

Article XVI did not provide a definition of export subsidy. However, those parties that put Article XVI:4 into effect agreed on a non-exhaustive list of measures that were to be regarded as subsidies for the purposes of Article XVI:4.¹¹³ The list did not make any reference to subsidies contingent upon export rather than production.

112 In support of this view, see Jackson (1969) at 393.

113 "Subsidies - Provisions of Article XVI:4" report adopted on 19 November 1960, (L/1381) *BISD* 9S/185, para 5. The list comprised:

- (a) currency retention schemes or any similar practices which involve a bonus on exports or re-exports;
- (b) the provision by governments of direct subsidies to exporters;
- (c) the remission, calculated in relation to exports, of direct taxes or social welfare charges on industrial or commercial enterprises;
- (d) the exemption, in respect of exported goods, of charges or taxes, other than charges in connexion with importation or indirect taxes levied at one or several stages on the same goods if sold for internal consumption; or the payment, in respect of exported goods, of amounts exceeding those levied at one or several stages on these goods in the form of indirect taxes or of charges in connexion with importation or in both forms;
- (e) in respect of deliveries by governments or governmental agencies of imported raw materials for export business on different terms than for domestic business, the charging of prices below world prices;

An interpretative note to Article XVI:3 excluded from the scope of the meaning of subsidy, for the purposes of that Article, certain schemes to stabilize returns to domestic producers.¹¹⁴ This implicitly recognized such schemes as a matter within domestic policy that should not be constrained by the GATT rules on export subsidies. However, the exclusion was tightly defined and, in particular, did not apply if the stabilization scheme was financed to any extent by the government.

Products Processed from Primary Products

One practical complication of having different rules for primary and non-primary products is that it is necessary in respect of each export subsidy to make a determination of which product is being subsidized. If a high internal price is maintained for a primary product and a subsidy is paid to purchasers of a primary product to compensate them for the higher price of that product, who is receiving the benefit of the subsidy? The purchasers of the product are no better off than they would have been had the internal price of the primary product been the same as the price of that product from foreign sources. Is it the producer of the primary product that is receiving the benefit of the subsidy or is it the producer of the processed product that needs to purchase the primary product? If it is the primary product that is being subsidized then it is the rules on primary products that apply. If it is the non-primary product processed from the primary product which is regarded as receiving the subsidy then the rules on non-primary products that apply. The rules on non-primary products would prohibit the subsidy if it were a "subsidy on the export of the product" within the terms of Article XVI:4. It would certainly fall within the terms of Article XVI:4 if it were only paid in respect of product that was exported. On the other hand, a subsidy for the purchase of a primary product input that was paid irrespective of whether the product processed from it was exported would not have fallen within the terms of Article XVI:4.

Therefore, one of the effects of having different rules for primary and non-primary products was that whilst an export subsidy was permissible on a primary product, it was not

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- (f) in respect of government export credit guarantees, the charging of premiums at rates which are manifestly inadequate to cover the longterm operating costs and losses of the credit insurance institutions;
 - (g) the grant by governments (or special institutions controlled by governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed;
 - (h) the government bearing all or part of the costs incurred by exporters in obtaining credit.

permissible on the primary product content of a processed product. Therefore, if the maintenance of export subsidies on primary products rendered producers of products incorporating those primary products uncompetitive, it was not permissible to use export subsidies to assist them. For this reason, the United States ratification of the Declaration applying Article XVI:4 was made subject to a reservation, called an "understanding", that the Declaration

shall not prevent the U.S., as part of its subsidization of exports of a primary product (not itself a primary product), which has been produced from such primary product, if such payment is essentially limited to the amount of the subsidy which would have been payable on the quantity of such primary product, if exported in primary form, consumed in the production of the processed product.¹¹⁵

This further eroded the prohibition on export subsidies on non-primary-products at least for the United States, probably for all parties in respect of their obligation owed to the USA, and possibly generally.¹¹⁶ Some other countries adopted the same 'understanding' as the United States and paid export subsidies on products which incorporated primary products.¹¹⁷

7 OPERATION OF THE RULES BETWEEN 1955 AND 1979

During this period, there were only three disputes over export subsidies on agricultural products that proceeded to panel reports. Consideration of the second and third of those can be undertaken more fruitfully after presentation of the impact of the Tokyo Round. The first is dealt with below.

114 See clause 2 of "Interpretative Note Ad Article XVI, Paragraph 3".

115 445 UNTS 294, 303 (1962); GATT, *Status of Legal Instruments* (GATT/LEG/1)11 - 4.2 (1971); see Coccia, Massimo, "Settlement of Dispute in GATT under the Subsidies Code: Two Panel Reports on EEC Export Subsidies" (1986) 16 *Georgia J Int Law* 1-44 at 33; and see also *EEC - Subsidies on Export of Pasta Products*, report of the panel, SCM/43 (not adopted) p5, paras 2.15 - 2.18.

116 Although the qualification was called an understanding rather than a reservation, it seems to have been a reservation rather than a statement of interpretation. If the reservation was accepted or tacitly accepted by other parties, then the effect would have been to limit the obligation of the party making the reservation and the obligation of such other parties owed to the party making the reservation. This rule of treaty law was subsequently adopted in Article 20 of the *Vienna Convention on the Law of Treaties*. It may have been possible to establish that subsequent practice had established a customary rule applicable to all parties reflecting the USA reservation. See the argument made by the EEC in the Pasta case (see below ch 13 under the heading "10.2.4 The EEC Pasta Case"). Generally on the impact of practice on treaty rules, see McGinley, Gerald P., "Practice as a Guide to Treaty Interpretation" (1985) *The Fletcher Forum* 211-230.

117 See the arguments by the EEC in *EEC - Subsidies on Export of Pasta Products*, SCM/43, 19 May 1983 report of the panel (not adopted) p10, para 3.12.

7.1 THE 1958 PANEL REPORT ON FRENCH EXPORT SUBSIDIES ON WHEAT AND WHEAT FLOUR

A dispute arose under Article XVI:3 in 1958. The dispute involved French assistance to exports of wheat and wheat flour.¹¹⁸ A panel report and the recommendation of the panel were adopted by the CONTRACTING PARTIES on 21 November 1958.¹¹⁹ One must be careful to read the report in the context of the stage of development at which the law was in relation to the interpretation of Article XXIII and the concept of nullification or impairment. The panel report found that there was a violation of Article XVI:3. This finding on Article XVI:3 became less authoritative and influential over subsequent years. Another aspect of the case, though, had substantial influence over the later application of Article XVI:3 and over negotiations to improve the operation of that Article. This was the emphasis given to displacement of the exports of other parties from their pre-existing export markets.

In this case, a body called the Office National Interprofessionnel des Cereales ('ONIC') exercised a monopoly on import and export of wheat and wheat flour in France.¹²⁰ Producers could sell wheat, up to an allocated quantum, to ONIC at a guaranteed internal price (subject to deduction of a tax levied on deliveries within the quantum at a progressive rate).¹²¹ For production outside the quantum, producers would receive only the price which was obtained on resale by ONIC plus an additional '*ristourne*' (payment) which was determined by a tender process between ONIC and exporters.¹²² Effectively, the *ristourne* would compensate the producer for the amount by which the actual sale price on world markets was less than the French guaranteed price.¹²³ In respect of exports of wheat flour, a *ristourne* was also payable. The amount of the *ristourne* on wheat flour was higher than the amount of *ristourne* on wheat presumably because the gap between the French domestic

118 On this dispute, see Hudec, *The GATT Legal system and world Trade Diplomacy* p101; Hudec, *Enforcing International Trade Law* case no 50 in Appendix/Part 1, p385 at 443-444; Boger, "The United States-European Community Agricultural Export Subsidies Dispute" (1984) 16 *Law & Policy in International Business* 173-238 at 201-203.

119 "French Assistance to Exports of Wheat and Wheat Flour" report adopted on 21 November 1958 (L/924) GATT, *BISD* 7S/46; and "French Assistance to Exports of Wheat and Wheat Flour" recommendation of 21 November 1958 GATT, *BISD* 7S/22.

120 GATT, *BISD* 7S/46 at 47, para 4.

121 As above.

122 GATT *BISD* 7S/46 at 48, para 5.

123 As above.

price and the world price was larger for wheat flour than for wheat.¹²⁴ The *ristourne* was partly financed by taxes on producers and partly by the French government.¹²⁵

The panel divided its task into three steps:

- (i) to determine whether the French system did amount to a subsidy on exports within the meaning of Article XVI:3;
- (ii) to determine whether the subsidy had resulted in a violation of Article XVI:3; and
- (iii) to determine whether the subsidy amounted to an impairment of a benefit accruing directly or indirectly under the Agreement to Australia.

This panel was decided at a time before the CONTRACTING PARTIES had standardized the terms of reference for panels so the division into the above of tasks is more a reflection of the way that Australia made the complaint than of any direction by the CONTRACTING PARTIES or any decision by the panel itself. With the benefit of hindsight, two aspects of the way that the panel dealt with the application of Article XXIII stand out. First, the panel decision was made before the law had developed a presumption that violations of the Agreement constituted nullification or impairment and, indeed, after finding that there was a violation, the panel proceeded to assess whether there was any impairment without the guidance of any presumption. Second, the panel seems to have proceeded on the basis that in order to find the existence of nullification or impairment, it was necessary to find actual injury to the trade of the complaining party. Such an approach no longer has any authority.¹²⁶

The first question was resolved easily. It was simply a matter of noting that the assistance was partly financed by the French government and that, therefore, the assistance was not excluded from the coverage of Article XVI:3 by the exemption in the interpretative note for stabilization schemes.

The panel does not even consider whether flour is or is not a primary product. They proceed on the basis that it is. Therefore, implicitly, the panel is finding that flour is a primary

124 GATT *BISD* 7S/46, para 5(c) at 48.

125 GATT *BISD* 7S/46, para 4 at 47 & para 12 at 52.

126 See the cases (Superfund case, Oilseeds case) cited in GATT, *Analytical Index* (6th ed) pp609-610 under the heading "Relevant of Trade Effects".

product in its natural form or that flour is wheat "which has undergone such processing as is customarily required to prepare it for marketing in substantial quantities in international trade". Given that the milling of wheat is not actually required in order for it to be traded internationally, the panel seems to be implicitly making a decision which is contrary to the wording of the interpretative note. It is, however, the first stage of processing and a fairly basic form of processing.

To answer the second question, the panel noted the absence of any definition of "equitable" share of world markets.¹²⁷ It also noted that the reference to "equitable share" related to the world market not to individual markets.¹²⁸ The panel considered statistical evidence of the absolute amount and the relative share of French exports in world trade in wheat and wheat flour. With respect to wheat, the panel noted that French exports amounted to 7.4% of world wheat trade for the period January to June 1958 and that this was substantially larger than the relevant figure for any year since 1934. Of the earlier years, the figure was below 3% for each year except for 1934 when it was 5.9% and 1950 when it was 3.9%. The panel found that, from 1954, there had been an increase in French exports of wheat and wheat flour in absolute quantities and as a share of world exports.¹²⁹

The panel also compared French export prices with those of other exporters. The panel reviewed statistics comparing French export prices with those of Australia, Canada, the Federal Republic of Germany, Sweden and the United States.¹³⁰ With respect to wheat exports, the statistics showed that, for 1957, French export prices were below those of its major competitors but only very marginally so in the case of Australia's. For 1954, 1955 and 1956, French export prices were comparable with but in some cases more than the prices of its major competitors, Canada, United States and Australia. With respect to exports of wheat flour, the statistical evidence was clearer. In 1954, the French export price was below that for all of the other countries for which prices were quoted except Australia and for 1955, 1956 and 1957, the French export price was significantly below that for all of the other countries quoted.

127 GATT *BISD* 7S/46, at 52, para 15.

128 As above.

129 GATT *BISD* 7S/46, at 53, para 17.

130 GATT *BISD* 7S/46, see Table 2 at 50.

Then the panel looked at evidence of import prices in particular countries. Although this might appear to be inconsistent with the panel's stated concern with the world market rather than individual markets, the panel looked at the prices in individual markets solely for the purpose of determining whether the increase in France's share of world trade had resulted from the subsidy scheme. The evidence showed the import prices in Ceylon, in Malaya and Singapore (which for the purpose of the statistics were regarded as a single country), and in Indonesia for imports from various exporters including France and Australia.¹³¹ These statistics showed that the price of French exports to each of the three countries was below the average import price for that country. In addition, with a small number of exceptions, the French export price was the lowest for each country for each of the years, 1954 through to 1957 and for the first half of 1958.¹³² The panel found that the statistical evidence showed that France had been able to sell at prices below other exporters.¹³³

The panel concluded:

it is reasonable to conclude that, while there is no statistical definition of an "equitable" share in world exports, subsidy arrangements have contributed to a large extent to the increase in France's exports of wheat and of wheat flour, and that the present French share of world export trade, particularly in wheat flour, is more than equitable.¹³⁴

Two findings are implicit in that conclusion: one relating to whether the size of the French share in world trade was "more than equitable"; and a second relating to whether France's share of world trade had been caused by the export subsidies. In subsequent disputes, panels have been unable to make the findings reached in this case. However, here, the panel did decide that the French share of world export trade for both products was "more than equitable" and the panel did decide that the existence of the French share of world export trade had resulted from the French export subsidy system.

131 GATT *BISD* 7S/46, See Table A of the Appendix at 58.

132 For Ceylon, in 1954 the French price was equal lowest with the export price from Belgium-Luxembourg, and in 1957, the Australian price was marginally lower than the French but the French price was the lowest for 1955, 1956 and 1958. For Malaya and Singapore, in 1954, the French price was second lowest to a substantially lower price from the Netherlands, and in 1956, 1957 and 1958, the French price was second lowest to a slightly lower German price. France had entered the Indonesian market in 1957 and had thereafter supplied the lowest price imports. See Table A of the Appendix at p58 of GATT *BISD* 7S/46.

133 GATT *BISD* 7S/46, at 53, para 18.

134 GATT *BISD* 7S/46, at 53, para 19.

After making those findings, the panel proceeded to the third question, that of nullification or impairment. It did so by asking whether the subsidy system had:

caused injury to Australia's normal commercial interests, and whether such an injury represented an impairment of benefits accruing to Australia under the General Agreement.¹³⁵

That manner of proceeding would become inconsistent with later jurisprudence on Article XXIII under which it would be presumed that a violation causes nullification or impairment.¹³⁶

In this context, the panel analyzed whether Australian exports of wheat flour to particular South East Asian markets had been displaced by French exports. The panel considered statistics, supplied by Australia, showing the absolute size and the percentage share of wheat flour exports of France, Australia and other suppliers to each of Ceylon, Malaya and Singapore together and Indonesia. France offered statistical evidence of Australian production and exports of wheat which showed some correlation between declines in tonnage of Australian wheat exports and declines in tonnage of Australian production to some extent in 1956/57 and particularly in 1957/58. France argued that Australia's reduced share of exports in South East Asia had not been caused by French exports but by Australia's inability to supply due to two consecutive short crops".

The panel considered the evidence and found that Australia had been injured in two ways. Firstly, it noted that:

- (1) between 1953/54 and 1957/58, the proportion of total French export sales of wheat flour to the whole world that had been that exported to the three South East Asian markets had increased from 13% to 34% while the proportion of Australia's total

135 GATT *BISD* 7S/46, at 54, para 20.

136 See McGovern, E., "Remedies for Subsidies" ch7 in Bourgeois, Jacques H.J., *Subsidies and international trade: a European lawyers' perspective* (Kluwer Law and Taxation, Deventer, Boston, 1991) pp157-174 at 159 (saying that the panels approach of considering nullification or impairment separate from its determination of a violation "is now obsolete"); Martha, Rutsel Silvestre J. "Presumptions and Burden of Proof in World Trade Law" (1997) 14(1) *J Int Arb* 67 at 75-81; & also Roessler, Frieder, "The concept of Nullification and Impairment in the Legal System of the World Trade Organization" in Petersmann, Ernst-Ulrich, *International Trade Law and the GATT/WTO Dispute Settlement System* (Kluwer, London, 1997) pp123--142 at p127 (saying that the presumption of nullification or impairment in cases of violations was never rebutted and was generally treated as irrebuttable).

export sales of wheat flour to the whole world that had been exported to those three markets had decreased from 64% to 50%;¹³⁷ and

- (2) between 1954 and the first half of 1958, of the total imports of wheat flour into the three South East Asian markets, France's share had increased from 0.7% to 46% while Australia's share had decreased from 83% to 37%;¹³⁸

and concluded that "French supplies [had] in fact to a large extent *displaced* Australian supplies in the three markets".¹³⁹ The panel was able to reach this conclusion even though it acknowledged that to some extent other suppliers of wheat flour may have displaced Australian exports to these markets. In this consideration of injury, the panel did not consider any evidence of change in Australia's share of the total world markets for wheat or wheat flour.

In addition, the panel found that Australia had been injured in a second way that arose from the influence of the French supplies on the differential between wheat prices and wheat flour prices. The panel found that the margin of wheat flour prices above wheat prices had narrowed and that, in consequence, Australia had exported wheat which would have otherwise been transformed into wheat flour and been available for export in that form.¹⁴⁰ The panel concluded, therefore, that even if part of the displacement of Australia's exports of wheat and wheat flour had been caused by the shortfall in its own wheat production rather than by subsidized French exports, the French subsidized exports had still caused Australia to export wheat instead of wheat flour thereby losing an amount equal to the difference between the prices of wheat and wheat flour for the volume of wheat flour displaced by French exports.¹⁴¹ The analysis considered only the price differential and did not consider milling costs or profit margins.

The panel made no explicit finding that a benefit accruing to Australia under the Agreement had been impaired but it appears to have reached that conclusion. The panel submitted a recommendation which was adopted by the CONTRACTING PARTIES. It was mentioned

137 GATT *BISD* 7S/46, at 54, para 23(a).

138 GATT *BISD* 7S/46, at 54-55, para 23(b).

139 GATT *BISD* 7S/46, at 55, para 23(c) (emphasis added).

140 GATT *BISD* 7S/46, at 55, para 23(d).

141 GATT *BISD* 7S/46, at 55, para 23(e).

above that the adoption, in Article XVI:3, of a standard based on effects rather than choice of instrument introduced significant uncertainty into the way that Article XXXIII might operate in relation to Article XVI:3. In this case, the recommendation of the CONTRACTING PARTIES did not refer to the violation of Article XVI:3. It did not refer to the equitable share standard. Instead, the recommendation asked France to consider appropriate measures to avoid the "adverse effects" of the system of payments upon Australian exports to South East Asia.¹⁴² According to Hudec, the dispute was settled by an agreement between France and Australia "said to involve" a procedure for consulting on prices.¹⁴³

It has been argued that the French Wheat Flour case was decided upon the basis of displacement of exports in particular individual markets.¹⁴⁴ As Jackson notes

while the Working Party concluded that there was a violation as the result of an increase in the equitable share of the "world market", its final recommendation concerns only South East Asia.¹⁴⁵

However, on the face of the panel report, the decision as to whether a violation existed was made upon the evidence relating to world trade. On the face of the report, the evidence about displacement in particular markets was considered only in relation to determination of whether the violation had been accompanied by such injury and trade effects as amounted to an impairment of a benefit accruing to Australia under the Agreement. In subsequent years, it would become the accepted view that this later inquiry was not necessary except perhaps with a view to rebutting the presumption that a violation does cause nullification or impairment.¹⁴⁶

142 "French Assistance to Exports of Wheat and Wheat Flour" recommendation of 21 November 1958, *BISD* 7S/22-23.

143 See Hudec, *Enforcing International Trade Law* p444.

144 See Estabrook, Jeffrey S., "European Community Resistance to the Enforcement of GATT Panel Decisions on Sugar Export Subsidies" (1982) 15(2) *Cornell International Law Journal* 397-427 at 405; Rivers, Richard B., & Greenwald, John D., "The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences" (1979) 11 *Law & Policy in International Business* 1447-1495 at 1461, fn77.

145 Jackson, *World Trade and the Law of GATT* p395. The writer notes that Jackson uses the term 'Working Party'. Hudec (1991) refers to the 'panel' being established by the Intersessional Committee citing IC/SR.38. The body writing the report (L/924) identifies itself as the Panel for Conciliation, see *BISD* 7S/46 at 46.

146 See the cases cited in GATT, *Analytical Index* (6th ed) pp609-610 under the heading "Relevance of Trade Effects" and the articles cited above at footnote 136.

7.2 THE EEC SUGAR CASES

Two further complaints under Article XVI:3, known as the EEC sugar cases, were made in 1978 and decided respectively in 1979 and 1980. Although the complaints were made before the end of the Tokyo Round, the panel reports relied substantially on interpretations of Article XVI:3 adopted in the course of negotiating the Tokyo Round *Subsidies Code* even though that Code was not binding on the parties in the disputes. Although the complaints were made and the disputes decided under Article XVI:3 only, since interpretations embodied in the *Subsidies Code* heavily influenced the panels, it is useful to explain the Tokyo Round *Subsidies Code* before further describing the two sugar cases.

8 NEGOTIATION OF THE SUBSIDIES CODE

When the parties next attempted to reformulate the rules on export subsidies during the Tokyo Round beginning in 1973,¹⁴⁷ the international trading environment had changed substantially from that prevailing during the 1955 General Review.¹⁴⁸ One major aspect of that environment was the EEC's common agricultural policy and, particularly, its utilization of export subsidies to dispose of agricultural surpluses. The use of export subsidies was not restricted to the EEC or to agricultural production. A number of developing countries used subsidies to encourage exports of industrial and agricultural production.¹⁴⁹ However, a major concern for the United States and other exporters of agricultural products was the EEC's use of export subsidies on agricultural products.

147 The round began with the Tokyo Declaration of 14 September 1973: see The Tokyo declaration issued at the end of the Ministerial meeting held in Tokyo, 12 - 14 September 1973 in GATT, *Activities 1973* (GATT, Geneva, 1974, Sales No GATT 1974/3) pp5-10.

148 Generally on the Tokyo Round, see Winham, Gilbert R., *International Trade and the Tokyo Round Negotiation* (Princeton University Press, Princeton, NJ 1986). More particularly, the negotiation of the Tokyo Round *Subsidies Code* is comprehensively reported and analyzed in Rivers, Richard R. & Greenwald, John D., "The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences" (1979) 11 *Law & Policy in International Business* 1447-1495 and in Tarullo, Daniel K., "The MTN Subsidies Code: Agreement Without Consensus" in ch5 in Rubin, Seymour J. & Gary Clyde Hufbauer (eds), *Emerging Standards of International Trade and Investment - Multilateral Codes and Corporate Conduct* (Rowman & Allanheld, Totowa, New Jersey, 1983) pp63-99.

149 See Rivers, Richard R & Greenwald, John D, "The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences" (1979) 11 *Law & Policy in International Business* 1447-1495 at 1452; and see Tarullo, Daniel K., "The MTN Subsidies Code: Agreement Without Consensus" p72. For more detail on subsidy practices at this time, see Guy de Carmoy, "Subsidy Policies in Britain, France and West Germany", Nobuyoshi Namiki, "Japanese subsidy Policies" & Steven J. Warneke, "The European Community and national Subsidy Policies"

The basic mechanisms of the common agricultural policy were explained above in chapter 10. Between the commencement of the policies in the early 1960's and the commencement of the Tokyo Round in 1974, the CAP caused substantial increases in production in the EEC member states.¹⁵⁰ As production increased above the quantity required for domestic consumption, the European Commission began to subsidize exports either by selling intervention stocks on the world market at prices substantially below the prices that they had been purchased from EEC farmers or by paying direct export subsidies. Mechanisms for paying export subsidies direct to farmers had been established as part of the organization of the common market for a number of products (and more were established in relation to other products in later years).¹⁵¹ The EEC became a net exporter of wheat and barley as early as 1974 and over the next few years would become a net exporter of other cereals, sugar wine, beef and veal.¹⁵² Therefore, by the time the Tokyo Round commenced, export subsidies together with variable levies, had become an integral part of the system of maintaining internal support prices.¹⁵³ The potential for even larger international effects of the CAP increased after the United Kingdom, Ireland and Denmark acceded to the EEC in January 1973. From the point of view of the United States, achieving some discipline over the international effects of the CAP was an important objective in the Tokyo Round.¹⁵⁴

all in Warneke, *International Trade and Industrial Policies* (Macmillan, London, 1978) respectively at pp35-57, 123-142 & 143-174.

- 150 Estabrook, Jeffrey S., "European Community Resistance to the Enforcement of GATT Panel Decisions on Sugar Export Subsidies" (1982) 15(2) *Cornell International Law Journal* 397-427 at 402 referring to examples of a 26% increase in wheat production and a 128% increase in corn production from a pre-CAP average to 1972-73 citing United States Executive Branch *GATT Study No12 - The Common Agricultural Policy of the European Community* in Subcommittee on Int'l Trade of the Senate Comm on Finance, Executive Branch GATT Studies (Comm Print 1974).
- 151 See the references to the EEC council regulations establishing export subsidies for various products in Bentil, J. Kodwo, "Attempts to Liberalize International Trade in Agriculture and the Problem of the External Aspects of the Common Agricultural Policy of the European Economic Community" (1985) 17(3) *Case Western Reserve Journal of International Law* 335-387 at 362-363 (export subsidies set up before 1973 included those in the common market organizations for various oilseeds, olive oil, sugar, dairy products, beef and veal, fruit and vegetables, raw tobacco; those set up in 1975 included cereal-based feedstuffs, processed cereals and rice, pork, eggs, poultry and rice).
- 152 Buckwell, Allan, "The CAP and World Trade" in Ritson, Christopher & Harvey, David (eds), *The Common Agricultural Policy and the World Economy - Essays in Honour of John Ashton* (CAB International, Wellingford, UK, 1991) p223-240 at 228.
- 153 Rivers & Greenwald at p1452.
- 154 See Tarullo, Daniel K., "The MTN Subsidies Code: Agreement Without Consensus" ch5 in Rubin, Seymour J. & Gary Clyde Hufbauer (eds), *Emerging Standards of International Trade and Investment - Multilateral Codes and Corporate Conduct* (Rowman & Allanheld, Totowa, New Jersey, 1983) pp63-99 at 72-73.

The negotiation was also shaped by the desire of many countries to impose an injury requirement on the United States' grandfathered countervailing duty law.¹⁵⁵ Under the Protocol of Provisional Application, the material injury requirement in Article VI:5 of the GATT only applied to the extent that it was not inconsistent with existing legislation.¹⁵⁶ Therefore, under the United States *Tariff Act* of 1930, countervailing duties could be applied without any consideration of injury to domestic industry.¹⁵⁷ Until 1967, the United States had used the countervailing duty remedy sparingly: only 41 times between 1897 and 1959 and not at all between 1959 and 1967.¹⁵⁸ However, between 1967 and 1974, the USA had imposed countervailing duties 17 times.¹⁵⁹ The USA's trading partners were also concerned with recent decisions of the USA Treasury applying countervailing duties to domestic subsidies. While s303 of the *Tariff Act* of 1930 did not distinguish between export subsidies and domestic subsidies,¹⁶⁰ until 1969, the USA executive had not applied a countervailing duty to a general subsidy on manufacturing or production.¹⁶¹ Subsequently, it adopted an 'export orientation' test.¹⁶² In 1972, in the Greek Tomato case, a CVD had been applied to a domestic production subsidy on tomatoes, 75% of which were exported.¹⁶³ More

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- 155 See Rivers & Greenwald at pp1453-1454 & Montana-Mora, Miguel, "International Law and International relations Cheek to Cheek: an International Law/International Relations Perspective on the US/EC Agricultural Export Subsidies Dispute" (1993) 19 *NCJ Int'l L & Com Reg* 1-60 at p21
- 156 See above, in chapter 2 at p37 and accompanying text explaining the effect of the Protocols of Provisional Application and quoting the existing legislation clause.
- 157 USA, *Tariff Act* of 1930, Pub L No 71-361, s303, 46 Stat 590 (codified at 19 USC s1303 (1976)); see Esterbrook, Jeffrey S., "European Community Resistance to the Enforcement of GATT Panel Decisions on sugar Export Subsidies" (1982) 15(2) *Cornell International Law Journal* 397-427 & Rivers & Greenwald at 1453.
- 158 Cooper, Richard N., "US Policies and Practices on Subsidies in International Trade" ch5 in Steven J. Warnecke (ed), *International Trade and Industrial Policies* (Macmillan, London, 1978) pp107-122 at p114.
- 159 Cooper, "US Policies and Practices on Subsidies in International Trade" p114.
- 160 *Tariff Act* of 1930 s303 (codified as 19 USC §1303) referred to "any bounty or grant upon the manufacture or production or export of any article or merchandise". These words had been carried forward from the 1922 amendments to s5 of the *Tariff Act* of 1897 which had referred only to "any bounty or grant upon the exportation". See King, DB, "Countervailing Duties - An Old Remedy With New Appeal" (1969) 24 *Business Lawyer* 1179-1192 at 1179-1180.
- 161 King, "Countervailing Duties - An Old Remedy With New Appeal" p1181.
- 162 See Beseler & Williams, *Anti-Dumping and Anti-Subsidy Law: The European Communities* (Sweet & Maxwell, London, 1986) pp138 fn 3 citing instances of use of the 'export orientation' test: *Radial Steel Belted Tyres from Canada*, 38 Fed Reg 1018 (1973), & *Float Glass from Belgium and West Germany* 41 Fed Reg 1299-1300 (1976). See also Marks & Milgren, "Negotiating Nontariff Distortions To Trade" (1975) 7 *Law & Policy in International Business* 327 at 348-350 describing the broad categories in which the USA had imposed countervailing duties.
- 163 See Tomato Products from Greece, TD 72-88, 6 Cust Bull 145 (1972), revised TD 68-270, 2 Cust Bull 604 (1968), revoked TD 69-41, 3 Cust Bull 66 (1969). See Marks & Milgren, "Negotiating

controversial was the Michelin case in 1973, in which countervailing duties were imposed in respect of various subsidies paid by the Canadian government for the establishment of a Michelin tyre factory in Nova Scotia.¹⁶⁴ The USA Treasury found that a substantial majority of the tyres produced by the factory were being exported to the USA. In neither the Greek Tomato case nor the Michelin case was the payment of the subsidy contingent upon export. Arguably, though, the subsidy in the Greek Tomato case could have been regarded as a disguised export subsidy. However, the subsidies, the subject of the Michelin case, were not even paid contingent upon production. The subsidies were merely designed to promote development in a particular region. This approach might have exposed regional development subsidies in various countries to the USA's countervailing duties. It posed an even stronger threat to production subsidies.

In addition, some of the amendments to USA CVD law contained in the *Trade Act of 1974* made it easier for countervailing duties to be imposed. First, whereas previously the law had only applied to dutiable products, the amendment made countervailing duties possible on non-dutiable products subject to satisfaction of an injury requirement.¹⁶⁵ Other amendments "resulted in specific time limits being applied to the administering agency's consideration of complaints, the opportunity for judicial review of those decisions, and a tightening of the criteria for the mandatory application of countervailing duties".¹⁶⁶ These

Nontariff Distortions to Trade" at pp348-349, fn 92 (in which it is stated that "it was established that 75 percent of Greece's tomato products, in fact, were being exported".) & see Cooper, "US Policies and Practices on Subsidies in International Trade" at pp114 (where it is stated that "direct payments to tomato producers were countervailed on the grounds that 90 per cent of the production was exported".)

- 164 "X-Radial Steel Belted Tires from Canada" TD 73-10, 7 Cust. B. 24, 38 Fed Reg 1018 (1973) (extracted in Jackson, *Legal Problems of International Economic Relations - cases, materials and text on the national and international regulation of transnational economic relations* (West Publishing Co, St Paul, Minn., 1st ed, 1977) pp787-789. Generally, see Guido, Robert V. & Morrone, Michael F., "The Michelin Decision: A Possible New Direction for US Countervailing Duty Law" (1974) 6 *Law & Policy in International Business* 237-266. Also see Pestieau, Caroline, "Revising the GATT Approach to Subsidies: A Canadian View" in Steven J. Warneke (ed), *International Trade and Industrial Policies* (Macmillan, London, 1978) pp91-106 at p93;
- 165 Trade Act of 1974, Pub L No 93-618, 88 Stat 1978 (1975) codified at 19 USC s2101-2487 (1976) (hereinafter referred to as Trade Act of 1974), s331(a) added 19 USC §1303(a)(2). See Jackson, "United States Law and Implementation of the Tokyo Round Negotiation" ch4 in Jackson, Louis & Matsushita, *Implementing the Tokyo Round - National Constitutions and International Economic Rules* (University of Michigan Press, Ann Arbor, 1984) pp156-157 & Rivers & Greenwald, at 1453.
- 166 Jackson, *The World Trading System - Law and Policy of International Relations* (The MIT Press, Cambridge Massachusetts, 1989) p257. For more detailed description of the amendments to USA countervailing duty law, see Marks & Malmgren, "Negotiating Nontariff Distortions to Trade" (1975) 7(2) *Law & Policy in International Business* 327-411 at 357-366.

amendments had a dramatic effect, resulting in a record number of countervailing duty investigations being commenced in 1975.¹⁶⁷

The 1974 *Trade Act* also granted the Secretary authority, for four years, to waive countervailing duties in circumstances in which imposition of the duty would be likely to jeopardize the successful conclusion of the Tokyo Round negotiations.¹⁶⁸ Early in the round, a number of applications were made in the USA for countervailing duties to be imposed against export subsidies granted by the EEC under the common agricultural policy. The USA Treasury decided that, under the legislation, countervailing duties could be imposed but their imposition was waived. For example, in 1975, there were 11 findings of subsidization but imposition of duties was waived in respect of six of those cases that related to agricultural production from Europe.¹⁶⁹ The time limit on the waiver, upon expiration of which these countervailing duties would come into force, became a means of applying pressure in the negotiation of new rules on subsidies. Therefore, these developments in USA CVD practice made it important to other member states, especially the EEC members, that USA CVD law should be restrained.

In broad terms, then, the Tokyo Round was conducted with the parties having different objectives.¹⁷⁰ Most parties in the negotiation sought some restraints on USA countervailing duty law, in particular, a material injury test. The United States sought new rules on subsidies, principally to limit the external effects of the EEC common agricultural policy. The USA and the European countries had reversed the roles held during the General Review in 1955. Whereas, in 1955, the European countries had sought a prohibition on export subsidies on all products including agricultural products, in the Tokyo Round, the EEC opposed any tighter regulation of export subsidies paid so as not to undermine the internal

167 Cooper, "US Policies and Practices on Subsidies in International Trade" at p114.

168 USC s1803(d)(2) (Supp. V 1975). See Barcelo, "Subsidies and Countervailing Duties - analysis and A Proposal" (1977) 9 *Law & Policy in International Business* 779-853 at 781. See also Hufbauer, Gary Clyde & Joanna Shelton Erb, *Subsidies In International Trade* (Institute for International Economics, Washington DC, 1984) p15-16.

169 See Cooper, p114. Eg., Canned Hams from EEC, TD 75-301, 9 Cust B & Dec No 50 at 11 (1975), 40 Fed Reg 55,6639; Dairy Products from EEC, TD 75-114, 9 Cust B & Dec No 22 at 19 (1975), 40 Fed Reg 21,720. See Barcelo (1977) p781 fn12 and accompanying text & p834, fn232.

170 Description of the different approaches of the USA and the EEC to the subsidies and countervailing duty negotiations are contained in, eg, Beseler & Williams, p15-17; Rivers & Greenwald, pp1465-1466; Estabrook, pp407-409, Tarullo, Daniel K., "The MTN Subsidies Code: Agreement Without

price support policies of the common agricultural policy and it sought to restrain the application of countervailing duties to its subsidies. Whereas, in 1955, the USA had opposed the application to agricultural products of a prohibition on export subsidies in order to avoid change to its own internal price support policies, in the Tokyo Round, the USA sought tighter regulation of all subsidies, especially export subsidies, including subsidies on agricultural products. The contracting parties had an opportunity to reinforce the distinction between export subsidies and other subsidies by bringing agricultural products under the prohibition on export subsidies and by introducing the distinction into countervailing duty law. Unfortunately, neither of those rule changes resulted from the ensuing trade-off between the negotiating objectives of the EEC and the USA.

The EEC's position was that the common agricultural policy was not negotiable. Prior to the Tokyo Meeting of Ministers, the European Council issued a "global conception" of the proposed trade negotiation¹⁷¹ which declared "that the CAP principles and their mechanisms could not be questioned and were not matters for negotiation".¹⁷² In contrast, the USA's overall objective was that "to the maximum extent feasible" agriculture and industrial trade should be liberalized together¹⁷³ and the Trade Act required negotiation of "any revisions [to the GATT] necessary to define the forms of subsidy to industries producing products for export ... which is consistent with an open, nondiscriminatory, and fair system of international trade".¹⁷⁴ For the first three years of the round, negotiations on the issue of subsidies on agricultural products was substantially stalemated by disagreement between the USA and the EEC over whether the issue was to be dealt with by the negotiating Group on Agriculture or by the Sub-group Subsidies and Countervailing Duties of the Group for

Consensus" ch5 in Rubin, Seymour J. & Gary Clyde Hufbauer (eds), *Emerging Standards of International Trade and Investment* (Rowman & Allanheld, Totowa, New Jersey, 1983) pp63-99.

171 Louis, Jean-Victor, "The European Economic community and the Implementation of the GATT Tokyo Round Results" ch2 in John H Jackson, Jean-Victor Louis & Mitsuo Matsushita, *Implementing the Tokyo Round - National Constitutions and International Economic Rules* (University of Michigan Press, Ann Arbor, 1984) pp24-26.

172 Louis, "The European Economic Community and the Implementation of the GATT Tokyo Round Results" p26.

173 Trade Act of 1974 (PL 93-618; 88 Stat 1978) The second sentence of s103 provided: "To the maximum extent feasible, the harmonization, reduction, or elimination of agricultural trade barriers and distortions shall be undertaken in conjunction with the harmonization, reduction, or elimination of industrial trade barriers and distortions".

174 Trade Act of 1974, s121(a)(11).

negotiations on Non-Tariff Measures.¹⁷⁵ The USA approached the negotiation with proposals for a new and more comprehensive scheme of regulation for subsidies and countervailing duties which would apply equally to agricultural products as to other products. The USA proposals have been described as a 'traffic light' approach.¹⁷⁶ They called for a three way classification of all subsidies. The 'red light' category was to have been export subsidies which would be prohibited and would be countervailable without an injury test. The 'amber light' category was to have been subsidies that are applied equally to production not just exports but which have significant trade effects. These were to be countervailable subject to an injury test. The 'green light' category was to have been domestic subsidies with no more than minor indirect trade effects. These were not to be countervailable. The EEC refused to negotiate general principles. In contrast, the EEC approached the negotiation with international management schemes for particular agricultural products and with the demand that an injury requirement be introduced into USA CVD law. The input of developing countries did not help to reinforce the distinction between export subsidies and other subsidies. A number of developing countries demanded that they should have freedom to use any subsidies.

It was not until 1977 that the parties even began to negotiate within a common framework. As a result of the disagreement about the jurisdiction of the different negotiating committees, the Agriculture Committee did not meet between December 1975 and December 1977 when it finally reached a compromise that the Agriculture Group could consider issues that were under discussion in other groups.¹⁷⁷ By this time, the USA had accepted that the negotiation on subsidies would not be able to proceed on the basis of the USA proposals for re-writing the rules which would necessarily require the complete

175 See GATT, *GATT Activities in 1976* (GATT, Geneva 1977, Sales No: GATT 1977/2) p20. See also McRae, D.M. & Thomas, J.C., "The GATT and Multilateral Treaty Making: The Tokyo Round" (1983) 77 *American Journal of International Law* 51-83 at 74-75; & Pestieau, Caroline, "Revising the GATT Approach to Subsidies: A Canadian View" in Warneke, *International Trade and Industrial Policies* (Macmillan, London, 1978) pp103-104.

176 See Hufbauer, Gary Clyde & Erb, Joanna Shelton, *Subsidies in International Trade* (Institute for International Economics, Washington DC, 1984), p22; Montana-Mora, Miguel, "International Law/International Relations Perspective on the US/EC Agricultural Export Subsidies Dispute" (1993) 19 *NCJ Int'l L & Com Reg* 1-60 at p22. See also Jackson, John H., "Perspectives on Countervailing Duties" (1989) 21 *Law & Policy in International Business* 739-761 at 748 (describing the same proposal made in the Uruguay Round).

177 McRae & Thomas, "The GATT and Multilateral Treaty Making: The Tokyo Round" (1983), p74; Bentil, "Attempts to Liberalize Farm Trade" p344; Pestieau, p104.

reorganisation of the common agricultural policy without export subsidies. The USA agreed to negotiate upon the basis of the existing framework of rules.¹⁷⁸ By December 1977, the USA and EEC had at least agreed on a framework for negotiation. They circulated a document entitled "Subsidies/ Countervailing Duties - Outline of an Approach".¹⁷⁹

The "Outline of an Approach"¹⁸⁰ indicates a number of key aspects of the negotiation:

178 See Estabrook, Jeffrey SW., "European Community Resistance to the Enforcement of GATT Panel Decisions on Sugar Export Subsidies" (1982) 15(2) *Cornell International Law Journal* 397-427; Rivers & Greenwald, pp1465-1466.

179 "Subsidies/Countervailing Duties - Outline of an Approach" GATT Doc MTN/INF/13 (23 Dec 1977). This document is reproduced in full in Rivers & Greenwald, "The Negotiation of a Code on Subsidies and Countervailing Duties" (1979) pp1466-1469.

180 The document provides as follows:

Satisfactory agreement for dealing with problems in the areas of subsidies and countervailing duties is an important MTN objective. To this end, there is agreement to draw on the present GATT rules and procedures with a view to improving their effectiveness by way of elaborating some of their aspects.

A preliminary outline of a possible approach to the subsidy/countervailing duty negotiations is set forth below. This outline is not exhaustive and does not prejudice the final form of a possible agreement.

A. SUBSIDIES

1. Subsidies in general

Subsidies can promote important objectives of national policy. They can also cause or threaten serious prejudice to the trade interests of any other contracting party [in home or other country markets](EC reservation) by increasing exports or reducing imports. The contracting parties should seek to avoid using subsidy practices in a manner which would cause or threaten to cause serious prejudice to other parties.

[In this connexion, more detailed guidelines with respect to the use of certain subsidies and counter-measures would be desirable.](EC reservation)

More effective notification, consultation and dispute settlement procedures with respect to problems raised by subsidies would also be desirable.

2. Export Subsidies

Recognition that export subsidies may have harmful affects.

Agreement should be sought not to use export subsidies, on non-primary products. To this end, an updated illustrative list of such export subsidies should be developed. [Together with a definition of export subsidies to be negotiated](EC reservation), this illustrative list shall guide countries in complying with commitment not to use export subsidies on non-primary products. The use of such subsidies would, prima facie, result in nullification and impairment, and, in such cases, appropriate international procedures would be followed.

3. Export Subsidies on Primary Products

[Agreement that countries should seek to avoid the use of export subsidies for primary products in such a manner as to capture more than an equitable share of the world market. Recognition that commodity agreements may have consequences on the use of export subsidies which could limit the level of export subsidies on the products covered by such agreements.](This first paragraph was the European Community version of what should be done with regard to export subsidy rules on primary products. The brackets reflect a US reservation. Because the European Community negotiators on agriculture did not participate in the preparation of Dec 23 paper, the agriculture provisions of the paper did no more than restate the traditional United States/European Community positions.)

[Recognition that there may be special factors which apply to trade in primary products and, in particular, the use of subsidies in such trade. Agreement that contracting parties should seek to avoid the use of export subsidies for primary products and agreement not to use such subsidies to capture a

- (1) that the prohibition on export subsidies was not going to be extended to primary products but that a distinction between export subsidies on non-primary products and those on primary products would be retained;¹⁸¹
- (2) that for export subsidies on primary products, some constraint in addition to the equitable share of world trade might be added to the rules though the EEC and the USA disagreed about what the additional constraint might be;¹⁸²
- (3) that in the area of countervailing duties, no distinction was being made between export subsidies and other subsidies; no attempt was made to restrict countervailing duties to export subsidies or to make them harder to apply to non-export subsidies;
- (4) that, subject to some additional constraints being placed on export subsidies on primary products, an injury test would be added to the grandfathered USA CVD law although the parties had not agreed on the standard to be used whether it should be 'material' or some other standard.
- (5) that there might be some limitation of the prejudicial effects of subsidies other than export subsidies.

larger share of a national market or, except as may be otherwise agreed, to maintain such a market share.

For particular agricultural products, specific rules on the use of subsidies and countervailing measures may be developed in a commodity context. In addition, agreement might be developed under which export subsidies would not be used, or would be limited, for specific agricultural products. The use of subsidies in a manner inconsistent with an agreement would result in nullification and impairment of such an agreement.

To the extent that no general understandings can be reached concerning subsidies in the field of primary products, the status quo on countervailing duties in this field would remain. (These three paragraphs are the US approach to the primary product issue. The brackets reflect a European Community reservation.)

B. COUNTERVAILING DUTIES

Agreement should be sought whereby a [meaningful](US reservation) test of injury [under](preferred by the US) [in accordance with](preferred by the EC) Article VI would be applied in connexion with the imposition of countervailing duties: criteria to be taken into account in determining injury should be defined.

More effective notification consultation and dispute settlement procedures with respect to problems raised by countervailing duties would be desirable.

C. SPECIAL AND DIFFERENTIAL TREATMENT FOR DEVELOPING COUNTRIES

The special situation of the developing countries and their developmental needs should be taken into account.

181 See Outline of an Approach, sections A2 and A3.

182 See Outline of an Approach, section A3, compare the first paragraph with the next three paragraphs.

In essence, the EEC had won the battle to keep the CAP out of the negotiation. Any renegotiation of the subsidy rules was not going to affect the instruments of the CAP. They had removed a CAP threatening amendment to the rules from the agenda but had kept on the agenda the imposition of an injury test on USA countervailing duties. The attempt to extend the prohibition of export subsidies to primary products had failed. The focus was shifted to four principal contentious areas: (1) the refinement of the test in Article XVI:4; (2) refinement of the test in Article XVI:3; (3) defining the content and application of the injury test for CVDs; and (4) defining some new discipline on domestic subsidies.

With respect to Article XVI:4, subject to an exemption for developing countries, the parties were agreed that export subsidies on non-primary products should be prohibited. The parties could not agree on a definition of export subsidies.¹⁸³ They reverted back to the illustrative list of export subsidies from the 1960 report and negotiated changes to that list. The USA had proposed to prohibit some domestic subsidies by adding them to the list of export subsidies. However, this proposal was rejected.¹⁸⁴

With respect to Article XVI:3, the United States position was that the article should be broadened to cover subsidies which increased market shares in particular national markets. The ECC objected to that and the negotiation moved to consideration of using the concept of displacement that had been utilized in the 1958 French wheat case and also to using the concept of price cutting.¹⁸⁵

Developing countries originally argued for exemption from CVDs and for no additional rules on developing country subsidies. They were able to negotiate a special position in relation to the Track II rules on export subsidies but not on the rules on countervailing duties.¹⁸⁶

With respect to the injury test in CVD law, once the USA had conceded that some kind of injury test would be acceptable to it, there ensued a battle as to whether the term 'material'

183 Rivers & Greenwald, pp1473-1474.

184 Tarullo, p82-83.

185 Rivers & Greenwald, pp1477-1478.

186 On the participation of developing countries in the negotiations on subsidies and countervailing duties, see Rivers & Greenwald, pp1480-1483 & Tarullo, p85-86.

should be added to the standard for injury in the Code.¹⁸⁷ In addition, the USA wished to avoid a test that would require having to prove that the subsidized imports were the principal cause of the injury. In the end, the USA agreed to the word material but received a less stringent test of causation. The previous proposal that injury should not be a requirement in the case of export subsidies appears not to have had any further influence.¹⁸⁸ The amendments to countervailing duties were negotiated generally, though not entirely, without making any distinction between export subsidies and other subsidies.

Even though the proposed amendments to the rules posed little threat to the CAP, the EEC was still concerned that the proposed provisions might be used to challenge essential elements of the CAP. In the closing stages of the Tokyo Round, the EEC asked for an assurance that the new Code would not be used in that way. In a strange ending to the Round, it seems that the Head of the US delegation gave a secret letter to the Head of the EEC delegation containing such an assurance whereupon the EEC accepted the Code.¹⁸⁹

9 THE RULES FOLLOWING FROM THE 1979 SUBSIDIES CODE

The *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade* which is usually referred to as the *Subsidies Code* was signed on 12 April 1979.¹⁹⁰ There were 17 original signatories to the Code including the European Community (EC9).¹⁹¹ It entered into force on 1 January 1980.¹⁹² For the parties to it, the Code applied concurrently with the GATT. By the beginning of the

187 See Rivers & Greenwald, pp1483-1486 & Tarullo, p79.

188 See above the reference to the traffic light approach including the red light category for which it was proposed that injury not be a requirement.

189 See Montana-Mora, Miguel at p28 citing Hudec "Transcending the Ostensible" at 221 and also "La politique agricole commune et le GATT" 298 *Le Notes Bleus* 2 (1986).

190 *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement*, Geneva, 12 April 1979, in force 1 January 1980 ('*Subsidies Code*'); 1186 UNTS 204; GATT *BISD*, 26S/56.

191 See Report of the Committee on Subsidies and Countervailing Measures Presented to the CONTRACTING PARTIES at the Thirty Fifth Session (L/5055) GATT, *BISD* 27S/31, para 1. It records the signatories on 23 October 1980 as Austria, Brazil, Canada, Chile, Finland, India, Japan, Korea, Norway, Pakistan, Sweden, Switzerland, United Kingdom on behalf of Hong Kong, United States, Uruguay, Yugoslavia and the European Communities [of 9].

192 See *Subsidies Code*, Article 19(4) and see GATT, *Analytical Index*, p430.

Uruguay Round, there were 25 signatories including the European Community (EC10).¹⁹³ This summary deals with Track 1 then Track 2.¹⁹⁴

9.1 TRACK 1 - COUNTERVAILING DUTIES

The major change effected by the *Subsidies Code* provisions on countervailing duties was the confirmation of the relevant provisions of Article VI of the GATT without the limitation of the pre-existing legislation in the Protocol of Provisional Application.¹⁹⁵ This meant that the United States became bound by the 'material injury' provisions in Article VI:6 of the GATT. In addition, the *Subsidies Code* set out extensive rules on procedural aspects of investigations and decision making relating to CVDs.¹⁹⁶ It also provided for detailed rules relating to the determination of injury to domestic industry including on the definition of domestic industry and the causal link between the subsidy and the injury.¹⁹⁷

The *Subsidies Code* did not contain a definition of a countervailable subsidy. The concerns with US countervailing domestic subsidies was addressed through the imposition of the injury test rather than by any limitation of the type of subsidy that could be countervailed. Apart from the injury test, nothing in the *Subsidies Code* prevented domestic subsidies from being countervailed. Article 11 stated that the parties did not "intend to restrict the right of signatories to use" "subsidies other than export subsidies" for achieving desirable policy objectives".¹⁹⁸ It is clear that Article 11 did not prevent Track 2 remedies from being taken against such subsidies. While the text says nothing about whether Track 1 remedies could be taken against such remedies, it seems that this provision did not prevent CVDs being

193 See "Committee On Subsidies and Countervailing Measures - Report (1986) presented to the CONTRACTING PARTIES at the Forty-second Session (L/6089) GATT, *BISD* 33S/197, para 1. It records the signatories on 1 November 1986 as Australia, Austria, Brazil, Canada, Chile, Egypt, Finland, Hong Kong, India, Indonesia, Israel, Japan, Korea, New Zealand, Norway, Pakistan, Philippines, Spain, Sweden, Switzerland, Turkey, United States, Uruguay, Yugoslavia and the European Communities [of 10].

194 Summaries of the *Subsidies Code* can be found in, eg, Jackson, *The World Trading System* (1989) p258-261; Montana-Mora, Miguel, "International Law and International relations Cheek to Cheek: an International Law/International Relations Perspective on the US/EC Agricultural Export Subsidies Dispute" (1993) 19 *NCJ Int'l L & Com Reg* 1-60 at p22-29; Snape, "International Regulation of Subsidies" (1991) 14(2) *The World Economy* 139-164; Tarullo, "The MTN Subsidies Code: Agreement Without Consensus" in Rubin & Hufbauer, *Emerging Standards of International Trade and Investment* (1983) pp63-99 at 78-87.

195 See *Subsidies Code*, Article 1.

196 See *Subsidies Code* Articles 2 to 5.

197 See *Subsidies Code* Article 6.

198 See *Subsidies Code* Article 11:1.

imposed on domestic subsidies. Therefore, countervailability was determined according to the effects of the subsidy not the type of the subsidy.

Article 6 provided that the determination of injury had to involve an examination of the volume of imports, the effect on prices and the "consequent impact" on the domestic producers.¹⁹⁹ One provision made special allowance for agricultural industries being that any "increased burden on government support programmes" had to be taken into account in considering whether the domestic industry was being injured.²⁰⁰ This meant that for agricultural industries but not other industries, a finding of injury could be made even in the absence of adverse effects on factors like output, sales, market share or profits if there had been an increase in the burden on Government support programmes.²⁰¹

9.2 TRACK II - MULTILATERALLY AUTHORIZED REMEDIES

The Code contained reinforcements of the provisions on export subsidies in Articles XVI:3 and 4 of the GATT and contained additional provisions regarding the effects of all subsidies including those that were not export subsidies.

9.2.1 Export Subsidies - The Prohibitions in Articles 9 and 10 of the Code

Under the Code, as under Article XVI, the rules on export subsidies distinguished between primary products and non-primary products. However, the Code altered the distinction between primary and non-primary products. It distinguished between "certain primary products" and "products other than certain primary products". "Certain primary products" was defined to have the same meaning as "primary products" in the General Agreement with the exception of minerals.²⁰² Therefore, minerals were treated as non-primary products and "certain primary products" essentially meant agricultural products.

The substantive rules were in Article 9 dealing with export subsidies on non-primary products and Article 10 dealing with export subsidies on primary products.

199 See *Subsidies Code* Article 6:1.

200 See *Subsidies Code* Article 6:3.

201 Zedalis, "Legal Effects of the Multilateral Trade Negotiations: Agricultural Commodities" (1980) 10 *Denver Journal of International Law & Policy* 89-111 at 101-102.

202 *Subsidies Code* footnote 29 to Article 9.

Export Subsidies on Non-Primary Products - Article 9

In relation to export subsidies on products other than certain primary products, Article 9 set out a prohibition. It was a simple and absolute prohibition. The dual price test from Article XVI:4 was not carried over into Article 9.

By virtue of Article 14:2, the prohibition in Article 9 did not apply to developing country signatories. An innovation in Article 14:5 provided that each developing country signatory should endeavour to reduce or eliminate export subsidies when the use of such export subsidies [was] inconsistent with its competitive and development needs.

This provision was part of the deal struck between the developing countries and the United States: that the United States would only apply the injury test to countervailing duties on developing country imports if the developing countries agreed to phase out export subsidies on non-primary products. In addition to its significance as part of the compromise reached in the negotiation, this provision is significant because it provided for a system of regulation of export subsidies other than by a prohibition. It allowed for reduction commitments which would include quantitative bindings on export subsidies at a series of points in time. Further, it restricted the use of countermeasures against export subsidies provided by a developing country in conformity with its reduction commitments. It provided that multilateral countermeasures could not be authorized against those export subsidies conforming to a developing country's commitment under Article 14:5.²⁰³ However, the provision did not provide for any immunity against countervailing duties.

Export Subsidies on Primary Products - Article 10

Article 10:1 of the Code repeated almost verbatim the prohibition in Article XVI:3 of the GATT on export subsidies which result in the subsidizing party having more than an equitable share of world export trade.²⁰⁴ Article 10(2) added provisions which were intended to improve the operation of the 'equitable share' test. The major modification was Article 10:2(a) which provided that a situation where a subsidy had the effect of displacing

203 *Subsidies Code* Article 14(6).

204 On the *Subsidies Code* provisions on export subsidies on primary products and particularly on the importance of the standard of 'displacement', see Estabrook, Jeffrey SW., "European Community

another signatory's exports was included in the circumstances in which a subsidy would be causing a signatory to "have more than an equitable share of world export trade". The determination of whether the export subsidy had the effect of displacing the exports of another signatory had to be made "bearing in mind the developments on world markets".

Article 10:2(b) qualified the requirement in Article XVI:3 that "account be taken of the shares of the contracting parties during a previous representative period. Article 10:2(b) provided that "a previous representative period" would "normally be the three most recent calendar years in which normal market conditions existed".

Article 10 also added a new separate prohibition dealing with export subsidies on certain primary products to particular markets. Article 10:3 prohibited such subsidies if they resulted "in prices materially below those of other suppliers to the same market."

The prohibitions in Articles 10:1 and 10:3 did apply to developing country signatories. However, it seems that if a developing country signatory had given a commitment under Article 14:5 relating to an export subsidy on a primary product then, under Article 14:6, multilateral countermeasures could not be authorized against such a subsidy so long as it complied with the commitment.

The Distinction Between Export Subsidies and Other Subsidies

Whereas Article XVI:3 employs the phrase "subsidy which operates to increase the export" and Article XVI:4 employs the phrase "subsidy on the export of any product", the prohibitions in Articles 9 and 10 of the Code were expressed to apply to 'export subsidies'. No definition of "export subsidy" was provided. Article 9(2) annexed a list of practices which were an "illustrative list of export subsidies". This list was more extensive than the list which had been agreed by the parties to the 1960 Declaration implementing Article XVI:4.²⁰⁵ Contingency on export performance' was introduced as a criteria for distinguishing export subsidies from other subsidies by paragraph (a) on the illustrative list which referred to

Resistance to the Enforcement of GATT Panel Decisions on Sugar Export Subsidies" (1982) 15(2) *Cornell International Law Journal* 397-427 at 409-413.

205 "Subsidies, Provisions of Articles XVI:4", report adopted on 19 November 1960, (L/1381), *BISD*, 9S/185, para.5.

- (a) The provision by governments of direct subsidies to a firm or an industry contingent upon export performance.

None of the items on the illustrative list were restricted by the dual price criteria in Article XVI:4 but this criteria was retained as an alternative criteria by paragraph (l) which referred to

- (l) Any other charge on the public account constituting an export subsidy in the sense of Article XVI of the General Agreement.

Other items on the list related to the provision of export credit²⁰⁶ and export credit guarantees.²⁰⁷ Remission of or exemption from indirect taxes on the production or distribution of exported products was permitted but only to the extent that it did not exceed the indirect taxes levied on like products sold for domestic consumption.²⁰⁸ Similarly, the remission or drawback of import charges was permitted but only to the extent of those levied upon imported goods physically incorporated in the exported product.²⁰⁹

9.2.2 Avoidance of Adverse Effects of Non Prohibited Subsidies - Article 8

Export subsidies were also subject to additional rules in Article 8 which applied generally to all subsidies, regardless of whether they were export subsidies or domestic subsidies. This provision constituted a considerable extension of the notion implicit in Article XVI:3 that it is more important to regulate the effects of subsidies than the actual action of subsidizing. Under Article 8.3, signatories undertook to "seek to avoid causing, through the use of any subsidy" certain "adverse effects". The relevant effects were:

- (a) "injury to the domestic industry of another signatory",²¹⁰
- (b) "nullification or impairment of the benefits accruing directly or indirectly to another signatory under the General Agreement",²¹¹ or

206 "Illustrative List of Subsidies" Annex to *Subsidies Code* para (k).

207 "Illustrative List of Subsidies" Annex to *Subsidies Code* para (j).

208 "Illustrative List of Subsidies" Annex to *Subsidies Code*, paras (g) & (h).

209 "Illustrative List of Subsidies" Annex to *Subsidies Code*, paras (i).

210 *Subsidies Code* Article 8:3(a).

211 *Subsidies Code* Article 8:3(b).

(c) "serious prejudice to the interests of another signatory".²¹²

Article 8 fell short of imposing any additional prohibition but it did extend the General Agreement obligations on export subsidies in important ways. First, it changed the obligation to talk about serious prejudice into an obligation to seek to avoid serious prejudice and also to avoid the other two adverse effects, "nullification and impairment"; and causing injury to the domestic industry of another signatory. The content of an obligation to "seek to avoid" is uncertain. However, whatever the scope of the obligation, the more important factor was that the dispute settlement provisions of the Code provided for countermeasures against parties that caused any of the adverse effects. The three adverse effects were reflected in the dispute settlement provisions of the Code. Parties could seek authorization to apply countermeasures wherever an export subsidy (or any other subsidy) was causing any one of the three adverse effects.²¹³

Each of the three effects was explained further by footnotes to Article 8.

The concept of "injury" was meant to be the same as that described in the context of countervailing duties in Article 6.²¹⁴ In that context, injury was determined by reference to an examination of the volume of subsidized imports, and their impact on prices and on domestic producers.²¹⁵ The effect of the inclusion of this "injury" provision created an additional 'track' of possible response to another signatory's non-violation export subsidy which injured a domestic industry. In addition to being able to impose countervailing duties, signatories could seek authorization to impose countermeasures. It seems unlikely that a party would bother seeking authorization to proceed along that track when it could impose a countervailing duty without having to obtain any authorization.

The concept of "serious prejudice" was meant to refer to the same concept of "serious prejudice" as is used in Article XVI and included the threat of serious prejudice.²¹⁶

212 *Subsidies Code* Article 8:3(c).

213 *Subsidies Code* Article 13(4).

214 Interpretative footnote 23 to Article 8(3)(a).

215 Article 6:1.

216 Interpretative footnote 25 to Article 8:3(c).

The paragraph relating to nullification or impairment of benefits was expanded upon by an interpretative footnote saying that "benefits" should be interpreted to include benefits accruing under a tariff concession.²¹⁷ Exactly how wide an interpretation of benefits was justified by the footnote is unclear. It seems that the footnote merely held the status quo about the uncertainty as to whether a non-violation claim could lie in relation to the nullification or impairment of some benefit other than a benefit accruing under a tariff concession.

In discussing the principle of nullification or impairment above (at section 4.3), doubt was expressed about applying this principle to situations in which:

- (i) subsidized exports from Country B to Country A displace domestic production from Country A's own producers; and
- (ii) subsidized exports from Country B to Country C displace exports from Country A to Country C.

Article 8:4 clarified that nullification or impairment or serious prejudice could arise in both these situations.²¹⁸ It provided that nullification or impairment or serious prejudice might arise through the effects of subsidized exports either:

- in the subsidizing country, by displacing or impeding imports(Article 8(4)(b)),
- in the importing country (Article 8(4)(a)), or
- in third countries by displacing exports from another signatory(Article 8:4(c)).

In relation to the situation in which subsidized exports from Country B to Country A displace domestic production from Country A's own producers, it was noted above that, generally, it would be possible to impose a countervailing duty and that, therefore, parties would not need to seek authorization to retaliate against this kind of non-violation export subsidy. Nevertheless, it was also noted that resort to the nullification or impairment principle would probably not lie because of the difficulty of establishing a relevant benefit

217 Footnote 24 to Article 8:3(b).

that was being impaired. There would not be any relevant tariff concession being impaired. The argument that the competitive situation that exists in the absence of seriously prejudicial export subsidies is a benefit accruing under the Agreement was regarded as unsustainable because, in the GATT itself, there is no actual obligation to avoid using seriously prejudicial export subsidies. The situation under the Code was quite different. The existence of the obligation to avoid seriously prejudicial subsidies in Article 8:3(c) of the Code might have made it easier to establish a non-violation nullification or impairment but, under the Code, it was even less likely that a party would be seeking to establish such a non-violation nullification or impairment. Apart from the likelihood of a preference for resort to countervailing duties, in these circumstances, there would be no need to establish a nullification or impairment because the *Subsidies Code* provides for the two other alternatives of establishing injury to Country A's domestic industry under Article 8:3(a) or serious prejudice to country A's interests under Article 8:3(c).

In relation to the situation in which subsidized exports from Country B to Country C displace exports from Country A to Country C, one needs to consider the footnote to Article 8(3)(b) on the meaning of benefit and also the footnote to Article 8:4(c) on effects in third country markets. Read in conjunction with the interpretative footnote on the meaning of "benefit", Article 8:4(c) suggests that the relevant benefit could be the benefit received by country A from country C's tariff binding and that the nullification and impairment could result from the displacement of country A's exports to country C by subsidized exports from country B. However, even if that interpretation is correct, the application of that interpretation to primary products was limited by an interpretative footnote to Article 8:4(c) which provided:

The problem of third country markets so far as certain primary products are concerned is dealt with exclusively under Article 10 below.

Therefore, for primary products, the equitable share rule in Article 10 was an exclusive code on the effects of export subsidies in third country markets. That meant that for primary products, parties could not establish either "nullification or impairment" or serious prejudice

218 The first situation is covered by Article 4(a) and the second situation is covered by Article 4(c). Article 4(b) deals with a third situation where a subsidy causes import substitution.

as a result of the displacement of country A's exports to country C by subsidized exports from country B.

9.2.3 The Dispute Settlement Provisions of the Code

Article 16 set up a separate Committee on Subsidies and Countervailing Duties to implement the conciliation and dispute resolution provisions in Article 13 and Articles 16 to 18. The Committee could make recommendations if it found either that:

- (i) an export subsidy was being granted in a manner inconsistent with the Agreement; or
- (ii) any subsidy was being maintained in such a way as to cause any of the three adverse effects covered in Article 8, injury, nullification or impairment or serious prejudice.

If the Committee's recommendations were not followed then the committee could authorize "appropriate countermeasures (including withdrawal of GATT concessions or obligations) taking into account the nature and degree of the adverse effect found to exist."²¹⁹

10 OPERATION OF THE RULES BETWEEN THE TOKYO ROUND AND THE URUGUAY ROUND

Reference has already been made to the two EEC sugar complaints made before the end of the Tokyo Round but decided after the end of the round. These decisions involved the equitable share test in Article XVI:3 that had already been applied once in the 1958 French Wheat export case. The two EEC sugar cases indicate the difficulties involved in applying the equitable share criteria.

In the years between the Tokyo Round and the Uruguay Round, most of the GATT complaints on export subsidies concerned either export restitutions paid under the EEC's Common Agricultural Policy or concerned countervailing duties applied by either Canada or the United States in response to the EEC's export restitution payments made under the CAP. The overall conclusion on the Tokyo Round *Subsidies Code* must be that it was not successful in achieving greater discipline over export subsidies. The adoption of each of the decisions made under the *Subsidies Code* was blocked. A challenge to the EEC's export subsidies on wheat under the equitable share test was unsuccessful indicating that the

Subsidies Code had failed to make the test more effective. A challenge to export restitutions on pasta indicated the difficulties inherent in the distinction between primary products and non-primary products. Decisions on the application of countervailing duties indicated that the greater elaboration of the injury test in the code had made it harder to satisfy. Arguably, this indicated a greater discipline over countervailing duties but hardly indicated any greater discipline over export subsidies.

Detailed consideration of the key decisions reveals considerable problems in the application of the tests in article XVI:3 and in the *Subsidies Code*. All of these difficulties arise from the failure to agree on how to regulate export subsidies, and the failure to apply the same rules to primary products as were applied to non-primary products. In particular, it is clear that the resort to a test based upon effects rather than instrument brought considerable legal difficulties both to the rules regarding multilateral remedies and the rules regarding countervailing duties.

10.1 TRACK 1 - APPLICATION OF THE CODE TO COUNTERVAILING DUTIES

Over the years following introduction of the *Subsidies Code*, the application of countervailing duties to agricultural trade gave rise to a few legal problems. To the extent that these countervailing duty actions might not have arisen had export subsidies on primary products been subject to more rigorous 'track 2' disciplines and remedies, some of the difficulties with application of countervailing duties to agricultural trade might be regarded as having arisen because of the absence of adequate regulation under track 2.

The insertion of the injury test did not lead to a decrease in the number of CVDs. The overall outcome was that countervailing duty actions increased rather than decreased. Some of that increase might be attributable to the failure to agree in the Tokyo Round on a tighter track 2 regulation of export subsidies. However, after the Tokyo Round the practice of countervailing domestic subsidies broadened and this also led to some disputes and to some legal difficulties.

In particular, the *Subsidies Code* did not result in a reduction in use of countervailing duties by the United States.²²⁰ The United States took the view that it was only obliged to offer the benefit of the obligations imposed by the *Subsidies Code* to those countries that had become parties to it. Therefore, it was not prepared to make a finding of material injury a prerequisite to countervailing duties to be levied against subsidies used by non-signatories to the *Subsidies Code*.²²¹ Further, in respect of developing countries which were not bound by Article 9, the United States would not apply an injury requirement unless those countries made satisfactory phase out commitments under Article 14.²²²

With respect to export subsidies, the application of the injury test brought up some problems in defining the scope of the domestic industry that must be demonstrated to have been injured. One dispute involved an EEC export subsidy on wine. The USA applied a CVD because of injury not to wine producers but to grape producers. A panel found, in 1986, that the application of a CVD in this case would require demonstration of injury to wine producers not grape producers and that grape producers should not be regarded as part of the wine production industry.²²³ The USA blocked the adoption of the report finally permitting its adoption in 1992. A similar problem arose in a dispute about an export subsidy paid by the EEC on boneless beef. Canada imposed a CVD upon the basis of injury to Canadian cattle producers.²²⁴ The panel rejected the view that producers of cattle should be regarded as part of the boneless beef producers industry.²²⁵ Canada considered that the exclusion of

220 For statistics on the post *Subsidies Code* use of countervailing duties in this period by the United States and others, see the summaries of CVDs annexed to each of the annual reports of the Committee on Subsidies and Countervailing Duties (GATT, *BISD* 27S/31, 28S/27, 29S/42, 30S/39, 31S/259, 32S/158, 33S/197, 34S/185, 35S/379, 36S/451, 37S/312, 38S/95, 39S/405, 40S/350).

221 See Jackson, "United States Law and Implementation of the Tokyo Round Negotiation" ch4 in Jackson, Lewis & Matsushita, *Implementing the Tokyo Round - National Constitutions and International Economic Rules* (University of Michigan Press, Ann Arbor, 1984) p160-161. See Trade Agreements Act 1979 s2(b)(2); 19 USC §2503(b)(2) (Supp III 1979).

222 Jackson, as above, p160-161. See *Trade Agreements Act* 1974, s126(c); 19 USC § 2136(c) (1976). Also see Winham, Gilbert R., *International Trade and the Tokyo Round Negotiation* (Princeton University Press, Princeton, NJ, 1986) pp359-360.

223 "United States - Definition of Industry Concerning Wine and Grape Products" SCM/71 (24 March 1986) adopted by the CSCM 28 April 1992, GATT *BISD* 39S/436.

224 See "Boneless Manufacturing Beef Originating in or Exported from the European Economic Community in respect of which subsidies had been paid directly or indirectly by the European Economic Community and/or the Government of a Member States" review no RR-95-003, Canadian International Trade Tribunal, 1 T.T.R. (2d) 407, 22 July 1996, review of the finding made by the Canadian Import Tribunal on 25 July 1986 in Inquiry No CIT-2-86 [12 CER 62].

225 "Canada - Imposition of Countervailing Duties on Imports of Manufacturing Beef from the EEC", report by the panel, SCM/85, 13 October 1987, not adopted.

the producers of the input product in this way to be too narrow a construction of the meaning of injury to the domestic industry. It opposed adoption of the report and continued to apply the CVD.²²⁶ Perhaps, if there had been a more rigorous multilateral limitation on export subsidies on wine then there would have been no cause for USA grape producers to have sought the protection of countervailing duties. Similarly, if there had been some limitation on export subsidies on boneless beef, then the Canadian cattle producers may not have sought the protection of countervailing duties.

10.2 TRACK 2 - MULTILATERAL DISCIPLINES ON EXPORT SUBSIDIES AFTER 1979

10.2.1 The EEC Sugar Cases

The French Wheat decision finding a violation of Article XVI:3 was made in 1958. That was the year of the Stresa conference which decided on the general principles of the European Community Common Agricultural Policy which started to be implemented almost four years later in January 1962. As discussed above in the context of the Tokyo Round negotiation on subsidies, the CAP stimulated European agriculture and changed it from a position of net importer to net exporter, and export subsidies also became an essential ingredient of the CAP. As discussed above in the context of import barriers, there was a reluctance to adjudicate on the GATT consistency of variable levies because they were an integral part of the CAP. The Sugar cases in 1979 demonstrate a reluctance to adjudicate on the legality of European export subsidies. This time, unlike the panel in the French wheat case, the panels in the two sugar cases were not able to cut through the great quantity of statistical evidence on shares of world trade to make a finding of a breach of the equitable share rule in Article XVI:3. The issue of sugar in the CAP was especially sensitive because it also affected the arrangement with Lome countries because much of the sugar that received EEC export subsidies was imported preferentially from Lome countries.

The EEC sugar subsidies were challenged separately by Australia, in September 1978, and by Brazil, in November 1978. Separate panels were appointed to hear the two complaints but the composition of the two panels was the same. Apart from some issues relating to part IV

226 Hudec (1993) synopsis of complaints. complaint no 149. See Committee on Subsidies and Countervailing Duties, report of the committee presented to the 49th session (L/7138), GATT *BISD*

of the GATT which were raised only in the Brazilian complaint, the reports are substantially the same.²²⁷ They are dealt with together.

(a) *The European Agricultural Policy for Sugar*

The common agricultural policy for sugar provided a system of price support made effective through export subsidies and import barriers in the form of variable levies. In essence, the EEC support system provided for an internal price at which intervention agencies were required to purchase sugar together with a variable import levy which was equal to the gap between the internal price and the world price of imports and with a system of export refunds equal to the gap between the internal price and the world price for exports.²²⁸ To explain the system of support, it is necessary to set out the following terms which are used in the EEC regulations:

"Target Price" was set for white sugar for the area of the Community which had the largest surplus (the lowest price);²²⁹

"Intervention Price" was set for the same products, same period and same areas as the Target Price but it was lower than the Target Price; for other areas "Derived Intervention Prices" were set taking account of regional variations;²³⁰

"Minimum Price" for white sugar was set for each producing area; it was derived from the Intervention Price; different Minimum Prices were set for a Basic Quota called Quota A and an additional quota called Quota B;²³¹

"Basic Quota" or "Quantity A" was allotted to each undertaking within the basic quantities assigned to each country or area of the EEC;²³² In 1975, the total "Quantity A" for the EEC had been raised from 7.82 million to 9.14 million tons.²³³

40S/350, para 12(c) recording the panel was still unadopted as at 28 October 1993.

227 "European Communities - Refunds on Exports of Sugar, complaint by Australia", report of the panel (L/4833) adopted 6 November 1979, GATT, *BISD* 26S/290 (the 'Australian complaint'); "European Communities - Refunds on Exports of Sugar - Complaint by Brazil" Report of the Panel adopted on 10 November 1979 (L/4833) GATT, *BISD* 27S/69 (the 'Brazilian complaint').

228 The system was set up under Regulation (EEC) No 3330/74 of the European Council of December 1974 as amended) (the various amendments are listed in para 3.2 of the report on the Australian complaint: *BISD*, 26S/290 at 301.

229 Reg 3330/74, Article 2. *BISD*, 26S/290 at 301, para 3.4.

230 Reg 3330/74, Article 11. *BISD*, 26S/290 at 301, para 3.5.

"Quantity B" was an additional amount in linear proportion to Quantity A.²³⁴ In 1975, Quantity B was 45% of Quantity A. In 1976, it had been changed to 35% and, in 1978, to 27.5% of Quantity A.²³⁵

"Maximum Quota" was the sum of Quantity A and Quantity B;²³⁶

"Quantity C" was the quantity produced in excess of the Maximum Quota;²³⁷

"Threshold Price" was used for setting the minimum effective price at which imports might enter the EC; the threshold price was based on the "target price" for the EEC area having the lowest price plus the cost of transport from there to the most distant EEC areas.²³⁸

The regulation set up an interrelated system of domestic price support, import barriers and export refunds.

Domestic Price Support:

The regulation imposed different obligations in relation to each quota level:

For Quantity A:

- Manufacturers were obliged to buy from beet producers at the Minimum Price;²³⁹
- Intervention agencies in each country were obliged to buy from manufacturers at the Intervention Price.²⁴⁰

For Quantity B:

- Manufacturers were obliged to buy beet from beet producers at the Minimum Price for Quantity B which was less than the Minimum Price for Quantity A;²⁴¹

231 Reg 3330/74, Articles 4 & 5. *BISD*, 26S/290 at 302, para 3.6.

232 Reg 3330/74, Article 24. *BISD*, 26S/290 at 302, para 3.7.

233 *BISD*, 26S/290 at 315, para 4.32.

234 Reg 3330/74, Article 25. *BISD*, 26S/290 at 302, para 3.7.

235 *BISD*, 26S/290 at 315, para 4.32.

236 Reg 3330/74, Article 25. *BISD*, 26S/290 at 302, para 3.7.

237 Reg 3330/74, Article 26. *BISD*, 26S/290 at 302, para 3.7.

238 Reg 3330/74, Article 13. *BISD*, 26S/290 at 303, para 3.11.

239 *BISD*, 26S/290 at 302, para 3.6.

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- The intervention agencies were obliged to buy from the manufacturers at the Intervention Price but were entitled to deduct a production levy paid to the State; the production levy could not exceed 30% of the Intervention Price.²⁴²

For Quantity C:

- The intervention agencies were not obliged to buy this quantity.
- Manufacturers were free to determine the price paid to beet producers upon the basis of conditions applying on the world market price.²⁴³
- Manufacturers could only export this quantity;²⁴⁴

Import Barriers:

To prevent the price of imports from causing the domestic price to fall and causing the intervention agencies to incur losses on resale, an import barrier was applied. The import barrier was in the form of a variable import levy. The amount of the levy was determined so that it would be equal to the amount by which the Threshold Price exceeded the import price.²⁴⁵

Export Refunds:

If manufacturers or producers exported sugar at world prices lower than internal EEC prices then they could tender to the intervention authority for an export refund. The intervention authority would pay the refund requested up to the maximum fixed refund (which was the difference between the world price and the EEC Intervention Price).²⁴⁶ Refunds could only be paid in respect of sugar manufactured from beet or cane purchased from either EEC

240 *BISD*, 26S/290 at 302, para 3.5.

241 *BISD*, 26/290 at 302, para 3.6 & 3.8.

242 *BISD*, 26S/290 at 302, para 3.8.

243 *BISD*, 26S/290 at 302-303, para 3.8.

244 *BISD*, 26S/290 at 303, para 3.9.

245 Reg 3330/74, Article 15. *BISD*, 26S/290 at 303, para 3.12.

246 Reg 3330/74, Article 19, para 3.13. *BISD*, 26S/290 at 303, para 3.13.

producers or producers in a Lome country.²⁴⁷ Refunds could only be paid upon exports of sugar within the Maximum Quota and could not be paid upon Quota C.²⁴⁸

(b) *The Sugar Market*

In 1967, the countries comprising the EEC were net importers of sugar.²⁴⁹ The EEC Common Agricultural Policy for sugar began to operate in 1968²⁵⁰ and the *International Sugar Agreement 1968*²⁵¹ entered into force in 1969.²⁵² In that year, world production and consumption of sugar were roughly in equilibrium: production of 70 million tons and consumption of 68 million tons.²⁵³ From 1969 to 1974, consumption grew faster than production and prices rose.²⁵⁴ In 1970 and 1971, export quotas under the ISA were increased and in 1972 they were suspended.²⁵⁵ In 1974, pursuant to a protocol to the Lome Convention concerning sugar, the EEC agreed to import 1.3 million tons of sugar from the ACP countries.²⁵⁶ In 1975, the upward price trend reversed with production increasing and consumption actually falling and a consequent decrease in price.²⁵⁷ In the following years, production grew at a faster rate than consumption with the price continuing to fall. In 1977, world stocks reached a record level and, in 1978, world prices fell to their lowest level since 1971.²⁵⁸

With a view to raising the level of the world sugar prices, a number of nations negotiated a new international agreement on sugar obliging them to limit their exports to specific tonnages. The European Community declined to become a party to the new agreement. Nevertheless, on 1 January 1978, the *International Sugar Agreement 1977* came into

247 *BISD*, 26S/290 at 303, para 3.14.

248 Reg 3330/74, Article 26; *BISD*, 26S/290 at 303, para 3.9.

249 Hathaway, Dale E., *Agriculture and the GATT: Rewriting the Rules* (Institute for International Economics, Washington DC, 1987) (No 20 in the series "Policy Analyses in International Economics") p39.

250 Under EEC Council Reg No 1009/67 of 18 December 1967, in force 1 July 1968. See *BISD* 26S/290 at 301, para 3.1.

251 *International Sugar Agreement 1968*, New York, 3-24 December 1968, UKTS 93 (1969), in force provisionally 1 January 1969, in force definitively 17 June 1969.

252 *BISD* 26S/290 at 304, para 3.18.

253 *BISD* 26S/290 at 304, para 3.18. *BISD* 27S/69 at 85, para 3.18.

254 *BISD* 26S/290 at 304, para 3.19. *BISD* 27S/69 at 85, para 3.19.

255 *BISD* 26S/290 at 304, para 3.20. *BISD* 27S/69 at 86, para 3.21.

256 On the *Lome Convention*, see chapter 10 above at fn67.

257 *BISD* 26S/290 at 304, para 3.19. *BISD* 27S/69 at 85, para 3.19.

258 *BISD* 26S/290 at 304, para 3.19. *BISD* 27S/69 at 85, para 3.19.

force²⁵⁹ and the parties to it had to limit their exports in accordance with it.²⁶⁰ However, the EEC was not subject to these limits and, by 1978, the EEC which had been a net importer of sugar a decade earlier, had become a substantial exporter of sugar.

(c) *The Arguments*

In their respective complaints, both Australia and Brazil argued that the EEC system of refunds on exports of sugar:

- (1) had resulted in the EEC exporters having more than an equitable share of the world export trade in terms of Article XVI:3;
- (2) caused or threatened serious prejudice, respectively, to Australia and Brazil; and
- (3) had nullified or impaired benefits accruing either directly or indirectly, respectively, to Australia and Brazil under the GATT.²⁶¹

Australia and Brazil supported these arguments with evidence of their own lost sales and of the EEC's increasing sales.

The response of the EEC was to provide a vast amount of statistical evidence and detailed arguments in relation to various changes in the world sugar market. However, there is one overriding factor that is implicit in the EEC's response. This is that continuance of the CAP was not negotiable. Were the EEC's export subsidies to be found illegal then the operation of the CAP would result in the accumulation of such surpluses that the CAP would become inoperable.²⁶² Nowhere is this factor better displayed than in the EEC response in the Australian complaint. Australia had argued that the EEC subsidies were in violation of Article XVI:3 because, first, being intended to increase EEC exports, they breached the obligation to "avoid the use of export subsidies on the export of primary products" and, secondly, because they resulted in the EEC having more than an equitable share of world trade. The report of the panel reproduced the EEC's response:

259 *International Sugar Agreement 1977*, 7 October 1977, Geneva, UN doc TD/SUGAR/9/10 of 17 Oct 77, Cmnd 7159, TIAS 9664; in force provisionally 1 Jan 1978.

260 *BISD* 26S/290 at 305, para 3.21. *BISD* 27S/69 at 86, para 3.21.

261 See *BISD*, 26S/290 at 291, para 2.1 and *BISD* 27S/69 at 69, para 2.2.

262 In support of this view, see Hudec, *Enforcing International Trade Law* (1991) p131.

The representative of the European Community argued ... *that there could be no question of considering an increased expenditure on refunds as having the objective or the effect of increasing Community exports.* A relatively large refund played the same role as a moderate one, in the sense of enabling Community exports to approach the world price. The amount of the refund was designed simply *to make exports possible and not to stimulate them.*²⁶³

That such an obvious piece of complete nonsense was argued by the EEC is evidence that the EEC was proceeding on the basis that the CAP itself could not be challenged. That the argument was reproduced in the panel report as a serious argument, instead of being dismissed as the nonsense that it was, indicates how seriously the panel took the EEC's warning.

(d) *The Nature of the Evidence*

The panels were presented with a vast amount of data relating to the world sugar market and various segments of it. In fact, the panels were inundated with statistical evidence. Data presented to the panel on the Australian complaint included statistics on the EEC share of exports to free markets,²⁶⁴ statistics comparing the EEC's share of the market with various previous periods,²⁶⁵ statistics comparing the absolute values of exports between Australia and the EEC²⁶⁶ and over time,²⁶⁷ comparing EEC export with and without export subsidies,²⁶⁸ statistics on production, trade, consumption and stocks of sugar for Australia and the EEC²⁶⁹ and for the rest of the world²⁷⁰ and statistics on EEC sugar production, consumption and target prices since 1960.²⁷¹

263 *BISD* 26S/290 at 294, para 2.10 (Emphasis added).

264 See *BISD* 26S/290 at 295, Table 1 for statistics comparing the total world exports and EEC exports of sugar to the free market and giving the percentages of Community exports as a proportion of total world exports.

265 See *BISD* 26S/290 at 309, Table 2 for a comparison of the share of the EEC's share of world export trade in sugar over the period the subject of complaint and various previous representative periods.

266 See *BISD* 26S/290 at 311, Table 4 for statistics comparing the absolute values of EEC and Australian exports of sugar to the world market and also to various segment of the world market (existing markets for both exporters, Australian exports to the EC, the major Australian markets, certain markets in the Mediterranean area, Middle East and Africa, and other markets).

267 See *BISD* 26S/290 at 314, Table 5 for statistics comparing the absolute values of EEC export of raw sugar to various markets between 1972 and 1978.

268 See *BISD* 26S/290 at 317, Table 6 for statistics comparing the absolute values of EEC exports with and without export subsidies

269 In Annex Table I which is referred to at para 4.30 at 315 of L/4833 (but not reproduced in the report published in *BISD* 26S) for statistics on production, trade, consumption and stocks of sugar for Australia and the EC.

In the Brazilian complaint, the evidence included even more detailed information about changes in individual markets and in groups of individual markets. Data submitted to the panel included statistics submitted by Brazil comparing EEC and Brazilian exports over time to the world market and segments of it,²⁷² similar statistics submitted by the EC for a slightly different period;²⁷³ statistics on imports of EEC and Brazilian sugar into various countries,²⁷⁴ statistics arguably showing displacement of Brazilian sugar exports by EEC exports,²⁷⁵ statistics showing the destination markets for Brazilian sugar over time,²⁷⁶ statistics as to Brazil's loss of export earnings,²⁷⁷ statistics on the quantity of EEC exports receiving export subsidies,²⁷⁸ statistics on the shares of the EEC, Brazil and others in world export trade in sugar²⁷⁹ statistics on imports into Brazilian markets,²⁸⁰ statistics on production, trade, consumption and stocks of sugar for Australia, the EEC and also for the whole world,²⁸¹ statistics showing changes in EEC production, consumption and target prices between 1969 and 1979, and statistics on the correlation between the amount of export refunds and the difference between EEC intervention price and the world price.²⁸²

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- 270 In Annex Table II which is referred to at para 4.30 at 315 of L4833 (but not reproduced in the report published in *BISD* 26S) for statistics on production, trade, consumption and stocks of sugar for the rest of the world.
- 271 Referred to in para 4.37 in *BISD* 26S/290 at 318 for data on EEC sugar production, consumption and target prices since 1969.
- 272 See *BISD* 27S/69 at 73, Table 1 for statistics (submitted by Brazil) of exports of Brazil and the EEC between 1973-75 and 1976-78 and the change for each of them between the two periods divided into traditional EEC markets, newer markets and total world market.
- 273 See *BISD* 27S/69 at 75, Table 2 for statistics (submitted by the EEC) comparing the world market and segments of the market between 1972-74 and 1975-77.
- 274 See *BISD* 27S/69 at 75, para 2.13 for statistics on imports of sugar into selected countries and groups of countries from 1972 to 1979 comparing the quantity of those imports that were sourced from Brazil and the EEC.
- 275 See *BISD* 27S/69 at 76, para 2.14 for statistics showing the number of markets in which, arguably, EEC exports had displaced Brazilian exports of both raw and white sugar.
- 276 See *BISD* 27S/69 at 76, para 2.14 for statistics showing the reduction in the number of destinations markets to which Brazil exported sugar between 1972-75 and 1977 and 1979.
- 277 See *BISD* 27S/69 at 78, para 2.22 for estimates of the losses in export earnings of Brazil between 1972-74 and 1976-78.
- 278 See *BISD* 27S/69 at 84, Table 3 for statistics on the volume of EEC exports receiving and not receiving export refunds between 1972 and 1979.
- 279 See *BISD* 27S/69 at 89, Table 4.
- 280 See *BISD* 27S/69 at 91, Table 5 for statistics on the shares of the total of imports into selected markets which were either traditional Brazilian markets or new markets in regions where Brazil had traditionally offered sugar for sale (referring to the list of countries contained in Annex Table IX)
- 281 Annex Table 1 referred to in para 4.19 of 27S/698 at 93 but not reproduced in the report published in *BISD*, 27S.
- 282 Annex Table VII referred to in para 4.28 of 27S/69 at 95 but not reproduced in the *BISD* report.

(e) *The Decision Under Article XVI:3 in The Australian Complaint*

The panel rejected the EEC's attempt to limit consideration to exports in the free market rather than the whole world export market saying that the words "world export trade" in Article XVI:3 should not be limited.²⁸³

The panel noted the different "previous representative period[s]" that had been suggested by the parties and that 1975, in particular, and also 1974 could not be considered to be representative because of the high prices in those years. The panel chose to compare the period subject to the complaint with 3 different baseline periods: the averages of 1971-73; of 1972-74 and of 1972, 1973 and 1976.²⁸⁴

Like the panel in the 1958 French Wheat case, the panel noted that the Agreement did not contain a definition of "equitable share".²⁸⁵ The panel said that it could analyze the changes in "individual market shares", markets and prices and "draw a conclusion on that basis". If by "individual market shares", the panel was referring to 'shares of individual markets' rather than to 'shares of individual countries in the world market', then it was making a major step beyond the words of Article XVI:3. The making of such a step could not be based on the 1958 French Wheat Flour decision which had decided there was a violation of Article XVI:3 on the basis of the change in France's share of the world market.²⁸⁶ In that case, the shares in individual markets were considered only for the purpose of determining whether an adverse trade effect such as would constitute an impairment of a benefit had occurred.²⁸⁷

The statistics for the chosen baseline years showed figures for the EEC's share of world export trade ranging between 7.5% and 8.5%.²⁸⁸ A comparison of any of the baselines with either 1976 or 1977 showed only small increases in the EEC's share. In 1976, the percentage was 8.3. In 1977, the percentage was 9.6, an increase from the various baselines

283 *BISD* 26S/290 at 307, para 4.9.

284 *BISD* 26S/290 at 308, para 4.11.

285 *French Wheat case* at 52, para 15. *EC Sugar - Australian Complaint BISD* 26S/290 at 308, para 4.11.

286 See above in this chapter at pp272-273.

287 Such an inquiry would no longer be necessary or appropriate: see "European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins" report adopted 25 January 1990, GATT *BISD* 37S/86 at 130, para 150.

288 *BISD* 26S/290 at 308, Table 2.

of between 1.1 and 2.1 percentage points.²⁸⁹ In 1978, the EEC's share was 14.3%, an increase of between 5 and 6 percentage points.²⁹⁰ However, the panel noted that 1978 was the year that the *1977 International Sugar Agreement* had come into force and that while, in that year, the parties to the Agreement had limited their exports in accordance with it, the EC, not being a party, was able to export without any such limitation.²⁹¹ The panel did not mention it but this change from about 8% to about 14% compared with the change from about 3% to about 7% in the French Wheat case which the panel, there, had found to be more than an equitable share.²⁹² In this case, the panel was not prepared upon the basis of the increase of between 5 and 6 percentage points or of about 60% in the EEC's share of world export trade to find that the EEC's share was "more than equitable".

Instead, at this point, the panel adopted an interpretation of Article XVI:3 which had been adopted in the wording of the Tokyo Round *Subsidies Code* which had been signed in the preceding April but was not yet in force.²⁹³ The EEC was an original signatory but, at that time, Australia was not a signatory.²⁹⁴ Without referring to the *Subsidies Code*, the panel stated that it

was of the opinion that the term "more than an equitable share of world export trade" should include situations *in which the effect of an export subsidy granted by a signatory was to displace the exports of another signatory, bearing in mind the developments in world markets*".²⁹⁵

The words in italics are identical to Article 10:2(a) of the *Subsidies Code*. The panel continued :

With regard to new markets, traditional patterns of supply of the product concerned to the world market, region or country, in which the new market is situated, should be taken into account in determining what would be "more than an equitable share of world export trade".²⁹⁶

The words in italics are identical to Article 10(2)(b) of the *Subsidies Code*.

289 *BISD* 26S/290 at 309, Table 3.

290 *BISD* 26S/290 at 308, Table 2 & at 309-310, para 4.14.

291 *BISD* 26S/290 at 310, para 4.15.

292 See above in this chapter at pp371-373.

293 *The Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement (BISD 26S/56, 1186 UNTS 204)* was signed on 12 April 1979 but entered into force for original ratifying parties on 1 January 1980. (see GATT, *Analytical Index*, p1056)

294 See report of the Committee on Subsidies and Countervailing Measures (L/5055) *BISD* 27S/31 at 31, para 1.

295 *BISD* 26S/290 at 310, para 4.17 (emphasis added).

The panel made no attempt to explain what it meant by displacement. On a simple meaning of the word 'displace', the appropriate comparison for determining whether subsidized exports had displaced other exports should be between actual figures for exports and figures constructed on the basis that the export subsidy had not been paid. However, the panel did not engage in such a comparison. Instead, it merely compared actual sales in the recent period with actual sales in the previous representative periods. Therefore, the 'displacement test' copied from the *Subsidies Code* was simply a new version of the 'previous representative period test' as found in the words of Article XVI:3 itself.

The panel assessed whether Australian sugar exports had been displaced by the subsidized exports from the EC, looking first at the world market as a whole and then at various groups of countries and individual countries.

For the world market as a whole, the panel observed that Australia's share had increased throughout the period ending in 1977 and had dropped off only in 1978 after Australia had become bound by a quota under the *International Sugar Agreement*.²⁹⁷ If we assemble the figures quoted for the Australian share with the figures quoted above in respect of the EEC's share, we can construct the following table:

<i>Share of World Exports</i>	<i>EEC per cent</i>	<i>Australia per cent</i>
Baseline 1971-73	7.8	9.5
Baseline 1972-74	7.5	9.5
Compared with		
1976	8.3	11.1
1977	9.6	11.1
1978	14.3	8.0

Clearly, in respect of the period before the *ISA* came into force, these figures do not demonstrate that Australia's pre-existing share of world exports had been displaced by EEC exports. On this interpretation of 'displacement' as implicitly adopted, EEC exports had not

296 As above (emphasis added).

297 *BISD* 26S/290 at 310, para 4.19.

displaced Australian exports from the world market. With respect to the 1978 year, the panel noted that Australia had been constrained by its quota under the *ISA*.²⁹⁸

The panel continued to analyze various subsets of the world market looking for evidence that EEC exports had displaced Australian exports. However, of the five segments of the market selected, four were irrelevant: two being composed of markets where Australia had never had any significant volumes of exports in the previous representative periods,²⁹⁹ one being composed of markets where even after the large EEC subsidies, the EEC did not have any significant exports,³⁰⁰ and the other being the import market into the EEC itself.³⁰¹ The only relevant segment of the world market considered was the group of countries where both Australia and the EEC had sold sugar in recent years in competition with each other.³⁰² From the statistics in Table 4 of the report, for exports to this Group, the panel might have found that EEC exports had displaced Australian exports. If one computes the averages for the base periods and the more recent years, one can construct the following comparison:

Average exports in thousand tons by EEC and Australia to the group comprising PR China, Finland, US and USSR.

	<i>EEC</i>	<i>Australia</i>	<i>EEC:Aust ratio</i>
1971-73 Baseline	60	323	0.18
1972-74 Baseline	34	385	0.09
1972, 73 & 76 Baseline	140	484	0.29
Compared with			
1976	317	602	0.53
1977	335	729	0.46
1978	212	301	0.70

298 *BISD* 26S/290 at 310, para 4.19.

299 *BISD* 26S/290 at 311, Groups IV and V in Table 4 & paras 4.24-4.25 at 313.

300 *BISD* 26S/290 at 311, Group III in Table 4 & para 4.23 at 312.

301 *BISD* 26S/290 at 311, Group II in Table 4 & para 4.22.

302 *BISD* 26S/290 at 311, Group I in Table 4 & para 4.21.

EC exports, assisted by export refunds, had risen from less than three tenths of Australian exports to this group of countries to be between four and seven tenths of Australian exports. It was certainly open for the panel to find that, in relative terms, EEC exports had displaced Australian exports. However, the panel appears not to have been interested in the relative sizes of EEC and Australian exports. This is consistent with an interpretation of displacement as taking away from a country's previous share rather than as taking away from the share a country would have had but for another country's export subsidies.

The panel discussed only the figures for 1978 which showed an absolute decrease in Australian exports from 1977.³⁰³ In assessing changes from 1977 to 1978, the panel observed that, in both the US market and the Chinese market, there had been an increase in exports from the EEC and a concurrent decrease in exports from Australia. With respect to the US market, the panel noted that the increase in EEC exports was only a tenth as large as the decrease in Australian exports and takes the consideration no further.³⁰⁴ The panel's implicit dismissal of the allegation that EEC exports had displaced Australian exports from the US market, that is, that it was not a "situation in which the effect of an export subsidy ... was to displace the exports of another signatory"³⁰⁵ necessarily involves one of two implied findings: either, that the partial reduction in Australian exports was not an 'effect' of the EEC export subsidy; or that a partial 'displacement' is not a displacement. With respect to the Chinese market, the panel noted that there was an increase in EEC exports of 93,000 tons concurrent with a decrease in Australian exports of 138,000 tons but was still not prepared to find affirmatively that the EEC sales displaced Australian sales because at the same time there had also been an increase in supplies from other countries.³⁰⁶ The panel concluded that

there was not enough evidence to state that the increased community exports in recent years had to a considerable extent directly displaced Australian exports from world markets although it should not be excluded that Community exports to China in 1978 could partly have replaced Australian supplies.³⁰⁷

303 *BISD* 26S/290 at 312, para 4.21.

304 *As above.*

305 *See para 4.17.*

306 *BISD* 26S/290 at 312, para 4.21.

307 *BISD* 26S/290 at 313, para 4.26.

The panel then considered whether EEC exports had *indirectly* displaced Australian exports. By indirect displacement, it meant possible displacement of Australian raw sugar exports by raw sugar exports from other countries that had, in turn, been displaced from their traditional markets in countries with sugar refining facilities by EEC exports of refined white sugar. The panel considered the size of the EEC'S exports of refined white sugar to markets which had "traditionally been regarded as important outlets for raw sugar".³⁰⁸ The statistics that were considered by the panel demonstrated an enormous increase in total EEC exports to the selected countries:

1972	173 (000 tonnes)
1975	74
1976	522
1977	871
1978	1,497

However, even on the basis of such an enormous increase, the panel was not prepared to find that Australian raw sugar exports had been indirectly displaced by EEC exports of white sugar.³⁰⁹ The panel's reasoning was that it "did not exclude the possibility" that increased EEC exports of refined white sugar might have resulted from re-export of sugar which the EEC had imported from Lome countries pursuant to its obligations under the Lome Agreement.³¹⁰ It seems that the panel's view was that the increased EEC exports were caused by the obligations under the Lome Agreement rather than by the export subsidies. However, the panel report does not evidence any attempt to ascertain what proportion of sugar imported from Lome countries and re-exported had received the benefit of export subsidies.

The panel reached a final conclusion on Article XVI:3

In the light of all the circumstances related to the present complaint, and especially taking into account the difficulties in establishing clearly the causal relationships between the increase in community exports, the developments of Australian sugar exports and other developments in the world sugar market, the

308 *BISD* 26S/290 at 313, para 4.28.

309 *BISD* 26S/290 at 314-315, para 4.28.

310 *BISD* 26S/290 at 314, para 4.28.

Panel found that it was not in a position to reach a definite conclusion that the increased share had resulted in the European Communities "having more than an equitable share of world export trade in that product", in terms of Article XVI:3.³¹¹

There are two issues dealt with in this finding: the issue of the size of an equitable share and the issue of causation. Because of the wording of the overall finding in the negative, it is impossible to separate the two issues. From the wording of the finding alone, it is impossible to tell whether the panel decided that the EEC's share of world trade was not "more than equitable" or whether it decided that the market share regardless of whether it was "more than equitable" had not resulted from the export subsidies or whether the panel was making both findings.

However, from the rest of the panel report and the other findings, it is possible to draw some separation, though not entirely distinct, between the two issues. The panel does make a finding that the increase in the EEC'S exports was caused by the export subsidies.³¹² However, despite this finding about the causal link between the export subsidies and the absolute size of EEC exports, there is no further express finding about a causal link between the export subsidies and the relative size of EEC exports in world export trade.

In conclusion, we note that the panel was *not* prepared to find:

- (a) that EEC share of world export trade was more than equitable:
 - (i) on the basis of evidence of an increase in EEC share of world export trade from about 8% to about 14%; nor
- (b) having adopted a test of displacement which in its own words was restricted to mean displacement "to a considerable extent", that the situation was one in which such displacement had occurred:
 - (i) directly, on the basis of evidence that the EEC'S share of exports to the principal markets contested by both the EEC and Australia had increased

311 *BISD* 26S/290 at 319, para (f).

312 *BISD* 26S/290 at 319, para (c).

from less than three tenths of the Australian share to between four and seven tenths of the Australian share; nor

- (ii) indirectly, on the basis of evidence that EEC exports of refined sugar to selected traditional raw sugar markets had increased from approximately a couple of hundred tons to approximately a thousand tons.

(f) The Decision on Article XVI:3 in the Brazilian Complaint

The facts of the Brazilian complaint made a stronger case for a violation of Article XVI:3 than the Australian complaint for two reasons. First, the complaint had the benefit of additional statistics since preliminary figures for 1979 were available and were taken into account by the panel. The 1979 statistics confirmed the trend of previous years. Second, the statistics showed a stronger case for Brazil's exports having been displaced by EEC exports.

As in the Australian complaint, there was argument about the choice of previous representative periods. The Brazilians argued that the average for the years 1972-4 should be compared with the years, 1977, 1978 and 1979.³¹³ The EEC wanted to compare the averages for the years 1972-74 and 1975-77 with the year, 1978.³¹⁴ The panel chose to compare the averages for 1971-73 and 1972-74 with the years 1976, 1977, 1978 and 1979.³¹⁵

Much of the panel's decision is the same as the decision in the Australian complaint. Again, the panel noted the absence of any definition of 'more than equitable share' and making an explicit mention of the causation aspect of Article XVI:3, the panel said that it could form a conclusion on the basis of an assessment of changes in "individual market shares" and a determination of "any causal relationship" between the increase in EEC sugar exports and changes in both Brazilian sugar exports and in the world sugar market.³¹⁶ The panel seems to have proceeded on the basis that "more than an equitable share" of an individual market might be enough to violate Article XVI:3. The panel referred to the interpretative

313 *BISD 27S/69* at 72, para 2.6.

314 *BISD 27S/69* at 74, para 2.10.

315 *BISD 27S/69* at 89, para 4.9.

316 *BISD 27S/69* at 88, para 4.6.

provisions on article XVI:3 in the *Subsidies Code* (compared to quoting them without source, as done in the report on the Australian complaint) and noted correctly that both the EEC and Brazil had accepted the *Subsidies Code*.³¹⁷

The panel made essentially the same observations about the size of the EEC's share of world export trade as had the panel in the Australian complaint. The figures for 1979 confirmed the change in the EEC's share of world trade from just under 8% to just over 14%. As in the Australian complaint, the panel was not prepared to find, upon the basis of this change of about 6 percentage points, that the EEC had more than an equitable share of world export trade but, instead, proceeded to determine whether EEC exports had displaced the complainant's exports of sugar.³¹⁸

The panel analyzed the export sales into various individual markets and also into a group of selected markets which were either traditional outlets for Brazilian sugar or were new country markets in regions where Brazilian sugar had traditionally been offered for sale.³¹⁹ The panel found that EEC exports had increased at the same time as Brazilian exports had decreased in only a few of the individual markets.³²⁰ For the group of selected Brazilian markets, the market shares of exports were:³²¹

	<i>EEC</i>	<i>Brazil</i>
Base Lines		
1971-73 (avg.)	6.5	15.7
1972-74 (avg.)	6.0	18.1
compared with		
1976	8.4	5.6
1977	8.9	11.4

317 *BISD 27S/69* at 88, para 4.7. See report of the Committee on Subsidies and Countervailing Measures in 27S/31; para 1 records both the EC and Brazil as signatories as at 23 October 1980 which was after the commencement of this complaint (on 10 November 1978) but before the adoption of the report of the panel (on 10 November 1980).

318 *BISD 27S/69* at 90, para 4.11 & 4.12.

319 *BISD 27S/69* at 90-91, para 4.13.

320 *BISD 27S/69* at 91, para 4.15.

321 See Table 5 entitled "share of the Total of Imports into Selected Markets (Countries Listed in Annex Table IX) at 91.

1978	15.6	11.3
1979	13.9	9.7

EC exports had more than doubled their share whilst Brazilian exports had fallen to less than two thirds of their share in the base line periods. The argument that the complainant's exports had been displaced by EEC exports was stronger than in the Australian complaint. From the market share shown by the statistics analyzed, it was open to the panel to find that EEC exports had displaced Brazilian exports. However, the panel preferred to emphasize other factors "such as particular trade relations, competition from other exporters and prevailing market prices" and found that the analysis of the particular markets "did not provide clear and general evidence that Brazilian supplies had been directly displaced" by subsidized EEC exports.

Therefore, the panel found that there was no violation of Article XVI:3 and expressed its conclusion in almost identical terms to the conclusion in the Australian complaint:

In the light of all the circumstances related to the present complaint, and especially taking into account the difficulties in establishing clearly the causal relationships between the increase in Community exports, the developments of Brazilian sugar exports and other developments in the world sugar market, the Panel found that *on the basis of the evidence available to it in this particular case*, it was not able to conclude that the increased share had resulted in European Communities "having more than an equitable share of world export trade in *the product*", in terms of Article XVI:3.³²²

As in the Australian complaint, there was no express finding about a causal link between the EEC's export subsidies and the EEC's share of world export trade but there was a finding that the increase in the EEC's exports in absolute terms was caused by the export subsidies.³²³ To the extent, then, that it is possible to separate a finding on 'equitable share' from a finding on 'causation', we can note that with respect to equitable share, the panel was not prepared to find:

- (a) that EEC share of world export trade was more than equitable

322 *BISD 27S/69* at 97, para V(e). The italics indicate words which are not identical to the corresponding paragraph in the panel report on the Australian complaint in *BISD 26S/290* at 319, para V(f).

323 *BISD 27S/69* at 90, para 4.11.

- (i) on the basis of evidence of an increase in the EEC share of world trade from less than 8% to more than 14%;³²⁴ nor
- (b) having accepted that 'more than an equitable share' exists in a case where subsidized exports displace another parties exports, that the case was one in which displacement had occurred:
- (i) directly, on the basis of evidence that the EEC share of exports to markets contested by the EEC and Brazil had increased twofold while the Brazilian market share had decreased by a third.³²⁵

(g) *Onus of Proof*

In making such findings, both panels clearly placed the onus of proof on the complainant to prove that the EEC's share was more than equitable. This contrasts with the approach in the French wheat flour case in 1958 where after observing the increase in French exports and the concurrent decrease in Australian exports, the panel seems to have regarded the onus as being on France, the defendant, to rebut the presumption that its share was inequitable.³²⁶

(h) *The findings on Serious Prejudice under Article XVII*

Having avoided a finding of violation of Article XVI:3, the respective panels in the two complaints proceeded to note that the EEC export subsidies had "contributed to depress world sugar prices".³²⁷ Each panel found that the export subsidies had caused serious prejudice to the interests of the respective complainants, Australia and Brazil, and continued to be a threat of further serious prejudice within the meaning of Article XVI:1.³²⁸ The consequence of that finding was that the EEC was obliged to discuss the "possibility of limiting the subsidization".³²⁹

324 See *BISD 27S/69* at 90, para 4.11 & at 96-97, para (b) to (e).

325 *BISD 27S/69* at 90-91, para 4.13.

326 See Boger III, William H., "The United States-European Community Agricultural Export Subsidies Dispute" (1984) 16 *Law & Policy in International Business* 173 at 203.

327 *BISD 26S/290* at 319, para (g) & *BISD 27S/69* at 97, para (g).

328 *BISD 26S/290* at 319, para (g) & (h) & *BISD 27S/69* at 97, paras V(f) & (g).

329 Article XVI:1.

(i) *The Side-Stepping of Non-Violation Nullification or Impairment*

Having found that the export subsidies had caused lower world prices, the panels could have considered whether the export subsidies, though not violations, had nevertheless nullified or impaired benefits accruing to Australia or Brazil under the Agreement. This would have required the panel to consider whether a non-violation nullification or impairment could exist in these circumstances. At that time nor any time since has there been a decision of a panel adopted that made a finding of non-violation nullification or impairment either of a benefit other than a tariff concession or in relation to a benefit involving access to a third country market. The panel neatly sidestepped having to deal with this problem by saying that it would not consider the non-violation nullification or impairment question because "[n]o detailed submission had been made as to exactly what benefits accruing to Australia under the General Agreement had been nullified or impaired".³³⁰

In the Brazilian complaint, the consideration of a non-violation nullification or impairment argument was excluded by the wording of the complaint which only alleged that a nullification or impairment had occurred as a result of a violation by the EC.³³¹

10.2.2 The EEC Wheat Flour Subsidy Case

In 1982, the USA made one last challenge under the equitable share rule. Once again it was the EEC's common agricultural policy that was the subject of the complaint. This time, the challenge was made in relation to the EEC's export subsidies on wheat flour. The challenge was made under *Subsidies Code*. A panel delivered a report which found that the USA's

330 *BISD* 26S/290 at 319, para (i).

331 *BISD* 27S/69 at 70, para 2.2(c).

complaint was not established.³³² The USA opposed the adoption of the report by the Committee on Subsidies and Countervailing Duties and the report was never adopted.³³³

The Common Agricultural Policy for Wheat Flour

The essential features of the common agricultural policy for wheat were described in chapter 10 and the policy for sugar was described in some detail earlier in this chapter. The common agricultural policy for wheat flour also established an internal target price which was supported by the imposition of variable levies and the payment of export subsidies both approximately equal to the difference between the internal target price and the world price for wheat flour.³³⁴ However, an important feature of the common agricultural policy for wheat flour was that the reference prices for calculation of the export subsidies were established by reference to the relevant prices for wheat. Thus the internal price for wheat flour was established by applying a fixed coefficient to a chosen representative price for wheat in the EEC and the world price for wheat flour was determined primarily upon the basis of the world price for wheat.³³⁵

The Arguments and the Evidence

The USA alleged that the EEC's export subsidies on wheat flour:

- (a) infringed Article 9 of the *Subsidies Code* which was applicable because wheat flour was a non-primary rather than a primary product; and
- (b) alternatively, infringed Article 10:1 because they resulted in the EEC having more than an equitable share of world export trade;

332 "European Economic Community - Subsidies on Export of Wheat Flour" report (SCM/42) of the panel submitted to the Committee on Subsidies and Countervailing Duties on 21 March 1983. The report is reproduced in 18 BNA ITEX 899-916 and is extracted in Jackson & Davey, *Legal Problems of International Economic Relations - Cases, Materials and Text* (West Publishing Co, St Paul, Minn., 2nd ed, 1986) pp735-739. The case is discussed in, inter alia, Coccia, Massimo, "Settlement of Disputes in GATT Under the Subsidies Code: Two Panel Reports on EEC Export Subsidies" (1986) 16 *Georgia J Int Law* 1-44; Boger III, William H., "The United States-European Community Agricultural Export Subsidies Dispute" (1984) 16 *Law & Policy in International Business* 173-238 at 208-214.

333 See Hudec (1993) Synopsis of Complaints, No 103, pp490-492 at 492 stating that "at the end of 1992, the Wheat Flour panel report remained on the GATT's list of unfinished panel business".

334 See SCM/42, para 3.5 referring to EC Regulation No 2734/75 under which the internal target price was established and para 3.8 referring to EC Regulation No 2746/75 under which the export subsidies were paid.

335 See SCM/42, para 3.10.

- (c) infringed Article 10:3 because they resulted in prices materially below those of other suppliers;
- (d) caused nullification or impairment of benefits accruing to the US under the General Agreement;
- (e) caused serious prejudice to the interests of the US in terms of Article 8 of *Subsidies Code*.³³⁶

The parties and the panel focussed on the alleged violation of the equitable share rule in Article 10:1. A number of issues were contentious. First, the USA argued that the "three most recent years in which normal market conditions [had] existed"³³⁷ could not be drawn from the period after the EEC had commenced to pay export subsidies.³³⁸ The ECC argued that it was not correct to interpret "a previous representative period" as excluding any period in which some subsidization had existed because the existence of export subsidies which were not prohibited could not be regarded as rendering the market abnormal.³³⁹ Secondly, the USA argued that the panel should consider the share of the EEC in the world commercial market not counting food aid transactions.³⁴⁰ The EEC argued that there was no basis for limiting the meaning of the words "world export trade" in Article 10:1 and that, in any case, much of the USA's food aid served a commercial purpose and could not be regarded as being outside the commercial market.³⁴¹ Thirdly, the EEC argued that proof of displacement of trade flows was an essential element in establishing that an export subsidy had resulted in "more than an equitable share of world export trade".³⁴² The USA disagreed, arguing that displacement was simply one way to establish a breach of the equitable share criteria.³⁴³

As in the Sugar cases, a substantial amount of statistical evidence was presented to the panel. The statistical evidence included:

336 See SCM/42, para 2.1 to 2.4.

337 *Subsidies Code*, Article 10:2(c).

338 See SCM/42, para 2.9.

339 See SCM/42, para 2.18.

340 See SCM/42, paras 2.10 & 2.11.

341 See SCM/42, para 2.14 to 2.16.

342 See SCM/42, para 2.19.

343 See SCM/42, para 2.11.

- a comparison of the average volume of exports to the world commercial market and the average share of the world commercial market of US, EEC, Australia, Canada and other countries between a reference period of the three year period before the commencement of the CAP, 1959/60 - 1961/62, and the most recent three year period, 1978/79 - 1980/81.³⁴⁴
- the volumes of exports to the world commercial market and the market shares in the world commercial market of Australia, Canada, US and EEC for each year from 1959/60 until 1980/81;³⁴⁵
- statistics in relation to the world market (including the world commercial market and special transactions of food aid) of volumes of exports and market shares of Australia, Canada, US and EEC for each year from 1959/60 until 1980/81;³⁴⁶
- a comparison of export volumes and markets shares of the US and the EEC and others in each of 17 individual country markets between the years 1959/60 and 1978/79-80/81.³⁴⁷

Much of the evidence and argument put by the EEC concerned the impact of other factors on the market for wheat flour. The other factors that the EEC drew to the attention of the panel included:

- the impact of the USA's food aid exports in displacing its own commercial exports;³⁴⁸
- the loss of certain of the USA's markets at various times for political reasons;³⁴⁹
- the progressive increase in milling facilities resulting in increased import demand for wheat rather than wheat flour;³⁵⁰

344 SCM/42, para 2.10 on pp4 & 7 referring to Table I "Relative Shares of the World Commercial Flour Market" on p4. .

345 SCM/42, para 2.10 on pp 4 & 7 referring to Table II "Wheat Flour: World Commercial Exports Crop Years 1959/60 - 1980/81" on pp5-6.

346 SCM/42, para 2.10 on p7 referring to Table III "Commercial and Special Transaction Wheat Flour Exports By Source Crop Years 1959/60 - 1980/81" on pp8-9.

347 SCM/42, para 2.11 on p7 referring to Table IV "US and EC Flour Exports to Specific Markets" on p10-12.

348 SCM/42, para 2.19 on p15.

349 SCM/42, para 2.19 on p15.

350 SCM/42, para 2.19 on p15.

- the figures for EEC exports included 'inward processing traffic' (in which wheat was imported and processed into flour which was exported) upon which export subsidies were not paid;³⁵¹
- the contribution of the EEC's historical links with ACP countries to the development of its markets in those countries;³⁵²

In essence, the EEC argued that the accumulation of these other factors rather than the export subsidies had caused the growth in the EEC's share of world export trade.

Disposal of the Primary vs Non-Primary Product Issue

The panel did not consider the question of whether wheat flour was a primary or non-primary product. It found that the question of conformity with Article 9 was not part of the matter referred to the panel by the Committee and proceeded to examine the allegations under Article 10 on the basis that export subsidies on wheat flour fell within Article 10 rather than Article 9.³⁵³ This decision has been criticized.³⁵⁴ For present purposes, it is important only to take note that the determination that a product is a primary was a necessary pre-requisite to the application of Article 10. This determination was required to be made in accordance with the criteria set out in the interpretative note to Article XVI:3 which has the effect that processed products could only fall within the definition of primary product if the product had "undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade". The implicit treatment of wheat flour as a primary product was consistent with the 1958 decision on French Export Subsidies on Wheat and Wheat Flour.

351 SCM/42, para 2.20 on p16. On such 'traffic', variable levies would not in effect be charged on the import of the flour (because the amount of the variable levy would be refunded on export of the flour). This refund of an import charge on a product incorporated into an exported product is not regarded as an export subsidy (see *Subsidies Code*, Annex "Illustrative List of Export Subsidies" item (i).

352 SCM/42, para 2.20 on p16.

353 See SCM/42, para 4.2.

354 See, eg, Coccia, "Settlement of disputes in GATT under the Subsidies Code: Two Panel Reports on EEC Export Subsidies" (1986) 16 *Georgia J Int Law* 1-44 at 11-14.

The Decision Under the Equitable Share Rule

At the outset the panel noted that "in GATT there was no precise definition of "more than equitable share of world export trade or detailed guidelines as to how that was to be determined".³⁵⁵ Notably, the panel abstained from mentioning the comment expressed by the panels in the sugar cases that it had not "in the past been considered absolutely necessary to agree upon a precise definition of the concept".³⁵⁶

The panel indicated that it was not "necessary or appropriate" to exclude food aid transactions from consideration.³⁵⁷ Therefore, it considered the statistics which included such transactions. This was consistent with the decision in the Sugar cases not to exclude from consideration export sales that were outside normal commercial trade.

The panel compared various periods. It compared the year 1980/81 with the period 1977/78 - 1979/80. It compared the average of the market shares for the years 1978/79 - 1980 - 1981 with the average for the period 1963/64 - 1965/66 (the three years prior to the commencement of EEC export subsidies on flour under the CAP). It also considered the whole period from 1963/64 to 1980/81.

In respect of the comparison with the three most recent years, the panel found that the EEC share of world export trade over those years had been:³⁵⁸

1977/78	54%
1978/79	57%
1979/80	62%
1977/80 (average)	58%
1980/81	66%

The panel noted that the EEC's average market share for the three year period 1977/78 - 1979/80 had increased by 14% to reach its level in 1980/81.³⁵⁹ In these terms, this was a

355 SCM/42, para 4.5, p28.

356 See GATT *BISD* 26S/290 at 308, para 4.11 & GATT *BISD* 27S/69 at 88, para 4.6.

357 SCM/42, para 4.7, pp28-29 at 29.

358 SCM/42, para 4.9, p30.

359 SCM/42, para 4.10, p30.

much smaller percentage increase to that which had been reviewed in the 1958 French wheat subsidies case or in the EEC sugar cases. However, it was an increase of 8 percentage points of world export trade which was slightly higher than the increase in those terms in any of the earlier cases.

Looking at the whole 20 year period, the panel observed that there was a consistent pattern of an increasing market share.³⁶⁰ In particular, comparing recent trade with the period before the CAP for wheat flour commenced, the panel constructed a table which showed that the market shares of the EEC in world export trade had been:³⁶¹

1963/64 - 1965/66 (average)	24%
1978/79 - 1980/81 (average)	62%

The panel observed that the overall increase in the EEC's share of the market was significant.³⁶² Indeed, it had increased by 158%. In these comparative terms, it is larger than the increase in the French wheat case approximately from 3% to 7% of world export trade and much larger than the increase in the sugar cases approximately from 8% to 14%. In terms of the number of percentage points of the share of world export trade, the increase of 38 percentage points in this case vastly exceeds the increase in any of the earlier cases. The Panel concluded that concurrently with the EEC's export subsidies on wheat flour, the EEC's share of world export trade had increased.³⁶³

The panel then considered factors relating to the market. It divided its consideration into special factors within the meaning of the term in Article 10 and also important general factors which it said were important in order to understand the world wheat flour market and the role of export subsidies in it. The general factors described were:

- (i) the progressive increase in milling facilities causing a shift from trade in flour to trade in wheat;³⁶⁴

³⁶⁰ SCM/42, para 4.11, p30.

³⁶¹ SCM/42, para 4.13, p31 incorporating Table VII on p31.

³⁶² SCM/42, para 4.13, p31.

³⁶³ SCM/42, para 4.15, p33.

³⁶⁴ SCM/42 para 4.16(i), p 33.

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- (ii) the generally "highly artificial" market in which no more than about 20% of all trade is on free commercial terms;³⁶⁵
 - (iii) the existence of large fluctuations in import quantities in a few of the large markets and in many of the small markets;³⁶⁶
 - (iv) the substantial effect of government subsidies on the purchasing decisions of importers (which the panel described in this way: "the opening of credit at highly reduced interest rates and/or other forms of government supported deals concerned within a framework of bilateral or other arrangements have sometimes been the major factor influencing the conclusion of transactions").³⁶⁷

The panel referred to the following as "special factors":

- (i) the loss of certain of the USA's export markets due to political factors;
- (ii) the possibility that non-commercial sales might have a market creating effect although the panel found that evidence of such an effect was unclear;
- (iii) that the USA might suffer from not having regular shipping lines to some African and Middle Eastern markets;
- (iv) the difficulty of establishing the effect on the market of other factors including "historical links, cultivation of "traditional markets", particular taste or dietary demands, trade practices of respective traders and increased milling capacity";
- (v) transportation costs although the panel found that these would be of minor importance; and
- (vi) the lower quality of EEC flour though the panel found that this was not a factor which helped explain the increase in the EEC's market share because the EEC's lower quality wheat flour was not lower price wheat flour except by reason of the export subsidies.

365 SCM/42 para 4.16(ii), p33.

366 SCM/42 para 4.16(iii), pp33-34.

367 SCM/42, para 4.16(iv), p34.

The panel did not address the dispute as to whether a finding of displacement was necessary for a finding of more than an equitable share. The panel considered the evidence of market displacement in the statistics relating to the seventeen markets that had been presented to it and found that market displacement in the sense of Article 10:2(a) was not evident.³⁶⁸ It noted that, in a number of the markets, there had been a reversal of the strength of the USA and the EEC but attributed this to changes in the nature and sizes of the market and to the presence of non-commercial sales by the USA in the earlier periods. The panel added ambiguously that

it could not rule out the possibility that the application of EEC export subsidies had resulted in reduced sales opportunities for the United States.³⁶⁹

In fact, for some of the markets, the EEC had almost completely taken over markets in which, prior to the EEC export subsidies, the USA had had a significant market share as the following examples show.³⁷⁰

	<i>Increase in EEC's share</i>	<i>Decrease in USA's share</i>
Cameroon	from 0% to 100%	from 100% to 0%
Chile	from 26% to 100%	from 70% to 0%
Israel	from 0% to 99%	from 100% to 1%
Lebanon	from 0% to 98%	from 100% to 2%
Nigeria	from 0% to 94%	from 55% to 6%
The Philippines	from 0% to 35%	from 40% to 4%
Saudi Arabia	from 2% to 61%	from 92% to 38%

Few of these changes in market shares are any less in magnitude than the change in market share which the panel in the 1958 French Wheat Flour case accepted as evidence of displacement. Recall that in that case, in three South East Asian markets, France's market share had increased from 0.7% to 46% while Australia's had fallen from 83% to 37%.³⁷¹

The final conclusion of the panel was that

³⁶⁸ SCM/42, para 4.28, p37.

³⁶⁹ SCM/42, para4.29, p37.

³⁷⁰ Extracted from Table IV "US and EC Flour Exports to Specific Markets" in SCM/42 at pp10-12.

it was unable to conclude as to whether the increased share has resulted in the EEC "having more than an equitable share" in terms of Article 10, in light of the highly artificial levels and conditions of trade in wheat flour, the complexity of developments in the markets, including the interplay of a number of special factors, the relative importance of which it was impossible to assess, and, most importantly, the difficulties inherent in the concept of "more than equitable share".³⁷²

The panel, therefore, decided that the EEC's share of the world market had increased but found that it was not established that the increased market share was "more than equitable" nor that it had been caused by the EEC's export subsidies. Both aspects of this finding raise certain difficulties.

The 'causation' aspect of the decision runs contrary to some of the dicta in the panel report which acknowledged the significance of price and of competition on the basis of price in making export sales. In its references to general factors relating to the wheat market, the panel referred in the passage quoted above to the impact of government support in "influencing the conclusion of transactions".³⁷³ In its references to special factors, in the discussion of the possibility of concessional sales creating markets, the panel acknowledged that such purchasers might simply choose EEC wheat because it was cheaper.³⁷⁴ It was clearly open for the panel to find that the EEC's larger market share had been caused, at least partly, by the fact that EEC prices were lower by reason of the export subsidies than they would have been without the export subsidies. In fact, such a finding was inevitable unless one took the view that purchasing decisions in this market were never taken on the basis of price. That view is implicit in the conclusion of the panel but is directly inconsistent with its dicta referred to above.

The failure to adjudicate under the "more than equitable share" standard arguably did not matter given the finding on the causation question. Had the causation question been resolved differently, then the failure to make a decision under the equitable share standard would have constituted a clear abdication of the judicial function vested in the panel, a dereliction of its duty to make a decision.

371 *French Wheat case* GATT *BISD* 7S/46 at 54-55, para 23(b).

372 *SCM/42*, para 5.3, p40.

373 *SCM/42*, para 4.16(iv), p34.

374 *SCM/42*, para 4.21, p35.

Even the panel itself expressed disappointment in its own finding. It expressed concern over "the situation as regards export subsidies" and with the "effectiveness of the legal provisions". The panel expressed the view that it was

anomalous, ... , that the EEC which without the application of export subsidies would generally not be in a position to export substantial quantities of wheat flour, had over time increased its share of the world market to become by far the largest exporter.³⁷⁵

However, the panel report seems to evidence a desire not to make a ruling on the basis of the equitable share criteria. The panel expressed the view that "solutions to the problem of export subsidies in this area could only be found in making the pertinent provisions of the Code more operational, stringent and effective in application" including by rendering the "more than equitable share" standard "more operational".³⁷⁶

Other Findings

The panel also found that there was "not sufficient ground to reach a definite conclusion" that the price undercutting test in Article 10:3 had been infringed.

Finally, the panel avoided making a finding on the adverse effects provisions of Article 8. The panel could have considered whether an export subsidy which has a detrimental effect on another party's exporting could be considered either as "nullification or impairment of a benefit under the Agreement" or as "serious prejudice to the interest of another member". As to the concept of "nullification or impairment of a benefit, the possibility of applying this concept to the effects on country A of subsidized exports from Country B to Country C was considered above. There it was noted that Article 8:4(c) indicated that either "serious prejudice" or "nullification or impairment" could arise from the effects of a subsidy in a third market but that a footnote to Article 8:4(c) indicated that as far as primary products were concerned the problem of effects in third country markets "is dealt with exclusively under Article 10". Having found that there was no violation under Article 10, the panel in this case should have made a decision on the interpretation of these provisions. The panel, though, made no attempt to offer any clear interpretation of the provisions. The panel merely noted that there was a "lack of clarity" in the way that Article 8 applied the concepts

375 SCM/42, para 5.8, p40.

376 SCM/42, para 5.9, p41.

of "nullification or impairment of benefits" and "serious prejudice" to the effects of subsidies in third countries.³⁷⁷

10.2.3 Other Disputes Relating to the "Equitable Share" test

Complaints regarding EEC Subsidies

Almost all of the remaining complaints made under the *Subsidies Code* concerned the EEC's export subsidies under the CAP. The USA brought further challenges to the EEC export subsidies arguing that they breached the "more than an equitable share" test. The first of these was in respect of EEC export subsidies on poultry.³⁷⁸ The USA held consultations with the EEC which revealed that Brazilian export subsidies on poultry were affecting the market. The USA initiated a complaint against Brazil as well.³⁷⁹ However, no panel was appointed in respect of either complaint. Consultations with both the EEC and Brazil were suspended in 1984 and never resumed.³⁸⁰

Another USA challenge to the CAP involved export subsidies on sugar. After the two panel reports in 1981, the GATT Director General organized a working party to convene discussions with the EEC on considering the possibility of limiting its export subsidies on sugar.³⁸¹ The processes of the working party over 1981 and 1982 did not result in satisfactory changes to the EEC export subsidies.³⁸² The EEC had made changes to its export subsidies on sugar which had failed to reverse the trend of increasing EEC production and exports. The EEC had introduced levies on sugar producers to fund the export subsidies. However, the levies were limited to a maximum amount and the internal

377 See Hudec, *The Enforcement of International Trade Law* (1993) Synopsis of Complaints, case no 103, pp490-492 at p491.

378 Complaint by USA, SCM/Spec/9; 24 February 1982. A request for consultations is listed in the reports of the Committee on Subsidies and Countervailing Duties for 1982, 1983 (GATT *BISD* 29S/42 at 46, para 15(b); GATT *BISD* 30S/39 at 43, para 17(b)) and a record of conciliation having taken place is listed in the report for 1985 (GATT *BISD* 32/S158). See the summary in Hudec (1993) Synopsis of Complaints, No 106 "US v EEC: Subsidies on the Export and Production of Poultry" at p493.

379 Complaint by USA, SCM/Spec/19, 27 September 1983. See the summary in Hudec (1993), Synopsis of Complaints, No 126 "US v Brazil: Subsidies on the Export and Production of Poultry" at pp513-514.

380 See Report (1985) of the Committee on Subsidies and Countervailing Duties, GATT *BISD* 32S/158 at 162, para 14(c).

381 "European Communities Refunds on Exports of Sugar, Article XVI:1 discussions, Report to the Council adopted on 10 March 1981 (L/5113), GATT *BISD* 28S/80-90, para 1.

prices had not been lowered but, in fact, had been raised.³⁸³ Consequently, EEC production had continued to increase. EEC consumption had levelled off. Therefore, the EEC exportable surplus had increased substantially.³⁸⁴ In the working party, the EEC was resisting examination of its export subsidy scheme on the grounds that it was a different scheme to the one that had been found to have been causing serious prejudice. During this period, the members of the 1977 International Sugar Agreement had been attempting unsuccessfully to draw the EEC into negotiations regarding accession to that agreement. On 7 April 1982, the USA made a complaint under the *Subsidies Code* alleging, inter alia, breaches of the equitable share rule and of the price undercutting rule. In particular, the USA argued that the increase in the EEC's share of world export trade from 8% to 18 % violated the more than equitable share rule.³⁸⁵ The following day, a group of 10 sugar producing countries also made a complaint.³⁸⁶ The complaint by the group of 10 also argued a breach of the more than an equitable share rule but under Article XVI:3 rather than under the *Subsidies Code* (since not all the parties to the complaint were parties to the *Subsidies Code*).³⁸⁷ The parties held consultations³⁸⁸ but neither complaint was followed with a request for establishment of a panel. In 1983, the EEC did enter into negotiations for a new International Sugar Agreement but the negotiations failed.³⁸⁹

Two other requests for consultations related to the EEC common agricultural policy for beef. Canada requested consultations arguing that EEC export subsidies on beef were infringing Article 10:3 because they were "causing prices materially below those of other

382 Also see the second report, "Working Party - Sugar", Report to the Council adopted on 31 march 1982 (L/5924), GATT *BISD* 29S/82-90..

383 See L/5113 & L/5924 and also Estabrook, Jeffrey S., (1982) 15(2) *Cornell International Law Journal* 397-427 at 420-424.

384 See "Working Party - Sugar, L/5924, GATT *BISD* 29S/82-90 at 84, para 6 & at 85, para 9.

385 Complaint by USA (SCM/M/Spec/5), see Hudec (1993) Synopsis of Complaints, Complaint No 109, pp499-500. See also the 1983 report of the Committee on Subsidies and Countervailing Measures GATT *BISD* 30S/39 at 42, para 14 & at 43, para 17(c).

386 Complaint by Argentina, Australia, Brazil, Colombia, Cuba, Dominican Republic, India, Nicaragua, Peru and Philippines (L/5309); see Hudec (1993) Synopsis of Complaints, Complaint No 110, pp500-501.

387 See Hudec (1993), p500. For a description of this complaint, see Bentil, J. Kodwo, "Attempts to Liberalize International Trade in Agriculture and the Problem of the External Aspects of the common Agricultural Policy of the European Economic Community" (1985) 17(3) *Case Western Reserve Journal of International Law* 335-387. For a list of the parties to the *Subsidies Code* as at 25 October 1982, see "Committee on Subsidies and Countervailing Measures, report (1982) presented to the CONTRACTING PARTIES at their Thirty-eighth Session (L/5402), GATT *BISDF* 29S/42.

388 GATT, *Activities in 1982*, p30 & pp56-58.

suppliers".³⁹⁰ However, Canada did not proceed to request establishment of a panel. Instead, it resorted to countervailing duties which were in turn the subject of a complaint by the EEC. The EEC export subsidies on beef also had some effects on exports of other countries in third country markets. Shortly after the Canadian request for consultations, Australia requested consultations alleging that the export subsidies were causing non-violation nullification and impairment but this complaint was not pursued legally any further.³⁹¹

Complaints Regarding USA Export Subsidies

In 1983, even before the release of panel report on EEC's export subsidies on wheat flour, the USA granted substantial export subsidies on sales of wheat to Egypt which had been a significant market for the EEC. With the assistance of the subsidies, USA producers were able to take the whole Egyptian market for 1983/1984 displacing EEC exports from that market.³⁹² The EEC sought consultations under the *Subsidies Code* and, in May 1983, the Committee on Subsidies and Countervailing Measures agreed to establish a panel to resolve the dispute.³⁹³ There seems to be an extremely strong argument that the USA's subsidy was in breach of the equitable share test because it had displaced the exports of another signatory within the terms of Article 10:2(a). However, the panel was never constituted and in the following year, the USA did not offer the same subsidy again.³⁹⁴

In 1985, in retaliation against EEC export subsidies, the United States introduced its Export Enhancement Programme ('EEP') as an addition to its other agricultural aid and trade programmes.³⁹⁵ Under the EEP, export subsidies were paid in cash or in product in order to

389 Hudec (1993) p500 & p501.

390 *Subsidies Code*, Article 10:2. See Hudec (1993) synopsis of complaints, complaint no 134, pp520-521. See also "Subsidies and Countervailing Duties Committee, report (1984) presented to the CONTRACTING PARTIES at their Fortieth Session (L/5719) GATT *BISD* 31S/259 at 263, para 15.

391 L/5715 (26 October 1984); see Hudec (1993) synopsis of complaints, complaint no 135, p521.

392 See Hudec (1993) Synopsis of Complaints, complaint no 123, pp511-512. See also complaint no 103 p490-492 at 492

393 See the report of the Committee on Subsidies and Countervailing Duties for 1983, GATT *BISD* 30S/39 at 42, para 15. Also GATT, *GATT Activities in 1983*, p16.

394 See Hudec (1993) complaint no 123, p512. See also Echols, Marsha A., "Just Friends: The US-EEC Agricultural Export Subsidies Standoff" (1983) 77 *Proc Am Soc IL* 119-130 at 128.

395 The export enhancement programme was introduced by s1127 of the *Food Security Act* of 1985 (PL 99-198 of 23 Dec 1987) (which at that time was codified as 7 USC §1736v).

offset the adverse effects on US producers of subsidy practices by foreign countries.³⁹⁶ For the three year period between 1 October 1985 and 30 September 1988, the US Secretary of Agriculture was required to spend not less than US\$2,000,000,000 under the programme.

The only other use of dispute settlement procedures under track 2 under the *Subsidies Code* arose as a response to the USA's EEP. The dispute arose, in 1988, when Brazil complained that the EEP subsidy on exports of soyabean oil were in violation of the *Subsidies Code* and were also causing non-violation nullification or impairment under Article 8 of the Code.³⁹⁷ No panel was established.

Therefore, after the 1958 French Wheat case, there was no other successful challenge to an export subsidy on a primary product whether under the equitable share rule in Article XVI:3 and Article 10 of the *Subsidies Code* or under the principles of nullification or impairment under Article XXIII:1(b) and Article 8 of the Code. There was one finding that an export subsidy caused serious prejudice under Article XVI:1 thus requiring consultations. However, under Article 8 of the *Subsidies Code* which provided for countermeasures not merely consultations, there was never a finding that an export subsidy caused serious prejudice.

10.2.4 The EEC Pasta case

The Problem of Non-Primary Products Incorporating Primary Products

The USA also challenged the EEC's export subsidies in another dispute under the *Subsidies Code* relating to pasta.³⁹⁸ A panel report was presented but the EEC blocked adoption of the report. The dispute illustrates a problem that arises in having different rules for primary and non-primary products. On a simple level, this is the problem of distinguishing between primary and non-primary products. More generally, because primary products are used as inputs in processed products, it raises the question of how the rules should deal with measures designed to compensate processors for the high internal prices of inputs that are themselves caused by protection. Where a dual price system is maintained, it will have the

396 See the complete statement of the purposes of the programme in s1227(3) of the *Food Security Act* 1985.

397 See Hudec (1993) *Synopsis of Complaints*, complaint no 190, pp571-572.

effect that products which are made from inputs with high internal prices will have prices which reflect the cost of those inputs. Such products will not be competitive with foreign products in the domestic market unless they receive a margin of protection or support in some form to cover their higher costs. Such products will not be competitive in export markets unless they receive a subsidy to cover those same higher costs.

For non-primary products, the rules under the *Subsidies Code* were fairly clear. A government wishing to compensate producers for the high internal cost of an input can pay a consumption subsidy to the purchasers of the input. However, it cannot make the payment of the consumption subsidy contingent upon export performance because then the subsidy would be a prohibited export subsidy.³⁹⁹ The government could pay the subsidy to all purchasers but could not selectively pay it to exporters. For primary products, those rules did not apply. If the processed product made from the primary product input could also be regarded as a primary product, then to compensate processors for the higher cost of the input, the government could pay a consumption subsidy contingent upon export performance subject to the subsidy not infringing the constraints of Article XVI:3 or Article 10 of the Code.

The above consequences of having a prohibition on export subsidies on non-primary products but not on primary product was the reason that, as described above, the United States had made its ratification of the Declaration Implementing Article XVI:4 subject to an 'understanding'. The understanding, quoted in full earlier, provided that Article XVI:4 would not prevent the USA from paying a subsidy on a non-primary product no greater than the export subsidy which could have been payable on primary products that were incorporated into the non-primary product. The *Subsidies Code* did not contain any special provisions relating to products incorporating primary products. The United States ratification of the *Subsidies Code* was not qualified by any reservation or understanding. The problem that had been addressed by the United States 'understanding' was the subject of the EEC Pasta Subsidies case.

398 "European Economic Community - Subsidies on Export of Pasta Products" report of the panel SCM/32 (not adopted) 19 May 1983.

399 *Subsidies Code*, Illustrative List of subsidies, item (I).

The EEC Subsidy on Pasta

The EEC's system of export refunds on pasta was related to the Common Agricultural Policy for cereals which has been described above⁴⁰⁰. As for wheat flour, an export subsidy on pasta was calculated upon the basis of the difference between the internal EEC price for wheat and the world price multiplied by a fixed coefficient representative of the amount of wheat required to produce one unit of pasta.⁴⁰¹

The Arguments

The USA argued that pasta did not fit within the definition of 'primary product' because pasta was not a primary product in a form "which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade."⁴⁰² Therefore, Article 9:1 of the *Subsidies Code* was applicable.

The EEC argued that the subsidy was not paid upon pasta but upon wheat and that, therefore, Article 10 rather than 9 was applicable. The EEC argued that the subsidy was paid on wheat regardless of whether it was in unaltered state or had been processed into another product.

The EEC also argued that the 'understanding' subject to which the USA had made its ratification of the Declaration on Implementation of Article XVI:4 and the subsequent practice of the parties had established a rule that permitted export subsidies on primary products when incorporated into non-primary products. The EEC argued that this rule still applied despite the coming into force of the *Subsidies Code*.⁴⁰³

The Decision

The panel rejected the EEC's arguments finding that the export subsidy was paid upon pasta not upon wheat and that Article 9 was applicable.⁴⁰⁴ The panel examined the EEC's submission that a course of practice had established a tolerance of export subsidies on non-primary products incorporating primary products. The panel found that even if such a

400 See ch10 at pp27-28, and see also in this chapter on the CAP for flour.

401 SCM/32, para 2.6 citing EEC Council Regulation No 3035/80 (11 November 1980).

402 SCM/32, para 3.2 paraphrasing the words of the Interpretative note Ad Article XVI Section B, 2.

403 SCM/32, para 3.12, p10.

practice had become accepted before the *Subsidies Code*, it had not survived the coming into force of the clear rule in Article 9.⁴⁰⁵

One Member of the panel dissented. The dissenting Member expressed the view that there had been a widespread practice of treating export subsidies on the primary product component of non-primary products as permissible. The dissenting member also argued that Article 9 should be interpreted as not altering the pre-existing interpretation of Article XVI:4.⁴⁰⁶

The Result

The EEC blocked adoption of the report. A fairly minor adjustment to the subsidy was negotiated in the context of resolution of another dispute over EEC preferences on imports of citrus fruits.⁴⁰⁷ However, the report was still not adopted leaving both this report and the report in the EEC wheat case unadopted.⁴⁰⁸ It is important to note that the adjustment to the subsidy practice that the EEC conceded did not in any way threaten the continuance of all of the mechanisms of the CAP. The negotiated adjustment only related to that part of the subsidy which might exceed the extra cost that EEC pasta producers had to pay because of the high internal EEC price for wheat.⁴⁰⁹ The EEC maintained its position on all of the elements of the system of maintaining high internal prices under the CAP: that it was entitled to maintain the high prices for primary products, like wheat, and that it was entitled to compensate downstream producers for the extra costs.

Comment

The decision that the export subsidy was a subsidy on pasta rather than on wheat was important. Any other decision would have meant that in respect of every subsidy on a processed product, an assessment would have to be made as to how much of the benefit of

404 SCM/32, para 4.4, p12.

405 SCM/32, para 4.9-4.10, pp13-14.

406 SCM/32, para 5.3-5.5, pp15-16.

407 EEC - Tariff Treatment of Citrus, L/5776. See Hudec (1993) synopsis of complaints, complaint 113.

408 "Report (1985) presented to the CONTRACTING PARTIES at their Fortieth Session" (of the SCM Committee) L/5719, GATT *BISD* 31S/259 at263, para 17.

409 See Hudec (1993) p154 citing the record of the negotiated settlement in *EC Official Journal* No L275/36 (1987).

the subsidy flowed through to producers of primary products. It was reasonable of the panel to take the view that such a result was not the intention of the parties.⁴¹⁰

Clearly, this kind of dispute only arises in consequence of there being different rules for primary and non-primary products. The result of the decision, if adopted, would have been that it would be permissible for the EEC to pay the consumption subsidy but only if it were paid to all purchasers of EEC wheat regardless of whether it was to be used to produce exports. This would have had such significant fiscal consequences that it would have required a significant change to the structure of the CAP. It was promising that a majority of members of a panel were prepared to make a legal decision that challenged the CAP. However, that the EEC vetoed the decision and the way in which they negotiated an adjustment to the subsidy that preserved the CAP mechanisms confirmed the impression given by the "equitable share" cases that the existing GATT rules were unlikely to force a reform of the CAP.

11 THE EXPORT SUBSIDIES WAR IN THE 1980'S

Before concluding this chapter, it is appropriate to offer some indication of the magnitude of the problems that arose from the failure to discipline export subsidies. Reference was made, above, to the establishment in 1985 of the Export Enhancement Programme in retaliation against the EEC's export subsidies. Indeed, the continued increase in EEC agricultural exports after the Tokyo Round caused significant discord in EEC-USA relations.⁴¹¹ The first significant response was the USA's subsidized wheat exports to Egypt referred to above.⁴¹² However, this was part of a wider program to extend the USA's subsidies on agricultural products. The cost of subsidies was also increased because the joint effect of the export subsidies by both the EEC and the USA was to depress world prices which

410 See Coccia, Massimo, "The Settlement of Disputes in GATT under the Subsidies Code: Two Panel Reports on EEC Export Subsidies" (1986) 16 *Georgia Journal of International Law* 1-44 at 26-29 arguing for the contrary view that consideration of the beneficial effects of the subsidy should have determined whether Article 9 or Article 10 applied.

411 Generally, see Butler, Nicholas, "The Ploughshares War Between Europe and America" (1983-84) Vol 62 No 1-3 *Foreign Affairs* 105-122.; Montana-Mora (1993) p32-34, & Dam, Kenneth W., "US Foreign Policy and Agricultural Trade" USA Department of State, *Bulletin*, Vol84, No 2083, February 1984, pp19-22.

412 See also Petit, Michael, "The Agricultural Trade Confrontation between the United States and the European community: a Challenge to our Profession" *Agricultural Economics*, 2 (1988) 185-195 at

broadened the gap between the EEC's internal prices and world prices. In 1984, the USA and the EEC together spent US\$35 billion on agricultural subsidies.⁴¹³

The failure to obtain a favourable decision in the EEC wheat case seems to have resulted in the USA relying on a trade war strategy to increase the cost of the CAP so that the EEC would have to change it rather than on an strategy of reforming the CAP through legal pressure in GATT dispute settlement.⁴¹⁴ It was in these circumstances, that the 1985 Farm Bill introduced the EEP. Relations were exacerbated by the enlargement of the EEC to include Spain and Portugal and the detrimental effects of that on USA grain exports to those two countries.⁴¹⁵ In 1986-87, about 40% of USA wheat exports were financed by the EEP. In 1986 and 1987, the cost of these subsidies to the USA was in excess of US\$25 billion.⁴¹⁶

The situation had reached a stand off with the EEC refusing to make major changes to the CAP and the USA applying increasing funds to pressure the EEC to change.

12 CONCLUSIONS

The drawing of conclusions from this chapter is left to the final chapter of this part of the thesis which draws conclusions from the analysis of all of the aspects of the application of the pre-Uruguay Round GATT to agriculture: import barriers, export subsidies and domestic support. One important factor that is demonstrated by this review of the application of the rules on export subsidies is the interrelationship of the various aspects of the rules. It is clear that most of the problems with the application of the export subsidy rules to agriculture arose out of market conditions that were at least partially caused by the ineffectiveness of the rules on import barriers. The whole framework of rules need to be considered together.

However, a preliminary summary of this chapter and a few observations are made here with respect to both threads of this analysis:

189 & Hufbauer & Erb, *Subsidies in International Trade* (Institute for International Economics, Washington, 1984) pp40-41.

413 Montana-Mora (1993) p34 citing Barbara Insel, "A World Awash in Grains" (1985) 63 *Foreign Affairs* 892 at 900.

414 Montana-Mora (1993) pp33-34.

415 Petit, (1988) p189.

416 Hathaway, Dale E., "Reforming World Agricultural Policies in Multilateral Negotiations" (1991) 1 *Transnational Law and Contemporary Problems* 392-414 at 407.

- (1) identification of the major problems with applying the rules on export subsidies to agricultural trade; and
- (2) identification of any deficiencies in the way that the rules on export subsidies embody appropriate distinctions between border and non-border instruments and price-based and quantity-based border instruments.

12.1 SUMMARY OF PROBLEMS IN APPLYING THE RULES ON EXPORT SUBSIDIES TO AGRICULTURE

One of the major problems with applying the rules on export subsidies to agriculture was simply that the parties could not agree on what the rules with respect to export subsidies should be. In the early years of the GATT, the problem was simply that there were no rules. In later years when some rules were in force, most of the problems derived from the original inability to reach agreement on the content of the rules.

However, to the extent that the parties did agree on rules and bring them into force, the major problems with applying those GATT rules on export subsidies to agriculture were:

- (1) the difficulty of defining subsidy and export subsidy and the consequent need to establish illustrative lists of export subsidies;
- (2) the wording of Article XVI:4 which necessitated the Declarations to bring it into force resulting in a law which only applied to a subset of the contracting parties;
- (3) the indeterminacy of the concept of the definition of equitable;
- (4) the determination of what was equitable was not helped by the reference to previous representative period largely because of the difficulty of determining what was a representative period;
- (5) the need, in making assessments under the "equitable share" test, to assess vast amounts of statistics and the disagreements as to which data was pertinent to the decision;

- (6) the imprecision involved in determining causation that necessarily flowed from a test that required that the share of trade be shown to have resulted from export subsidies;
- (7) the difficulty of determining how to apply the prescription that other factors should be taken into account in making the determination under the 'equitable share' test;
- (8) as with the "equitable share" test, the application of "displacement" test was also impeded by imprecision as to what was meant by displacement and by matters of causation;
- (9) the need to distinguish between primary and non-primary products and the consequent difficulty in dealing with export subsidies on non-primary products incorporating primary products;
- (10) the difficulty of defining a countervailable subsidy which resulted in a gradual extension of countervailing duties to subsidies which were regarded as domestic policy like regional development subsidies;
- (11) the need to establish injury in order to be able to countervail against export subsidies;
- (12) generally, there were substantial difficulties in applying rules that were based on the effects of policies rather than on the classification of the policies;
- (13) finally, the ineffectiveness of disciplines on export subsidies left the parties with no rule-based mechanism for dealing with agricultural surpluses.

12.2 EMBODIMENT OF DISTINCTIONS BETWEEN POLICY INSTRUMENTS IN THE RULES ON EXPORT SUBSIDIES

The review of the three negotiations relating to the original rules, the 1955 rules and the Tokyo Round rules all revealed a lack of consensus as to how the rules should distinguish between different subsidies and how the rules on subsidies should fit into the broader framework of rules. On the basis of the argument made in chapter 8 for the relative desirability of non-border instruments over border instruments and price-based border instruments over quantity-based border instruments, it is submitted that the rules should

prefer domestic subsidies to export subsidies and should prefer export subsidies to quantitative restrictions. It is submitted that, the rules that did come into force were deficient in embodying an appropriate distinction between export subsidies and other subsidies and between subsidies and other trade policy instruments.

These deficiencies included:

- (1) a preoccupation with trying to regulate export subsidies with prohibitions rather than some consideration of a mode of regulation more like that applied to import tariffs;
- (2) failure to provide a mechanism for negotiating limits to export subsidies;
- (3) a failure to make a clear distinction between export subsidies and other subsidies because of the special treatment made for agricultural subsidies resulting in a more or less equivalent absence of regulation of either export subsidies or other subsidies;
- (4) a failure to make a clear distinction in countervailing duty law between export subsidies and other subsidies resulted in a fall back to determining countervailability on the basis of effects.

12.3 LINKS BETWEEN THE DISTINCTIONS BETWEEN INSTRUMENTS AND THE PROBLEMS WITH AGRICULTURAL EXPORT SUBSIDIES

This thesis submits that the abovementioned deficiencies in the embodiment of the two distinctions between policy instruments were a part of the causes of the abovementioned problems in the application of the rules on export subsidies to agriculture. It is clear that the application of these rules to agriculture also suffered from strong political forces. However, it is submitted that defects in the stated defects in the formulation of the rules were part of the reason that those political forces could not be managed by the rules.

This argument is completed in the context of the overall framework of rules in chapter 15 at the end of this part.

CHAPTER 13

THE PRE-URUGUAY ROUND RULES ON DOMESTIC SUPPORT

A bounty on the production of corn then, would produce no real effect on the annual produce of the land and labour of the country, although it would make corn relatively cheap, and manufactures relatively dear.

David Ricardo, *On the Principles of Political Economy and Taxation*
(John Murray, Albemarle Street, London, 1817), p325.¹

It must be emphasised that the subsidy valve is an integral part of the commercial policy proposals and is intended to be used in this way

"Memorandum from Melville to Curtin, 21 April 1944, Report on London discussions on Article VII, February - March 1944" document no 113 in Australia, Department of Foreign Affairs and Trade, *Documents on Australian Foreign Policy 1937-49*, volume VII:1944, W.J.Hudson (ed), (AGPS, Canberra, 1988) para 36.

1 INTRODUCTION

This chapter continues the more detailed analysis, carried out in the last two chapters, of the application of the pre-Uruguay round rules to agricultural trade. This chapter analyzes the way the GATT rules relating to domestic support have affected trade in agricultural products.

In assessing the problems with domestic support for agriculture, this analysis builds a more complete picture of the framework of GATT rules presented in chapter 2 and maintains the focus begun in that chapter on the differences between the way that the GATT rules regulate different policy instruments. Therefore, this chapter:

¹ Also in the opening of word of Chapter XXII entitled "Bounties on Exportation, and Prohibition of Importation" in *The Works and Correspondence of David Ricardo* (edited by Piero Sraffa) Vol I *On the Principles of Political Economy and Taxation* (Cambridge University Press, Cambridge, 1951).

- (1) analyzes the way that the GATT rules on domestic support have operated in relation to trade in agricultural products and identifies and explains the areas of difficulties; and
- (2) searches for defects in the way that the rules on domestic support embody the distinction between border and non-border instruments;

so as to make possible an assessment of whether any such defects referred to in paragraph (2) contributed to the difficulties referred to in paragraph (1).

Recall that it was submitted in Chapter 8 that for the rules to facilitate the guidance of the behaviour of the parties toward policies that would enable them to achieve economic benefits and non-economic objectives, they should leave parties substantially free to use non-border instruments, of course, including domestic subsidies. It is necessary to stress the consequences of the conclusions from chapter 8 and the rest of part 2 of this thesis for the question as to the extent to which parties need to be free to implement domestic subsidies. In chapter 7, we observed that non-economic objectives might influence a community so that the welfare maximizing level of support to a particular industry might be greater than zero. The analysis in chapters 4 to 6 demonstrated that if it was desired to give some level of support to an industry, the cost to the rest of the community of giving that support would be less if it were given by a domestic subsidy rather than a border instrument. If the use of a domestic subsidy leads to the same consequences of having to give compensation or having to suffer retaliation (regardless of whether the legal basis is track 1 or track 2) as the use of border instruments, then the rules would be failing to guide parties toward the adoption of the least costly instrument and, in some cases, where the adoption of the domestic subsidy would be welfare enhancing, the rules would actually be frustrating the adoption of welfare enhancing policy.

It was submitted that the rules need to guide parties toward adopting domestic subsidies instead of border instruments like import quotas, import tariffs and export subsidies. It was also submitted that the rules could provide for negotiation of limits on domestic subsidies.

Arguments for disciplining domestic subsidies focus on their effects. Subsidies can displace imports from the home market, cause injury to producers in foreign markets, and can

displace other countries exports from third country markets. However, the preceding analysis of the differences between types of instruments indicates that domestic subsidies are usually the best instrument for a government to achieve a non-economic objective. For that reason, caution must accompany the giving of remedies against domestic subsidies whether through discriminatory countervailing duties or through multilaterally authorized but still discriminatory countermeasures. This chapter considers the remedies against domestic subsidies. However, it is stressed that the arguments for disciplining domestic subsidies must also be considered in the context of the wider framework of rules relating to other policy instruments. For example, one could ask whether there is any need for the safeguards exception which provides an escape clause for protecting domestic industry from injury needs to be supplemented by an additional escape clause for situations in which some causal link can be drawn between the injury and another party's domestic subsidy.²

This analysis draws upon the material in the last chapter which provided an explanation of most of the rules relating to subsidies. That description is brought to completion by the addition of description and analysis of aspects of the subsidies rules which apply solely or at least predominantly to domestic subsidies. Again, it is necessary to stress that the description of the law relates to the law as it was at various times between 1947 and the Uruguay Round. Generally, the description is in the past tense even where the description is still accurate in respect of the current law. Use of the past tense should be taken only to mean that the description refers to the law as it was and not necessarily that the current law is different (although in many respects, it is).

There have been only a few cases relating to domestic support. Most of the important disputes relate to the EEC's Common Agricultural Policy or the effects of it. In general, the disputes over domestic support have arisen out of the failures in the regulation of other policies. There has been a link between domestic support policies for agriculture and the other agricultural policies manifested in the form of import barriers or export subsidies. Similar interconnections between policies have already been observed in the discussion of the problem of export subsidies upon products processed from products on which internal

² See Horlick, G., Quick, R., & Vermulst, E., "Government Actions Against Domestic subsidies, An analysis of the International Rules and an Introduction to United States' Practice" (1986) 1 *Legal*

prices are supported by import barriers. This was the problem which produced the ECC Pasta dispute; that the high internal prices caused a perceived need for an export subsidy on pasta. Internal prices can also cause pressure to introduce other domestic support policies. For example, internal prices for one product may cause consumers of that product to buy another product in substitution for it which may result in substantial increases in imports for the substitute product or products. Government might be pressured to react to this situation by providing incentives to purchase the product which is losing market share or to help the producers of the substitute product. This is exactly what happened as a result of the EEC common agricultural policy for grains; it caused other animal feeds to be substituted for grains based animal feeds.

In considering regulation of domestic support, it is important to be aware that domestic support policies can take two forms. They can take the form of disguised import barriers or they can take the form of assistance to production or producers which do not affect imports. Putting this in terms of the analysis in part 2, domestic support measures can have the same effects as border instruments if they have the effect of raising the price for domestic consumers above the world price and also have the effect of raising the price for producers above the world price. This is so in the case of domestic content requirements or sales taxes that discriminate against imports. However, domestic support can also take the form of domestic subsidies which have no effects on the price at which consumers can purchase imports.

The GATT disciplines domestic support in two ways. It has rules in Article III to prevent disguised import barriers. Secondly, there are rules on domestic subsidies. Article III regulates the giving of any favourable treatment to domestic producers through indirect taxes or through any laws or regulations affecting the internal sale, distribution or use of goods. Domestic subsidies are regulated through the same two track regulation as applies to export subsidies: the first relating to countervailing measures and the second relating to multilaterally authorised remedies. As for export subsidies, the rules relating to domestic subsidies that applied prior to the Uruguay Round arose from the original 1947 rules, from

the 1955 review of the Agreement and from the Tokyo Round Subsidies Code. The following analysis deals with the relevant material under the following headings:

- Negotiation of the Rules on Domestic Support
- The Original Rules of GATT 1947
- Discipline of Domestic Support under Article III
- Discipline of Domestic Subsidies under the Nullification or Impairment Principle
- Domestic subsidies under the Tokyo Round Code on subsidies
- Domestic Subsidies under Countervailing Duties Rules
- The Oilseeds Case

The Oilseeds case is left until last. It deals with a domestic support programme which was challenged under Article III and also as a non-violation subsidy under the nullification or impairment principles. It was a culmination of a dispute which went back to the original Article XXIV:6 negotiation when the EEC was first created. This dispute became a crucial issue in the final settlement of the agriculture negotiation in the Uruguay Round.

2 NEGOTIATION OF THE RULES ON DOMESTIC SUPPORT

2.1 TRACK I - NEGOTIATION OF THE COUNTERVAILING DUTIES RULES

The previous chapter's discussion of export subsidies mentions that there is no indication in any of the negotiating drafts of Article VI of any distinction between export subsidies and domestic subsidies. The only indication in the reports of the preparatory sessions which might indicate some attempt at the making of such a distinction is that the London Report records the view of one member that the committee should consider providing an immunity from countervailing duties for subsidies that have been agreed upon with other parties.³ However, that suggestion was not incorporated into any texts. As mentioned, the wording adopted in the New York Draft, referring to subsidies on "manufacture, production or

³ See *London Session Report*, UN Doc E/PC/T/33 (see above, chapter 2, fn24 and accompanying text) at p17, Section D, para 1(d)(xiv).

exportation", was quite clear that it could apply to domestic subsidies or export subsidies.⁴ In summary, there is no indication in the drafting history that domestic subsidies should be less exposed to countervailing duties than export subsidies except as was a consequence of the adoption of an injury test.

2.2 TRACK II - NEGOTIATION OF THE ORIGINAL ARTICLE XVI

The last chapter mentioned the way that export subsidies were dealt with under Meade's *Proposal for an International Commercial Union*. His illustration of possible conditions had suggested a restriction on export subsidies to a maximum of 10 %.⁵ Domestic subsidies were covered by a clause suggesting that

members would be forbidden to give a preference (whether by tax, subsidy, price offered by state trading body or other means) in price to their home producers which was more than, say, 25 per cent greater than the price offered to similar goods produced by other members of the Union.⁶

Clearly, the clause suggests a maximum on import tariffs of 25%. However, the words are expressed to apply to a preference whether given by tax or by subsidy. They appear to cover a domestic production subsidy. As discussed in chapter 11, the suggestion of a maximum tariff rate evolved into other British proposals of formulas for across the board tariff cuts. Without wishing to make a definitive statement on the matter, it seems that the proposal for limiting domestic subsidies disappeared fairly early in the negotiation. It does appear to have survived the evolution of discussions toward agreement on the bilateral-multilateral model for tariff cuts.

Some insight to the understanding of negotiating parties of the role of domestic subsidies in the new proposed order may be gained from the reports made back to the Australian Prime Minister on the discussions on Article VII of the Mutual Aid Agreement.⁷ On 21 April 1944, the Australian delegate to discussions in London reported on the UK proposals for a formula cut to tariffs:

4 See Article 17(2) of the New York Draft ITO Charter and Article IV:2 of the New York draft of the GATT in *Report of the New York Session* UN Doc E/PC/T/34/Rev.1 (see ch 2, fn28 and accompanying text).

5 Para 13 (viii) or James E Meade, "A Proposal for an International Commercial Union" (25 July 1942) reproduced in "James Meade's War-time Proposal for a Liberal Trade Regime" (1987) 10 *The World Economy* 399-407 at 405.

6 As above, para 13(iv) at 404.

Subsidies could be used to supplement tariffs where more protection was required than provided by the formula. ... Quantitative restrictions on imports would be banned except for balance of payments purposes. Two price systems (i.e. one price for local sales and another for exports) would also be banned but direct subsidies to production could be substituted for them.⁸

The delegate, Melville, requested the Australian government to make an investigation into the effects of the proposals:

this investigation would need to include a detailed examination of the extent to which subsidies can be used as an alternative form of protection in order to offset all or part of the effects of tariff cuts or the prohibition of the two price system or to enable us to establish new industries. *It must be emphasised that the subsidy valve is an integral part of the commercial policy proposals and is intended to be used in this way.*⁹

A few days later, Melville added

You may have had an opportunity to consider whether it is possible by means of subsidies to give protection to industries to supplement that allowed by the Commercial Policy proposals. It seems to me there may be serious political, fiscal and administrative obstacles in the way of the payment of subsidies.¹⁰

The absence of any intention to regulate domestic subsidies was confirmed when the USA released the 1945 *Proposals for Expansion of World Trade and Employment*.¹¹ With respect to export subsidies, the *Proposals* introduced a prohibition based on a dual price test¹² but, with respect to domestic subsidies, the only applicable obligation was an obligation to consult in relation to "any subsidy which operates to increase exports or reduce imports" where such subsidy threatened serious injury to international trade.¹³ Even that limited obligation was curtailed by special provisions on commodities in "burdensome world surplus" the application of which to export subsidies was discussed in the last chapter.

7 See above at ch2, fn11 and accompanying text

8 "Memorandum from Melville to Curtin" 21 April 1944, "Report on London discussions on Article VII; February - March 1944" document no 113 in Department of Foreign Affairs and Trade, *Documents on Australian Foreign Policy 1937-49*, volume VII:1944, W.J.Hudson (editor), (Australian Government Publishing Service, Canberra, 1988) para 36. Paragraphs 36 to 40 relate to the discussions on commercial policy.

9 As above, para 36 (emphasis added).

10 "From Melville to Curtin (in Washington) Washington 26 April 1944, document no 119 in DFAT, *Documents on Australian Foreign Policy 1937-49*, volume VII:1944, W.J.Hudson (editor) (AGPS, Canberra, 1988).

11 United States, Department of State, *Proposals for Expansion of World Trade and Employment* (November 1945) (Department of State Publication 2411).

12 *Proposals*, Section D, para 1.

13 *Proposals*, Section D, para 1.

For such commodities, the obligation to consult would not apply without a decision of the Organization if the parties had entered into negotiations for an international commodity agreement and the negotiations failed.¹⁴

The essence of these provisions was carried into Article 25 of the *Suggested Charter*¹⁵ which became the basis for negotiations at the First Preparatory Conference for the UN conference. The Conference observed that the clause imposed "moderate and few" requirements on the use of industry assistance:

- "(i) If the subsidy does not reduce imports, no requirements are made;
- (ii) If the subsidy does reduce imports, the only requirement ... is that it is to be reported to the [ITO] together with an indication of the probable effect of the subsidy and the reason why it is necessary.
- (iii) Even if the subsidy should cause serious injury to international trade, the only requirement is that the members granting it discuss with members, whose interest is seriously prejudiced, the possibility of limiting the subsidy".¹⁶

As discussed in the context of export subsidies, Article 25 of the *Suggested Charter* became Article 30 of the London Draft ITO Charter.¹⁷ At the New York session, the drafting committee removed the exemption from this notification and consultation obligation that had formerly applied in respect of commodities.¹⁸ In addition, the consultation provision was altered slightly so that it applied to any subsidy "which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory".¹⁹ The commentary in the New York Report indicates that the addition of the

14 *Proposals* Section D, para 3b.

15 *Suggested Charter*, see above, ch2, fn 21 and accompanying text.

16 *Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, UN Doc E/PC/T/33 (London, Oct 46) Section D, para 2(b). This paragraph refers to the disciplines on subsidies other than export subsidies on manufactured goods. The parties believed that commodities would be governed by the chapter on commodity agreements rather than the provision on subsidies. However, the observations about the clause are equally applicable to any manufactured goods or other goods.

17 *London Draft* of the ITO charter, see above, ch2 at the text accompanying fn24.

18 See the *New York Report* in the *New York Draft*, Article 30(4)(b) and in the Commentary at para (a) under "Paragraph 4(b)".

19 *New York Draft*, see above, ch2 at fn28 and accompanying text, Article 30(1).

words "directly or indirectly" ensure that the clause cannot "be interpreted as being confined to subsidies operating directly to affect trade in the product under consideration".²⁰ It was in this form that the clause on notification and consultation was carried over from the draft ITO Charter into the draft of the GATT.²¹ This clause in the New York draft of the GATT was not substantially altered at the Geneva Session of the Preparatory Committee and it became Article XVI of the original GATT signed in 1947.

As mentioned in the last chapter, at the Geneva Session, the United States argued that the prohibition on export subsidies that increased the subsidizing nation's share of world trade should apply to domestic subsidies as well.²² Perhaps, this argument was simply a tactic in arguing for a less strict formulation of the rule as it applied to export subsidies. In the result, as mentioned in the last chapter, the USA was not successful in limiting the application of the rule relating to export subsidies in the draft charter. In the GATT, however, the USA succeeded in having the whole of the clauses regulating export subsidies deleted. In neither the draft charter nor the GATT was there any serious likelihood of additional constraints being imposed on domestic subsidies. Both Canada and Brazil responded to the USA's argument saying that it was appropriate to prohibit export subsidies but not domestic subsidies. They argued that export subsidies needed to be controlled because "when exports were only a small part of total output, it was easy to grant a very large export subsidy, whereas it was not easy to subsidize the total output."²³

3 THE ORIGINAL RULES OF GATT 1947

3.1 RULES ON DOMESTIC SUBSIDIES - ARTICLE XVI

Article XVI (renumbered Article XVI:1 in 1955) provided for notification in respect of the grant or maintenance of

any subsidy, including any form of income support, which operates directly or indirectly to increase exports of any products from, or to reduce imports of any product into the party's territory,

(a) of the extent and nature of the subsidization

20 UN, *Report of the Drafting Committee of the Preparatory Committee of the United Nations Conference on Trade and Employment*, UN doc E/PC/T/34/Rev.1, 29 May 1947.

21 See the *New York Report*, Part III, Draft General Agreement on Tariffs and Trade, Article XIV.

22 See Brown, *The United States and the Restoration of World Trade*, p118.

23 See Brown, *The United States and the Restoration of World Trade* p119.

- (b) of the estimated effect of the subsidization on the quantity of the affected product or products imported or exported into its territory; and
- (c) of the circumstances making the subsidization necessary.

It also provided for consultations in

any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization.

In that case, upon request, the party granting the subsidy was obliged to discuss "the possibility of limiting the subsidization".

3.2 ARTICLE III - RULES ON NATIONAL TREATMENT AND THE EXEMPTION FOR DOMESTIC SUBSIDIES -

Article III imposes considerable constraint on the way in which domestic support may be provided. In essence, Article III prevents the provision of domestic support by discriminating between domestic and foreign goods in internal laws affecting sale of goods in ways that have similar effects to barriers imposed at the frontier. Article III:2 prohibits the imposition of de facto tariffs through higher rates of sales tax for imports than local goods. The first sentence of Article III:2 prohibits higher sales taxes being applied to imported goods than is applied to "like" domestic products". The second sentence applies in respect of dissimilar taxation of products which even, if not 'like products', are directly competitive or substitutable. It prohibits taxes from being applied to imported products so as to afford protection to domestic production" of "directly competitive and substitutable product".

In addition Article III:4 prohibits any domestic law affecting internal sale²⁴ from treating imported products less favourably than "like" products of national origin. In respect of internal laws imposing quantitative regulations, a prohibition applies under Article III:5 if they are applied "so as to afford protection to domestic production". Further, Article III:5 prohibits regulations which require that any "specified amount or proportion of any product ... must be supplied from domestic sources".

24 "sale, offering for sale, purchase, transportation, distribution or use": see Article III:4.

Article III:8(b) provides a specific exemption from these national treatment rules for domestic subsidies. The exemption is limited to "the payment of subsidies exclusively to domestic producers".

In essence, the national treatment rules are directed towards internal measures which are de facto import barriers.

3.3 NON-VIOLATION NULLIFICATION OR IMPAIRMENT - ARTICLE XXIII

Domestic subsidies and other domestic support schemes could be affected by the principles of nullification or impairment operating under Article XXIII of the GATT. Recall from chapter 2 that Article XXIII operated upon criteria of nullification or impairment of benefits rather than upon the criteria of whether or not there has been a violation. Article XXIII:1(b) provided for the dispute settlement procedure to operate where

any benefit accruing to [a party] directly or indirectly under this Agreement is being nullified or impaired ... as the result of

- (b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement

Therefore, even though domestic subsidies could not constitute violations of the Agreement, they could cause nullification or impairment of a benefits under the Agreement. As described in chapter 2, the argument is that if Country A negotiates a tariff binding then the subsequent introduction of a domestic subsidy by Country A impairs the benefit that its trading partners would have otherwise received from the tariff binding.

4 DISCIPLINE OF DOMESTIC SUPPORT UNDER ARTICLE III

Whether the national treatment rule is conceptualized as a rule prohibiting de facto import barriers or a rule prescribing the forms of permissible domestic support, it has had some impact on the permissible forms of domestic support.

4.1 LIMITATION OF THE ARTICLE III:5 EXEMPTION

Despite the exemption for domestic subsidies, some types of domestic subsidies have been disciplined by Article III. The Article III:8(b) exemption has been interpreted so that subsidies to purchasers of products are not to be regarded as subsidies to the producers.

This was the effect of the decision in the case concerning Italian Discrimination Against Imported Agricultural Machinery.²⁵ There, a subsidy in the form of credit terms to purchasers of Italian agricultural machinery was held not to be a subsidy to the domestic producers of the machinery within the meaning of Article III:8(b).²⁶ This question of indirect subsidies arose in the context of agricultural trade in the Oilseeds dispute which is dealt with later in this chapter.

4.2 USING DOMESTIC SUPPORT PROGRAMMES AS DISGUISED IMPORT BARRIERS

Article III has had a direct impact on various domestic support schemes employed to support agricultural industries. Two disputes are particularly important.

4.2.1 Animal Feed Proteins case

In the animal feed proteins case, the measure at issue could either be viewed as a barrier to imports of certain vegetable animal feeds or as a support to the dairy industry that was a supplement to the EEC's common agricultural policy for milk.²⁷ In fact, the measure was only necessary in consequence of the accumulation of surpluses of milk powder caused by the EEC's high import barriers to milk and milk products. In order to help deplete some of the accumulated stockpile, the EEC introduced regulations requiring both domestic producers and importers of various vegetable products used as animal feeds to purchase a specified quantity of skimmed milk powder held by EEC agencies.²⁸ The regulations applied to EEC producers or importers of oilseeds²⁹, cakes and meals, dehydrated fodder and compound feeds. An additional regulation required importers of corn gluten³⁰ to

25 "Italian Discrimination Against Imported Agricultural Machinery" GATT *BISD* 7S/60-68.

26 GATT *BISD* 7S/60-68 at 64, para 14.

27 "EEC - Measures on Animal Feed Proteins" report of the panel adopted 14 March 1978 (L/4599) GATT *BISD* 25S/49.

28 GATT *BISD* 25S/49 at p50-51, paras 2.2-2.5.

29 The term "oilseeds" refers to a group of agricultural commodities including palm, coconut, soybeans, rapeseed, sunflower and cottonseed. Apart from some direct human consumption of soybeans, oilseeds are produced for vegetable oils which are consumed by humans, principally as cooking oil and margarine, and for use in protein meal in combination with low protein products in animal and poultry feeds. See Hathaway, *Agriculture and the GATT: Rewriting the Rules*, p31-32.

30 As explained by Hathaway, corn gluten feed is "the by-product of the wet-corn milling industry, which produces high fructose sweetener, ethanol, and other products from corn": Hathaway, Dale, *Agriculture and the GATT: Rewriting the Rules* (No20 in the series "Policy Analysis in International Economics") (Institute for International Economics, Washington DC, September 1987) p30.

purchase a quantity of skimmed milk powder but no similar obligation applied to domestic producers of corn gluten.³¹

The Import Barrier Argument

The USA had at stake a considerable trade in the various vegetable animal feed products. It exported over US\$3 billion of these products to the EEC accounting for almost one half of US agricultural exports to the EEC.³² One of the consequences of the EEC common agricultural policy for grains was that the EEC livestock, dairy and poultry producers sought cheaper foodstuffs to substitute for wheat and coarse grains for which the internal EEC prices were high.³³ In 1962, when the EEC had withdrawn bindings on various agricultural products so as to be able to apply variable levies to products to be subject to dual price support schemes under CAP, part of the package of compensation was that the EEC gave zero tariff bindings on various grain substitutes including all of the products to which these regulations applied.³⁴ In the years that followed, there had been steady large increases in USA exports of various grain substitutes to the EEC including all of the "oilseeds" and corn gluten.³⁵ The EEC had established a CAP for oilseeds but due to the zero tariff bindings, the policy could not use import barriers and therefore, to maintain a high internal price for oilseeds, relied on a system of paying domestic processors for purchasing domestically produced oilseeds.³⁶

The argument that the measure requiring purchases of skimmed milk powder constituted an import barrier in the form of an additional import charge on imports of oilseeds and corn gluten arose out of the way that the measure was enforced. The purchase obligations was enforced:

- (a) by making the granting of aid to domestic producers of oilseed and dehydrated fodder, as provided under the EEC common agricultural policy, conditional upon the

31 GATT *BISD* 25S/49 at 50-51, paras 2.2-2.5.

32 See Pierson, Brian, "American Agricultural Exports and the EEC's Common Agricultural Policy" (1982) 1 *Wisconsin International Law Journal* 133-150 at 135 & at 143-144 in Appendix 2.

33 See Hathaway at 27 & 74.

34 See Hathaway, *Agriculture and the GATT: Rewriting the Rules*, pp30-31.

35 Hathaway at 74. See also Josling, Tim, "Agricultural Trade Issues in Transatlantic Trade Relations" (1993) 16(5) *The World Economy* 553-573 at 562.

36 The EC set a target price and made payments to processors

presentation of a document providing proof of the purchase and the denaturing of the skimmed milk powder; and

- (b) by making the free circulation in the EEC of imported oilseeds, cakes and meals, dehydrated fodder and corn gluten subject to the presentation of a protein certificate issued by member States upon the provision of a document of proof of the purchase and the denaturing of the skimmed milk powder.³⁷

Both importers and domestic producers could be exempted from providing the document evidencing proof of purchase if they produced either a cash deposit or a bank guarantee. If the document evidencing purchase was produced later, then the deposit or bank guarantee was returned. If the document was not produced, the security was forfeited.³⁸ Therefore, for domestic producers, the consequences of failing meet the purchase obligation was forfeiture of a security deposit but they still retained their production subsidy which had been received upon lodgement of the security deposit and, for importers, the consequence of failing to purchase the skimmed milk powder was that they forfeited their security deposit but they were still allowed to sell the product in the EEC since they had already provided the security deposit. Therefore, the USA argued that the forfeiture of the security deposit was a charge on importation in violation of Article II:1(b).³⁹

Part of the United States' reliance on Article II:1(b) was based on the alleged fact that over 95% of the security deposits were collected in respect of imports rather than domestic product.⁴⁰ In fact, the effect was that where both importers and domestic producers failed to meet the purchase requirement, the net effect was that there was a net charge imposed on imports equal to the forfeited security deposit. Some parallels can be drawn between this situation and the forfeiture of a security deposit in the EEC Minimum Import Prices case which was decided a few months after the Animal Feed Proteins case. In that case also the panel had to decide whether the forfeiture of a deposit could be regarded as a charge upon importation, though in that case the amount to be forfeited was calculated by reference to the gap between a designated import price and an actual import price. As observed in chapter

37 GATT *BISD* 25S/49 at 51, para 2.7.

38 GATT *BISD* 25S/49 at 51, para 2.9.

39 GATT *BISD* 25S/49 at 57-58, para 3.23 - 3.27.

40 GATT *BISD* 25S/49 at 58, para 3.27.

11 above in the discussion of the MIPS case, there is little practical difference between enforcing a minimum price scheme by deductions from a refundable deposit and doing so by charging a variable levy. In the case of the Animal Feed Proteins regulation, one might observe that there is little practical difference between imposing an import duty and forfeiting a cash deposit.

The panel dismissed the argument that there was an import charge. It found that the forfeiture of the security was an enforcement mechanism for the purchase obligation and was not a charge on importation. Therefore, the panel found that the measure should be examined as an internal measure under Article III rather than as a border measure under Article II.⁴¹

The National Treatment Arguments

With respect to corn gluten, there was a clear breach of Article III:4 because the purchase obligation being applicable to imported corn gluten and not to domestic corn gluten clearly accorded less favourable treatment to the imported product.⁴²

In respect of the other vegetable proteins, various arguments were put. Two arguments were made under Article III:4. It was argued that the administrative arrangements relating to the purchase obligation and the forfeiture of the security accorded less favourable treatment in respect of imported oilseeds, cakes and meals, dehydrated fodder and compound feed than to the same domestic products. The panel regarded the various arrangements for imported products and domestic products as being equivalent and therefore not inconsistent with Article III:4. It was also argued that since the regulations applied to vegetable proteins and not to animal, fish or synthetic proteins then imported animal feed proteins were being treated less favourably than like products of national origin. The panel held that the fact that the measures did not apply also to animal, fish and synthetic proteins was not a violation of Article III:4 because the vegetable proteins and the animal, fish and synthetic proteins were not "like products".⁴³

41 GATT *BISD* 25S/49 at 67-68, paras 4.17-4.18.

42 GATT *BISD* 25S/49 at 65, para 4.10.

43 GATT *BISD* 25S/49 at 65-66, para 4.11.

It was argued that the regulations were inconsistent with the first sentence of Article III:5 because they were an "internal quantitative regulation" requiring that a specified amount or proportion of the animal feed must be supplied from domestic sources of milk powder. However the panel observed that this rule only applied to "internal quantitative regulation" which "related to the mixture, processing or use of products in specified amounts or proportions". The panel found that the measures were 'internal quantitative regulations' but because there was only an obligation to purchase a certain quantity of milk powder, they were not regulations "relating to the mixture, processing or use of products in specified amounts or proportions".⁴⁴

Finally, it was argued that the regulation was inconsistent with the second sentence of Article III:5 because it was an "internal regulation" affecting the purchase of milk which contrary to Article III:1 was "applied to imported or domestic products so as to afford protection to domestic production". There is an exception to the rule in the second sentence of article III:5 for "cases in which all of the products subject to the regulations are produced domestically in substantial quantities".⁴⁵ However, the panel found that the exception did not apply because not all of the vegetable protein products subject to the purchase requirement were produced domestically in substantial quantities. The panel found that the intervention agencies only held domestically produced skim milk powder and that therefore the purchase requirement afforded protection to domestic production of skimmed milk powder.⁴⁶ Therefore, the panel found a violation of the second sentence of Article III:5.

4.2.2 Spanish Soya Bean Oils case

As mentioned above, in 1978, the year of the Animal Feeds Proteins case, oilseeds and oilseeds products accounted for over US\$3 billion of USA exports to the EEC (then of 9) and just under one-half of all USA agricultural exports to the EEC. A little over US\$2 billion of that or almost a third of USA agriculture exports to the EEC was exports of soybeans or, in American parlance, soya beans.⁴⁷ The United States also exported soya beans in substantial quantities to Spain which did not become a member of the EEC until

44 GATT BISD 25S/49 at 64-65, para 4.6.

45 GATT Interpretative Note Ad Article III, paragraph 5.

46 GATT BISD 25S/49 at 65, para 4.7.

47 Pierson (1993) at 143-144 in appendix 2.

1986. At the time of acceding to the GATT at the end of the Dillon round in 1963, Spain had given a tariff binding at the low rate of 5%. Between 1963 and 1978, the United States exports of soya beans to Spain increased from less than 16,000 tons to more than 1,600,000 tons.⁴⁸ The processing of soyabeans into soya bean oil was having a significant impact on the production and sale of olive oil in Spain. In order to protect the olive and olive oil industry, Spain introduced certain measure which were the subject of a dispute with the United States, "Spanish Measures concerning Domestic Sale of Soyabean Oil".⁴⁹ A GATT panel found in favour of the Spanish measure but the legal reasoning, generally regarded as wrong, was controversial and the panel report was never adopted by the CONTRACTING PARTIES.

To understand the situation in this case requires some consideration of the options available to the Spanish government to prevent the injury to the olive and olive oil industry. Spain could not increase the import duty on soya beans, for it was bound at 5%. A sale tax on soyabeans but not on olives would almost certainly have been a violation of the second sentence of Article III:2 because it would have been a difference in tax operating to protect a directly competitive and substitutable product. Spain could have protected Spanish producers of Soyabean oil by increasing the import tariff on Soyabean oil, for it was not bound. However, this would not have prevented the import of soyabeans and their processing into soyabean oil which would have been sold at a lower price than olive oil. Again, a sales tax on soyabean oil but not on olive oil would almost have certainly been a violation of the second sentence of Article III:2 because it would have been a difference in tax treatment operating to protect a directly competitive and substitutable product. Finally, the Spanish government could have simply done nothing to restrain imports of soya bean or processing of soyabean oil, allowing the price of soya bean oil to undercut the price of olive oil, but the government could have compensated the producers of olives and olive oil with direct subsidies.

The protective measure adopted by the Spanish government was to empower a government instrumentality to impose a maximum quantity of soyabean oil which could be sold on the

48 "Spain - Measures concerning Domestic sale of Soyabean Oil" panel report L/5142, dated 17 June 1981, at p4, para 2.11.

domestic market in Spain.⁵⁰ There were no quantitative limitations on the domestic sale of any other vegetable oil. This measure did not stop large quantities of soyabeans from continuing to be imported into Spain and the large scale processing into soyabean meal and soyabean oil. However, since domestic sales of soyabean oil were limited, most of the soyabean oil derived from imported soya beans had to be exported.

The United States made a number of arguments but the panel was not prepared to accept any of them. The USA argued that the internal quantitative restriction was a violation of Article III:4 because the treatment of imported soyabean oil was less favourable than the treatment of domestically produced olive oil. However, a violation of Article III:4 can only exist where the treatment of the imported product is less favourable than the treatment of a domestically produced "like product". The panel found that soyabean oil and olive oil were not like products.⁵¹ In reaching that part of its decision, the panel regarded the term 'like product' as meaning "more or less the same".⁵²

Secondly, the United States argued that the Spanish measures was a violation of Article III:1 because it operated to protect domestic produce. On this argument, the panel made the controversial finding that there could not be a violation of Article III:1 unless it was established that the measure had actually caused adverse effects on United States trade. As exports of soyabeans had continued to increase, the panel found that no adverse effects had been established.⁵³

Thirdly, the United States argued that the Spanish measure was an internal quantitative measure within the meaning of the second sentence of Article III:5 which operated to protect domestic produce within the meaning of Article III:1. On this point, the panel again said that the requirement of Article III:1 could not be satisfied unless actual adverse effects were established.⁵⁴ In addition, the panel found that this situation fell within an exception to Article III: 5 set out in the interpretative note excluding from the second sentence of Article

49 "Spain - Measures Concerning Domestic Sale of Soyabean Oil" panel report L/5142, dated 17 June 1981.

50 For the details of the government instrumentality and its various powers, see para 2.3 to 2.8 of L/5142.

51 L/5142, para 4.7, p14.

52 L/5142, para 4.6, p14.

53 L/5142, para 4.2, p13.

III:5 restrictions on products produced in substantial quantities in Spain.⁵⁵ Upon the basis of this interpretative note, the panel found that the internal quantitative restriction applied to a product, soyabean oil, of which there was substantial production in Spain, so the prohibition did not apply.⁵⁶ There was significant disagreement between Spain and the USA on whether the panel had interpreted the interpretative note correctly. The USA complained that acceptance of the panel's interpretation would exclude the prohibition from situations in which the quantitative restriction had a protective effect not on the product to which it applied directly, but on the input for that product, in this case soyabeans, which was not produced in significant quantities in Spain.⁵⁷

The United States objected to all of these three parts of the decision. Twenty four other parties were also not in agreement with the adoption of the panel.⁵⁸ The CONTRACTING PARTIES were not able to adopt the decision but merely took note of it.⁵⁹ Although the disputes over interpretation of "like products" and the interpretative note were important, the aspect that caused the most controversy was the decision that a violation of Article II:1 required demonstration of actual trade effects. A number of parties took the view that actual trade effects were irrelevant. Although the decision under Article III:1 can be logically separated from an inference that nullification or impairment under Article XXIII required demonstration of trade effects, the views of the parties show a concern that this decision as to trade effects might set a precedent for interpretation of the general principle of nullification or impairment under Article XXIII. To this time, the problem of violations not being a sufficient on their own to establish nullification or impairment had been remedied by the development of a presumption that nullification or impairment was present in the case of all violations and in effectively regarding the presumption as un rebuttable. The

54 L/5142, para 4.5., p14.

55 See GATT, Interpretative Note Ad Article III, paragraph 5.

56 L/5142, para 4.5, p14.

57 See "Spain - Measures Concerning Domestic Sale of Soyabean Oil - United States: Comments to the Report of the Panel", L/5161, 26 June 1981.

58 See Hudec, *Enforcing International Trade Law* (1993) synopsis of complaints, no 92, p479-481 at p480.

59 See C/M/52 on "Spain - Measures concerning domestic sale of soyabean oil - report of the panel (L/5142 and corr.1, L/5161, L/5188)".

Contracting Parties were opposed to adoption of a report which might have threatened this approach to interpreting Article XXIII.⁶⁰

4.2.3 Domestic support under Article III

These cases illustrate how important Article III is in the scheme of regulation. It has a vital role in the prevention of disguised import barriers. The two cases on Article III that arose in relation to agriculture both derive from the original Article XXIV:6 negotiation relating to the establishment of the CAP. In 1962, a trade off was made between unbinding various product including grains and giving the very low bindings on soyabeans and other proteins used for human and animal consumption in oils and meals. The convoluted scheme in the Animal Proteins case only came about because of the market effects of the existence of high import barriers for grain based animal feeds. Not directly, connected, but in all likelihood related was the low binding on soyabeans given by Spain when it acceded to the GATT during the Dillon round,⁶¹ which eventually caused the threat to the Spanish olive oil industry.

5 DISCIPLINE OF DOMESTIC SUBSIDIES UNDER THE NULLIFICATION OR IMPAIRMENT PRINCIPLE

The application of the non-violation nullification or impairment principles to domestic subsidies has not been clearcut.⁶² The nullification or impairment principle has only been

60 Eg, see the records of the submissions of the delegates of Canada on p14, Egypt on p11, and India and Japan on p16 of C/M/152.

61 See L/5142, para 11.

62 Generally, on non-violation nullification or impairment, see Cottier, Thomas & Schefer, Krista Nadakavukaren, "Non-Violation Complaints in WTO/GATT Dispute Settlement: Past, Present and Future" ch3 in Petersmann, Ernst-Ulrich, *International Trade Law and the GATT/WTO Dispute Settlement System* (Kluwer, London, 1997) pp143-183 (arguing that the principle of non-violation nullification or impairment can be subsumed into a broader principle of protection of legitimate expectations); Hudec, Robert E, "Retaliation Against "Unreasonable" Foreign Trade Practices: The New Section 301 and GATT Nullification and Impairment" (1975) 59 *Minnesota Law Review* 461-539, Petersmann, Ernst-Ulrich, "Violation Complaints and Non-Violation Complaints in Public International Law" (1991) 34 *German YIL* 175-229; & Petersmann, Ernst-Ulrich, "'Non-Violation Complaints" and "Situation complaints" in GATT/WTO Law: what is their Legitimate Function?" ch4 in Petersmann, *The GATT/WTO dispute settlement system: international law, international organization, and dispute settlement* (Kluwer, The Hague, 1997) pp135-176; Roessler, Frieder, "The concept of Nullification and Impairment in the Legal System of the World Trade Organization" ch 2 in Petersmann, (1997) see immediately preceding citation, pp125-142; Von Bogdandy, Armin, "The Non-Violation Procedure of Article XXIII:2, GATT" (1992) *JWT* 95-111; and Williams, Brett, "Non-Violations in the WTO System" in the WTO System" in Mengozzi, Paulo (ed), *International Trade Law on the 50th Anniversary of the Multilateral Trade System* (Giuffre, Milan, 1999) pp675-797.

applied to non-violations in a small number of cases.⁶³ It was applied in non-violation situations in two early GATT cases in 1949 and 1952 respectively.⁶⁴ After that, in two cases in 1982, one of which related directly to the question of domestic subsidies on agricultural products, non-violation nullification violation or impairment formed the basis of panel decisions but the reports were not adopted by the CONTRACTING PARTIES.⁶⁵ During the Uruguay Round, another dispute involving domestic subsidies arose. This was another round of the long running dispute over EEC attempts to stem the massive flow of imports of oilseeds from the USA. This was the third time, and the first time since 1952 that the CONTRACTING PARTIES adopted a panel report containing a finding that a non-violation measure nullified or impaired a benefit under the Agreement.

5.1 THE TWO EARLY CASES ON NON-VIOLATION NULLIFICATION OR IMPAIRMENT - AMMONIUM SULPHATE & GERMAN SARDINES

Neither of the two early cases involved domestic production subsidies. Nevertheless, they are important to this discussion because of the parameters that they establish for the application of the nullification or impairment principle to non-violations. Both involved unusual facts and, in both cases, the respective panels stressed the particular facts in reaching their decisions.

5.1.1 Australian Subsidy on Ammonium Sulphate

The Australian government imposed war time price restrictions on many food products and, to minimize the impact on food producers, also imposed maximum prices on fertilizers. The Australian government appointed a private company, Nitrogenous Fertilizers Pty Ltd to act as the sole Australian distributor of two types of fertilizer, ammonium sulphate and sodium nitrate. The company purchased some ammonium sulphate from Australian suppliers. It

63 For a survey of the cases in which non-violation nullification principles have been considered, see Hudec (1975), Petersmann, (1991), Petersmann, (1997) and Williams (1999) all cited in the immediately preceding footnote.

64 "The Australian Subsidy on Ammonium Sulphate" report adopted by the CONTRACTING PARTIES on 3 April 1950 (GATT/CP/4/39) GATT *BISD* Vol II, 188 and "Treatment by Germany of Imports of Sardines" report adopted by the CONTRACTING PARTIES on 31 October 1952 (G/26) GATT *BISD* 1S/53-59.

65 "European Economic Community - Production Aids Granted on Canned Peaches, Canned Pears, Canned Fruit Cocktail and Dried Grapes" unadopted report by the panel dated 20 February 1985 (L/5778). "European Economic Community - Tariff Treatment of Citrus Products from Certain Mediterranean Countries" unadopted report by the panel L/5776 dated 7 February 1985.

also purchased both types of fertilizer from the Australian government which purchased them from abroad and onsold them to Nitrogenous Fertilizers at cost. The Australian government purchased the sodium nitrate from Chile and the ammonium sulphate from various countries not including Chile. The government imposed a uniform maximum price on the company's sales of both fertilizers but the government reimbursed the company for the losses incurred by the company. In the first GATT round, 1947, no binding was given on ammonium sulphate but a tariff binding at a rate of zero was given in respect of sodium nitrate. Imports of ammonium sulphate were subject to the unbound tariff rate of 12.5%. From 1 July 1949, the government ceased to impose maximum prices on the fertilizers. The government stopped meeting the losses on sodium nitrate and Nitrogenous Fertilizers stopped trading in sodium nitrate. The government continued to purchase ammonium sulphate from abroad, to sell it to the company at cost and, up to a maximum, to meet the company's losses on resale.⁶⁶ The net effect on the Chilean exporters of sodium nitrate was that they had to compete in a market in which Australian purchasers were being subsidized to buy ammonium sulphate whether from Australian suppliers or from non-Chilean foreign suppliers.

The working party⁶⁷ decided that there was no violation of the Agreement. They found that there was no 'internal tax or other internal charge' on sodium nitrate and that, therefore, Article III:2 did not apply.⁶⁸ Further, they found that there was no breach of the national treatment rule in Article III:4 because Article III:4 only applied to 'like products' and the working party found that the two types of fertilizers were sufficiently different as not to be regarded as 'like products'. The finding that the two fertilizers were not 'like products' also meant that there was no violation of the most favoured nation rule in Article I.⁶⁹

Having found that there was no violation, the working party considered whether there was non-violation nullification or impairment. The report introduced the concept of 'reasonable expectations' into law relating to nullification or impairment. It did so by stating that there would be nullification or impairment of a benefit accruing under the Agreement

66 *BISD* Vol II 188 at 189, para 4.

67 Note that the appointment of a representative working party in this dispute predates the establishment of the practice of appointing panels of independent members.

68 *GATT BISD* Vol II 188 at 191, para 7.

69 *GATT BISD* Vol II 188 at 191-192, paras 8 & 9.

if the action of the Australian government which resulted in upsetting the competitive relationship between sodium nitrate and ammonium sulphate could not reasonably have been anticipated by the Chilean government, taking into consideration all pertinent circumstances and the provisions of the General Agreement, at the time it negotiated for the duty-free binding on sodium nitrate.⁷⁰

Then the working party observed that normally the removal of a subsidy would be within the reasonable expectations of a party negotiating a tariff binding. It also said that it would be harder to establish that the introduction of a subsidy on one of two competing products was beyond reasonable expectations than it was to establish that the action the subject of the present case was beyond expectations. The working party referred to the particular facts emphasizing that the subsidies were a continuation of a war-time scheme that had existed when the tariff binding was negotiated and that the two types of fertiliser were closely related.⁷¹ It reached the conclusion that during the negotiation of the tariff binding in 1947, Chile could not reasonably have anticipated that the subsidy would be removed from sodium nitrate before it was removed from ammonium sulphate.

The Australian delegate to the working party issued a separate statement. The Australian statement contested the finding that there could have been a reasonable expectation of the continued equal treatment of the two products. It also criticized the way that the working party used reasonable expectations as a criteria for determining the existence of nullification or impairment. The statement asserted:

The history and the practice of tariff negotiations show clearly that if a country seeking a tariff concession on a product desires to assure itself of a certain treatment for that product in a field apart from rates of duty *and to an extent going further than is provided for in the various articles of the General Agreement*, the objective sought must be a matter for negotiation in addition to the actual negotiation respecting the rates of duty to be applied.

If this were not so, and if an expectation (no matter how reasonable) which has never been expressed, discussed or attached to a tariff agreement as a condition is interpreted in the light of the arguments adduced in the report of the working party, then tariff concessions and the binding of a rate of duty would be extremely hazardous commitments and would only be entered into after an exhaustive survey of the whole field of substitute or competitive

70 GATT *BISD* Vol II 188 at 192-193, para 12.

71 GATT *BISD* Vol II 188 at 193, para 12.

products and detailed analysis of probable future needs of a particular economy.⁷²

5.1.2 German Imports of Sardines

A finding of non-violation nullification or impairment was again made in the case relating to 'Treatment by Germany of Imports of Sardines' and again the concept of reasonable expectations was used as a criteria for determining the existence of nullification or impairment.⁷³ This case also involved unusual facts.

Prior to 1923, Germany gave the same treatment to imports of three different types of sardines: 'sprats' and 'herring' which it imported from Norway and 'pilchards' which it imported from Portugal. In 1923, Germany and Portugal negotiated a reduction in the rate applicable to pilchards.⁷⁴ Then in 1925, Germany undertook to Norway to provide the same customs treatment to sprats and herring as it gave to pilchards. When Germany acceded to the GATT in 1951, Germany gave a binding of 25% on sprats and on herrings.⁷⁵ At that time, Portugal was not a party to the GATT and Germany was able to leave the rate on pilchards unbound at 30%.⁷⁶ After the negotiation of the binding, but before it came into force, Germany decided that it was still bound by the tariff concession granted to Portugal on pilchards in 1923 and proceeded to reduce the tariff on pilchards to 14%.⁷⁷ Norway complained on two grounds. First, it argued that the tariff treatment given to sprat and herring from Norway was less favourable than the treatment of pilchards from Portugal and, therefore, was in violation of the most favoured nation rule in Article I. Secondly, Norway argued that the less favourable treatment was contrary to a specific assurance given by the German delegation during the Torquay round of tariff negotiations.

72 "Statement by the Australian representative", annex to the report of the panel on "Australian Subsidy on Ammonium Sulphate" GATT *BISD* Vol II 181 at 195-196, para 3 (emphasis in original).

73 "Treatment By Germany of Imports of Sardines" report adopted by the CONTRACTING PARTIES on 31 October 1952 (G/26) GATT *BISD* 1S/53-59.

74 Hudec, (1990) p174.

75 GATT *BISD* 1S/53059 at 54-55, para 3. (It also gave a binding of 20% on one particular type of herring).

76 At 54-55, para 3.

77 GATT *BISD* 1S/53 at 55, para 5. See also Hudec (1990) pp174-175.

The Article I claim depended on the three types of sardine being regarded as "like products". The panel, with somewhat questionable reasoning,⁷⁸ found that it was not established that the products were like products. Therefore, it went on to consider the alleged assurance by the German delegation. The panel report does not give much detail on the facts surrounding the alleged giving of the assurance. Relying on an account by Hudec,⁷⁹ it seems that the Germans indicated that such an assurance had not been authorised nor reported to either the head of the German delegation or the home government. Apparently, the official alleged to have given the assurance could not be found. On the other hand, Norway stated quite clearly that the German delegation had given an assurance that the products would be treated equally and that they had reported the assurance back to the Norwegian parliament.⁸⁰ Clearly, the panel was in a difficult position in that if it found the assurance had been made, it would have offended Germany by finding, at best, that either a member of the German delegation had acted without authority of the head of delegation or that the head of delegation had acted without authority of the home government. If it found that the assurance had not been given, it would have been finding that the Norwegian delegation was incompetent in failing to ensure that a legally binding obligation was secured.

The panel did not make any finding on whether the German delegation had given the alleged assurance. Instead, it resolved the case by following the formula that had been used in the Ammonium Sulphate case. It said that the tariff binding on herring and sprat would have been impaired

if the action of the German government, which resulted in upsetting the competitive relationship between [the different kinds of sardines] could not reasonably have been anticipated by the Norwegian government at the time it negotiated [the tariff bindings].⁸¹

The panel found that Norway had offered counter concessions on the basis of an assumption that the equal treatment of the products would continue, that is, upon a reasonable

78 The panel thought it had to decide whether in the course of negotiations Germany and Norway had regarded the products as like products: see 1S/53 at XX para X.

79 See Hudec (1990) p174-175.

80 See Hudec (1990) pp174-177.

81 GATT *BISD* 1S/53 at 58, para 16.

expectation that Germany would not upset the equal treatment of the products. Therefore, Germany had impaired the tariff binding.⁸²

5.2 APPLYING THE REASONABLE EXPECTATIONS CONCEPT TO DOMESTIC SUBSIDIES

These two early decisions have formed the basis for subsequent arguments of non-violation nullification or impairment. However, for the next 35 years, there were no further dispute settlement decisions adopted by the CONTRACTING PARTIES based upon non-violation nullification or impairment. Neither of the two early decisions were terribly good authority for broader propositions of law: the German sardines case because of the dubious decision on the undertaking and both decisions because of the peculiarity of their fact situations.⁸³ While both of the decisions place emphasis on their own findings of fact, the way that the concept of reasonable expectations was used raised questions about the potential scope of non-violation complaints. In particular, it raised a question of whether the negotiation of a tariff concession created a reasonable expectation that a domestic subsidy would not be introduced to increase the relative competitiveness of domestic products. The report in the Ammonium Sulphate case did not lay down general rules about what could or could not be reasonably anticipated. In particular, it abstained from laying down any rules about whether any particular types of subsidies would fall within the realms of reasonable expectations and, therefore, be a cause of non-violation nullification or impairment. The report makes reference to "the freedom under the General Agreement of the Australian Government to impose subsidies and to select the products on which a subsidy would be granted" and contemplates that this would have to be taken into account in determining the scope of reasonable expectations.⁸⁴ The statement is certainly directed to consideration of the question of whether the binding on ammonium sulphate would have been impaired by the subsequent introduction of a consumption subsidy on sodium nitrate or another competing product and it hints that such a situation might not be regarded as outside reasonable expectations.⁸⁵ However, the statement has wider relevance. One has to consider whether,

⁸² GATT *BISD* 1S/53 at para 16(c).

⁸³ See Williams, Brett, "Non-Violation complaints in the WTO System" in Mengozzi (ed), *International Trade Law on the 50th Anniversary of the Multilateral Trade System*, as above.

⁸⁴ GATT *BISD* Vol II, 188 at 193, para 12.

⁸⁵ One would have to consider whether such a subsidy was a breach of Article III:4 and outside the scope of Article III:8(b).

given the freedom which the Agreement gives, other types of subsidies should be regarded as inside or outside the scope of reasonable expectations. The question arises as to whether a production subsidy on a product on which a tariff binding has been given is impaired by the introduction of a production subsidy on the same product or whether that tariff binding is impaired by the introduction of a production subsidy on a directly competitive and substitutable product.

It is stressed that the facts of the Ammonium Sulphate case did not involve the introduction of a subsidy upon the product (sodium nitrate) upon which the tariff concession had been given. The general principle introduced by the panel seems capable of application to that situation. However, the panel carefully limited its decision to the facts. As mentioned, it said it would have had difficulty in finding that the introduction of a subsidy was not within reasonable expectations. The words of the panel were:

The situation in this case is different from that which would have arisen from the granting of a new subsidy on one of two competing products. In such a case, given the freedom under the General Agreement to impose subsidies and to select the products on which a subsidy would be granted, it would be more difficult to say that the Chilean Government had reasonably relied on the continuation of the same treatment for the two products.⁸⁶

It is not clear whether the panels comments relate only to the situation in which a subsidy were to be introduced upon the product, ammonium sulphate, which was competitive with the bound, sodium nitrate or whether the comments also relate to the situation in which a subsidy were to be introduced on the bound product itself, sodium nitrate.

Similarly, it was not clear from the Australian statement whether they were objecting in a narrower sense or a broad sense to the application of the notion of reasonable expectations. The objection could be interpreted in a narrow sense as an objection to the notion of reasonable expectations being used in a way that affected policy options relating to a product other than the product upon which the tariff binding had been given. The objection could be interpreted in a broader sense as an objection to the application of the notion of reasonable expectations so as to create any obligations at all beyond those that had been expressly set out in the schedule of concessions, including but not being limited to the

86 GATT *BISD* Vol II 188 at 193, para 12.

creation of obligations affecting the right to grant subsidies on the product upon which the tariff binding has been given.

If the panels decision were accepted in a broad sense, then every tariff concession would carry with it an obligation not to grant a domestic subsidy upon the product upon which the tariff concession is given unless the schedule of concessions also included a reservation of a right to grant such a subsidy. If the Australian objection were accepted in a broad sense, then other parties would not be able to seek authorization to withdraw their own concessions in response to another party introducing a subsidy upon a bound product unless they had expressly made their own concessions subject to such a condition.

This is a crucial question with respect to the regulation of domestic subsidies and to the whole framework of GATT rules: whether the giving of a tariff concession implies an obligation not to introduce a production subsidy on the product upon which the tariff concession is given.

5.3 REVIEW OF THE RULES ON DOMESTIC SUBSIDIES DURING THE 1955 REVIEW

In the context of export subsidies, reference has been made to the 1955 Review of the Agreement. While the negotiation to strengthen regulation of export subsidies was a major feature of the 1955 Review, discussion of domestic subsidies was a much less important part of the Review but it did arise and, in fact, did so in the context of agricultural policy.

In the context of the 1955 review of the export subsidy rules, reference has already been made to statements of various country representatives which sought amendments to the rules and how, although the negotiation focussed on the export subsidy rules, a few countries had also expressed concerns with the effects of domestic subsidies as well as export subsidies.⁸⁷ These concerns were expressed by countries whose agricultural exports were being affected displaced by subsidized produce: Canada, France, New Zealand, South Africa and Australia. In fact, few suggestions were made for revision of the regulation of domestic subsidies.

87 See above ch12 at 354-362 referring to SR.9/17.

The most comprehensive proposal relating to domestic subsidies came from Australia. First, Australia proposed that negotiations on domestic subsidies should be incorporated into negotiations on tariff reduction. It proposed that

domestic subsidies for the purposes of negotiation of reduction in barriers to trade should be treated on an equal footing with tariffs and other protective devices.⁸⁸

This suggestion was not embraced although it was arguably 'tolerated' by the way that the negotiating rules were established for the fourth multilateral round of tariff negotiations due to start later that year.⁸⁹

In addition, Australia submitted draft articles to be incorporated into the GATT. Australia's proposals could only be consistent with the narrower interpretation of its statement of objection to the report in the ammonium sulphate case. In proposing the new articles, Australia referred to widespread use of domestic subsidies as a means of protection for primary industries and to the inadequacies of the existing rules with respect to domestic subsidies⁹⁰. Firstly, it observed that Article XXVIII did not apply to domestic subsidies and that, in consequence, parties were able to increase subsidies without having to go through the process of negotiation and compensation which would be required if they used tariffs to protect their primary industries.⁹¹ It then referred to the difficulty of seeking redress against domestic subsidies by a non-violation nullification or impairment claim under Article XXIII:

whether or not Article XXIII could provide effective recourse to a contracting party which claimed that a domestic subsidy had impaired or nullified the concession it had obtained or the benefits which it expected would have accrued to it directly or indirectly under GATT, it must be admitted that recourse to this Article would be an involved and tortuous procedure. This Article was designed to provide for the exceptional case of impairment not suitably or explicitly provided for in other Articles, and certainly could not be viewed as part of a regular procedure to be used as a kind of parallel to Article XXVIII.⁹²

88 Review Working Party III on Barriers to Trade other than Restrictions or Tariffs, "Domestic Subsidies - Note by Australian Delegation for discussion", W.9/67, 6 December 1954 at p2 and referring to the Australian delegations earlier suggestion in W./9/28.

89 See the negotiating rules for the Geneva Round at GATT *BISD* 4S/75.

90 "Domestic Subsidies - Note by Australian Delegation for Discussion" W.9/67 (6 December 1954) at p2.

91 W.9/67 at p2. .

92 W.9/67 at p2.

Australia further stressed the inadequacy of relying on Article XXIII to deal with domestic subsidies by saying that this problem particularly detracts from the negotiation of concessions on agricultural products:

As long as a domestic subsidy can be imposed unilaterally and can make ineffective a tariff concession gained by negotiation, there is no inducement for exporters of primary goods which already have low or free rate of duties against most of their exports to enter into negotiations. They stand to get concessions which can be revoked at will and for which any compensation can only be sought by doubtful resort to Article XXIII.⁹³

The proposed articles created a separate dispute settlement mechanism for dealing with subsidies which "decrease imports of any [primary] commodity in respect of which it has entered into obligations through negotiations with any other contracting party".⁹⁴ The articles provided for consultations with parties whose interests were seriously prejudiced by the subsidies. The article further provided that in the event that consultations did not result in agreement, the concerned parties could suspend the application of "substantially equivalent" obligations or concessions to the subsidizing country's trade.

5.3.1 The Report of the 1955 Review of the Agreement

As discussed in the last chapter, as a result of the report following the 1955 review, the parties amended the Agreement to insert additional provisions on export subsidies into Section B of Article XVI. However, with respect to domestic subsidies, the Australian suggestion that the Agreement be amended to include additional rebalancing provisions to deal with domestic subsidies did not gain the support of other parties. The Review Working Party did not recommend any additional provisions on domestic subsidies.⁹⁵ The Working Party took the approach that domestic subsidies could be dealt with adequately as non-violation complaints under Article XXIII and made a statement to confirm that parties could reasonably expect that a party giving a tariff binding would not subsequently introduce a domestic subsidy on the product the subject of the concession. The relevant part of the report said

93 W.9/67 at p3.

94 "Domestic Subsidies - Note by Australian Delegation for Discussion" W.9/67, (6 December 1954) at p3.

95 See "Reports Relating to the Review of the Agreement - Other Barriers to Trade" GATT *BISD* 3S/222 at 222 at para 2, at 224-225, paras 13-15.

- 13 ...So far as domestic subsidies are concerned, it was agreed that a contracting party which has negotiated a concession under Article II may be assumed, for the purpose of Article XXIII, to have a reasonable expectation, failing evidence to the contrary, that the value of a concession will not be nullified or impaired by the contracting party which granted the concession by the subsequent introduction or increase of a domestic subsidy on the product concerned.
- 14 The Working Party also agreed that there was nothing to prevent contracting parties, when they negotiate for the binding or reduction of tariffs, from negotiating on matters, such as subsidies, which might affect the practical effects of tariff concessions, and from incorporating in the appropriate schedule annexed to the Agreement the results of such negotiations;⁹⁶

Note that these statements only refer to subsidies on the product upon which the tariff concession has been given and not to subsidies on other products which are competitive with the product upon which the tariff concession has been given.

5.3.2 The 1960 Panel on Subsidies

The provisions of Article XVI were reviewed in 1960. A panel on subsidies referred to the paragraphs 13 and 14 of the report of the General Review relating to the application of nullification or impairment to non-violation subsidies. The panel

noted that the expression "reasonable expectations" was qualified by the words "failing evidence to the contrary". By this the Panel understands that the presumption is that unless such pertinent facts were available at the time the tariff was negotiated, it was then reasonably to be expected that the concession would not be nullified or impaired by the introduction or increase of a domestic subsidy.⁹⁷

Together the 1955 and 1961 reports set out a general rule that a tariff concession did carry with it an obligation not to grant or increase a domestic subsidy on the bound product. This meant that parties to whom a concession is given are entitled to the benefit of the competitive position established by the tariff binding without any "impairment" caused by a subsequent subsidy. The rule was qualified if "pertinent facts" about a subsidy were available at the time of negotiation. This seemed to be a fairly clear statement of the law.

96 GATT *BISD* 3S/222 at 224-225, para 13 & 14.

97 GATT *BISD* 10S/201 at 209, para 28.

However, until 1989, the CONTRACTING PARTIES declined all opportunities to confirm the rule in the adoption of dispute settlement reports.

6 DOMESTIC SUBSIDIES UNDER THE TOKYO ROUND CODE ON SUBSIDIES

The treatment of domestic subsidies under both remedy tracks arose in the Tokyo Round negotiation.

6.1 TRACK 1 - COUNTERVAILING DUTIES AGAINST DOMESTIC SUBSIDIES

The description in the last chapter of the negotiation over countervailing duties described how one of the concerns of a number of countries was the use by the United States of CVDs against domestic subsidies.⁹⁸ These concerns were brought about by the change in United States' practice in the early 1970s resulting in the application of countervailing duties to subsidies that were not paid contingent upon export. The Greek Tomato case dealt with a CVD applied to a subsidy that was paid on all production, a high proportion of which was exported, upon the basis of an 'export orientation' test.⁹⁹ Of even more concern was the precedent established by the Michelin case which dealt with a CVD on a subsidy which was not even paid contingent upon production but was paid to promote development in a particular region of Canada.¹⁰⁰

The EEC and the USA disagreed over the issue of whether domestic subsidies should be countervailable. The USA defended its practices, arguing that domestic subsidies should be countervailable in the same way as export subsidies. The EEC argued that domestic subsidies should not be countervailable unless they were disguised export subsidies,¹⁰¹ in effect, accepting that the type of subsidy dealt with in the Greek Tomato case could be countervailable but that the type of subsidy dealt with in the Michelin case should not be. However, as described in the last chapter, the negotiation did not result in any distinction being made in countervailing duty law between export subsidies and other subsidies. The concern with the USA countervailing domestic subsidies was addressed through the

98 See, above, ch12 at pp377-380.

99 See, above, ch12 at p379, fn163 ("Tomato Products from Greece" case).

100 See above, ch 12 at pp379-380, fn164 ("X-Radial Steel Belted Tires from Canada" case).

application of the injury test rather any limitation of the type of subsidy that could be countervailed.

6.2 TRACK 2 - MULTILATERAL REMEDIES AGAINST DOMESTIC SUBSIDIES

Another way in which regulation of domestic subsidies arose in the Tokyo Round negotiation was that participants considered the extent to which parties should remain free to utilize domestic subsidies.¹⁰² In part, this required consideration of whether they should define the concept of nullification or impairment of a benefit under Article XXIII. Among other aspects of this concept, one question before them would have been whether some actual trade effect must be established.¹⁰³ The question was not unequivocally resolved in the text of the *Subsidies Code*.

Chapter Two's introduction to the framework of GATT rules briefly described the provisions of the *Subsidies Code* creating an obligation to avoid certain adverse effects of domestic subsidies and providing remedies against such adverse effects of domestic subsidies. Some aspects of these rules apply to export subsidies and, in chapter 12, the text of these provisions were more fully explained.

The relevant provision, Article 8 created an obligation to "seek to avoid causing through the use of any subsidy" the three adverse effects: injury, nullification or impairment of benefits, or serious prejudice. The part of that provision which affected domestic subsidies was the reiteration of the nullification or impairment rule from Article XXIII. Article 8.4 provided that nullification or impairment could arise through the effects of a subsidy in the

101 See Barcelo, "A History of GATT Unfair Trade Remedy Law - Confusion of Purposes" (1991) 14(3) *The World Economy* 311-333 at 329 citing Beseler, J.F. & Williams, A.N., *Anti-dumping and anti-subsidy law: The European Community* at 15-17

102 See, eg, Rivers & Greenwald, "The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences" (1979) 11 *Law & Policy in International Business* 1447- 1495; and Turillo, Daniel K., "The MTN Subsidies Code: Agreement without Consensus" ch5 in Rubin, Seymour J. & Hufbauer, Gary Clyde (eds), *Emerging Standards of International Trade and Investment - Multilateral Codes and Corporate Conduct* (Rowmand & Allanheld, Totowa, New Jersey, 1983) pp63-99.

103 The outcome of the negotiation indicates that they also considered whether "benefit" could be a benefit other than a benefit under a tariff concession and whether a nullification or impairment could arise from effects of a second country's measure in a another country's market.

subsidizing country.¹⁰⁴ As to what was required to demonstrate nullification or impairment, the following word were incorporated into Article 8(4):

The adverse effects to the interests of another signatory required to demonstrate nullification or impairment ... may arise through

...

(b) the effects of the subsidy in displacing or impeding the imports of like products into the market of the subsidizing country.

This provision begs the question as to whether the use of the words 'displacing or impeding' mean that actual trade effects have to be demonstrated. The word 'displacing' seems to be consistent with a need to prove actual trade effects but the use of the word 'impeding' seems to be consistent with a need to prove only a change in competitive conditions. These words did not unambiguously resolve the issue.

The discussion in the Round as to the extent to which parties should be free to use domestic subsidies also resulted in the adoption of Article 11 of the *Subsidies Code*. Article 11 consisted of largely hortatory language about the freedom to subsidize which appears not to have had any impact on the remedies available against domestic subsidies. Paragraph 1 of Article 11 provided that

Signatories recognize that subsidies other than export subsidies are widely used as important instruments for the promotion of social and economic policy objectives and do not intend to restrict the right of signatories to use such subsidies to achieve these and other important policy objectives which they consider desirable.

Paragraphs 1 also contained a list of the objectives of such subsidies and paragraph 3 listed a number of means of subsidies that might help to achieve those objectives. The list in Article 11(3) was restricted to "subsidies granted with the aim of giving an advantage to certain enterprises" and included various forms of governmental assistance but did not include simple production subsidies. However, paragraph 2 confirmed the possibility of applying multilateral remedies for non-violation nullification or impairment against such subsidies, providing that

signatories recognize ... that subsidies other than export subsidies ... may nullify or impair benefits accruing to another signatory under the General

104 *Subsidies Code*, Article 8(4)(a).

Agreement, in particular where such subsidies would adversely affect the conditions of normal competition.¹⁰⁵

The provisions of Article 11 did not contain anything to say that non-specific subsidies, those which were granted generally and without "the aim of giving advantage to certain enterprises", would not be subject to track 2 remedies including the non-violation or impairment remedy. However, arguably, it was implied.¹⁰⁶ With respect to specific subsidies, it is clear that the non-violation nullification or impairment principle would still be applicable. Nothing at all in Article 11 referred to the countervailing duty track. Therefore, the recording of the views of the parties in Article 11 did almost nothing at all to change the status quo with respect to the remedies available against domestic subsidies.

A special version of Article 11 for developing countries was provided for in Article 14(7). This did exclude both the countervailing duty and non-violation nullification or impairment remedies against 'specific' subsidies by developing countries that fell within the types of measures listed in Article 11(3). It preserved the possibility of non-violation nullification or impairment against other non-export subsidies (like production subsidies).

The discussions about the need to protect the right to grant subsidies other than export subsidies and the formulation of Articles 11 and 14 did not, in fact, for developed countries result in any additional protection of that 'right' to grant subsidies other than export subsidies though, for developing countries, some additional protection was provided.

7 DOMESTIC SUBSIDIES AFTER THE TOKYO ROUND

7.1 TRACK1 - COUNTERVAILING DUTIES AFTER THE TOKYO ROUND

In summary, the principal difficulties with the application of countervailing duty rules after the Tokyo Round were in three areas:

- (1) the withholding by the USA of the injury test from some countries; this was described in chapter 12 in relation to export subsidies;

105 *Subsidies Code*, Article 11(2).

106 See Montana-Mora, Miguel, "International Law and International Relations Check to Check: An International Law/International Relations Perspective on the US/EC Agricultural Export Subsidies Dispute" (1993) 19 *NCJ Int'l L & Com Reg* 1-60 at pp26-27 where he appears to agree with this view.

- (2) the difficulty of proving injury, particularly in cases in which the subsidy was paid on one product but where there is an injury to upstream or downstream producers; a similar problem to that described in chapter 12 in relation to export subsidies on processed agricultural products causing injury to producers of primary agricultural products arose in relation to domestic subsidies;
- (3) proof of the existence of a subsidy under USA law which had incorporated the test of specificity.

At the end of the Tokyo Round, the USA amended its CVD law to introduce an injury test and also to redefine subsidies for the purposes of CVDs. The new law confirmed that USA CVDs could be applied against domestic subsidies but added a specificity test.¹⁰⁷ The new law also broadened the scope of subsidies that could be countervailed by defining a subsidy to include the conferral of a benefit rather than necessarily requiring the outlay of funds.¹⁰⁸ Subsidies were countervailable if they fell within a new definition which included export subsidies and

the following domestic subsidies, if provided or required by government action to a specific enterprise or industry, or group of enterprises, whether publicly or privately owned or whether paid or bestowed directly or indirectly on the manufacture, production or export of any class or kind of merchandise ...¹⁰⁹

The net effect of these changes to the law was that the use of countervailing duties by the United States increased rather than decreased. Between 1982 and mid 1989, the USA initiated 192 CVD investigations or 62% of all of the CVD investigations initiated in the whole world.¹¹⁰ The USA continued to apply CVDs to domestic subsidies and quite complex disputes arose which led to GATT disputes.¹¹¹ One related to the issues of

107 The specificity requirement was introduced into US law in 1979 by s100 of Public Law 96-39 (26 July 1979). Section 100 inserted Title VII into the Tariff Act of 1930. Title VII contained ss771-778. Section 771 contained a definition of export subsidies.

108 See Barcelo III, John J, "Subsidies, Countervailing Duties and Antidumping after the Tokyo Round" (1980) 13 *Cornell International Law Journal* 257-288.

109 *Tariff Act of 1930, s771(5)* (codified at 19 USC 1677).

110 Barcelo, John J., "A History of GATT Unfair Trade Remedy Law - Confusion of Purposes" (1991) 14(3) *The World Economy* 311-333.

111 Generally on the complexities of the application of USA CVD law to domestic subsidies, see Gary Horlick, Reinhard Quick & Edwin Vermulst, "Government Actions Against domestic subsidies, An Analysis of the International Rules and an Introduction to United States' Practice" (1986) 1 *Legal Issues of European Integration* 1-51 esp at 38-45; Lehmann, Christoph, "The Definition of "Domestic Subsidy" under United States Countervailing Duty Law" (1987) 22 *TILJ* 53-86 and Hufbauer, Gary

whether a Canadian practice of selling timber to lumber producers conferred a benefit.¹¹² Another related to the issue of determining injury to a downstream producer: specifically whether an injury to USA producers of pork could be established to have been caused by a Canadian subsidy to swine producers.¹¹³ In short, the countervailing of domestic subsidies continued to cause frictions and legal difficulties.

7.2 TRACK 2 - MULTILATERAL REMEDIES AFTER THE TOKYO ROUND - THE CANNED FRUIT CASE

The application of the non-violation or impairment principle to domestic production subsidies arose directly in the EEC Subsidies on Canned Fruit case.¹¹⁴ The case involved another challenge by the USA to an element of the CAP. The USA challenged the payment by the EEC of subsidies on canned fruit and dried grapes. A panel found that the subsidies on canned peaches, canned pears and canned fruit cocktail did impair tariff bindings on those products but that the subsidy on dried grapes did not impair any of the tariff bindings on dried grapes. In the meeting of the GATT Council, the EEC disagreed with the other parties about two aspects of the report and agreement could not be reached to adopt the report. Despite the non adoption of the report, the course of the dispute did, arguably, demonstrate areas of agreement and disagreement among the parties as to the interpretation of the GATT provisions on non-violation nullification or impairment and their appropriate application to domestic subsidies.

The complaints can be considered as four separate complaints.

- (i) The first related to a subsidy paid to producers of canned peaches. The EEC had given bindings in the 1962 Article XXIV:6/Dillon round negotiation, in 1967 in the

Clyde, "Subsidy Issues After the Tokyo Round" ch10 in William R. Cline (ed), *Trade Policy in the 1980s* (Institute for International Economics, Washington DC, 1983) p327-361 at 351-354.

112 On the countervailing duty actions, see Holmer, Alan F. & Bello, Judith Hippler, "US Trade Law and Policy Series #11 - The US-Canada Lumber Agreement: Past as Prologue" (1987) 21(4) *Int Lawyer* 1185-1198. On the GATT complaints, see Hudec (1993) Synopsis of Complaints, complaint no 121 (in 1983) and complaint no 147 (in 1986) and see "Panel on United States - Measures Affecting Imports of Softwood Lumber From Canada" report of the panel adopted by the Committee on Subsidies and Countervailing Measures on 27-28 October 1993 (SCM/162) GATT *BISD* 40S/358-517.

113 See "Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada" report by the panel adopted on 11 July 1991, GATT *BISD* 38S/30.

114 "EEC - Production Aids Granted on Canned peaches, Canned Pears, Canned Fruit Cocktail and Dried Grapes" report by the panel dated 20 February 1985 (L/5778).

Kennedy Round, in 1973 in the Article XXIV:6 accession negotiations over the accession of the UK, Ireland and Denmark to the EEC. On 1 July 1978, the EEC had introduced a subsidy on canned peaches. In the Tokyo Round, the EEC gave a lower binding which came into force pursuant to a protocol dated 30 June 1979.

- (ii) The second complaint related to a subsidy paid to producers of canned fruit mix. The EEC had also given bindings on canned fruit mix in 1962, 1967, 1973 and 1979. The EEC had also introduced a subsidy to producers of canned fruit mix on 1 July 1978.
- (iii) The third complaint related to a subsidy paid to producers of canned pears. The EEC had given bindings on canned pears in 1962, 1967, 1973 and 1979. On 24 July 1979, three weeks after the Tokyo Round bindings came into effect, the EEC introduced a subsidy to producers of canned pears.
- (iv) The fourth complaint related to subsidies paid to production and storage of dried grapes. The EEC had also given bindings on dried grapes in 1962, 1967, 1973 and 1979. On 1 July 1981, Greece became the 10th member of the EEC. From 27 July 1981, the EEC introduced subsidy schemes in respect of dried grapes. The scheme was different from those relating to the other fruits because it made special provision for storage, separating subsidies for storage from subsidies for other elements of production.¹¹⁵ The subsidy scheme replaced a pre-existing scheme operated by Greece. In practice, the EEC subsidy was paid only to processors in Greece and not to processors in other parts of the EEC.

In essence, the subsidies were calculated as the difference between the amount by which the EEC's internally set prices for the products exceeded the world market prices for the products.

Although, it did not affect the outcome of the case, another relevant fact was that in giving the 1973 bindings, the EEC had given notice of withdrawal of the bindings previously given in 1962 and 1967. However, the EEC's 1973 bindings on these products had contained a

115 L/5778, p3, para 11.

note carrying forward the initial negotiating rights accorded by the EEC to the USA in respect of the Article XXIV:6 and Dillon round negotiations.

In argument, the EEC referred to various provisions of the GATT which recognize that there is at least some proper role for domestic subsidies: the exception in Article III:(8)(b) and the provisions of Article 11 of the *Subsidies Code* referring to "objectives of social and economic" policy.¹¹⁶ The EEC countered the suggestion that a production subsidy "was equivalent in protective effect to a tariff" pointing out that a production subsidy is not equivalent to a tariff because it only affects production decisions and not both production decisions and consumption decisions as a tariff does.¹¹⁷

The panel made its decision under Article XXIII in three steps. The first step was to decide whether the United States could claim any "benefit accruing to it directly or indirectly to it under the Agreement". The panel decided that the 1974 and 1979 bindings had created benefits accruing to the United States. The panel said it was unnecessary for the United States to establish initial negotiating rights in those concessions since (under Article I and II) the benefits of the concessions had to be accorded to all parties.¹¹⁸ In deciding that the USA had benefits under the 1974 and 1979 bindings, the panel avoided having to consider what reasonable expectations might have existed before the introduction of the CAP for fruits in 1967. The panel noted that, in 1974, the EEC had given notice that the 1962 and 1967 bindings had been withdrawn and replaced by the 1973 bindings.¹¹⁹ The panel did not make any express finding on whether this giving of notice had been effective to withdraw the earlier bindings but the panel proceeded to ignore the earlier bindings.

Next, the panel said that there were two requirements in establishing a non-violation nullification or impairment claim, that:

- (1) the measure "could not have reasonably been anticipated by the party bringing the complaint at the time of negotiation of the tariff concessions",¹²⁰ and

116 L/5778, p11, para 29.

117 L/5778, p11, para 29 in response to the USA argument at p8, para 18.

118 L/5778, p16, para 49.

119 L/5778, pp16-17, para 49.

120 L/5778, p17, para 51.

- (2) "the measure resulted in the upsetting of the competitive position of the imported products concerned".¹²¹

With respect to the first element and with respect to the canned fruit products, the panel found that, at the time the EEC gave the various bindings on canned fruit, the USA could not reasonably have expected the subsequent introduction of the subsidies.¹²² Therefore, for both canned peaches and canned fruit mix, the subsidies introduced before the 1979 bindings could have been reasonably expected at the time of those 1979 bindings but could *not* have been reasonably expected at the time of the 1974 bindings. With respect to canned pears, the subsidy introduced after the 1979 binding on canned pears could not have been reasonably expected at the time of either the 1974 or the 1979 bindings. In relation to dried grapes, the panel found that at the time the EEC gave the bindings on dried grapes, the USA could reasonably have expected that "in the case of an accession of Greece to the EEC - the national Greek subsidy scheme would possibly be replaced by an equivalent EEC subsidy scheme for *Greek* processors¹²³ and, implicitly, that the United States could not reasonably have expected that the EEC would introduce a subsidy to Greek producers that went further than the previous Greek subsidy or that the EEC would introduce a subsidy to EEC producers outside of Greece.

In assessing whether the subsidies upset the competitive position established by the tariff bindings, the panel noted that while the regulation, pursuant to which the subsidies were paid, said that the purpose of the subsidies was to compensate for the higher cost of raw fruit in the EEC, the subsidy was not, in fact, calculated by reference to the margin between the cost of raw product in the common market and its cost on the world market.¹²⁴ The purchase of raw product in the EEC was a condition of eligibility for the subsidy but the amount of the subsidy was calculated by reference to the margin between the EEC price and the duty free world price for the processed product, that is the canned fruit or the dried grapes, rather than that for the raw product, that is, the fresh fruit or fresh grapes.¹²⁵ With respect to all of the products, the panel found:

121 L/5778, p17, para

122 L/5778, p18, para 52.

123 L/5778, p19, para 54 (emphasis in original).

124 L/5778, p2, para 7 & p21, para 59.

125 L/5778, p2, para 7-8 & p21, para 59.

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- firstly, that the subsidy completely insulated EEC producers from changes in the world price of the processed product;
 - secondly, that the subsidy went beyond compensating for the higher cost of buying unprocessed fruit in the EEC; and
 - thirdly, that "since the production aid [was] calculated as the difference between the computed EEC price and the duty free- price of imported product the bound rates of tariff duty had become an absolute margin of protection for EEC products".¹²⁶

With respect to canned fruit, canned fruit mix and canned pears, the panel found that those effects amounted to an upsetting of the competitive conditions established by the tariff bindings described above. However, with respect to dried grapes, the panel found that those effects did not cause any market distortions that went beyond those imparted by the previous Greek subsidy scheme.¹²⁷ Therefore, the panel concluded that:

- the subsidies on canned peaches and canned fruit mix impaired the benefits under the 1973 bindings but did not impair the benefits under the 1979 bindings on those products;
- the subsidies on canned pears impaired the benefits under both the 1973 and the 1979 bindings on canned pears; but
- the subsidies on dried grapes did not impair the benefits under either the 1973 or the 1979 bindings.

The panels reasoning is far from a simple statement that the subsequent introduction of a domestic subsidy impairs a tariff binding. Instead, the reasoning is much more complicated. It seems to have been deliberately contrived to avoid any finding that would have been inconsistent with the continued maintenance of high internal prices for fruit under the CAP and generally with the continued operation of the mechanisms applying under the CAP for products with tariff bindings. Apart from sidestepping the question of whether there were benefits accruing from pre-CAP bindings, the panel effectively avoided the consideration of the simple question of whether the mere introduction of a domestic subsidy impaired a tariff

126 L/5778, p24, para 65.

127 L/5778, p25, para 70.

binding. Instead, the panel focussed on the question of whether nullification or impairment had been caused by the introduction of a subsidy that did more than compensate processors for the margin by which EEC fruit prices exceeded world fruit prices. By doing so, the panel was able to avoid having to make a finding on whether the EEC would have been impairing tariff bindings on bound processed agricultural products if it exactly compensated, or even only partly compensated, producers of those products for the higher costs, imposed on them by the CAP, of purchasing the raw agricultural products.¹²⁸ Implicitly, the panel said that when the EEC negotiated the bindings in 1974, other parties should have taken account of the fact that the EEC already had a common agricultural policy for fruits and vegetables,¹²⁹ and would probably introduce a common market policy for products processed from fruits and vegetables, one element of which would be compensation to EEC processors for the higher prices imposed on them by the price supports under the CAP for fruits and vegetables.

The EEC vetoed adoption of the panel for two reasons. First, it argued that the panel should have required proof of trade effects in order to establish nullification or impairment by a subsidy. The panel had stated its view that "it was not necessary to establish statistical evidence of damage in order to make a finding of nullification or impairment".¹³⁰ The EEC argued that the references in Article 8(4) of the Subsidies Code to the way in which nullification or impairment "may" arise should be interpreted to mean that "displacing or impeding" of imports must be demonstrated by actual effects on trade flows.¹³¹ The second objection related to the complicated question of whether a binding given by a customs union could be impaired by the payment of a subsidy to producers in a member of the customs union which was not a member at the time the customs union gave the binding. Although the EEC agreed with the final conclusion that the binding on dried grapes had not been impaired, it disagreed with the part of the panel's reasoning which indicated that it would be possible for a binding given by the EEC of nine to be impaired by the payment of a subsidy

128 See Hudec, *Enforcing International Trade Law* (1993) p154 saying that the panels analysis assumed that a subsidy that merely equalized the two prices would not have nullified or impaired the benefit of the tariff concession.

129 Introduced under Council Regulation (EEC) No 23, 4 April 1962, J.O.Comm.Eur. 965 (1962) reprinted in O.J.Eur Comm (Special ed 1959-62) (Progressive Establishment of a Common Organization of the Market in Fruit and Vegetables).

130 L/5778, p28, para 77.

131 See C/W/476.

to producers in Greece, the tenth member of the EEC which was not a member at the time the binding was given.

The EEC offered to accept the report if the CONTRACTING PARTIES adopted an understanding reflecting the position of the EEC.¹³² The understanding would have effectively removed the two offending findings from the report. It would have left open the question as to whether demonstration of actual trade effects was an necessary element in proof of non-violation nullification or impairment by a subsidy. The other parties rejected the EEC's position and the report was not adopted.

The fact that the EEC was prepared to adopt the report subject to the understanding does indicate agreement among the parties to some extent. The parties were agreed that the subsidies on canned fruits which overcompensated producers of canned fruit so as to completely insulate them from movements in the world prices of canned fruits could not have been reasonably expected at the time of the negotiation of the tariff bindings. Therefore, the parties were in agreement as to at least one element of a claim of non-violation nullification or impairment by a subsidy: that in these cases, it must be established that the subsidy could not have been reasonably expected at the time of the negotiation of the tariff binding. However, the willingness to adopt the report would not have indicated any general agreement that the introduction of a domestic subsidy subsequent to the giving of a tariff binding constitutes nullification or impairment of the tariff binding.

The outcome of the dispute also stressed again the disagreement about the relevance of actual trade effects that had been at the heart of the USA's veto of the adoption of the report in the Spanish Soyabean oil case. In that case, the Spain had argued and the panel had accepted that nullification or impairment had not been established because the USA had failed to provide demonstrate that the EEC's measures had had an actual impact on trade flows. In the Spanish Soya Bean case, the panel had required demonstration of trade effects in the case of a violation of Article III. This question goes to the very heart of the GATT system: whether it protects export volumes or competitive conditions. The response of the USA and other parties to the report indicated that the widely held view was that the system

132 See C/M/192 (GATT Council, October 1985) and C/W/476 containing the text upon the basis of which the EEC was prepared to accept the report.

protected competitive conditions rather than actual export volumes and that, accordingly, demonstration of trade effects was not necessary. In the case of the non-violation nullification or impairment, the EEC (then negotiating the accession of Spain to the EEC) made the same argument that Spain had made in the Soya beans case. Arguably, there were two points of distinction: first that this case involved a non-violation; and secondly that it involved a domestic subsidy. The EEC drew support from the provisions of the *Subsidies Code* to support its argument that in the case of a non-violation subsidy, demonstration of actual adverse trade effects was required. That this was one of the grounds on which the EEC objected to the panel report indicated a continuing disagreement about how domestic subsidies were and should have been regulated.

Of great significance is the way that this panel decision was constructed so as not to affect the operation of the CAP. Even if the report had been adopted, nothing in the report indicated that the EEC could not compensate processors of agricultural products for the increased costs of primary products caused by the high internal prices maintained under the CAP. This is the same result that the EEC achieved by negotiation in the Pasta dispute, there, also, blocking adoption of the report and negotiating a solution that involved the USA backing down to the point of permitting the subsidy on the pasta to the extent that it compensated pasta producers for the increased cost of wheat caused by the internal prices for wheat maintained under the CAP.¹³³ In the event, the Canned Fruit dispute ended in the same way. The EEC and the USA negotiated a settlement which involved the EEC restricting the subsidy to the amount necessary to compensate the processors for the higher cost of fruit and the USA agreed not to push for adoption of the report.¹³⁴

This dispute was the third failure by the USA to seek reform of the CAP through the GATT dispute settlement system. The Wheat case had failed to have any impact on the EEC's use of export subsidies which accumulated as a result of the high internal prices for wheat. Neither the Pasta dispute over export subsidies nor the Canned Fruit dispute over domestic subsidies had had any impact on the EEC's measures to compensate downstream processors

133 See Hudec (1993) p156.

134 See Hudec (1993) p157. See also Bello, Judith Bello & Alan F. Holmer, "US Trade Law and Policy Series #10: Significant Recent Developments in Section 301 Unfair Trade Cases" (1987) 21(1) *Int Law* 211-231 at 229-230.

to ensure that the lack of competitiveness of agricultural products caused by the high internal prices did not further contribute to surpluses.

8 THE OILSEEDS CASE

The final part of this review of the application of the GATT rules on domestic support to agriculture is a consideration of the Oilseeds case which, in many respects, was a culmination of many of the factors that have been reviewed so far.¹³⁵ The dispute commenced almost three years after the Uruguay Round commenced. It was a part of the long running dispute over oilseeds that derived from the way that the CAP had been structured at the time of the original Article XXIV:6 negotiation when the EEC was formed. From the beginning of the CAP and the original setting of the EEC internal price for wheat well above the weighted average of the prices existing in the member states, the EEC price of grains had encouraged increases in the quantity of production. The prices had been buttressed by variable levies which had operated outside the discipline of any of the rules of the GATT. In the original Article XXIV:6 negotiation, part of the price for removing the bindings from products to be regulated by variable levies was the giving of low bindings on oilseeds, soybeans, rapeseed, sunflower seeds and oilcake, so the prices for oilseeds for EEC consumers of them were at or near to the world price. As mentioned in the discussion, above, of the Animal Feed Proteins case, one of the consequences of the EEC maintaining high internal prices for grains was that there was an enormous substitution by EEC farmers of oilseed based animal feed for grain based animal feeds. This had led to a number of factors. It contributed to the surplus of grains which had resulted in the high utilization of export subsidies such as those the subject of the dispute in the EEC Wheat Export Subsidies case and the Pasta Subsidies cases. By the late 1980's, the EEC was holding stockpiles in excess of 8 million tonnes of cereals after having risen almost to 13 million tonnes in 1986.¹³⁶ The substitution of oilseeds for grain led to substantial increases in EEC production of oilseeds which led to high levels of utilization of the EEC's programme of

135 "European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins" (L/6627) adopted on 25 January 1990, GATT *BISD* 37S/86 & "Follow-Up on the Panel Report "European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins" DS28/R, 31 March 1992), not adopted.

136 See GATT, *Trade Policy Review European Communities 1991* Volume 1 (GATT, Geneva, 1991) p166.

subsidies under its CAP for oilseeds. For example, in 1989, the EEC spent ECU 3 billion on subsidies on oilseeds.¹³⁷ The substitution of oilseeds for grain also contributed to a high demand for imported oilseeds (and corn gluten¹³⁸). In 1988, the EEC imported 24 million tonnes of oilseeds.¹³⁹ The combination of policies and their market effects had created an enormous lobby in the USA concerned with the detrimental effects of the EEC subsidies on USA exports of oilseeds to the EEC.

The USA challenged the domestic subsidies on two grounds: that the subsidies were in violation of Article III; and that they were causing a non-violation nullification or impairment. A number of the issues that had arisen in the other disputes concerning domestic support arose in this case:

- the question as to the scope of the domestic subsidies exception in Article III:8 which had been dealt with in the Italian Tractor case (Italian Discrimination Against Imported Agricultural Machinery), whether a subsidy to a purchaser of a product is a subsidy to the producer of the product;
- the question that had arisen in the Canned Fruit case about whether expectations from the original Dillon round tariff concessions had been erased by the subsequent Article XXIV:6 negotiations on each enlargement of the EEC;
- the question that had arisen in both the Spanish Soya bean dispute and the Canned Fruit dispute about whether demonstration of nullification or impairment requires demonstration of actual adverse effects on trade; and
- the question that had arisen in both the Pasta dispute and the Canned Fruit dispute as to whether it was permissible to pay a subsidy to the extent necessary to compensate for higher internal prices.

137 See GATT, *Trade Policy Review European Communities 1991* Volume 1 (GATT, Geneva, 1991) p179.

138 By 1983, the EEC imported US\$500 in corn gluten from the USA. This also led to a dispute between the USA and the EEC after EEC attempts to re-impose import barriers on corn gluten. See "US Opposes Agricultural Trade Restrictions by EC" *USA Department of State Bulletin* Vol 84, No 2084, March 1984 p30.

139 See GATT, *Trade Policy Review European Communities 1991* Volume 1 (GATT, Geneva, 1991) p179.

The oilseeds dispute was carried on during a period in which the EEC was negotiating reform of the CAP and was negotiating improvements to the GATT disciplines on agriculture in the Uruguay Round. The outcome of the dispute was important to the decisions by the EEC as to how future subsidies should be maintained under the CAP and to the attitude of all parties to the Uruguay Round negotiation on agriculture as to how the GATT rules should deal with domestic subsidies, particularly those used by the EEC but also those used by other parties.

The EEC subsidies schemes which the USA challenged had commenced at various times. The subsidy scheme for rapeseed and sunflower seeds had commenced in 1966, that for soybeans in 1974 and that for pulses in 1978. The subsidies were paid to EEC processors of the oilseeds and were calculated as the difference between a target price for the relevant product and the import price of that product. The subsidies were only paid upon proof that the EEC processors had actually purchased oilseeds from an EEC producer at a price not less than the target price. The subsidy compensated the EEC processors for the extra cost caused by the high target price.

Parallels can be drawn between the mechanism used for oilseeds and the mechanism in the Pasta case which compensated exporters of Pasta for the higher EEC cost of wheat, and the mechanism in the Canned Fruit case which compensated producers of Canned Fruit for the higher EEC cost of fruit. However, in those cases, the higher cost of the raw product was caused by import barriers. In this case, there were no import barriers and the domestic consumer price for the raw product was roughly equal to the world price.

8.1 THE DECISION UNDER ARTICLE III

The USA argued that the payment of the subsidy to purchasers of EEC oilseeds but not to purchasers of imported oilseeds meant that the EEC was according less favourable treatment to the imported oilseeds than to the domestic oilseeds in respect of their internal purchase in violation of Article III:4.¹⁴⁰

There is no doubt that a subsidy paid direct to the EEC producers of oilseeds would have fallen within the exception to the national treatment rule in paragraph 8(b) of Article III.

However, the subsidy was paid to the processors of the oilseeds but only on condition that, in essence, they had paid a price no less than the sum of the world price and the subsidy. The panel had to decide whether such a subsidy fell within the scope of paragraph 8(b) as a subsidy paid "exclusively to domestic producers". Interestingly, the panel did not refer to the decision in the Italian Tractor case which had been made on the basis that a subsidy paid to a purchaser of domestic produce did not fall within the scope of the meaning of subsidy paid to domestic producers under Article III:8(b) nor did it rule precisely on that point. Instead, it considered the possibility that a subsidy not made directly to domestic producers might still be made *exclusively* to domestic producers if the whole of the subsidy was passed on to the domestic producers. The panel found that because of the way that the subsidy was calculated, it was possible that the subsidy could be an amount greater than the difference between the amount that processors pay to producers and the price of imported oilseeds. On that basis, it was possible that some part of the subsidy was retained by the processor and that, therefore, the subsidy was not paid exclusively to domestic processors and could not fall within the paragraph 8(b) exception.¹⁴¹

The panel then found that since the subsidy could overcompensate processors for the cost of oilseeds, then they could "discriminate" against imported oilseeds and therefore were in violation of Article III:4.¹⁴² One wonders at the narrow basis of the decision. The decision seems to imply the surely wrong proposition that, if the subsidy had been limited to the compensation for the high internal price of oilseeds, then the payment of the subsidy to buyers of domestic oilseeds but not to buyers of imported oilseeds would not have been less favourable treatment of imported oilseeds than of domestic oilseeds.

The narrow reasoning for the ruling achieved exactly the same result as would have been achieved by modifying the principle established in the Italian Tractor case so that an indirect subsidy to producers paid by way of a subsidy to consumers of the domestic produce could fall within Article 8(b) to the extent that it was passed on to domestic producers. Perhaps the decision was constructed narrowly to avoid having to either confirm or overrule the Italian Tractor case.

140 GATT BISD 37S/86 at 94, para 36.

141 GATT BISD 37S/86 at 124-125, paras 137-140.

142 GATT BISD 37S/86 at 125, para 141.

The narrow basis of the decision fell short of prohibiting the EEC from maintaining internal prices on products with tariff bindings by payment of subsidies to purchasers of the product. Allowing for some difference in fact situations, that result was the same as the results of the negotiation in the Pasta dispute and the unadopted report in the Canned Fruit dispute which was that the EEC preserved the arguable legality of the basic mechanisms of the common market organization.

8.2 THE DECISION ON NON-VIOLATION NULLIFICATION OR IMPAIRMENT

Even though the panel had found that the subsidies were in violation of Article III:4, the panel decided to make a ruling on the nullification or impairment question because if there was nullification or impairment, it would be possible that bringing the measure into conformity with Article III:4 would not remove the nullification or impairment.

In relation to nullification or impairment, the EEC made a broad argument against the application of the non-violation concept to domestic subsidies. The EEC argued against creating a general rule from the principles deriving from the Ammonium sulphate and German Restrictions on Sardines cases because they had dealt with very "particular and proximate" situations and because such a general application of those principles to domestic subsidies would effectively rewrite GATT rules by giving "protection to tariff concessions under Article II that went far beyond the precise rules of that Article".¹⁴³ The EEC argued that Article XVI conferred a right to use domestic subsidies. They conceded that that right was subject to the obligations to avoid adverse effects as set out in the *Subsidies Code* which, the EEC argued, required demonstration of trade effects and, further, that the guidance from the *Subsidies Code* overrode the earlier GATT reports interpreting Article XXIII.¹⁴⁴ On that basis, the EEC diminished the authority of the 1955 Review Session Report. The EEC expressed the view that

the concept of non-violation impairment in relation to subsidies affecting tariff concessions was superfluous and legally disputable, since it would involve the notion of rights and obligations being superseded by considerations of equity and subjective expectations. The matter should therefore be dealt with in

143 GATT BISD 37S/86 at 116, para 109.

144 GATT BISD 37S/86 at 116-117, para 110.

accordance with Article XVI and the relevant principles governing its interpretation and application.¹⁴⁵

The EEC was correct in arguing that the non-violation principles had not been confirmed by the adoption of a dispute settlement report since the two original cases. However, the EEC's argument was inconsistent with the basis upon which it had indicated it would have been prepared to accept the Canned Fruit report.

The USA contended that the EEC's approach was incorrect because the absence of a prohibition in Article XVI did not amount to a right to subsidize and that

there was no basis for claiming that the absence of a prohibition in one GATT Article should take precedence over rights and expectations of contracting parties with respect to other GATT provisions and negotiated commitments.¹⁴⁶

The panel decided that the general concept of non-violation nullification or impairment did apply to the present case. On the general purpose of article XXIII:1(b), it said

that these provisions, as conceived by the drafters and applied by the CONTRACTING PARTIES, serve mainly to protect the balance of tariff concessions. The idea underlying them is that the improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the Agreement. In order to encourage contracting parties to make tariff concessions they must therefore be given a right of redress when a reciprocal tariff concession is impaired by another contracting party as a result of the application of a measure, whether or not it conflicts with the General Agreement.¹⁴⁷

The panel confirms the importance of reasonable expectations. The inquiry into reasonable expectations necessitated a finding as to which were the relevant bindings. The EEC had given a series of bindings: first, in 1962, in the original Article XXIV:6/Dillon Round negotiation; then with each subsequent enlargement of the EEC, in 1972, with the accession of Denmark, the UK and Ireland; in 1981, with the accession of Greece; and, in 1986, with the accession of Spain and Portugal. On this same question, the panel in the Canned Fruit case had accepted that the USA had expectations deriving from 1974 bindings and had not enquired further to determine whether the USA also had expectations deriving from earlier

145 GATT BISD 37S/86 at 119, para 117.

146 GATT BISD 37S/86 at 119, para 118.

147 GATT BISD 37S/86 at 126-127, para 144. Cf Justice Pescatore's co-authorship of this explanation of the rationale for Article XXIII:1(b) with subsequent labelling of non-violation nullification or impairment as a "useless and dangerous construction" (see Pescatore, "The GATT dispute settlement mechanism - its present situation and its prospects" (1993) 71(1) *JIA* 27-41.

bindings, referring to the EEC's statement that the earlier bindings had been withdrawn and replaced by the 1974 bindings. In the present case, the EEC argued that the USA's expectations should be determined at the time of the 1986 binding (when all of the subsidy schemes were already in place) because the withdrawal and replacement of the tariff bindings had reestablished the balance of concessions. The panel decided that the reasonable expectations to be protected were those which existed when the concessions were originally negotiated in 1962.¹⁴⁸

Then the panel stressed the difference between the EEC and USA views on the reasonable expectations as to domestic subsidies. It noted that the USA's argument was essentially based on the statement in the report of the 1955 Review of the Agreement that there is a presumption that a party negotiating a concession has a reasonable expectation that the "value of the concession will not be nullified or impaired ... by the subsequent introduction of a domestic subsidy."¹⁴⁹ It also noted the counter argument of the EEC that

it is not legitimate to expect the absence of production subsidies even after the grant of a tariff concession because Articles III:8(b) and XVI:1 explicitly recognize the right of contracting parties to grant production subsidies. This right would be effectively eliminated if its exercise were assumed to impair tariff concessions.¹⁵⁰

This difference of opinion may be viewed as a question about upon whom the onus lies to insert specific protection in schedules of concessions relating to the use or absence of domestic subsidies. The EEC argument essentially places the onus on a party receiving a tariff concession to also negotiate either a specific restriction on the freedom of the party giving the concession to pay a domestic subsidy or that its own tariff bindings are conditional upon other parties not introducing domestic subsidies on bound products. The USA argument places the onus on the party giving a tariff concession to reserve a right to pay a domestic subsidy on the bound product. The question is one of interpreting the GATT to determine where the parties intended that the onus should lie.

148 GATT BISD 37S/128, para 146.

149 GATT BISD 37S/86 at 128, para 147 quoting from "Other Barriers to Trade" report adopted 3 March 1955 in GATT BISD 3S/222 at 224.

150 GATT BISD 37S/86 at 128, para 147.

The panel avoided having to choose between the two views by making a finding of fact which enabled it to take a narrower approach to its decision as to what domestic subsidies could be reasonably expected. The panel found that these subsidies

are product specific subsidies that protect producers completely from the movement of prices for imports and thereby prevent tariff concessions from having any impact on the competitive relationship between domestic and imported oilseeds. ... The United States could not reasonably have anticipated the introduction of subsidy schemes which protect producers *completely* from the movement of prices for imports and thereby prevent the tariff concession from having *any* impact on the competitive relationship between domestic and imported oilseeds.¹⁵¹

The panel drew back from making a more general pronouncement in two ways. First, it did not say whether a domestic subsidy which only *partially* offsets the price effect of the tariff concession on the competitive conditions between imported and domestic products should be regarded as being beyond reasonable expectations. Secondly, it restricted itself to a *product specific* subsidy and did not say whether a subsidy which was not product specific could be regarded as being beyond reasonable expectations.

The panel found that it is changes in competitive position that are relevant for the purposes of determining nullification or impairment. Citing the Superfund case,¹⁵² the panel dismissed the argument that demonstration of actual trade effects is required, saying that tariff bindings protect "commitments on conditions of competition for trade, not volumes of trade".¹⁵³

Therefore, the oilseeds report became only the third report containing a finding of non-violation nullification or impairment that was adopted by the CONTRACTING PARTES and the first such report to contain a finding of non-violation nullification or impairment caused by a subsidy. However, the report did not contain any recommendation to the CONTRACTING PARTIES to take any action to remove the nullification or impairment and the decision to adopt the report was accompanied by a reservation by the EEC on the

151 GATT BISD 37S/86 at 128-129, paras 148-149 (emphasis added).

152 "United States - Taxes on petroleum and Certain Imported Substances" report of the panel (L/6175) adopted on 17 June 1987, GATT BISD 34S/136.

153 GATT BISD 37S/86 at 130, para 150.

finding of non-violation or impairment and on the finding that the 1962 bindings had been replaced by the later bindings.¹⁵⁴

8.3 FOLLOW-UP REPORT OF THE OILSEEDS PANEL - 1992

The original Oilseeds panel report was adopted on 25 January 1990. The EEC was not quick to comply because of the need to reformulate the CAP for oilseeds and for the member states to agree on it. It was not until December 1991 that the EEC passed new regulations for a modified subsidy scheme for oilseeds. The subsidy schemes had been altered in conjunction with wider reforms of the CAP. For oilseeds, the dual price support system had been replaced with a limited deficiency payment system. The new subsidy system was called a support system for producers of oilseeds.¹⁵⁵ Under the dual price support system, oilseeds producers had received a target price for their production which was fixed at a level above the market price. Producers had received the target price from the processors because of the purchase incentives provided to the processors. Under the new deficiency payment system, producers sold their crop at the market price but received an additional deficiency payment based on the gap between the market price and the target price. The payment was made on a per hectare basis and was calculated according to a yield per hectare determined for each region of the EEC. The amount paid per hectare was the difference between a target price and a reference world market price.

The new deficiency payments did not guarantee the target price in all circumstances:

- (i) any produce in excess of the standard yield could be sold at the market price but was not eligible for any subsidy and had no bearing on the calculation of the per hectare subsidy; and
- (ii) there could be a part of the difference between the reference world market price and the actual world price at which production was sold which would not be taken into account in calculation of the per hectare payment. This could occur, firstly, because of the timing of the determination of the reference world market price, and secondly,

154 See GATT BISD 37S/86 at 132, para 157; and GATT Doc L/6636 dated 25 January 1990 described in Hudec (1993) p560.

155 See the heading and Article 1 of Council Regulation (EEC) No 3766/91 of 12 December 1991 establishing a support system for producers of soya beans, rape seed, colza seed and sunflower seed.

because the reference world market price specific in the regulations was not adjusted for fluctuations within an 8 percent band.

The USA argued that the new scheme still impaired the tariff bindings and sought a re-examination. The EEC opposed a new examination. It would have been concerned about the ramifications of the panel making a general finding applying non-violation nullification or impairment to domestic subsidies in the broad terms of the 1955 Review Report. The EEC agreed to a reconvening of the original panel. However the terms of reference given to the reconvened panel were limited to examining whether amendments to the oilseeds subsidy schemes complied with the rulings of the original panel report.¹⁵⁶ The panel convened in February 1992.

The parties agreed that there was no longer any violation of Article III. There were two strands to the EEC's argument. First, it argued strictly on the basis of the words used by the panel. It argued that the new subsidy did not *completely* insulate the producers from movements in world prices and that, therefore, the change to the subsidy scheme had complied with the first panel report.

The second strand of the EEC's argument was that the new scheme no longer guaranteed a price but was a decoupled income support scheme. This second argument seems to have been unnecessary. This concept of "decoupled income support scheme" was drawn from a text which was under consideration in the Uruguay Round negotiation on agriculture.¹⁵⁷ The Dunkel Text on Agriculture had been presented by the Chairman of the negotiating group on agriculture to the participants in the negotiation on 20 December 1991. As is explained more fully in a subsequent chapter, the draft text required reduction commitments to be made in respect of domestic subsidies but not in respect of those domestic subsidies that were "decoupled income support". Such subsidies had to be "decoupled" from

156 "Follow-Up on the Panel Report "EEC - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins", report of the Members of the Original Oilseeds Panel, DS28/R, 31 March 1992, GATT BISD 39S/91. See, at p91, "The report was first considered by the Council at its meeting on 30 April 1992. At its meeting on 19 June 1992, the Council, without adopting the follow-up report, authorized the Community to enter into negotiations under Article XXVIII:4 for modification of tariff concessions with respect to certain relevant tariff positions.

157 "Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations" MTN.TNC/W/FA, 20 December 1991 ('the Dunkel Text'); the draft agreement on agriculture is on ppL.1-L.74 ('Dunkel Text on Agriculture').

production in the sense that they did not provide an incentive to produce. The EEC did not actually refer to the provisions of the negotiating text but it made a number of references to criteria that were embodied in that text. The EEC used the phrase "decoupled income support" without acknowledging the use of the phrase in the draft text.¹⁵⁸ The EEC referred to elements of the previous price support system that had been abolished, without mentioning but obviously contemplating the requirement of the draft text that "the support ... shall not have the effect of providing price support to producers".¹⁵⁹ The EEC also listed features of the new subsidies: that they were not based on production, yields or price received;¹⁶⁰ but did not mention the correspondence of these feature with the criteria for "decoupled income support" in the draft text.¹⁶¹ The argument that the subsidies fell within the scope of an exception in the negotiating text was surely irrelevant to the determination of whether the subsidies were nullifying or impairing benefits under the Agreement. No doubt the EEC was concerned that, after any Uruguay Round Agreement came into force, it would still be able to operate some form of common market organization for oilseeds (or for other products) which paid domestic producers a target price substantially above the world price. The outcome of the negotiation was still in doubt. At that stage, the EEC had declared the negotiating text unacceptable but it still had to consider what kind of text would in the end be acceptable. It had to decide how the text should be worded to ensure that it could maintain its CAP for oilseeds and whether to insist on a specific clause to ensure that it could maintain some version of its CAP for oilseeds. It was uncertain as to whether the EEC would be able to achieve the insertion into the negotiating text of a particular clause for that purpose. It seems that the EEC introduced the arguments based on the Uruguay Round negotiating text for the purpose of drawing commentary from both the USA and the panel as to the meaning of the draft words of the negotiating text.

The USA took the bait. It responded with a list of reasons why the EEC's new subsidies would not meet the tests set out in the Dunkel Text on Agriculture. The USA observed that the subsidies were linked to production because eligibility to receive the subsidies required engagement in production and harvest of a crop, and the payments were based on the land

158 See GATT DS28/R, p13, para 44; Dunkel Text on Agriculture, Annex 2, clause 6.

159 GATT DS28/R, p13, para 44, Dunkel Text on Agriculture, Annex 2, clause 1(ii).

160 GATT DS28/R, pp13-14, para 45.

161 Dunkel Text on Agriculture, annex 2, clause 6.

actually employed.¹⁶² It is almost humorous to observe the EEC's response: that the "arguments of the United States regarding the decoupled nature of the new system of direct payments [were] incorrect and *irrelevant*."¹⁶³

The panel reaffirmed the interpretation of the 1955 Review Session that parties have a reasonable expectation that the value of a concession will not be nullified or impaired by the introduction of a domestic subsidy on the product concerned. The panel noted that the 1955 report referred to a "domestic subsidy" without referring to the manner of payment. The panel declined to consider the question of whether the subsidies constituted income or price support. It said the relevant question was whether they were "product-specific production subsidies",¹⁶⁴ for the first time explicitly introducing the concept of product specificity into the requirements for a track 2 remedy against a domestic subsidy. The panel found a number of reasons to conclude that the new subsidies were product specific: the subsidies were paid only in respect of oilseeds, they supplemented the income from oilseeds, payment was almost always dependent on proof of harvest and the subsidies were linked with yields.¹⁶⁵

Secondly, the panel considered whether the new subsidies continued to impair benefits under the tariff concessions even if producers were no longer completely protect from movements in the world price. The panel acknowledged that the finding in its earlier report was based upon the fact that the subsidy system *completely* protected domestic producers from movements in imported prices and thereby prevented the tariff concessions from having any effects and noted that the new system did not *completely* protect domestic producers from movements in import prices. However, the panel indicated that there was

nothing in the reasoning of the original Panel that indicated that the impairment of tariff concessions through a production subsidy could only take place through a subsidy which completely protected producers from the price movements of imports.¹⁶⁶

The panel referred to a wider basis for the decision: that parties in tariff negotiations must "be assumed to base their tariff negotiations on the expectation that the price effect of the

162 GATT DS/28/R, p14, p46.

163 GATT DS/28/R, p14, para 48 (emphasis added).

164 GATT, DS/28/R, p25, para 79.

165 GATT, DS/28/R, p25, para 80.

tariff concessions will not be systematically offset". The panel found that the new subsidy system prevented the competitive conditions established by the tariff bindings from having any effect. If foreign sellers dropped their price, EEC producers could drop their price to match the price of imports but would not be receiving any less because the per hectare payment would be adjusted upwards as a result of the lower world price. The panel found that the new subsidy system

effectively offsets the general movement of import prices and renders the level of community production substantially insensitive to the general movement of world prices, and thereby continues to impair the benefits the United States could reasonably expect to accrue to it under the tariff concessions in question.¹⁶⁷

The follow-up report was never adopted. It cannot be regarded as a decision of the CONTRACTING PARTIES. The EEC did enter into Article XXVIII negotiations to renegotiate the tariff concessions. This has been argued to constitute an admission by the EEC that the USA was entitled to some compensation, and therefore, an acknowledgement that the tariff bindings actually had been nullified or impaired by the subsidies.¹⁶⁸ However, as is shown in subsequent chapters, the EEC did not reach agreement on the article XXVIII negotiation until it had been assured that this type of complaint would not be possible under the Uruguay Round Agreement on Agriculture.

9 CONCLUSIONS

As with the previous two chapters, the drawing of conclusions from this chapter is left for the final chapter of this part of this thesis. It was observed at the end of the last chapter that many of the difficulties in the application of the rules on export subsidies to agriculture arose out of market conditions that were at least partially caused by the ineffectiveness of the rules on import barriers. The same can be said for many of the problems with respect to the application of GATT rules on domestic support to agriculture. As observed there, the whole framework of rules must be considered together.

At this point, a preliminary summary of this chapter is given and a few observations made with respect to both threads of this thesis:

166 GATT, DS/28/R, p26, para 81.

167 GATT DS/28/R, p27, para 83.

168 See Hudec (1993) p248.

- (1) identification of the major problems with applying the rules on domestic support to agricultural trade; and
- (2) identification of any deficiencies in the way that the rules on domestic support embody appropriately the distinctions between border and non-border instruments.

9.1 SUMMARY OF PROBLEMS IN APPLYING THE RULES ON DOMESTIC SUBSIDIES TO AGRICULTURE

The main problem with disciplining domestic support was a continuing lack of consensus as to the most fundamental issues relating to subsidies: whether parties should have a right to subsidize; whether parties should discipline certain types of subsidies; or whether subsidies should be disciplined on the basis of their effects rather than any classification. These problems overlap substantially with the problems with export subsidies.

The key problems with the application of the GATT rules on domestic subsidies to agriculture were manifestations of uncertainty or disagreement

- (1) over whether the exception for domestic subsidies in Article III:8 should only apply to direct subsidies to producers or should include indirect subsidies to producers paid as subsidies to consumers contingent upon consumption of domestic produce;
- (2) over whether demonstration of actual trade effects is necessary to establish that a measure "afforded protection" contrary to Article III:1;
- (3) over the scope of the non-violation nullification or impairment provisions and their application to agriculture, particularly, whether domestic subsidies per se should be regarded as outside the scope of reasonable expectations, whether domestic subsidies compensating for high internal prices should be regarded as outside reasonable expectations, whether demonstration of trade effects is required, and determining the relevant date for determining expectations.
- (4) over the extent to which domestic subsidies should be exposed to countervailing duties.

9.2 EMBODIMENT OF DISTINCTIONS BETWEEN POLICY INSTRUMENTS IN THE RULES ON DOMESTIC SUPPORT

The analysis of the original rules and their negotiation reveals two impediments to an incentive structure that would guide parties toward the use of domestic subsidies instead of other instruments:

- (1) the lack of clarity in the agreement as to the application of the provisions on non-violation nullification or impairment, generally, but most importantly, in relation to non-violation subsidies;
- (2) the failure any formal distinction between export subsidies and domestic subsidies for the purposes of determining countervailability.

9.3 LINKS BETWEEN THE DISTINCTIONS BETWEEN INSTRUMENTS AND THE PROBLEMS WITH AGRICULTURAL DOMESTIC SUPPORT

This thesis submits that the abovementioned deficiencies in the embodiment of the distinction between domestic subsidies and border instruments were a part of the causes of the abovementioned problems in the application of the rules on domestic support to agriculture.

This argument is made in the final chapter of this part in the context of the wider argument that deficient embodiment of the two distinctions between border instruments and non-border instruments and between price-based and quantity-based instruments arguments was a cause of the problems in the lack of success in applying the whole framework of GATT rules to agriculture.

CHAPTER 14

PRE-URUGUAY ROUND ATTEMPTS TO IMPROVE THE RULES AND THE APPLICATION OF THE RULES TO AGRICULTURE

1 INTRODUCTION

Chapters 11 to 13 have drawn out the problems in the application of the rules to agricultural trade. To some extent those chapters have also indicated the way that the parties have recognized those problems and have attempted to deal with them. This chapter will round out that coverage of the attempts to deal with the problems by reviewing the pre-Uruguay Round efforts to make the GATT more successful in relation to agricultural trade.

Although the focus is agriculture, the description necessarily extends in a limited way to review the attempts to improve the operation of the agreement generally. Naturally, this facilitates the completion of the examination of the complete framework of rules, the way that that framework distinguished between different policy instruments and the assessment of whether there is a connection between the way the rules were constructed to distinguish between policy instruments and the problems that occurred in applying those rules to agricultural trade.

The review of the operation of the rules revealed a number of aspects of the problems with applying the GATT to agriculture which are confirmed in this review of the many attempts to remedy those problems. First, the problems are not recent. The problems at the beginning of the Uruguay Round were closely related to problems that emerged in the first 10 years of the Agreement. Second, there has been a longstanding tension between regulation according to specific instruments and regulation on the basis of the effects and levels of protection. This is manifested in a lack of consensus as to whether the problems

should be remedied by changing the rules or by making the existing rules work better. Third, (as in all many of international law), there has been a continuing tension as to where the line should be drawn between matters that should be subject to international regulation and matters that should be regarded as internal and beyond international regulation.

This review is not only important to round out the description of the operation of the pre-Uruguay rules. As indicated in chapter 1, this thesis proceeds on the basis that "the reasons for the failure of the GATT in application to agriculture derive from defects in the rules themselves rather than from any inherent quality of the agriculture sector which would make it impossible to apply the rules to agriculture" and, in particular, looks for defects in the way that the rules distinguished between different instruments and whether such defects might be responsible for the problems with agriculture. This review of the previous attempts to improve the rules or their operation is important to that enquiry for a number of reasons. First, it reveals the disagreements over many years on the issue of whether one set of rules for all sectors is appropriate or whether agriculture needs special rules. Secondly, it confirms the connection already evident from previous chapters, that the problems with agriculture derived at least to some extent from the way that the agreement was set up in the beginning. Thirdly, it reveals a shifting focus on whether the rules should be directed at the use of policy instruments necessarily involving some distinctions between instruments or should be directed at the effects of policy instruments focussing on containing the size of the effects rather than on the instrument employed. In addition, this review is important because the pre-Uruguay attempts to improve the rules had a substantial influence on the approach taken during the Uruguay Round. Therefore, this review lays the foundation for the description in the next part of the thesis of the Uruguay Round negotiation on agricultural trade.

2 THE KEY ELEMENTS IN THE REVIEW OF 1947 TO 1986

This review consists basically of a review of two series of events:

First, there are the seven earlier rounds of multilateral round negotiations :

- the 1st round, the Geneva Round in 1947;
- the 2nd round, the Annecy Round in 1949;

- the 3rd round, the Torquay Round in 1950-51;
- the 4th round, the Geneva Round in 1955-56;
- the 5th round, the Dillon Round in 1960-61;
- the 6th round, the Kennedy Round in 1963-67;
- the 7th round, the Tokyo Round in 1974-79.

When one traces through the framework of objectives and negotiating rules that were set up for each round, it becomes clear how much of a problem agriculture posed. In the next part of the thesis, it will become apparent that the negotiating framework for the Uruguay round broke new ground .

Secondly, beginning only a few years after the Agreement itself, there has been a continual procession of committees, working parties, work programmes, reports, processes of information gathering, and Ministerial statements which have been either specifically directed at, or at least significantly concerned with, solving the problems in agricultural trade.¹ The most important studies and processes were:

- (1) the Review of the Agreement conducted in 1954-55;² which was discussed above in the context of the review of the rules on export subsidies;
- (2) the report "Trends in International Trade" (generally called "The Haberler report") in 1958,³ and the (post-Haberler report) "Programme of Action towards an expansion of International Trade" with its committees including Committee II which dealt with agriculture and operated from 1958 until 1961 (and from which sprang some committees dealing with specific commodities which operated for some further years);⁴

1 See the brief summary of the principal agriculture committees in the GATT in "Agriculture in the GATT" note prepared by the Secretariat, CG.18/W/59/Rev.1, 20 January 1982 at pp36-39.

2 The General review of the agreement was carried out at a special session in Geneva in November and December 1954. The reports for the General review were adopted at the end of the 9th session of the contracting parties (October 1954 - March 1955) and are reported in GATT *BISD*, 3S/170.

3 GATT, *Trends in International Trade* (GATT doc 1958-3) (GATT, Geneva, 1958). For the decision requesting the report, see GATT *BISD* 6S/18.

4 The Programme was adopted in the decision of the contracting parties of 17 November 1958 GATT, *BISD*, 7S/26.

- (3) the Work Programme established in 1967 after the Kennedy Round which divided its work into a number of committees including a new Committee on Agriculture;⁵
- (4) the Work Programme established in 1979 after the Tokyo Round which again divided its work among a number of committees which included a new Committee on Agriculture which operated from 1982 until the beginning of the Uruguay Round.⁶

3 PERIOD ONE: 1947 TO 1955

AGRICULTURE UNDER THE FIRST THREE ROUNDS OF MULTILATERAL NEGOTIATIONS (GENEVA 1947, ANNECY 1949, TORQUAY 1950-51), THE USA WAIVER, THE 1955 GENERAL REVIEW OF THE AGREEMENT AND THE 1955 GENEVA ROUND

The First Three Rounds

Differences in the application of the agreement to agriculture emerged in the early years of the operation of the Agreement. Even after the initial round of multilateral negotiations under which the first schedules came into force there were fewer tariff bindings conceded on agricultural products than on industrial products.⁷ In the next two rounds of multilateral negotiations, the Annecy round in 1949 and the Torquay round in 1950-51, the pattern continued. During the course of the Torquay round, it had been noticeable that further negotiations using the same procedure might have only limited success. These first three rounds had utilized the simple request and offer procedure described in Chapter 2.⁸ It had been intended that the rebinding of a tariff for a further period of time should be regarded as a concession for which something could be obtained in return.⁹ However, in practice, countries tended to regard only reductions in bound rates or new bindings as concessions. This meant that those countries with lower levels of tariffs inevitably had less to bargain

5 The "Programme of work of the Contracting Parties" was adopted by a decision of the contracting parties on 24 November 1967, GATT, *BISD*, 15S/66.

6 The 1983 Committee on Agriculture was established pursuant to a Ministerial decision of 29 November 1982, GATT, *BISD*, 29S/9.

7 See Timothy E. Josling, Stefan Tangermann & T.K. Warley, *Agriculture in the GATT* (Macmillan Press, London, & St Martin's Press, London, 1996) p23.

8 See above, chapter 2, pp44-46.

9 *GATT in Action*, third report on the operation of the GATT, January 1952, (GATT, Geneva 1952), p10.

with than those countries which had high tariffs.¹⁰ This problem became apparent during the Torquay round as the schedules of the higher tariff countries were reduced by much less than was generally hope for and the problem of disparity between tariff rates of different countries was not remedied.

The French Plan of 1954

At that stage, tariff negotiations were not an institutionalized feature of the GATT. It was not until a few months after the conclusion of the Torquay round at the Sixth Annual Session of the contracting parties in 1951 that a procedure for regular multilateral rounds of negotiations was adopted.¹¹ At the time there were widespread concerns about the extent of tariff reductions that could be achieved from further rounds.¹² Not all countries were primarily concerned with the operation of a global system. There were also concerns among European countries as to the disparity of tariff rates in different European countries. In March 1951, a Group of 10 (the USA plus 9 European countries, not including the UK and counting the Belgium Luxembourg Economic Union as one) submitted a report on the "Problems of Disparity of European Tariffs" seeking to initiate some action by GATT parties.¹³ Shortly after, in September 1951, France proposed an "across-the-board" reduction of 30% by all contracting parties of all tariffs.¹⁴ This became known as the French plan. The reduction was to be implemented in three annual reductions of 10%. In addition to addressing the disparity of tariff levels between parties, it was also hoped that an across-the-board approach might have a greater impact on agricultural products. The plan made no distinction between industrial products and industrial products.¹⁵ However, there

10 See Curzon, p87-88.

11 Although the Agreement was not amended until 1955 when Article XXVIIIbis was added by the *Protocol Amending the Preamble and Parts II and III of the GATT* (1955, Agreement No 33 in App C). The same instrument contained amendments to Article XXVIII which changed the duration of schedules so that they had indefinite application with a right to withdraw them arising every three years.

12 See Curzon, Gerard, *Multilateral Commercial Diplomacy: The General Agreement on Tariffs and Trade and its Impact on National Commercial Policies and Techniques* (Michael Joseph Ltd, London, 1965) pp87-89.

13 See Curzon, p88 citing GATT/CP/103.

14 See "Tariff Reduction - Technical Aspects and application of the French Proposal for the Reduction of Tariff Levels" report adopted by the CONTRACTING PARTIES on 8 November 1952 (G/31), GATT *BISD* 1S/67, para 1. See the summary of the French plan in Muhammed, V.A.Seyid, *The Legal Framework of World Trade* (Stevens & Sons, London, 1958) pp116-117.

15 See Curzon (1965) p89. See "The Disparity of European Tariffs " report adopted by the CONTRACTING PARTIES on 27 October 1951 (GATT/CP.6/53) GATT *BISD* Vol II, p211.

was still some concern that agricultural products might not be sufficiently lowered because the plan did not require a 30% reduction on all items but a reduction of 30% in the weighted average of all items with a number of sectors. Therefore, protection on some items could be retained. The French plan was reviewed by a GATT working party, was revised and resubmitted (with support of 4 other European governments) and reviewed again.¹⁶ The plan was modified to achieve some reduction of disparity in tariff rates.¹⁷ The plan lacked the support of the USA and the UK. The USA had supported the Plan for Reducing Disparity in European tariffs but failed to support the more general multilateral plan. The UK opposed the Plan for Reducing Disparity in European Tariffs saying that such matters should be dealt with in within the multilateral system.¹⁸ However, the UK also opposed the multilateral French plan complaining of the political difficulty of such large tariff reductions. No doubt the political difficulties were caused in part by the continuing support for Imperial preferences.¹⁹

The General Review of the Agreement in 1954-55

Tariffs and tariff reductions were only a part of the problems that had emerged in application of the Agreement. Many other problems had emerged and many of them related to agriculture. These problems were the subject of the General Review of 1954-55 to which reference has already been made in chapter 12, in the context of the renegotiation of rules on export subsidies.²⁰ Apart from the problems with disciplining export subsidies and generally dealing with agricultural surpluses, the most significant problem in application of the GATT rules to agriculture was the widespread use of quantitative restrictions. In general, the Review identified the same problems that have already been discussed above, in chapter 11, in the context of the application of the GATT rules on import barriers to

16 See G/31, (cited above) GATT *BISD* 1S/67; and "Tariff Reduction - Technical Study of the French Proposal for the Reduction of Tariff Levels" report adopted on 13 October 1953 (G/53) GATT *BISD* 2S/67.

17 See Rule III "Additional commitments regarding the reduction of high tariffs" in G/53, GATT *BISD* 2S/67 at 78.

18 Curzon (1965) pp88-90.

19 Curzon (1965) p92 (citing Press Release GATT/140, 15 October 1953) and p93.

20 See above, chapter 12, at pp353-362. See "Arrangements for Review of the General Agreement" decision of 24 October 1953 GATT *BISD* 2S/28; and "Reports Relating to the Review of the Agreement" 3 March 1955 GATT *BISD* 3S/170-252.

agriculture. In the course of the general review, the parties discussed the resort to justifying quantitative restrictions under certain exceptions in of the Agreement:

- (1) the balance of payments justification was used by many parties and proposals for its stricter application were considered;²¹
- (2) there was also a large number of programmes purported to be justified under Article XI:2(c) and some amendments were proposed but rejected;²²

In addition, as described in chapter 12, by this time the absence of rules in the Agreement restricting subsidies had become a reason for concern for a number of parties and the Review resulted in the addition of Articles XVI:2 to 5. Concerns were also voiced as to the impact that domestic subsidies were having on the effects of tariff concession on agricultural products which resulted in the parts of the Review report which (as described in chapter 13) subsequently played a significant role in the development of the law on non-violation nullification or impairment.²³ The Review resulted in the adoption of guidelines for giving notifications on subsidies, thus initiating a process of information gathering on subsidies.²⁴

The Dairy Dispute and the 1955 USA Agricultural Waiver

The early 1950s saw the playing out of the dispute between the USA and the Netherlands over the USA import quotas on dairy products imposed under the *Agricultural Adjustment Act*.²⁵ As described in detail in chapter 10, even after a GATT panel had ruled that the USA's quotas on dairy products under s22 of the *Agricultural Adjustment Act* were not justified under Article XI:2(c) and had authorized the Netherlands to impose a quota on USA wheat in retaliation, the USA congress was not prepared to bring the legislation into conformity with the GATT. Instead it amended the Act to provide that no international agreement entered into shall be applied in a manner inconsistent with the provisions of s22. Then the USA applied for and was granted a waiver under Article XXV of the GATT from

21 Report on Quantitative Restrictions (adopted 2,4 & 5 March 1955) *BISD*, 3S/170 at 170-179.

22 Report on Quantitative Restrictions (adopted 2,4 & 5 March 1955) *BISD*, 3S/170, at 189 para 66 and following.

23 Report on "Other Barriers to Trade" adopted 3 March 1955 (L/334, and Addendum) *BISD*, 3S/222, para 13 at p224.

24 L/334, GATT *BISD*, 3S/222 at 225, para 15.

25 See, above, ch10 at pp209-218.

its obligations under Articles II and XI to the extent necessary to avoid any inconsistency between the obligations of the USA under the General Agreement and s22 of the *Agricultural Assistance Act*.

As discussed in chapter 10, the waiver on USA agriculture was followed by waivers on restrictions of agricultural trade by other countries, for Belgium and Luxembourg later in 1955 and Germany in 1959.²⁶

The decision by the USA government marked a hardening of the political resistance within the USA to any changes to the way that the GATT affected agriculture. This was also manifested in the way that the General Review was unable to agree on any new disciplines over agricultural surpluses other than the ill-defined Article XVI:3.²⁷

The Geneva Round of 1955

At about the same time as the USA waiver was given and the reports of the General Review were adopted, the contracting parties appointed a working party to negotiate the format for another multilateral round.²⁸ In the June 1955, the USA extended its *Trade Act* giving the President authority to negotiate tariff reduction but without making any special provision to negotiated across the board reductions. The Presidents authority was limited to 15% over 3 years.²⁹ In the meeting of the working party also in June 1955, a majority of the parties were in favour of adopting the French plan as the basis for a round of tariff reductions. However, both the USA and the UK were opposed. They wished to negotiate according to the established method.³⁰ The working party concluded that it was not practicable to adopt the French plan. The parties considered further proposals to make the negotiations more fruitful given that the problems, to which the French plan had been addressed, still existed. The tariff negotiation rules that were adopted did not change the method of request and offer. An attempt to address the disparity problem was made by a specification that binding of a low duty should be recognized as a concession equivalent in value to the reduction of a

26 See above, chapter 11 at p279.

27 On the change in USA's attitude to reform in the agricultural sector, see Curzon (1965) pp168-169

28 See the appointment of the intersessional working party on 4 March 1955, GATT *BISD* 3S/14.

29 See Curzon (1965) p93.

30 See "Plans for Tariff Reduction and Rules and Procedures for the 1956 Tariff Conference" adopted 18 November 1955, GATT, *BISD* 4S/75 at 77, para 8.

high duty.³¹ In addition, the rules made special provision for the binding of the rate of mark-up provided by state trading monopolies.³² A number of countries were not satisfied. One of the most noticeable aspects of the 1955-56 Geneva round, the fourth round of negotiations, was the list of contracting parties that did not participate: Burma, Chile, Czechoslovakia, Indonesia, New Zealand, Pakistan, Peru, Federation of Rhodesia and Nyasaland, and Uruguay. The round did little to reduce protection applied to agricultural trade. Japan acceded to the GATT in time to participate in the round and participated in the working party to negotiate the rules. Japan had supported the move to an across the board tariff reduction but its agricultural trade was largely subject to quotas protected under the terms of its accession protocol.³³

4 PERIOD TWO: 1955 TO 1963

THE HABERLER REPORT - COMMITTEE II OF THE PROGRAMME OF ACTION TOWARDS THE EXPANSION OF INTERNATIONAL TRADE - THE FORMATION OF THE EUROPEAN ECONOMIC COMMUNITY AND THE INCEPTION OF THE COMMON AGRICULTURAL POLICY - THE DILLON ROUND 1960-61

The Haberler Report - Trends in International Trade

In 1957, the year after the Geneva round, in consequence of concerns about the failure of developing countries to benefit from international trade and of the widespread resort to agricultural protection, the contracting parties commissioned an expert examination of international trade.³⁴ The terms of reference included an examination of "

the extent to which trade in agricultural products has failed to benefit from the progressive liberalization of international trade in general.³⁵

31 Rules and Procedures for the Tariff conference commencing in Geneva on 18 January 1956, annex to "Plans for Tariff Reduction and Rules and Procedures for the 1956 Tariff Conference" adopted 18 November 1955, GATT, *BISD* 4S/75 at 79, see para 11(c) on p81

32 Rule 4 of the negotiating rules provided:
"Protection afforded through the operation of import monopolies, etc., as provided in Article II (including the Annexes thereto), III and IV of the revised General Agreement, shall be subject to negotiation in accordance with these rules. Accordingly, requests may be submitted for concessions in respect of these matters in the same way as requests for tariff concessions". (*BISD*, 4S/75)

33 See Accession of Japan to the General Agreement on Tariff and Trade, decision of 11 August 1955, GATT *BISD* 4S/33 & note Japan's membership of the Intersessional Working Party on Tariff Reductions appointed 4 March 1955, GATT *BISD* 3S/18. See also Josling, Tangermann & Warley (1996) p35.

34 Decision of the contracting parties of 29 November 1957, *BISD*, 6S/18. See Curzon (1965) p178-180; & Josling, Tangermann & Warley (1986) p35-38.

35 *BISD*, 6S/18, para 5.

The report entitled "Trends in International Trade"³⁶ but more commonly referred to as "The Haberler Report" was the first time that detailed information on agricultural trade and policies was collected by the contracting parties. It identified the measures employed and attributed some importance to the differences between the policy instruments employed. It adopted the classification that has been used ever since of measures affecting import access, measures encouraging exports, and measures supporting domestic production.³⁷ It noted:

practically all scheme of agricultural protection, however complicated in detail, can in the last resort be analyzed into some combination of these three elements.³⁸

The report enunciated the differences between price support policies employing import barriers and possibly export subsidies, and deficiency payments, explaining the advantage of the latter because of the lesser economic cost and the higher likelihood of moderation through political processes.³⁹

Josling, Tangermann & Warley refer to three other significant aspects of the Haberler Report. First, it made a "firm link" between domestic agricultural income support policies and the state of world agricultural trade. Second, it sought to establish a measure of protection that could compare the protection granted by different instruments by calculating and comparing the margins between world prices and domestic support prices. Thirdly, the report drew a connection between the policies of agriculture protecting rich countries and the harm suffered by developing countries.⁴⁰

Committee II

After receipt of the Haberler report, the contracting parties established a "Programme of Action Directed Towards an Expansion of International Trade" to work towards implementing its findings.⁴¹ The task was divided among three committees. Committee I

36 GATT, *Trends in International Trade* (GATT, Geneva, 1958) Sales No GATT/1958-3. The panel of experts comprised Roberto de Oliveira Campos, Gottfried Haberler, James Meade and Jan Tinbergen.

37 Curzon (1965) p180 there quoting from the p83 of the Report : "Practically all schemes of agricultural protection, however complicated in detail, can in the last resort be analyzed into some combination of these three elements."

38 See Curzon (1965) p180 citing *Trends in International Trade* p83.

39 See GATT, *Trends in International Trade* pp97-99.

40 See Josling, Tangermann & Warley (1996) pp36-37.

41 "Programme of Action Directed Toward an Expansion of International Trade" Decision of the of 17 November 1958, GATT, *BISD*, 7S/27.

was to deal with tariff reductions and Committee III was to deal with exports of developing countries. Committee II, the Committee on Agriculture was:

to assemble data regarding the use ... of non-tariff measures for the protection of agriculture, or in support of incomes of agricultural producers and the agricultural policies from which these measures derive; [and]

to consider, in the light of such data, the extent to which the existing rules of GATT and their application have proved inadequate⁴²

Committee II delivered three reports between May 1959⁴³ and November 1961.⁴⁴ Committee I led to the commencement of the Dillon round of multilateral negotiations. Concurrent with these initiatives, there was a perceived need to improve the application of the agreement to the use of subsidies and with the use of state trading enterprises both of which significantly affected agricultural trade. A Panel on Subsidies and State trading studies these problems from 1959.⁴⁵

However this period was dominated by the formation of the European Economic Community and the formation of the Common Agricultural Policy described in chapter 10. The implementation of the EEC common tariff and the negotiation within the community of its agricultural policy had a great influence upon the way in which the Dillon Round was conducted. As discussed in chapter 10, the simple practical effect of time constraints forced the two matters together. First, under the treaty of Rome, the EEC members would start to adapt their tariffs to the common EEC tariff on January 1962. Secondly, the negotiating authority of the US President was due to expire on 30 June 1962. Therefore the negotiation under Article XXIV:6 with the EEC had to be completed by January 1962 and the multilateral negotiation had to be completed by June 1962. The process of negotiation in Committee I about the rules for the two negotiations foreshadowed the future. Just at the point where the GATT studies were pointing to deficiencies in GATT rules and a need to

42 GATT, *BISD*, 7S/27 at 280.

43 The 1st report of Committee I on Tariff reduction was adopted by the contracting parties on 29 May 1959, GATT, *BISD*, 8S/101.

44 "Agricultural Protection" 3rd report of Committee II adopted on 15 November 1961 (L/1461) GATT *BISD* 10S/135; See also the 2nd report (L/1192) adopted 20 May 1960) GATT *BISD* 9S/110 & the progress report (L/1326) adopted 14 November 1960, GATT *BISD* 9S/118.

45 See "Notifications of State-Trading Enterprises" report adopted on 13 May 1959 (L/970) GATT *BISD* 8S/142.

attack matters other than tariffs, the EEC firmly adopted the approach that its internal negotiation on formation of the CAP was more important than the international negotiation.

Just before the adoption of the 1st report of Committee II, the Panel on Subsidies and State Trading commenced a process of information gathering on state trading.⁴⁶ The 1st report of Committee II commenced a procedure for consultations and collection of information on policies affecting agricultural trade. It requested parties to supply information relating to all policies including non-tariff import barriers, export subsidies and domestic subsidies. The information was to be given separately in respect of different commodities. The information sought included that necessary to quantify the extent of protection: the size of quotas and whether they were based on a minimum price, the mark-ups applied by state trading enterprises (in almost identical terms to the information requested by the Committee on Subsidies and State Trading) and the criteria for determining the quantity of imports and domestic prices, the amount of export subsidies and domestic subsidies on a per unit basis, and the level of any guaranteed prices.⁴⁷ In the deliberations of the committee, agricultural exporting countries argued that widespread agricultural protectionism had frustrated the balance of rights and obligations under the Agreement.⁴⁸ They argued that they had paid for some concessions and had then seen the concessions granted to them impaired by non-tariff measures. They indicated that they would not give further concessions in order to have illegal measures removed. Although, the agricultural exporting parties did not make submissions about the GATT consistency of any measures, they observed that there had been

a tendency to use the latitude given by the rules to apply the weight of permitted restrictions more on imports of agricultural products than on industrial products.⁴⁹

On the question of remedying the situation, the report says:

46 "Notifications of State-Trading Enterprises" report adopted on 13 May 1959 (L/970) GATT *BISD* 8S/142.

47 "Background Information to be Supplied by Countries Being Consulted", and appendix "Outline of Papers for Committee II" (COM.II/1), Annex B to "First report of Committee II adopted on 29 May 1959" (COM.II/5) GATT *BISD* 8S/121. See paras 7,8 &9 of Annex B, and paras III(ii), & IV of the appendix COM.II/5.

48 The 1st report of the Committee II on Agriculture Protection in the Programme for expansion of International Trade (COM.II/5) adopted 29 May 1959, GATT, *BISD*, 8S/121.

49 GATT *BISD* 8S/121 at 125, para 10.

Most of the members holding this view [, the agricultural exporting countries,] considered that the approach to the correction of this imbalance should lie not so much in seeking further amendments of the rules but rather in concentrating on their effective operation and application.⁵⁰

This was indicative of a continuing problem in GATT negotiations on agriculture: whether to seek to change the rules or to change policies without changing the rules. Subsequent negotiations including the Uruguay Round have also been influenced by this tension.

Before Committee I, there was considerable argument as to whether the new round of negotiations should extend to non-tariff import barriers and to subsidies. On the question of whether quantitative restrictions justified under Article XI:2(c) should be subject to negotiation, it was put that:

There could hardly be any question of negotiating these restrictions, since they were either "unnecessary" in which case they constituted a violation of the Agreement, or they were "necessary" in which case there was no room for negotiation. In fact, for a contracting party to grant a concession in the form of a reduction of the level of restrictions would be equivalent to giving away something it was not entitled to possess.⁵¹

The argument is clearly fallacious in that there is no reason why the whole domestic programme which made the import restrictions necessary might not themselves be negotiable. The existence of the argument shows the reluctance to extend the negotiations to measures that might be illegal anyway. This reluctance was another feature of subsequent GATT negotiations. It can be observed that, in the Uruguay round, that the parties avoided inferences of illegality of particular measures and, thereby, at least kept those measures within the scope of the negotiation. On the question of subsidies, the committee acknowledged the statement in the report of the 1955 Review that parties were free to negotiate commitments on subsidies, some parties did not want this reflected in the negotiating rules, apparently being concerned that it might suggest an obligation to negotiate on subsidies.⁵²

50 GATT *BISD* 8S/121 at 125, para 10.

51 The 1st report of the Committee I on Tariff Reduction in the Programme for Expansion of International Trade, *BISD*, 8S/101 at pp106-107. See also GATT, *The Activities of GATT* (GATT 1960-2) (GATT, Geneva, May 1960) p10.

52 "Second report of Committee I adopted on 19 November 1959" (L/1043) GATT *BISD* 8S/103.

In the course of discussing the rules for the multilateral negotiation, Committee I also discussed the scope of negotiations under Article XXVIII. It was proposed that a party introducing a non-tariff measure having the effect of impairing the value of a tariff concession should have to use the procedure of Article XXVIII. A number of parties were averse to Article XXVIII negotiations covering matters which were not the specific subject of a commitment in a schedule.⁵³

When the rules for the Dillon round were finally agreed, the request and offer method on a product by product basis was retained.⁵⁴ The rules did not incorporate any elements of the French plan for across the board negotiations. However the rules were expanded to cover non-tariff measures. Paragraph II (b) (ii) of the negotiating rules provided :

Participating countries may also enter into negotiations in accordance with these rules in respect of the following matters:

- the protection afforded through the operation of import monopolies, as provided in Articles II and XVII (including the interpretative notes);
- internal quantitative regulations as provided in paragraph 6 of Article III (mixing regulations);
- the level of screen quotas as provided in Article IV;
- import restrictions as provided in paragraph 2(c) of Article XI;
- the level of a subsidy which operates directly or indirectly to reduce imports;
- internal taxes.⁵⁵

The European Community was not in agreement and issued a statement saying that regardless of what was contained in the negotiating rules, it would be negotiating on tariffs only.⁵⁶

Before the Dillon round had begun, the second report of Committee II on Agriculture was adopted.⁵⁷ It divided its discussion among the various ways in which agriculture was protected and included sections on support prices, deficiency payments, quantitative restrictions, and aids to exports. The process of information gathering was ongoing. At about the same time, the Committee on Subsidies and State Trading reported on progress in

53 The 1st report of the Committee I on Tariff reduction, *BISD*, 8S/101.

54 See "Rules and Procedures for the Tariff Conference Commencing in Geneva on 1 September 1960", Annex A to "Second report of Committee I", (L/1043) *GATT BISD* 8S/103 at 118, para VII(a).

55 See the annexe to the report of Committee I, *BISD*, 8S/101.

56 "Statement By the Representative of the Commission on Behalf of the EEC in Committee I", Annex B to Second Report of Committee I (L/1043, Add.1, Corr.1), *GATT BISD* 8S/101 at 121.

57 "Second Report of Committee II adopted on 20 May 1960" (L/1192) *GATT* 9S/110.

the gathering of notifications on subsidies and refined its own questionnaire,⁵⁸ and also gave a final report on the information gathering on state trading indicating that the information received on price-mark ups and the differences between import and domestic prices had been inadequate.⁵⁹

As described in chapter 10, the Article XXIV:6 negotiation proceeded with some difficulty and most of the disagreements related to agricultural products. By early May 1961 the parties were unable to complete the Article XXIV negotiation. They agreed to proceed with the Dillon round of multilateral negotiations in the hope that the remainder of the Article XXIV:6 negotiation would be completed in the course of the Dillon round.⁶⁰ The difficulties in the Article XXIV:6 negotiation were also the subject of review by Committee II where the EEC's proposals for the CAP were subjected to scrutiny and criticism. As noted above, the original examination under Article XXIV of the formation of the EEC had failed to declare the illegality of the creation of import barriers to maintain internal prices. However, at that time, some parties had complained that the maintenance of intra-EEC prices would necessarily lead to a need for external barriers.⁶¹ These views were raised again in Committee II.⁶²

As the round proceeded, even more detailed reporting on agricultural protection was being undertaken. The collection of information on quantitative restrictions on agriculture showed the extent of the problem with quantitative restrictions on agriculture. It was observed in GATT , Activities of 1960-61:

While the removal of import restrictions applied to protect their balance-of-payments has shown an encouraging trend, there remains a large problem which was formerly concealed to some extent, but is now coming into the open. This is the use of quantitative restrictions to protect domestic agriculture. A number of industrial countries cannot see their way in the near future to abandoning the use of such protective measures in the agricultural sectors of their economies. The use of import quotas and controls is deeply integrated into their commercial policies and economic systems and a sudden

58 "Review Pursuant to Article XVI:5" report by the panel adopted 24 May 1960 (L/1160), GATT *BISD* 9S/188.

59 "Notifications of State-Trading Enterprises" final report adopted on 24 May 1960 (L/1146), GATT *BISD*, 9S/179 at 183, para 19.

60 GATT, *Activities in 1960-61*, p9.

61 See "The European Economic Community" report adopted on 29 November 1957 (L/778) GATT *BISD* 6S/68 at 83-84, para 4.

62 See Josling, Tangermann & Warley (1996), pp39-40.

change to some other means of protection is not feasible, in the short run. Reinforcing this situation is the fact that the common agricultural policy of the EEC will probably tend towards self-sufficiency in agriculture and will require the use of an effective system of controls on imports of agricultural products from outside. Thus there exist powerful reasons why the complete liberalization of trade in many industrial countries cannot be foreseen unless and until the basic problem of agricultural protection can be resolved or at least alleviated.⁶³

The 3rd report of Committee II, delivered 21 November 1961, included specific reports on six groups of commodities: dairy products, meat, cereals, sugar, fish and vegetable oils.⁶⁴ The level of detail went so far as to identify almost every measure of protection applied by each of the 34 participating countries on each commodity covered by each sub-committee. The report documented the extent of the problem with quantitative restrictions: that of the 34 countries surveyed three-quarters had quantitative restrictions on dairy products, 25 had quantitative restrictions on meat, and that countries accounting for three-quarters of wheat production applied quantitative restrictions.⁶⁵ In addition, the investigation by the Subsidies committee had found that the bulk of subsidies existed on primary products rather than on other products.⁶⁶

At the end of that same month, November 1961, a meeting of ministers reviewed the programme for Expansion of International Trade. The Dillon Round was still continuing. As discussed in chapter 10, it was not until January 1962 that the EEC announced the mechanisms of the CAP, and not until March 1962 that the parties to the Article XXIV:6/Dillon Round participants reached agreement subject to the reservations that were dragged out into the 'chicken war'.⁶⁷ However, it was clear by the time of the ministerial meeting in November 1961 that the Dillon round would not achieve any liberalization on agricultural trade because the parties had not offered any significant concessions on

63 GATT, *The Activities of GATT 1960/61* (GATT, Geneva, May 1961) p21.

64 "Programme for Expansion of International Trade - Agricultural Protection, third report of Committee II adopted on 15 November 1961 (L/1461) GATT *BISD* 10S/135.

65 See L/1461, GATT *BISD* 10S/135. See also the figures mentioned above, in chapter 11, at p15 drawn from the documents prepared for Committee II: COM.II/86/Add.7/Rev.1 (3 March 1961) & COM.II/112 (3 March 1961).

66 "Subsidies - Operation of the Provisions of Article XVI" report adopted on 21 November 1961 (L/1442 & ADD.1-2) GATT, *BISD* 10S/201.

67 See above chapter 10, pp232-234.

agricultural products.⁶⁸ In respect of the work of Committee I and of the Dillon Round, the ministers observed that little was likely to be achieved by further negotiations on a bilateral product by product basis and that a new technique "in particular, some form of linear tariff reduction" would be necessary.⁶⁹ They also acknowledged that the round had produced no substantial results in respect of agricultural products.⁷⁰ In response to the work of Committee II, it was agreed that the parties should form groups to examine particular commodities and should maintain Committee II to continue the process of reporting.⁷¹

5 PERIOD THREE: 1963 TO 1972

THE KENNEDY ROUND AND THE 1967 COMMITTEE ON AGRICULTURE

The Kennedy Round

In May 1963, after receipt of all of the reports of the Programme of Action for the Expansion of International Trade, a ministerial meeting was held to implement some of its findings. The Ministerial meeting concluded, *inter alia*, that:

- (1) there would be a new round of negotiations beginning on 4 May 1964;⁷²
- (2) that the negotiations would deal with non-tariff barriers as well as tariffs;⁷³
- (3) that the negotiations would adopt linear reductions with a minimum of exceptions rather than negotiate requests and offers on a product by product basis;⁷⁴
- (4) that the negotiations would "provide for acceptable conditions of access to world trade of agricultural products."⁷⁵

68 "Programme for Expansion of International Trade - Meeting of Ministers" conclusions adopted on 30 November 1961, GATT *BISD* 10S/25 at p26. See also GATT, *The Activities of GATT 1961/62* (GATT, Geneva, July 1962) pp7-19 at 13.

69 10S/25 at 26.

70 10S/25 at 26.

71 10S/25 at 27.

72 "Ministerial Meeting, May 1963 - Conclusions and Resolutions adopted on 21 May 1963" GATT, *BISD* 12S/36 at p47, resolution A1.

73 As above, 12S/35 at 47, resolution A3.

74 As above, 12S/35 at 47, resolution A4.

75 As above, 12S/35 at 48, resolution A7.

The USA's initial demands for the Kennedy Round were a 50% cut on all tariffs on all products including agricultural products.⁷⁶ This would have entailed that the EEC would have to give bindings on tariffs on agricultural products. That would have meant that the EEC could not proceed with setting up the common agricultural policy in the way that it was, because it would have been unable to use variable levies.⁷⁷ The EEC responded that it could negotiate for a 50% linear reduction on manufactured goods but not on agricultural goods.

For agricultural goods, the EEC made what became known as the 'montant de soutien' proposal.⁷⁸ Under this proposal, countries would not have to bind tariffs on agricultural products but instead would bind the margin of support (or 'montant de soutien') without regard to the policy instruments by which that support was provided. Under this proposal, the important thing would be to measure and bind the level of support. The level of support was to be calculated as the difference between the internal support price and a fixed reference price. The reference prices were to be either based on market prices or on negotiated prices. The margin between the two prices was to be bound. However, the plan also would have permitted the charging of an additional levy upon imports at prices below the fixed reference prices. Therefore, if world prices fell, the margin of protection could be widened. The plan would have completely removed agriculture from market forces. If adopted, it would have entitled every country to set internal prices so as to create desired levels of self-sufficiency. Many countries would have had surpluses. The plan would have been the antithesis of an intelligent distinction between policy instruments. It would have provided no incentives at all to encourage the use of less costly policy instruments instead of more costly ones. It would have entrenched the size of the transfers to agricultural

76 See Warley "Western Trade in Agricultural Products" (1976) p381. Generally, on the Kennedy Round, see Dam (1970) pp68-78; and Norwood, Bernard, "The Kennedy Round: A Try at Linear Trade Negotiations" (1969) 12(2) *Journal of Law & Economics* 297-320. Note the doubts that the USA would have been able to comply with its own negotiating position in Johnson, D. Gale, "Liberalizing Agricultural Trade between Canada and the United States" (1973) 6 *Case W Res J Int'l L* 60-65 at 61-62.

77 See McMahon (1992) at 226.

78 On the 'montant de soutien' proposal and its role in the Kennedy Round negotiation, see Evans, John W., *The Kennedy Round in American Trade Policy - The Twilight of the GATT?* (Harvard University Press, Cambridge, Mass., 1971) p209-215; Warley, "Western Trade in Agricultural Products" (1976) 382-385; Dam, Kenneth W., "The European Common Market in Agriculture" (1967) 67(2) *Columbia Law Review* 209-265 at 258-263; Warley, "Problems of World Trade in Agricultural Products" (1967) pp67-68; and Josling, Tangermann, and Warley, (1996) pp62-65.

producers and with them their political influence. One advantage would have been that it would have set a maximum on the per unit export subsidy that could be paid. Export subsidies could not have exceeded the bound margin of support.

Unfortunately the USA deviated from its original proposition and began to pursue the possibility of negotiating minimum quantities of market access for particular export products.⁷⁹ Such an approach of negotiating for the creation of quotas and the dividing up of market shares was completely inconsistent to its original market oriented proposal.

The multilateral round, called the Kennedy round, lasted from 4 May 1964 until 30 June 1967. For most of that time, the USA and EEC were unable to agree on a basis for negotiation on agricultural products. It was clear that the USA would not agree to the binding of margins of support. After a year of disagreement, the USA allowed the negotiation on industrial products to move forward in advance of the negotiation on agricultural products.⁸⁰ It was not until July 1966 that the EEC submitted a revised offer on agriculture. They offered some tariff reductions but in the key areas they offered proposals for commodity agreements. Therefore, in the end, the linear approach was abandoned in the case of agricultural products and participants resorted to the request and offer method.⁸¹ The results were limited. Some tariff reductions were achieved but not in the principal areas of grains, meat and dairy products.⁸² On wheat, an international agreement was entered into which provided, inter alia for the maintenance of a minimum price (though without any fixed commitments to intervene to hold up the price).⁸³ Some progress was achieved on some non-tariff barriers. A Code on anti-dumping duties was negotiated. However, the round had negligible impact on the range of non-tariff barriers affecting agriculture.

79 Dam (1967) pp260-261.

80 See Preeg, Ernest H., *Traders and Diplomats* (The Brookings Institution, Washington DC, 1970) p148.

81 See Evans, *US Trade Policy - New Legislation for the Next Round* (Harper & Row), New York, 1967) chapter 3 "Erosion of Linear Reductions" at pp21-28.

82 Preeg, *Traders and Diplomats* (1970) p358.

83 See Preeg, *Traders and Diplomats* (1970) p151ff; and Dam (1970) p272.

The 1967 Committee on Agriculture

During the round the process of information gathering continued. The secretariat held consultations with each of the EEC, the UK and the USA and published reports detailing their agricultural policies in 1965.

After the Kennedy round ended, the contracting parties reviewed the previous work to improve the operation of the GATT including in the "Programme for Expansion of International Trade" and, in an attempt to implement some of the recommendations that had been adopted and to reap some benefit from all of the information that had been collected, adopted a "Programme of Work".⁸⁴ The work programme was to cover three areas: industrial products, agriculture, and trade of developing countries. A new Agriculture Committee was established.

The Agriculture Committee divided its work into 4 areas:

- Group 1: measures which affect exports;
- Group 2: measures which affect imports;
- Group 3: measures which affect production;
- Group 4: other relevant measures.⁸⁵

That there was a particular focus on measures that affect production as distinct from trade was evidence of the recognition that agricultural trade problems could not be solved without modifying the domestic policies of countries protecting agriculture. The importance of this aspect was also emphasised by the Director General at the 26th session in February 1970 in a plea

for national discipline to take a grip on production, and for intensified international cooperation to solve the problems of world agricultural trade.⁸⁶

Many delegates insisted on the need "to change policies which encourage self-sufficiency by uneconomic production".⁸⁷ That a number of countries must have resisted this type of thinking, tending as it does, to bring domestic policies under international regulation is

84 "Programme of work of the Contracting Parties; conclusions adopted on 24 November 1967" GATT *BISD*, 15S/67.

85 "Agriculture Committee" report adopted on 25 February 1970 (L/3320) GATT *BISD*, 17S/110.

86 GATT, *Activities in 1969-70*.

87 GATT, *Activities in 1969-70*.

illustrated by para 6 of the conclusions of the Agriculture Committee at the time it adopted its work programme:

It was understood that this work would be essentially of an exploratory nature and that the definition of a range of possible solutions did not imply a commitment to conform to any of these solutions.⁸⁸

The most concrete work of the committee consisted of establishing a detailed inventory of measures affecting the agricultural imports of the major countries. However, the committee also formulated a number of alternative possible solutions for both the long and the short term for each of the areas of exports, imports and production.⁸⁹ The suggestions included alternatives for future negotiations in the agriculture sector.⁹⁰

6 PERIOD FOUR: 1973 TO 1986

THE TOKYO ROUND AND THE 1979 COMMITTEE ON TRADE IN AGRICULTURE

The Tokyo Round

In early 1972, each of two joint declarations, one by the USA and Japan and another by the USA and the EEC," voiced undertakings to initiate a new round of negotiations.⁹¹ In November 1972, the contracting parties set up a preparatory committee to provide guidelines for the negotiations. The committee reviewed the suggestions of the post Kennedy round Agriculture committee. The deliberations of the Committee show that the concerns of developing countries had become much more prominent in GATT deliberations. In particular, the developing countries wanted to renegotiate the safeguards provision in Article XIX. They argued that the imposition of safeguards by developed countries was disrupting their export trade.

The round was commenced with a Ministerial Declaration in Tokyo on 14 September 1973. The negotiating mandate did a little, but only a little, to propel negotiations to liberalize agricultural trade. The Ministerial Declaration stated that the negotiation would aim to, *inter alia* :

3 ..

88 *BISD*, 17S/110 at para 6.

89 *GATT, Activities in 1970-71*, p17.

90 *GATT, Activities in 1972*, p17.

91 *GATT, Activities in 1972*, p36.

- (a) conduct negotiations on tariffs by employment of appropriate formulae of as general application as possible;
 - (b) reduce or eliminate non-tariff measures or, where this is not appropriate, to reduce or eliminate their trade restricting or distorting effects, and to bring such measures under more effective international discipline
- ...
- (e) include, as regards agriculture, an approach to negotiations which, while in line with the general objectives of the negotiations, should take account of the special characteristics and problems in this sector;
- ...
- 4 The negotiations shall cover tariffs, non-tariff barriers and other measures which impede or distort international trade in both industrial and agricultural products, ..."92

This was the first time that a round had been initiated with a direction to take account of the special characteristics of agriculture. Perhaps this express enunciation of the "special characteristics of agriculture" occurred as a reaction to the demands by so many countries that agricultural should be subject to the same disciplines as other trade. The formulation of aim 3(b) perhaps also reveals a disagreement as to whether trade problems should be solved by the stricter enforcement or changing of rules or rather by negotiating reductions in the trade distorting effects of measures without regard to the rules. The pressure that existed to achieve some liberalization of agricultural trade is indicated by the fact that the Ministerial declaration included the statement that:

the negotiations should be considered as one undertaking the various elements of which should move forward together.⁹³

It is of note that at around the time that the Tokyo round was beginning, developing country issues had become more prominent in all international forums. 1974 was the year of the United Nations General Assembly resolution calling for "Declaration on the Establishment of a New International Economic Order"⁹⁴ The growing call for a new international economic order was manifested by demands for special and differential treatment for developing countries in the GATT. This had at least three tangible effects on the framework for the Tokyo round. One was the developing countries call for a generalized system of preferences.⁹⁵ Second was the demand that exceptions should be made for developing

92 Tokyo Declaration, 14 September 1973, reproduced in GATT, *Activities in 1973*, p5

93 Tokyo Declaration, 14 September 1973, reproduced in GATT, *Activities in 1973*, p5 at p9, para 8.

94 General Assembly resolution 3201 (S-VI).

95 Eg, see the Report of the Committee on Trade and Development adopted 14 November 1973.

countries when safeguard measures are implemented. Third was a demand that negotiations should be directed particularly to achieving liberalization in products in which developing countries have an interest. In November 1973, the Committee on Trade and Development reported:

It was also suggested that developing countries should be given preferential treatment in the field of agriculture with respect to such measures as tariff, import quotas and levies and, where this was not possible, priority attention in the negotiations should be accorded to products of special interest to developing countries.⁹⁶

Finally, the principle of reciprocity was under attack and some developing countries were making their participation in the Tokyo round dependent upon the incorporation of a principle that developed countries should not expect reciprocity from developing countries.⁹⁷

Chapter 12 has already outlined the difficulties with negotiations on subsidies and how part of the problem was that there was a standoff between the United States wanting agricultural trade to be dealt with along with industrial trade in the various negotiating sub-committees in tariffs, non-tariff barriers and subsidies, etc but the EEC wanting the agriculture committee to have exclusive authority to deal with how the various trade policies affected agriculture.⁹⁸ It was noted in chapter 12 that this meant that nothing happened in the subsidies negotiation for 2 years. Neither was there any progress in any other aspect of negotiations on agriculture. GATT, Activities in 1976 observed:

Trade in agricultural products is recognized as presenting some of the greatest difficulties facing the negotiators. As exporters, as importers, or often as both at once, the participating countries, both developed and developing, see the agricultural negotiations as touching their vital political economic and social interests. The issues themselves are exceptionally complex, and are not seen in the same way by the various governments concerned. There are basic differences of opinion between some of the major agricultural trading nations as to how these products should be dealt with in the negotiations. In consequence, progress in Negotiating group "Agriculture" has been limited. As 1977 opened, it was clear that a concerted effort would be needed in the coming months to move the agricultural negotiations ahead more rapidly if

96 Para 13 of the report of the Committee on Trade & Development adopted on 14 November 1973; *BISD*, 20S/53.

97 3rd report of the Group of Three, *BISD*, 20S/73, para 49.

98 On the disagreement between the USA and the EEC on the structure of the negotiation, see Warley, T.K., "What Chance has Agriculture in the Tokyo Round" (1977) 1 *World Economy* 177-194 at 190.

they were not to hamper successful conclusion of the Tokyo round as a whole."⁹⁹

The Tokyo Round was completed in 1979. The parties agreed to implement tariff reductions according to a harmonization formula which reduced the highest tariffs the most but agriculture was excluded from these formula tariff reductions.¹⁰⁰ As well as two protocols¹⁰¹ implementing the tariff reductions over eight years, the round resulted in a number of other agreements, arrangements and understandings to which contracting parties could choose to become parties.¹⁰² These included arrangements relating to dairy products and to bovine meat.¹⁰³ (Attempts to negotiate an agreement relating to wheat were unsuccessful.) In addition the agreements on Import Licensing Procedures, and on Subsidies and Countervailing Duties held some prospect of limiting the use of non-tariff measures on agricultural trade. Separate bodies were set up to monitor each of the Tokyo Round agreements.¹⁰⁴ However, in liberalizing agricultural trade, the results of the Tokyo Round were widely regarded as disappointing.¹⁰⁵

99 GATT, *Activities in 1976*, pp22-23.

100 See Josling, Tangermann & Warley, (1996) p85. On the formula used in the Tokyo Round, see Hoekman & Kostecki, (1995) p74; on the exclusion of agriculture from the formula and the conduct of request and offer negotiations in relation to agriculture, see Filipek, Jon G., "Agriculture in a world of Comparative Advantage: The Prospects for Farm Trade Liberalization in the Uruguay Round of GATT Negotiations" (1989) 30(1) *HILJ* 123-170 at 143.

101 *Geneva (1979) Protocol to the General Agreement on Tariffs and Trade (L/4875)*; *Protocol supplementary to the Geneva (1979) Protocol to the General Agreement on Trade and Trade (L/4812)*. The texts of each of these protocols appear at *BISD* 26S/3.

102 *Agreement on Technical Barriers to Trade*.

Agreement on Government Procurement

Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (known as the "Subsidies Code")

Arrangement Regarding Bovine Meat

International Dairy Arrangement

Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (known as the Customs Valuation code) and a Protocol to it

Agreement on Import Licensing Procedures

Agreement on Trade in Civil Aircraft

Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade

The texts of each of the above agreements appear in full at *BISD* 26S/3.

103 See short summaries of these agreements in Zedalis, "Legal Effects of the Multilateral Trade Negotiations: Agricultural Commodities" (1980) 10 *Denver Journal of International Law and Policy* 89-111 at 109-111.

104 Committee on Subsidies and Countervailing Measures

International Dairy Products Council

Committee on Technical Barriers to trade

International Meat Council

Committee on Import Licensing

Committee on Trade in Civil aircraft

The Committee on Trade in Agriculture

As soon as the round was over, there were new moves to investigate ways of reducing agricultural protection. There were also other areas of the Tokyo round that required supervision or further work. For these purposes the contracting parties adopted a "Future Work Programme", one of the key elements of which was to adopt a work programme for agriculture. The formulation of the content of the work programme was a drawn out process lasting until 1982. The Secretariat was requested to prepare a number of studies relating to agriculture and to review the General Agreement and the Tokyo round codes from the point of view of agricultural trade.¹⁰⁶ The reports gave a detailed analysis of the reasons that the GATT did not apply to agricultural trade in the same way as it did to industrial trade, referring to, inter alia:

- differences incorporated into the General Agreement itself;
- the effects of long-standing derogations;
- disagreements as to the interpretation of certain GATT articles;
- the existence of residual quantitative restrictions;
- the general low level of tariff bindings on agricultural products; and
- the undefined status, in GATT terms, of certain trade measures.

However, at the July and October meetings of the group entrusted with setting the format of the work programme on agriculture (the Group of Eighteen), there was an inability to agree on the work programme.¹⁰⁷ The impasse was broken by a ministerial meeting in November 1982. The Ministerial declaration included the following:

7 In drawing up the work programme and priorities for the 1980's, the contracting parties undertake, individually and jointly :

...

- (v) to bring agriculture more fully into the multilateral trading system by improving the effectiveness of GATT rules, provisions and disciplines and through their common interpretation; to seek to improve terms of

Committee on Anti-dumping Practices

Committee on Trade and Development

Committee on Safeguards

See the first reports of each of these bodies for the period November 1979 to November 1980 which appear in *BISD*, 27S.

105 GATT, *Activities in 1979*, p6.

106 GATT, *Activities in 1981*, p26.

107 Group of eighteen, report to the council of Representatives, Presented to the CONTRACTING PARTIES at their 38th session (L/5387); *BISD* 29S/77.

access to markets; and to bring export competition under greater discipline. To this end a major two-year work programme shall be undertaken.

The Ministerial Declaration also established a Committee on Trade in Agriculture to examine and make recommendations on:

- (1) trade measures affecting market access and supplies;
- (2) the operation of the GATT as regards subsidies affecting agriculture, especially export subsidies;
- (3) trade measures affecting agriculture maintained under exceptions to or derogations from the GATT.¹⁰⁸

The examination was to cover all measures affecting trade, market access and competition and supply in agricultural products. It was to take into account the effects of national agricultural policies.

The Committee commenced by dividing its task into Exercise A which covered matters listed as 1 and 3 above and Exercise B which covered subsidies (listed as 2 above).

In the work of Exercise A, the committee drew on the information collected by earlier committees, and called for information from and held consultations with parties which classified measures into:

- (a) measures taken by virtue of provisions with special reference to agriculture in the General Agreement (eg. Article XI:2, XVI:3, XX(b) and (h)).
- (b) measures taken by virtue of waivers granted under Article XXV:5, or of provisional application or accession (eg. grandfather clauses)
- (c) measures resulting from the lack of observance or application of certain provisions of the General Agreement (e.g. limited use of Article II, residual restrictions)
- (d) measures resulting from particular interpretations of certain provisions of the General Agreement (e.g. Articles III or XXIV).
- (e) measures not explicitly provided for in the General Agreement (e.g. variable levies, voluntary restraint agreements, long-term arrangements)
- (f) all other measures (indicate GATT relevance, to the extent possible).¹⁰⁹

¹⁰⁸ Ministerial Declaration, adopted on 29 November 1982 (L/5424), *BISD*, 29S/9 at 16.

With respect to Exercise B, the committee called for information from parties on all kinds of subsidies. It consulted with parties on such matters as the meaning of equitable share, special factors and primary products.¹¹⁰ This process was being carried out at about the same time as the EEC Wheat Export subsidies dispute which resulted in the panel, in effect, failing to make a decision under the criteria of Article XVI:3 and the USA vetoing adoption of the report.¹¹¹ The committee sought submissions from the parties and requested the Secretariat to prepare an "analytical index" to the law on Article XVI.

In April 1984, the secretariat was asked to prepare recommendations.¹¹² In essence, some members of the committee and the secretariat were together using the draft secretariat's report as a vehicle to keep negotiations going and the essential recommendation of the committee was to keep working on the secretariat's 'recommendation', now to be called an "elaboration". These was the essential recommendation of the subsequent report of the committee's submitted in November 1984. This called for "elaboration" of conditions under which "substantially all measures affecting trade in agriculture would be brought under more operationally effective GATT rules and disciplines".¹¹³ On the question of import barriers, such an elaboration was required to propose appropriate rules for

- voluntary restraint agreements,
- variable levies,
- minimum import price arrangements,
- restrictions maintained under waivers,
- other derogations and exceptions, and
- the import activities of state enterprises.¹¹⁴

With respect to subsidies, the elaboration was required to use two parallel approaches:

109 "Committee on Trade in Agriculture, Progress report to the council of representatives", adopted 21-23 November 1983, L/5563, *BISD*, 30S/100 at 104, para 7.

110 "Committee on Trade in Agriculture, Progress report, *BISD*, 30S/100 at 104-105, para 8-9.

111 See, above, chapter 12 at section 10.2.2 The EEC Wheat Flour Subsidy Case.

112 "Committee on Trade in Agriculture" (L/5733) report presented to Council, during 26-30 November 1984, GATT, *BISD*, 31S/209.

113 "Trade in Agriculture" (L/5753) recommendations adopted during 26-30 November 1984, GATT *BISD* 31S/10.

114 L/5753, 31S/10 at 11, para 1(a).

- an approach based on improvements in the existing rules; and
- an approach based on a general prohibition subject to exceptions.¹¹⁵

The Committee also placed emphasis upon the impact of domestic agricultural policies referring to:

reinforcing the linkages under Articles XI and XVI between national policies and trade measures in a manner which more clearly defines the limits to the impact of domestic agricultural policies on trade.¹¹⁶

In 1985, the year following the report of the Committee on Trade in Agriculture, the United States introduced its Export Enhancement Policy in an attempt both to recover market share from the EC and to convince the EC to wind back its export subsidies. In June 1986, the Secretariat prepared the lengthy revised version of its recommendations, the "draft elaboration".¹¹⁷

The outcome of the multilateral rounds and the attempts in the last four of them to deal effectively with agriculture and of the continued efforts at information gathering and report writing, was that all of the problems of trade in agricultural products had become better understood and better documented than at any stage of the history of the GATT. However, the problems were also as serious as they had ever been.

7 WHAT'S NEXT

With this review completed, we can now move to draw some conclusions on the whole analysis of the application of the GATT to agriculture and whether the problems derived from defects in the way that the framework of rules was set up, in particular, defects in the way those rules embodied distinctions between instruments. Therefore, it is appropriate not to try to separate our conclusions from this review of the attempts to improve the rules from the rest but rather to move on to the conclusions from the whole of chapters 9 to 14.

115 L/5753, 31S10 at 11, para 1(b).

116 From L/5732, 31S/10.

117 "Recommendations: Draft Elaboration" note prepared by the Secretariat in consultation with the Chairman, prepared for the committee on Trade in Agriculture, AG/W/9/Rev3, 4 June 1986.

CHAPTER 15

SUMMARY AND CONCLUSIONS FROM PART 3

Agricultural trade liberalization is an area in which GATT has had meagre success. However, this is not because there is anything fundamentally deficient in the GATT as a legal document as it pertains to agriculture. What is missing above all else ... [is a] willingness on the part of virtually all important Contracting Parties to allow agriculture to be subject to the same rules and travel the same route at the same speed as industrial products.

Warley, T.K., "Western trade in agricultural products" in Shonfield, Andrew (ed) *International Economic Relations of the Western World*, 1959071, Volume 1, *Politics and Trade* (Oxford University Press, London, 1976) p287 at 352.¹

1 THIS APPROACH TO THE FAILURE OF GATT WITH AGRICULTURE

This part of the thesis has approached the question "Why was the GATT unsuccessful in relation to agricultural trade?" with a particular approach. As described in chapter 1, the approach here has been to determine whether the content of the rules contributed to the failures with agricultural trade.² I have not excluded the possibility that the failure may have been contributed to by other aspects of the system of law like the dispute resolution mechanisms or the direct applicability of the rules but I have concentrated on finding a connection between the content of the rules and their substantive scheme of regulation and that failure.³

The general analysis of the rationale for GATT rules in Part 2 concluded that for GATT rules to be able to guide the conduct of parties so that they can achieve both economic and

1 See also the quotation of this passage and discussion of this idea in McMahon, Joseph A., *Agricultural trade, protectionism and the problem of development: a legal perspective* (St Martins Press, New York, 1992) p219ff.

2 See, above, chapter 1 under the heading "An Approach to the Problem" pp13-16.

3 As above at pp14-15.

non-economic objectives requires that GATT rules must be constructed in accordance with particular rules derived from economic theory and public choice theory including particular rules relating to the differences between different policy instruments.⁴ That analysis also concluded that there was no reason for those general conclusions not to be applicable to rules for regulating agriculture.⁵

The task of this part of the thesis has been:

- (1) to search for any defects in the way that the GATT 1947 rules embodied distinctions between policy instruments; and
- (2) to search for the ways in which the GATT 1947 'failed' in application to agricultural trade by analyzing the way that GATT rules affected trade in agricultural products and identifying and explaining the areas of difficulty;

so as to be able to make an assessment of whether the defects in the embodiment of the distinctions between instruments in the rules contributed to the failures in the application of the rules to agriculture.⁶

Both of those tasks have been completed. The description of the framework of GATT regulation presented in chapter 2, which gave a general picture of the way that the rules influence the choice between policy instruments, has been completed by the detailed description of the rules applying to import barriers, export subsidies and domestic support.⁷ The course of that description has highlighted the extent to which the rules have embodied the distinctions between border instruments and non-border instruments and between price-based border instruments and quantity-based border instruments. Secondly, the description and analysis of the way in which those rules applied to agriculture has drawn out all of the many and varied problems that together constituted the failure of the GATT in application to agriculture.

4 See, above, chapter 8 especially from "7. The Division Between Matters of International Concern and Matters of Domestic Concern Must Embody the Two Distinctions between Instruments" pp192-193 to "8. Embodiment of the Two distinctions in GATT Rules" pp193-195.

5 See, as above, chapter 8 "9. Do These Conclusions Apply to Agriculture?" pp195-199.

6 See the setting out of this task in chapter 1, pp13-16 and in chapter 9, pp204.

7 See above in chapters 11, 12 and 13.

This chapter assesses whether there is a causal link between those flaws in the rules and the failure with respect to agriculture.

2 ABSENCE OF POLITICAL WILL OR DEFICIENCY IN THE RULES

The review of the application of the GATT to agriculture confirms chapter one's general observations that agricultural protectionism was not disciplined to any significant extent by GATT rules. The review of the legal aspects of that application has revealed many difficulties and, generally, it seems that each element of the problems was linked and caused by other elements of the problems and each element was incapable of being remedied in isolation. Each element in the problem seems to have been a step in an uncontrollable chain reaction.

The inability to agree on negotiating rules that could reduce agricultural import tariffs and the inability to agree on narrower exceptions to the prohibition on quantitative restrictions both arose substantially from the presence of so many non-tariff barriers on agricultural products.⁸ The inability to discipline the subsidies on processed agricultural products, like the domestic subsidies disputed in the Canned Fruit case⁹ and export subsidies disputed in the Pasta case,¹⁰ arose from inability to discipline policies which had led to high internal prices in unprocessed agricultural products (in those cases, fresh fruit and wheat, respectively). The inability to discipline export subsidies on primary agricultural products arose in consequence of gross surpluses of agricultural products which had arisen from a failure to discipline policies which had led to high internal prices in those agricultural commodities (and, eventually, to low world prices). The high prices were caused by an inability to discipline import barriers on agricultural products so that not only was no liberalization achieved but the growth of enormous political lobbies for agricultural protection was facilitated. One of the most important failures to discipline import barriers arose out of the deal done between Germany and France in setting an EEC uniform price for wheat at the time the CAP was created.¹¹ That such a deal was possible was due to the absence of a tariff bindings on wheat and on other agricultural products which was due to

8 See, above, chapter 11 "2. Overview of the Negotiation of the Rules on Import Barriers", pp246ff.

9 See chapter 13 on the Canned Fruit case, section 7.2 at pp477-485.

10 See chapter 12 on the Pasta case, 10.2.4 at pp432-436.

11 See chapter 10 at p234.

the original Article XXIV:6 negotiation and the failure to apply the rules of Article XXIV:6.¹² This might also be blamed on the presence of residual balance of payments restrictions. The resulting permission for high protection in the EEC might be blamed on the high priority accorded to the maintenance of security in Western Europe,¹³ on the existence of protection in the USA and also on the pre-existing protected situation of agriculture in Europe. The existence of high agricultural protection in the USA derived from the 1955 waiver. The waiver was a consequence of agricultural surpluses in the USA, the extreme political pressure within the USA, the relative bargaining strength in 1955 of the USA with the rest of the GATT parties and of the previous legal interpretation of Article XXV which itself was substantially influenced by the priority of matters of military security.¹⁴ The political pressure within the USA and the agricultural surpluses in the USA at that time were fed by the continued maintenance of high internal agricultural prices in the USA. That those policies could be maintained was due to the exceptions negotiated in the GATT which themselves were the consequence of the extreme political pressures existing at the time of the original negotiation of the GATT and the resulting compromises. Those political pressures arose in consequence of the pre-existing agricultural policies. The USA compromised its position by arguing for exceptions and omissions so that it could maintain its agricultural policies. The UK compromised its position by arguing that it needed to maintain imperial preferences themselves largely based on maintaining agricultural supplies to the UK and agricultural exports of other commonwealth countries.

One has to consider whether the problems that arose would have arisen regardless of the way in which the rules were constructed and, in particular, regardless of there being a more careful ranking of the incentive to use different policy instruments. The strong pressure to grant the USA's 1955 waiver would still have been present. The overwhelming pressure not to prevent the formation of the EEC would still have been present. There still would have been a Korean war and a Berlin blockade. It seems that whatever the content of the GATT rules adopted in 1948, all of the same pressures would have been there.

12 See chapter 10 under "The GATT Committee Report on the Treaty of Rome" at pp226-231 & under "The Formation of the Common Agricultural Policy and the First Article XXIV:6 Negotiation" at pp231-235.

13 See chapter 10 under "Application of Article XXV to the European Coal and Steel Commission" at pp219-223.

14 As above.

After all, it is only possible to construct an international treaty upon the basis of political agreement and the reaching of political agreement requires that some equilibrium of all of the political forces can be reached. The political environment in which the GATT was negotiated must be taken as a given: the pre-existing levels of protection in the agricultural sector; the insistence by the USA Congress that there be a safeguards exception and an agricultural exception; the concern by all parties about their exposure to balance of payments problems caused by international recession or by competitive devaluations resulting in agreement on a balance of payments exception; the relative strengths of the different economies and the existence of discrimination by the countries of the British empire against other countries. In the face of all of these factors, perhaps, the GATT 1947 was the best political equilibrium that could have been reached in the circumstances.

Given all of these important political factors, is it reasonable to suggest that everything would have been different if the rules had been a more thorough and orderly embodiment of economic theory? Is it reasonable to propose that a neater ranking of instruments might have made the law work despite all of the political pressures that bore down upon it? That proposition that must now be evaluated.

3 DEFICIENCIES IN EMBODIMENT OF DISTINCTIONS BETWEEN POLICY INSTRUMENTS

3.1 THE CONNECTION BETWEEN DISTINCTIONS BETWEEN POLICY INSTRUMENTS AND THE 'FAILURE' WITH AGRICULTURE

Part 2 of this thesis concluded with criteria for the successful operation of GATT rules. Before reaching those conclusions, the previous chapters had identified the transfers and deadweight losses involved in the use of different policy instruments so as to be able to rank them in order of the cost that they impose on the community for the achievement of a given objective¹⁵ and also to rank them in order of the likelihood that they will be chosen by processes of governmental decision making.¹⁶ The conclusions reached were aimed at optimizing the way that the international consequences of compensation and possible retaliation are inserted into the governmental decision making process so as to modify that

¹⁵ See chapter 6 under "3. Summary of Conclusions" at pp139-140 and chapter 8 under "1. Summary of Chapters 3 to 7" at pp173-180 esp the table on p177.

process to make it more likely to choose the lowest cost instrument to achieve any given objective and to do so without restraining the ability of governments to achieve any objectives, including the correction of market failures.

The criteria submitted were the following.¹⁷

- (1) GATT rules must modify political decision making so as to reduce the level of protection.

It was submitted that the rules should facilitate commitments to reduce protection in any form: enlargements of import quotas (to the extent that they are legal), reductions in import tariffs, export subsidies and domestic subsidies.

- (2) GATT rules must modify political decision making so as to make it more difficult to apply border instruments than non-border instruments.

It was submitted that there should be some benefit from replacing border instruments with non-border instruments (like domestic subsidies instead of export subsidies or import tariffs), that the reduction of the level of a border instrument should confer greater benefits than the reduction of the level of a non-border instrument and that the violation of an obligation on border instruments should impose greater costs than the violation of an obligation on non-border instruments.

- (3) GATT rules must modify political decision making so as to make it more difficult to apply quantity-based border instruments than price-based border instruments.

Similarly, it was submitted that there should be some benefit from replacing import quotas with import tariffs. Generally, the balanced of benefits and costs should favour the use of import tariffs over import quotas.

- (4) GATT rules must leave parties substantially free to utilize non-border instruments.¹⁸

16 See chapter 7 under "Conclusions" pp167-171 esp under "The Choice of Policy Instrument" at pp169-170 and chapter 8 under "1. Summary of Chapters 3 to 7" at pp173-180 esp the table on 180.

17 See chapter 8 under "8. Embodiment of the Two Distinctions in GATT Rules" at pp193-195.

18 The end of chapter 8 acknowledged that the analysis of domestic subsidies could be taken further so as to draw distinctions between different types of domestic subsidies.

It was submitted that the rules should accommodate undertakings to reduce domestic subsidies but that there should be a presumption that in the absence of express undertakings, the ability to use domestic subsidies should remain unrestricted. It was acknowledged that this submission was qualified by the fact that the analysis used in this thesis had not attempted to deal with the sub-classifications of domestic subsidies and that further analysis might lead to refinement of this submission. It was stressed though that this limitation of the analysis did not affect the validity of the first three submissions and did not affect the basic submission that guiding parties toward the use of domestic subsidies instead of other instruments resulted in an increase in economic welfare and did not impose any constraint on the ability of governments to achieve non-economic objectives.

3.2 CONSISTENCY OF THE RULES WITH THE TWO DISTINCTIONS BETWEEN POLICY INSTRUMENTS

At the beginning of this part, note was taken of the way that the framework of rules (as described in chapter 2) was in many substantial ways consistent with the criteria as set out above.

- (1) The preference for price-based border instruments over quantity-based border instruments was manifested in the way that a prohibition applied to import quotas whereas a system of bindings applied to import tariffs and that the prohibition on import quotas applied to all products whereas the disciplines on import tariffs applied to products included in a schedule.
- (2) The preference for non-border instruments over border instruments was manifested in the way that import barriers and export subsidies were regulated but domestic subsidies were left substantially unregulated.

However, some inconsistencies were also noted at that stage. In examining in more detail the rules relating to import barriers, export subsidies and domestic subsidies, the consistency with the criteria was further examined. The following section summarizes and elaborates on the findings from that examination.

3.3 DEFECTS IN THE EMBODIMENT OF THE CRITERIA ON POLICY CHOICE

3.3.1 The Rules on Import Barriers

Chapter 11 established that there were a number of ways in which the rules on import barriers, particularly the various exceptions to the general rules, impaired the clear preference for import tariffs over import quotas. The notable deficiencies were:

- (1) The number of exceptions to the prohibition on quantitative restrictions undermined the preference for tariffs over quantitative restrictions. Further comment is made on each of these exceptions. In general, though, none of the exceptions made it any easier to impose a tariff instead of a quota and once quotas were imposed, none of the exceptions required a progressive enlargement of the quotas.
- (2) The existence of so many quantitative restrictions and the ease with which they could be maintained or new ones imposed created a disincentive to negotiating tariff bindings; It was intended that binding be a matter for negotiation and it was envisaged that the system would be able to function even if there were significant numbers of products that were not subject to bindings. However, it was not intended that parties would be reluctant to offer bindings because of the existence of quantitative restrictions or the ease of their introduction.
- (3) The voluntary nature of the rule for giving tariff bindings implicit in the bilateral multilateral system for negotiating tariff bindings created a leeway for unbound tariffs to be varied so that they had the same effect as quantitative restrictions;
- (4) The granting of permanent grandfathered rights for existing import quotas instead of arranging for a transition toward the use of tariffs instead of quotas undermined the preference for tariffs and it also created a disincentive to negotiate tariff bindings on the products subject to grandfathered import quotas;
- (5) The waiver provision did not contain any incentive or reward for resorting to a tariff instead of a quota (or a domestic subsidy instead of a border instrument);

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- (6) The balance of payments provisions certainly did not encourage the use of import tariffs instead of import quotas given that they only expressly provided for import quotas. In addition, the balance of payments eroded the preference for tariffs over quotas and impeded the movement toward lowering barriers because the provisions did not discourage the resort to balance of payments restrictions in ways that were not part of an overall macroeconomic policy to deal with the balance of payments deficit and the provisions did not establish fixed rules for the removal of balance of payments restrictions after their justification had expired;
 - (7) The agriculture exception also undermined the preference for tariffs over quotas and the preference for non-border instruments over border instruments. It had no mechanism for encouraging a shift from protecting farm incomes by dual price systems supported by quotas toward protecting farm incomes with bound tariffs in conjunction with production subsidies and other types of subsidies;
 - (8) The safeguards provision had no provision to discourage the use of quotas instead of tariffs nor did it have any provision to encourage subsidies instead of import barriers. The safeguards provision failed to create an overall framework of rules so that parties would be encouraged, by immunity from retaliation or exemption from having to provide compensation, to adjust to changing import flows by using tariffs and subsidies instead of quotas or instruments having the effect of quotas;
 - (9) Similarly, with the economic development exceptions other than the balance of payments exception, the provisions failed to fit the exceptions into the framework of rules so that developing countries would be encouraged, by immunity from retaliation or exemption from having to provide compensation, to support infant industries by using the less costly policy mixtures of tariffs, export subsidies and production subsidies rather than import quotas. Instead, the economic development exceptions offered no substantial concession from the ordinary Article XXVIII procedure. Therefore, the structure of the various provisions encouraged the resort to import quotas under the balance of payments exception instead of to other instruments under the other economic development exceptions.

3.3.2 The Rules on Export Subsidies

The export subsidy rules and their development over time displays a lack of consensus as to how the rules should distinguish between different subsidies and how the rules on subsidies should fit into the broader framework of rules. It is submitted that the rules should prefer domestic subsidies to export subsidies and should prefer export subsidies to quantitative restrictions. Chapter 12 established that the rules were deficient in embodying an appropriate distinction between export subsidies and other subsidies and between export subsidies and other trade policy instruments.

- (1) The development of the rules was dominated by a preoccupation with trying to regulate export subsidies with prohibitions rather than some consideration of a mode of regulation more like that applied to import tariffs.
- (2) Neither the original rules nor any of the later rules provided a mechanism for negotiating limits to export subsidies.
- (3) The failure to make a clear distinction between export subsidies and other subsidies because of the special treatment made for agricultural subsidies resulted in a more or less equivalent absence of regulation of both export subsidies and other subsidies on agricultural trade.
- (4) Countervailing duty law did not embody a distinction between export subsidies and other subsidies and this resulted in a fall back to determining countervailability on the basis of effects.

3.3.3 The Rules on Domestic Subsidies

The analysis of the original rules on domestic subsidies and their negotiation in chapter 13 revealed two impediments to an incentive structure that would guide parties toward the use of domestic subsidies instead of other instruments.

- (1) The lack of clarity in the agreement as to the application of the provisions on non-violation nullification or impairment, generally, but most importantly, in relation to non-violation subsidies meant that they operated as a disincentive to the giving of

tariff concessions on products upon which it was contemplated that domestic subsidies might be paid or increased in the future. The application of the law in this area revealed a considerable reluctance to constrain domestic subsidies.

- (2) The failure of the rules on countervailing duties to contain any formal distinction between export subsidies and domestic subsidies resulted in disagreement about the application of countervailing duties. The possibility of having countervailing duties levied against domestic subsidies frustrated the creation of an incentive to switch from giving protection by import barrier to giving support by subsidy and failed to create an incentive to switch to using domestic subsidies instead of export subsidies.

The question of optimal countervailing duty law deserves further comment because, since a full analysis is outside the scope of this work, it has not been fully considered. Chapters 12 and 13 explained that the parties attempted to constrain countervailing duties by the measurement of the effects of subsidies using the injury test rather than upon the basis of the difference between the two policy instruments, export subsidies and other subsidies. Whilst generally the injury test will be difficult to satisfy in the case of domestic subsidies, it is submitted that a simpler and more economically sound way to control countervailing duties would have been to make domestic subsidies immune from countervailing duties. Parties would still have been able to resort to the safeguards clause in situations in which subsidized imports caused injury (subject to the different standard of serious injury rather than material injury). It still would have been possible to create a framework in which bindings on domestic subsidies could have been negotiated. In terms of the analysis in chapter 8, there is a simple difference between permitting the imposition of countervailing duties against export subsidies and permitting them against domestic subsidies. The export subsidy is never the best means to deal with a market failure in the domestic economy. The risk of countervailing duties discourages using an export subsidy to correct a market failure. However, the same argument does not apply to domestic subsidies. Although it would be unusual, it is possible that a domestic production subsidy could be the best instrument to correct a market failure so that use of a countervailing duty would be frustrating the

implementation of a welfare improving measure.¹⁹ This approach of permitting countervailing duties against export subsidies only would not necessarily have arrived at the first best policy on countervailing duties because even allowing the use of countervailing duties against export subsidies does not normally achieve an improvement in economic welfare.²⁰ However, limiting countervailing duties to export subsidies would have removed the protective effects of discriminatory countervailing duties to a limited extent and would have provided a clearer incentive to use domestic subsidies instead of export subsidies.

Therefore, there are a number of ways in which the rules failed to use the international consequences of compensation and potential retaliation to create a structure of rules that would guide the behaviour so as to make it more likely that parties would adopt domestic subsidies, export subsidies, import tariffs and import quotas in that order, would shift the implementation of their protection from the latter to the former instruments and would reduce the level of protection by all instruments.

4 PROBLEMS WITH APPLYING THE GATT TO AGRICULTURE

The problems that have been identified with the application of the rules to agriculture are many and varied. The numerous problems were listed at the end of chapters 11, 12 and 13.²¹ It is submitted that a substantial part of those problems arose out of the abovementioned deficiencies in the rules which handicapped the power of the rules to guide parties toward better policy choice. The connection of a number of such problems with the failure to optimally embody the distinctions between instruments in the rules is explained below.

4.1 PROBLEMS WITH THE RULES ON IMPORT BARRIERS

The single biggest element in the failure of the GATT in regulating agricultural policies was the problem with controlling import quotas. The proliferation of import quotas and its

19 In those cases, the subsidies would be correcting market failure and it would be the countervailing duties that introduced inefficiency, see Sykes, Alan O., "Second Best Countervailing Duty Policy: A Critique of the Entitlement Approach" (1990) 21(4) *Law & Policy in International Business* 699-721.

20 See, eg, Trebilcock, Michael J., "Is the Game Worth the Candle? Comments on a Search for Economic and Financial Principles in the Administration of US Countervailing Duty Law" (1990) 21(4) *Law & Policy in International Business* 723-733 reviewing literature on the point (in particular see the conclusions at p732).

21 See ch 11, pp332-333, ch 12, pp338-339 & ch 13 p498.

rippling effects on the operation of other rules of the GATT made it impossible for rounds of negotiations to achieve any significant liberalization of agricultural trade. Firstly, in the face of import quotas, tariff reductions were worthless and, secondly, the existence of import quotas greatly complicated the currency of negotiations which otherwise would have been quantifiable in terms of tariff rates. The protection given by import quotas also facilitated the growth and entrenchment of lobby groups that, in some cases, made it more difficult to achieve liberalization as time went on. There were import quotas under the grandfathering clause, under country specific waivers, under the balance of payments provisions (including the developing country balance of payments provisions), under the agricultural programmes exception, and quasi-import quotas in the form of variable levies and voluntary export restraints.

While the reasons for the difficulties with particular provisions of the GATT are different, there is a single overriding factor relating to the construction of the rules that must be considered. This is that in 1947 when the parties began negotiating on tariff reductions, they had not agreed on an effective regulatory scheme for import quotas. Once the parties had commenced negotiations on import tariffs, as explained in chapter 11, a certain amount of urgency was introduced into the process because the longer the delay, the larger the risk that lobbying would undermine the negotiated reductions. Therefore, the tariff reductions and the time pressure became an impediment to negotiating an effective agreement on abolishing or gradually removing quantitative restrictions.²² Had the negotiators regarded the abolition of quantitative restrictions as their first priority, then they would not have moved on to negotiate tariff reductions until the first priority had been achieved. That is not to say that a prior negotiation of rules on import quotas would have been easy.

Agreement on a prohibition of import quotas would have required an agreement that the domestic objectives sought to be achieved by import quotas could be achieved just as well by other instruments. To have achieved a satisfactory abolition of import quotas would have required, first of all, an agreement on the question of balance of payments restrictions. However, had there been a considerable freedom to introduce temporary import tariff surcharges for balance of payments purposes, it may have been possible to limit

22 See ch11 at p253.

substantially the recourse to quotas for balance of payments purposes. In this study, attention was also directed to the flawed premises of providing the balance of payments exception as a way to remedy macroeconomic problems.²³ Even had that problem not been dealt with completely, the restriction of the balance of payments exception to a mostly tariffs only escape route would have at least had the advantage of making the protective effect of BOP restrictions transparent and increased the pressure to phase them out which would have had a positive effect on liberalization of agricultural trade. It might have prevented or minimized the problems that arose with hard core or residual restrictions. Had the same approach also been taken with the developing country BOP exception in Article XVIII B, then there may have also been more readiness to exchange concessions with developing countries which might have given developing countries more negotiating strength with which to obtain concessions on agricultural products from developed countries.

It would have been necessary to respond to the USA's demands for two other exceptions: one to ensure that the programmes under the *Agricultural Adjustment Act* be protected; and another to provide an emergency safeguards clause. Had the negotiators first priority been to abolish quantitative restrictions, then they would have had to consider how the objectives of the programme protected under the *AAA* could be maintained using other instruments. That consideration would have necessarily involved consideration of how best to frame the emergency safeguards clause. At that time, the programmes under the *AAA* involved dual price policies that required import barriers. However, the import barriers could have been provided by import tariffs. Even if the negotiators had been prepared to permit the USA to maintain unbound tariffs on the relevant products, at least the rate of protection would have been transparent and more susceptible to negotiating pressures. If the USA could have been given a right to maintain unbound tariffs but not to maintain import quotas, then at least there would have remained the possibility that a binding or reductions could have been achieved in a multi product negotiation with the possibility of such a binding or reduction to be linked to other benefits. The permission for the maintenance of the import quota broke the possibility of ever utilizing such a linkage. The maintenance of that linkage may have contributed substantially to the liberalization of agricultural trade.

23 See chapter 11, p287-288.

The achievement of bindings and tariff reductions on products subject to *AAA* programmes would have been substantially affected by the freedom that remained under the safeguards clause to increase the tariff rate in the event of falling prices. Nevertheless, the safeguards clause would still have only provided a temporary escape and for a permanent escape the USA would have had to renegotiate the tariff binding or provide the price support with subsidies instead of import barriers. The clarification that the USA could use domestic subsidies to maintain its income parity objectives might have increased the likelihood that the USA would have given bindings on the products subject to the *AAA* programmes.

Had the first priority of the negotiators been to abolish quantitative restrictions, then the pre-existing restrictions would have been addressed differently. The parties could have required that the existing quantitative restrictions be notified and a negotiation could have been held on the enlargement of these quantitative restrictions. Perhaps, it would have been possible to agree on a progressive enlargement. One must bear in mind that the original negotiators did not have any certainty that there would be recurrent rounds of further negotiations apart from accession negotiations. Nevertheless, it would have been possible to create a framework within which enlargements of the pre-existing quotas could have been negotiated. In this regard, recall that the parties did in fact create a similar framework under Article III:6 for negotiating on grandfathered internal quantitative restrictions.²⁴ A similar approach to grandfathered quantitative import restrictions may have removed or enlarged a significant number of restrictions on agricultural trade.

Even if the rules had brought a more complete prohibition of quantitative restriction into effect, the problems with voluntary export restraints, variable levies, state import monopolies and waivers could still have arisen. The voluntary export restraint, variable levy and state import monopolies problems can be considered only after considering the rules on tariffs.

As to the waiver provision, assigning first priority to eradicating quantitative restrictions might have suggested a wording that distinguished between waivers of Article XI and waivers of Article II. Perhaps, the provision could have offered an escape from Article II subject to a softened application of Article XXVIII and a temporary escape from Article XI

only after that negotiation had been unsuccessful. Regardless of the way in which Article XXV had been drafted, the contracting parties would still have had to make the decision on the ECSC and the focus on the voting rather than the legal requirements may still have occurred. However, the ECSC decision need not have undermined a well-constructed distinction in the rules between waivers of Article II and waivers of Article XI. It may have been possible in 1955 to provide the USA with a waiver of Article II only, which at least would have ensured the transparency of the level of protection.

The achievement of a complete prohibition on quantitative restrictions would have required that the negotiators perceived there to be adequate flexibility in the use of the other instruments, particularly the use of import tariffs. However, the continued political viability of a complete prohibition on quantitative restrictions would also depend on the disciplines on tariffs working effectively enough to constrain levels of protection enough to constrain the growth of lobby groups interested in particular products.

Flexibility in the use of tariffs was in fact provided by Article XXVIII and Article XIX. Two points can be made about these provisions that indicate some deficiencies in the ability of these provisions to guide the choice of policy instrument. With respect to Article XIX, mention was made of the fact that fairly limited recourse was made to this escape clause even though the pre-requisites to invoking it were reasonably easy to satisfy.²⁵ The reason was that the cost of using the clause in terms of the compensation that had to be given or the potential retaliation that might be suffered was little different to that which followed from resort to Article XXVIII. If Article XIX had provided some immunity or concessional treatment in terms of compensation or retaliation, then parties may have used this escape clause rather than other import barriers. In particular, they may not have resorted to voluntary export restraints. In addition, a more flexible safeguards clause might have encouraged more tariff bindings and more tariff reductions, generally, but in particular on agricultural products. A similar argument can be made in respect of the developing country renegotiation provision in Article XVIII A. We observed that it was used much less than the BOP exception in Article XVIII B.²⁶ We also observed that Article XVIII A did not make it

24 See *GATT 1947*, Article III:6, second sentence.

25 See chapter 11 under "Was invocation of Article XIX Difficult?" at pp317-318.

26 See chapter 11, under "4.6 The Exception for Economic Development" pp321-330 at 322.

much easier for a developing country to renegotiate a tariff binding than the ordinary Article XXVIII procedure.²⁷ It would have been more useful if developing countries had received more concessional treatment but had been encouraged to use Article XVIII A rather than XVIII B. Such concessional treatment need not have undermined the liberalization of developing country tariffs. For example, the concessional treatment could have related to the timing of giving compensation rather than the value of compensation to be given. The main point with these exceptions is that the escape clauses needed to be drawn to make it easier to impose a tariff surcharge, particularly a temporary tariff surcharge, so as to maintain the viability of the prohibition on quantitative restrictions.

The failure to obtain more widespread bindings on tariffs on agricultural products meant that the rule in Article II:4 limiting mark-ups could not operate which meant that there could not be any discipline on quasi quantitative restrictions imposed by state run or state authorized import monopolies. In the absence of a restriction on the mark-up, there was no way to control any discretionary decisions by import monopolies to import lesser quantities than could be sold domestically at the world price. Therefore, the failure to devise a system that would result in widespread tariff bindings itself resulted in a proliferation of this kind of quantitative restriction. It is difficult to predict just how much more widespread bindings may have been on agricultural products if the restrictions under grandfathering, BOP provisions and the agricultural exception had been more tightly constrained. Arguably, it might have resulted in a situation in which an effective negotiation on tariffs could be carried out so as to include widespread tariff bindings on agricultural products. However, the prevalence of state import monopolies alone may still have undermined such negotiations from achieving results in the agricultural sector.

Because of the difficulty of regulating discretionary quantitative limits on the purchases of state import monopolies and of the proliferation of state import monopolies in agriculture, unless tariff bindings are widespread, it was difficult to control quantitative restrictions in the agricultural sector and, given the continuing application of quantitative restrictions, it was difficult to constrain the power of lobby groups in that sector. This problem involves the choice of method for tariff negotiations. This is one of the problems with the bilateral-

27 See chapter 11 at pp325-327.

multilateral model of negotiating tariff reductions. We have discussed how in the original negotiation of the GATT, the USA refused to accept an agreement providing for across the board tariff cuts.²⁸ This review demonstrates that after the first three rounds of negotiations, it was clear that the bilateral multilateral model was not going to achieve liberalization in agriculture. In every subsequent round, there has been an attempt to move away from that model for negotiations and, in every round, the failure to move sufficiently away from the bilateral-multilateral model contributed to the failure to achieve significant liberalization in agricultural trade. At each stage, there was some significant party that opposed across the board tariff cuts: in 1947, the UK supported but the USA opposed an across the board tariff cut; in 1955, it was France that proposed across the board cuts and the UK that opposed it; in the Kennedy and Tokyo Rounds the USA supported across the board cuts but the EEC opposed them. Once established the bilateral-multilateral model proved very difficult to change. We observed that the choice of the bilateral-multilateral model resulted in a choice of a method of tariff reductions that could result in net shifts of resources from less protected sectors to more protected sectors thereby not merely resulting in a failure to ensure that gains in economic welfare would be maximized but resulting in a system that in some circumstances could cause net losses in economic welfare.²⁹ It could be added that the same method allows for the possibility of more protected sectors gaining even more political lobbying strength in comparison to other sectors. The additional point that can be made here is that the failure to adopt an across the board method of tariff reductions also undermines the efficacy of the prohibition on quantitative restrictions in sectors where import monopolies are prevalent as was and is the case with the agricultural sector.

The final barrier to be considered is the variable levy and, with respect to that instrument, the arguments made in the immediately preceding paragraph apply directly. The choice of the bilateral-multilateral method enabled agricultural products to be left unbound. As unbound products, the rates of duty could be changed often. In practice, in the EEC, the duty was changed often enough for the application of customs duty to limit imports in the same way as a quantitative restriction. Therefore, the failure to adopt an across the board method of tariff reductions not only impaired the ability to reduce tariffs but it undermined

28 See chapter 11 at pp246-248.

29 See chapter 11 at 248 reflecting the point made in chapter 5 at p122.

the efficacy of the prohibition of quantitative restrictions. It can be admitted that even with the bilateral-multilateral method in place, it may have been possible to negotiate a discipline on the way that tariffs on unbound products could be changed which would have prevented variable levies being used as effective quantitative restrictions. However, such a rule would have had to have been in the rules from the beginning. A midstream agreement on a rule to discipline an instrument used by one party would have been unlikely.

4.2 PROBLEMS WITH THE RULES ON EXPORT SUBSIDIES

At various stages, there were some parties who wanted to include reduction of export subsidies in rounds of multilateral tariff negotiations. However, in the early years, the USA opposed such an inclusion and later the EEC opposed it. Given the absence of rules on export subsidies and the absence of a mechanism for negotiating on export subsidies, it was extremely difficult to create a mechanism for controlling them. Just as attempts to negotiate a rule to control export subsidies were unsuccessful, so were attempts to add negotiations on export subsidies into the tariff negotiation process.

The failure to establish any constraint on export subsidies was to cause significant problems. However, those problems did not arise out of the isolated failure to adopt a better regulation of export subsidies. They arose because of the surpluses that were generated as a result of the failure to reduce the protection given by import barriers. The problems that arose in regulating export subsidies are really another aspect of the construction of rules that did not adequately regulate quantitative restrictions or satisfactorily facilitate tariff reductions in the most protected sectors. Eventually, these problems with the rules on import barriers spilled over into problems with the rules on export subsidies. It is possible, though, that better rules on export subsidies might have prevented some of the problems by requiring parties to adjust to their own excess supply situations internally rather than unload the problem onto the world market.

The difficulties in constructing and applying rules on export subsidies were comprehensively analyzed in chapter 12 and summarized at the end of that chapter.³⁰ That analysis showed that the problems in applying rules on export subsidies arose mostly from

30 See chapter 12, pp332-333.

the lack of agreement on how the rules should be constructed in the first place. Part of that disagreement stemmed from the cross purposes of the different parties engaging in negotiations to agree on rules to govern subsidies which manifested itself most clearly in the Tokyo Round with the USA trying to restrain the use of subsidies and most other countries trying to restrict the use of countervailing duties.³¹ The absence of agreement manifested itself in difficulties in applying the rules because of the difficulties in making judgements about the effects of subsidies, the choice of representative periods, the concept of equitable share, determinations of causation, displacement and the influence of "other factors". The absence of agreement also resulted in some friction over the extension of countervailing duties from export subsidies, to export oriented subsidies, and to specific subsidies. Both the multilateral disciplines on subsidies and the rules on countervailing duties suffered from difficulties in defining subsidies, export subsidies and countervailable subsidies.

It is submitted that the regulation of export subsidies should have been constructed to fit within two principles of preferring export subsidies as a price-based instrument to quantity based border instruments and of preferring non-border instruments to export subsidies as a border instrument. Therefore, control of export subsidies should have been regarded as less important than attaining an abolition of quantitative restrictions and achieving a reduction of import tariffs. Secondly, control of subsidies contingent upon export sales should have been regarded as more important than controlling other types of subsidies.

It is submitted that if, in 1947 and 1955, the parties had clearly established these priorities then they would have ensured that quantitative restrictions could not be raised so high as to result in the production of huge surpluses. However, even if the regulation of import barriers had still been flawed, concentration on these priorities may have led the parties to negotiate bindings of export subsidies, even ceiling bindings, instead of arguing fruitlessly over the framing of a prohibition on export subsidies. The substantial energy devoted to framing of the provisions on subsidies turned out to be an almost complete waste of time because they were so rarely applied successfully. Ideally, if the ceiling bindings had been in the form of per unit amounts, then parties would have had to take the ceiling bindings into account when they established the level of import barriers. In that situation, parties would

31 See chapter 12 under "Negotiation of the Subsidies Code" at pp377-386.

have to consider the consequences of excess supply having to be absorbed within the domestic economy. However, even if the bindings were in the form of expenditure or volume bindings, they would have had similar effects depending on the product specificity of the bindings.

It is further submitted that the possibility of achieving some ceiling bindings on export subsidies would have been high if the negotiation had made it perfectly clear that the bindings would not apply to any subsidies that were not contingent on export performance. A clearer focus on the economic difference between border and non-border instruments would have resulted in the dismissal of arguments relating to the trade effects of domestic subsidies or in the quarantining of the negotiation on export subsidies from any additional negotiation on domestic subsidies. There still would have been little chance that parties would have agreed to any substantial limitation on domestic subsidies. However, it is reasonable to think that an agreement on ceiling bindings on export subsidies could have been reached.

Once such ceiling bindings were in place, then they could have been the subject of further negotiation. In the 1950's when the USA's export subsidies were a concern, it might have been possible to create a linkage between reduction of the USA's bindings on export subsidies and either the bindings of export subsidies of other countries or the bindings on import barriers of other countries. It may have been possible to create a linkage between the application of a formula to tariff reductions with the application of a formula to the reduction of export subsidy bindings. In the situation in which export subsidies were not subject to any quantitative binding, there was no scope for linking their liberalization to liberalization of import barriers. In the case of the experience with the CAP, even if the absence of discipline on variable levies had existed, the existence of export subsidy bindings would have affected the exercise of the EEC's discretion in setting the internal target prices. As the EEC moved from being a net importer to being a net exporter, the EEC would have come up against a ceiling. To avoid surpluses, the EEC would have had to limit support prices. It still could have paid domestic subsidies but the payment of subsidies on every unit of production may have exceeded the EEC budget and threatened the principle of joint financing which itself was one of the keys to holding the community together. Admittedly,

this may have occurred around 1970 when disunity threatened the continued existence of the EEC. This would have been a substantial test for any system of bindings of export subsidies. Whether the system would have withstood the pressures would have depended on how large those pressures were, which would have depended principally on how much more successful regulation of import barriers could have been in the preceding years. If the binding had withstood the political pressure that would have followed the EEC reaching net exporter capacity, then the subsequent surpluses would probably have been much smaller.

The second way in which the parties could have manifested a distinction between subsidies contingent on export and other subsidies was countervailing duty law. This point is elaborated upon in the following discussion of problems with the rules on domestic support.

4.3 PROBLEMS WITH THE RULES ON DOMESTIC SUPPORT

A significant recurring element of the problems involving the application of the rules on domestic support was that those problems were a manifestation of a disagreement over the extent to which parties should have a 'right' to use domestic subsidies. Disputes arose about whether domestic subsidies fitted into the exemption from Article III, whether countervailing duties could be imposed in response to domestic subsidies and whether track 2 remedies could be authorized against domestic subsidies upon the basis of nullification or impairment of the benefit accruing under a tariff concession.

The Article III problem seems to have been resolved with a limitation of the exception to subsidies paid directly to producers. That interpretation is consistent with ensuring that Article III operates to prevent hidden import tariffs.

The fact that countervailing duties could be applied to domestic subsidies on agricultural products did in fact lead to some friction evidencing concern with maintaining a right to grant domestic subsidies. In particular the application of CVDs to the production subsidy in the Greek tomato case was contentious and the precedent set by the application to a regional subsidy in the Michelin case was even more contentious. If countervailing duties on domestic subsidies had been prohibited, parties could still have used safeguard measures in these situations.

The application of the non-violation nullification or impairment rule also aroused significant differences over the 'right' to subsidize. Although the non-violation nullification principles had been adopted in the two early cases, the CONTRACTING PARTIES avoided every other opportunity to confirm those principles in dispute settlement until they were finally confirmed in the adoption of the Oilseeds panel report. The main barrier was that the EEC maintained that it should be able to use domestic subsidies to implement an internal producer price on products on which tariff barriers existed. The EEC blocked the application of the non-violation principles in the Canned Fruit case and finally accepted only a very limited interpretation of those principles in the Oilseeds case but refused to implement the decision until it had been assured that a similar complaint could not occur again under the Uruguay Round *Agreement on Agriculture*.

It is submitted that concept of non-violation nullification or impairment and its accompanying concept of reasonable expectation was used in a way that runs counter to a desirable ranking of instruments. Firstly, the giving of a tariff concession should not automatically be presumed to carry a reasonable expectation that a domestic subsidy will not be introduced: the undertaking to limit an instrument that has both production and consumption effects and is not subject to government budget scrutiny should not carry with it a presumption that the country giving the concession will not introduce an instrument that only has production effects and is subject to budget scrutiny. Secondly, even if a tariff concession does carry with it a reasonable expectation that a subsidy will not be introduced, the law should recognize that a domestic (production) subsidy can only nullify or impair the 'production' effect of the tariff concession and cannot nullify or impair the 'consumption' effect of the tariff concession and that, therefore, the rules should limit the acceptable compensation or the permissible retaliation accordingly.

It is submitted that it would have been better to leave regulation of domestic subsidies to the parties to negotiate commitments. Such an arrangement would have more effectively provided an incentive to use domestic subsidies instead of other instruments.

5 OTHER FACTORS

This analysis has indicated that a more ordered implementation of the distinctions between policy instruments would have improved the regulation of agricultural trade. However, the analysis has also uncovered some other factors that are important. In particular, the importance of dispersion and linkage has emerged. These ideas have not been analyzed in any detail. That omission does not detract from the validity or importance of the arguments made in relation to the distinctions between border and non-border instruments and price-based and quantity-based border instruments. However it is worth mentioning the importance of these ideas.

5.1 DISPERSION

Dispersion was mentioned briefly in chapter 5 as an exception to the general rules that removal of a protective measure increases economic welfare.³² The qualification was that, in a situation in which many prices in an economy are distorted, a reduction of protection for a single product that has a low rate of protection may cause a decrease in overall economic welfare because it has the effect of shifting resources to production of a product with a high rate of protection.

The reduction of dispersion is important because it helps to prevent the formation of strong lobby groups in particular sectors. Therefore, it is important for the rules to reduce barriers in a way that reduces rather than increases dispersion. We observed above that the proliferation of import quotas on agriculture and the failure to adopt an across the board method of tariff reduction permitted the process of tariff reduction to miss agriculture and for extremely strong political lobby groups to be formed in the agricultural sector. Therefore, failure to incorporate a dispersion decreasing mechanism in the rules was also a factor contributing to problems with agriculture. However, a more effective embodiment of the distinctions between instruments would have diminished the dispersion problem.

32 See chapter 5 p122.

5.2 LINKAGE

When protection in particular areas cannot be negotiated in the context of protection in other areas, then the opportunities for successful bargaining are decreased.³³ This was one of the factors relevant to the failure in applying the rules to agriculture. In each negotiation, once the parties permitted an unlinking of the agriculture negotiation from the rest of the negotiation, then it became politically impossible to achieve any liberalization of agricultural trade. Various factors made it, not impossible, but difficult to link negotiations on agriculture with negotiations in other areas. In particular, the prevalence of import quotas on agricultural products meant that parties would not offer anything in exchange for a tariff binding or reduction on those agricultural products. This suggests that to the extent that it might be appropriate for the rules applicable to agriculture to be different from the rules applying to other sectors that it is still essential that whatever differences are permitted, they must not impede the political necessity of maintaining a link between liberalization of agricultural trade and other trade. The importance of linkage reinforces that there has to be a very strict treatment of quantitative restrictions because the presence of quantitative restrictions virtually ensures the delinking of sectors from each other. The absence of quantitative restrictions may not be sufficient to ensure the negotiation of liberalization but it is necessary.

6 CONCLUSIONS

This analysis has made a case for the proposition that the problems with agriculture derived from the way that the framework of rules was set up at the beginning. It has stated the case that the rules do need to distinguish appropriately between the different policy instruments and that the failure to do so effectively was a significant factor in the failures in applying the rules to agriculture.

Part 2 explained how the rules need to operate to overcome the political pressures that make it more likely that government decision making processes will adopt the most costly policy instruments and regardless of instrument will adopt a higher level of protection than would be chosen by a referendum of well-informed voters. It has elucidated the fairly

33 Generally on the importance of linkage in negotiations, see Hoekman, *The Political Economy of the World Trading System*, p63 ff including the references on p83.

straightforward distinctions between instruments which are offered by economic theory. Border instruments are always less costly than non-border instruments because border instruments cause losses through changes to both the decision of producers (production effects) and the decisions of consumers (consumption effects) whereas non-border instruments only ever cause one and not both of such losses with domestic subsidies causing production effects but not consumption effects. Secondly, quantitative border instruments create a loss that can increase without limitation in the context of changes to prices, costs, demand, and exchange rates whereas price-based border instruments cause a loss that is roughly fixed regardless of any such changes. Therefore, to guide parties to achievement of economic benefits requires that the rules insert international consequences into domestic politics in a way that creates an incentive to adopt price-based border instruments instead of quantity-based border instruments and non-border instruments instead of border instruments. Such a set of incentives does not encroach upon the ability of states to achieve non-economic objectives.

The within analysis has demonstrated that the rules did not sufficiently guide the parties' choices in the desirable way. Further, the analysis has demonstrated that many of the problems with application of the GATT to agriculture arose because of the deficiencies in creating the desirable incentive structure in the rules. The parties persistently sought to achieve their non-economic objectives by choosing more costly instruments in preference to less costly ones. The rules did not provide an incentive structure to encourage the choice of less costly policy instruments.

Therefore, this analysis supports the theory offered in Part 2 on the necessary criteria for successful GATT rules. That theory does provide a plausible explanation for the failure of the GATT rules in application to agriculture. The rules were unsuccessful in regulating the relations between states in the field of agricultural policy because the rules were not constructed to guide individual states to the achievement of their internal long term interests in the field of agricultural policy embracing both economic objectives and non-economic objectives. One of the reasons that the structure of the rules was inadequate to achieve the internal long term interest of states in the field of agricultural policy was that it failed to embody appropriately the two distinctions between policy instruments.

It is admitted that this analysis has concentrated on technical considerations and has not given comprehensive consideration to whether it would have been possible in 1947 to reach agreement on a framework of rules which more appropriately embodied the distinctions between policy instruments. The whole question of the construction of rules must necessarily be considered in the light of what was politically feasible. However, the concentration on the economic factors in this study still provides a valuable lesson. The lesson is that if the economic principles are not given due regard in the construction of the rules, then it is possible to predict that the rules will not work.

It is essential in the construction of international economic law that negotiators are conscious of the fact that they are constructing rules which have the purpose of disciplining political forces so as to prevent those political forces from having detrimental effects on economic welfare. If the construction of the rules is left to a political equilibrium without having some ideas imposed on it, then the resulting rules will not be adequate to discipline the very strongest of the political forces that the system needs to discipline. To discipline the strongest political forces requires that the framers of the rules must be guided, not merely by politics, but by the ideas supplied by economic theory. The ideas do matter.

The Importance of Disciplining the Choice of Policy Instrument to the Effectiveness of GATT as International Law Disciplining Agricultural Trade Policies

Part 4

The Uruguay Round Rules on Agriculture

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| Chapter 16 | Introduction to and Outline of Part 4 |
| Chapter 17 | The Uruguay Round Negotiation on Agriculture from Punta Del Este to Brussels |
| Chapter 18 | Distinctions Between Policy Instruments and the Failure to Reach Agreement in Brussels |
| Chapter 19 | From Brussels to Marrakesh – The Conclusion Of the Uruguay Round Negotiation On Agriculture |
| Chapter 20 | Post-Uruguay Round Rules on Import Barriers |
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| Chapter 22 | Post-Uruguay Round Rules on Domestic Support |
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CHAPTER 16

INTRODUCTION TO AND OUTLINE OF PART 4

INTRODUCTION

Having identified certain deficiencies in the way that certain economic theory was embodied in the pre-Uruguay Round GATT and having linked those deficiencies to the difficulties with the application of those rules to agricultural trade, this thesis has accomplished the first of the two tasks set out in chapter 1. The other task set out in chapter 1 is to assess:

- (a) whether any such deficiencies in the rules were remedied in the Uruguay Round in the formation of the GATT 1994; and
- (b) what influence this will have on whether the post-Uruguay Round rules are likely to be successful.¹

This part of the thesis examines the Uruguay Round negotiation on agriculture and the post-Uruguay Round rules applicable to agricultural trade. At the end of this examination, it is proposed to make an assessment of whether the negotiation solved the problems with applying the GATT to agriculture that were identified in Part 3 of this thesis. In particular, it is proposed to assess whether the defects in the rules which were identified in Part 3 and were submitted to have been one of the causes of the problems in applying the GATT to agriculture have been remedied.

The defects that were identified in Part 3 related to the embodiment in the rules of the distinctions between the principal policy instruments that were explained in Part 2. Therefore, the examination of the negotiation and of the rules that were the outcome of that

1 See, above, chapter 1, p14.

negotiation is conducted with a focus on the regulation of the different policy instruments. This has two parts: the negotiation and the final outcome. It is proposed to make an assessment of whether the post-Uruguay Round rules applicable to agriculture appropriately distinguish between price-based and quantity-based border instruments and between border instruments and non-border instruments. In addition, an assessment can also be made as to whether the outcome of the negotiation was influenced by the extent to which the negotiating positions and the conduct of the negotiation were influenced by those two distinctions.

Since the focus is on the emergence of the variables in the negotiation and how they affect regulation of different policy instruments, then certain other important and interesting aspects of the negotiation are not dealt with here. The description of the negotiation does not attempt to cover aspects of internal policy making which affected the negotiation. In particular, the description refers to but does not cover the internal negotiation of the reform of the EEC's CAP. The description deals only in a limited way with the negotiating authority of the USA government which did in fact have an important impact on the timing of the negotiation. It does not with other aspects of the negotiation like, say, services, intellectual property, dispute settlement or the creation of the WTO.

OUTLINE OF PART 4: THE URUGUAY ROUND RULES ON AGRICULTURE

In the agriculture negotiation, the important variables in the negotiation including those relating to the regulation of different policy instruments had emerged by the time of the 1990 Ministerial Meeting in Brussels which had been intended to conclude the Uruguay Round but failed to do so largely because of the inability to reach agreement in the negotiating group on agriculture. After that time, some important political decisions were made and important trade-offs occurred but little in the way of new proposals were made. The final Agreement on Agriculture was significantly based on the draft put forward by the Secretary General of the GATT one year after the breakdown of the Brussels meeting, the Dunkel text.² However, the Dunkel text was based on the ideas that had already been proposed prior to the Brussels meeting. Therefore, it is not proposed to describe in any

² For details of the Dunkel text, see below, chapter 19 at the end of the section headed "1. Post-Brussels"

detail the prolonged political negotiations that occurred between the Brussels meeting in December 1990 and the tentative agreement reached in December 1992 that was adjusted into the final agreement reached in December 1993. It is proposed to describe the variables in the negotiation at the time of the Brussels meeting and to describe how, in the end, the last stages of the negotiation resolved those variables. In particular, the description of the negotiation is interrupted after the Brussels meeting in order to assess how the negotiation was influenced by the distinctions between policy instruments and to assess whether an agreement might have been possible in Brussels if the positions of the parties had been influenced more substantially by the importance of regulating the choice of policy instrument rather than by the motivation of trying to deal with all protection and assistance at once.

Chapter 17 The Uruguay Round Negotiation on Agriculture from Punta Del Este to Brussels

The chapter begins with the negotiating mandate established at the Ministerial meeting in 1986, illuminates the main elements of the major proposals in the negotiation and concludes with the failure to reach agreement in Brussels.

Chapter 18 Distinctions Between Policy Instruments And The Failure to Reach Agreement in Brussels

This chapter assesses the inability to reach agreement in the light of what the negotiating priorities of the parties should have been if determined upon the basis of the arguments made in Part 2 of the thesis about the importance of distinctions between policy instruments in constructing optimal GATT rules.

Chapter 19 From Brussels to Marrakesh - The Conclusion Of The Uruguay Round Negotiation On Agriculture

This chapter briefly describes how the differences between the parties were resolved producing the Uruguay Round Agreement on Agriculture. It describes the role of the 1991 Dunkel text. To avoid duplication in the description of the final Agreement on Agriculture, the description of the Dunkel text is limited to what is necessary to highlight the importance differences between the parties that were resolved in the last part of the negotiation.

Chapter 20 Post Uruguay Round Rules on Import Barriers**Chapter 21 Post Uruguay Round Rules on Export Subsidies****Chapter 22 Post Uruguay Round Rules on Domestic Support**

The next three chapters describe the way that import barriers, export subsidies and domestic supports in the agricultural sector are regulated by the Uruguay Round Agreement on Agriculture. Some consideration is given to the impact of other parts of the Agreement Establishing the World Trade Organization.

Chapter 23 Summary and Conclusions from Part 4

This chapter assesses whether the failures to embody the distinctions between price and quantity based border instruments and between border and non-border instruments in the GATT rules applicable to agricultural trade have been remedied in the course of the Uruguay Round. From that assessment, some predictions are made as to likely future success of the post Uruguay Round rules in liberalizing agricultural trade and achieving conformity with the rules.

CHAPTER 17

THE URUGUAY ROUND NEGOTIATION ON AGRICULTURE FROM PUNTA DEL ESTE TO BRUSSELS

1 THE PUNTA DEL ESTE DECLARATION

The possibility of a new round had been discussed as early as 1983 and continued to be raised as the GATT parties proceeded with the 1982 Work Programme.¹ The first formal discussion of the subject matter of a new round was a meeting in February 1984 of trade ministers of the "quad" - Canada, the EEC, Japan and the USA.² There were a number of factors that led to the initiation of the Uruguay Round, most of them contentious.³ The United States and a number of other countries wanted to extend the GATT system to services and to protection of intellectual property. Developing countries were reluctant to even discuss any international legal obligations in these areas.⁴ However, many developing countries were interested in liberalizing trade in the areas in which the GATT had achieved little liberalization including agricultural products and also clothing, textile and footwear

1 See the description of the lead up to the Uruguay Round in Croome, John, *Reshaping the World Trading System - a History of the Uruguay Round* (World Trade Organization, Geneva, 1995) at pp12-27. Generally, on the Uruguay Round negotiation, the most comprehensive record is Stewart, Terence, P. (ed), *The Uruguay Round - A Negotiating History (1986-1992)* (Kluwer, Deventer, 1993). It contains lists of the documents submitted to the committees in the negotiations. The agriculture negotiation (up to January 1993) is dealt with in Stewart (1993) at 127-254. Also see Preeg, Ernest, *Traders in a Brave New World* (University of Chicago Press, Chicago, 1995), in particular on the agriculture negotiation at pp114-5, 119-122 & 127-147; and Josling, Timothy E., Tangermann, Stefan, & Warley, T.K., *Agriculture in the GATT* (Macmillan Press London & St Martin's Press, New York, 1996) chapter 7 "The Uruguay Round Negotiations" pp133-174.

2 See Croome (1995) at p21.

3 On the commencement of the Uruguay Round and the factors that led to it, see Oxley, Alan, *The Challenge of Free Trade* (Harvester Wheatsheaf, Hemel Hempstead, UK, 1990) esp ch10.

4 On the disagreement about bring new issues into the GATT Round see, Croome, John, *Reshaping the World Trading System - a History of the Uruguay Round* (World Trade Organization, Geneva, 1995) p118-121.

products. In addition, many contracting parties perceived the possibility that the competition between the USA and the EEC in export subsidies on wheat might develop into an all out trade war in which GATT rules would become irrelevant so concern about the future of the GATT system itself was a major reason for parties to discuss the possibility of a new round.⁵ After a couple of years of disagreement, in November 1985, the CONTRACTING PARTIES established a Preparatory Committee to make recommendations on the subject matter and procedures for a new round for adoption at a meeting of ministers to be held in September 1986.⁶

In anticipation of the launch of a new round of multilateral trade negotiations, ministers from a number of agricultural exporting countries, at the invitation of the Australian government, met in Cairns in north east Australia in August 1986.⁷ The 14 countries were: Australia, Argentina, Brazil, Canada, Chile, Colombia, Fiji, Hungary, Indonesia, Malaysia, New Zealand, The Philippines, Thailand and Uruguay.⁸ Subsequently, they were referred to as the Cairns group. These countries had in common that they were suffering as a result of low world prices caused by subsidies of the USA and the EEC and as a result of the general high barriers to agricultural trade. They were concerned to avoid the outcome of previous rounds in which little improvement occurred in the application of the GATT to agricultural trade. They wished to ensure that any ministerial declaration establishing a new round would give an adequate negotiating mandate in relation to agricultural products.⁹

5 A succinct summary of developments in trade relations that threatened respect for GATT principles, see Greenaway, David, "The Uruguay Round: Agenda, Expectations and Outcomes" in Ingersent, Rayner & Hine, *Agriculture in the Uruguay Round* (St Martins Press, Basingstoke & New York, 1994) p8-25 at pp12-15.

6 Croome (1995) p26-27.

7 On 26-27 August 1986. On 28-29 April 1986, representatives of Argentina, Australia, Brazil, New Zealand, and Uruguay met in Montevideo. On 23-25 July, at the invitation of the Thai government, representatives of those 5 countries plus another 7 countries, Canada, Chile, Hungary, Indonesia, Malaysia, Philippines, and Thailand. See Australia, Department of Foreign Affairs, *Trade Negotiations Brief*, Issue No 1, November 1987, p2. Also see Oxley (1990) p118.

8 Note that Fiji was not a contracting party to the GATT but was still a participant in the Uruguay round.

9 Cairns Group, *Declaration of the Ministerial Meeting of Fair Traders in Agriculture*, Cairns, August 1986. Generally, on the formation and objectives of the Cairns group, see Oxley, Alan, *The Challenge of Free Trade* (1990) p111ff; Tyers, Rod, "The Cairns Group Perspective" in Rayner & Hine, *Agriculture in the Uruguay Round* (St Martins Press, Basingstoke & New York, 1994) p88-109 at pp88ff.

The Ministerial meeting commenced on 14 September 1986 at Punta Del Este in Uruguay.¹⁰ The meeting culminated in the issue on 20 September 1986 of the Punta Del Este Declaration¹¹ by which the ministers launched a new round of negotiations, which immediately became known as the Uruguay Round. The part of the declaration which deals with agriculture provides as follows:

The CONTRACTING PARTIES agree that there is an urgent need to bring more discipline and predictability to world agricultural trade by correcting and preventing restrictions and distortions including those related to structural surpluses so as to reduce the uncertainty, imbalances and instability in world agricultural markets.

Negotiations shall aim to achieve greater liberalization of trade in agriculture, and bring all measures affecting import access and export competition under strengthened and more operationally effective GATT rules and disciplines, taking into account the general principles governing the negotiations, by :

- (i) improving market access through, *inter alia*, the reduction of import barriers;
- (ii) improving the competitive environment by increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade, including the phased reduction of their negative effects and dealing with their causes;
- (iii) minimizing the adverse effects that sanitary and phytosanitary regulations and barriers can have on trade in agriculture, taking into account the relevant international agreements.

In order to achieve the above objectives, the negotiating group having primary responsibility for all aspects of agriculture will use the Recommendations adopted by the CONTRACTING PARTIES at their Fortieth Session, which were developed in accordance with the GATT 1982 Ministerial Work Programme, and take account of the approaches suggested in the work of the Committee on Trade in Agriculture without prejudice to other alternatives that might achieve the objectives of the negotiations."

The great significance of the Punta Del Este declaration in relation to agriculture is that it took all of the measures that were described in the report of the Committee on Trade in Agriculture¹² and expressly made them the subject of a round of multilateral negotiations.

10 Croome, p29.

11 "Ministerial Declaration on the Uruguay round, Declaration of 20 September 1986. GATT, *BISD* 33S/19.

12 On the reports of the Committee on Trade in Agriculture, see above, chapter 14 at pp527-530.

This meant that for the first time, the negotiation clearly would embrace non-tariff barriers such as variable levies and minimum import prices and domestic agriculture policies including dual price policies and deficiency payments.

2 STRUCTURE FOR THE URUGUAY ROUND NEGOTIATION

The declaration established a Trade Negotiations Committee ("TNC"), a Group of Negotiations on Goods ("GNG") and a Group of Negotiations on Services ("GNS"). The TNC created a Committee to Monitor the Standstill and Rollback Undertakings contained in the Ministerial declaration.¹³ All of these committees reported to the Trade Negotiations Committee. A decision by the Group of Negotiations on Goods¹⁴ divided the goods negotiation into several negotiating groups thereby creating the following structure:



13 See the Ministerial Declaration, on establishment of the TNC in the first paragraph, the GNG in para G, the GNS in Part II.

14 Decision of the TNC on 28 January 1987, GATT *BISD* 33S/31.

3 THE INITIAL PLAN FOR THE AGRICULTURE GROUP

The negotiating plan for the agriculture group was established by a resolution of the Group of Negotiations on Goods.¹⁵ The resolution set out the negotiating objective as that stated in the Punta Del Este declaration above and adopted the following negotiating plan:

Principal Stages of the Negotiating Process

Initial Phase

- Identification of major problems and their causes, including all measures affecting directly or indirectly agricultural trade, taking into account, *inter alia* work done by the CTA [Committee on Trade in Agriculture], and elaboration of an indicative list of issues considered relevant by participants to achieving the Negotiating Objective.
- The concurrent submission of supplementary information on measures and policies affecting trade in the AG/FOR-series,¹⁶ including full notification of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade.
- Consideration of basic principles to govern world trade in agriculture.
- Submission and initial examination of proposals by participants aimed at achieving the Negotiating Objective.

Subsequent Negotiating Process

- Within this process, further examination as appropriate of proposals and initiation of negotiations.
- Negotiations with a view to reaching agreement on
 - (a) comprehensive texts of strengthened and more operationally effective GATT rules and disciplines;
 - (b) the nature and the content of specific multilateral commitments to be undertaken including as appropriate implementation programmes and transitional arrangements;
 - (c) any other understandings which should also be deemed necessary for the fulfilment of the Negotiating Objective; and

15 "Agriculture, Negotiating Plan" pp39-41 in "Negotiating Plans" Annex 3 to "Decisions of 28 January 1987" GATT *BISD* 33S/31 at 35-28. This resolution of the GNG of 28th January 1987 is also set out in *GATT Activities 1987*.

16 The AG/FOR series was the inventory of non-tariff measures affecting agriculture compiled in the consultation and reporting procedures of the 1982 Committee on Trade in Agriculture: see above ch14, p527.

(d) exchange of concessions, as appropriate."

The Negotiating Objectives and the Negotiating Plan were capable of consistency with a variety of approaches and possible outcomes. Everything was included, though nothing mandatorily, and nothing was excluded. The plan and objectives would have been consistent with rule changes making some policy instruments illegal but would also have been consistent with the making of some reduction commitments on some policies without changing any of the rules relating to any particular policy instruments.

4 OPENING PROPOSALS OF THE EEC AND THE USA

The agriculture group operated under the chairmanship of Mr Aert De Zeeuw who was the former Dutch Minister of Agriculture and had previously been chairman of the Committee on Trade in Agriculture. By the end of 1987, six nations or groups of nations had submitted proposals and a number of others had put statements or communications before the negotiating group.¹⁷

4.1 THE USA PROPOSAL OF 1987

The initial USA proposal¹⁸ was for a complete elimination over 10 years of all import barriers and all subsidies that directly or indirectly affected trade. In addition, to prevent the unloading of surplus stocks during the 10 year period, the quantities of products exported with export subsidies were to be reduced over the transition period. The proposal envisaged two concurrent methods of implementation:

17 See Stewart (1993) p233-234. The proposals were from the USA (MTN.GNG/NG5/W/14), Canada (MTN.GNG/NG5/W/19), the EEC (MTM.GNG/NG5/W/20), the Cairns Group (MTN.GNG/NG5/W/21), the Nordic countries (MTN.GNG/NG5/W/35), and Japan (MTM.GNG/NG5/W/39). These 1987 proposals of USA, EEC, Cairns group and Japan are summarized in Filipek, Jon G., "Agriculture in a World of Comparative Advantage: The Prospects for Farm Trade Liberalization in the Uruguay Round of GATT Negotiations" in (1989) 30(1) *Harvard Int'l LJ* 123-170. The 1987 proposals are also reviewed in Thomas, Harmon, "Agriculture in the Uruguay Round: Interests and issues" in UNCTAD, *Uruguay Round: Papers on Selected Issues* (UN doc UNCTAD/ITP/10, 1989).

18 "United States Proposal for Negotiations On Agriculture" MTN.GNG/NG5/W/14, 7 July 1987. Also reproduced as Appendix 5 to Petersmann, Ernst-Ulrich & Hilf, Meinhard, *The New GATT Round of Multilateral Trade Negotiations - Legal and Economic Problems* (Volume 5 of *Studies in Transnational Economic Law*) (Kluwer, Deventer, 1st ed, 1991). See also "Statement of the US Delegation Presenting a Proposal for Negotiation on Agriculture" presented to the Negotiating Group on Agricultural, Clayton Yeutter, July 6, 1987 reproduced in Yeutter, Clayton, "US Negotiating Proposal on Agriculture in the Uruguay Round" in Petersmann & Hilf, as above, p265 of 2nd ed.

- (1) first, reductions of agricultural support measured in terms of an aggregate measure of support. The aggregate measure would provide a common unit of measurement for all of the different types of policies used to support agriculture. The proposal was largely based on the concept of the Producer Subsidy Equivalent ('PSE') which had been proposed and calculated in OECD work.¹⁹ Reductions of the AMS would be applied to all policies that provide "price, income or other support". Under the heading of "Market price support", specific mention was made of, inter alia, import quotas and variable levies and, under the heading of "Income support", specific mention was made of, inter alia, deficiency payments. The proposal allowed for an exception for "direct income or other payments decoupled from production and marketing"²⁰ which were described by the US delegate as "those policies which do not distort production, consumption or trade."²¹
- (2) secondly, commitments on specific policies in the form of a 10 year plan. The commitments were to take the status of a binding in each country's schedule of concessions.²² The proposal did not go into detail on the type of commitments that would be satisfactory to the USA. Each party's commitments were to "achieve their commitment to reductions in overall support".²³

Finally, the USA proposal called for negotiations to determine the rules which would apply at the end of the transition period. It gave little detail on this aspect except that the rules would have to "reflect the trading environment that w[ould] exist at the end of the transition period".²⁴

19 On Producer Subsidy Equivalents (PSEs), see OECD, "The concept and Measurement of Producer Subsidy equivalents (PSEs) and consumer Subsidy Equivalents (CSEs)" Annex II in OECD, *National Policies and agricultural trade* (OECD, Paris, 1987)pp99-124.

20 MTN.GNG/NG5/W/14, p3.

21 "Statement of the US Delegation" 6 July 1987, as above, p269.

22 MTN.GNG/NG5/W/14, p3.

23 MTN.GNG/NG5/W/14, p3.

24 MTN.GNG/NG5/W/14, p4.

4.2 THE EEC PROPOSAL OF 1987

The EEC proposal²⁵ was vastly different. The EEC had already acknowledged that changes to the CAP were necessary to reduce the volume of production.²⁶ The European Community had begun to discuss the need for prices paid to producers to be more in line with world prices. This meant closing the gap between the prices paid to producers and the world price or even scrapping the dual price systems altogether. There was widespread recognition that the budgetary cost of the CAP was too high. However, in 1987, the political process of change within the Community was at an early stage.²⁷ Importantly, it was committed to utilizing dual price systems.

The EEC's GATT proposal was reflective of the negotiation which was proceeding within the EEC. It proposed a reduction in the negative effects of agricultural support. The concentration on effects rather than measures contrasts with the US proposal to phase out certain measures. The EEC did not propose any phase out of support measures. The EEC proposal set out a two-stage plan:

- (1) emergency measures for the most distorted markets of cereals, sugar and dairy products to deal with falling world prices due to export subsidy competition or stockpiles. These would consist of agreement between exporters on export prices and agreement by holders of stockpiles as to rules on disposal of those stockpiles;
- (2) reductions (of unspecified size) in support and border barriers to reduce internal production incentives.

It was proposed that by the end of the second stage, the GATT rules on subsidies, import barriers and export competition would be supplemented and improved and would become genuinely operational.²⁸

25 "European Communities Proposal for Multilateral Trade Negotiations on Agriculture", MTN.GNG/NG5/W/20, 26 October 1987.

26 A significant example is the publication of the views of the European Commission in EC, *Perspectives for the Common Agricultural Policy*, COM 85, 333, 13 July 1985

27 See Stewart, *The GATT Uruguay Round* (1993) commenting that the EEC "wished to perform critical analysis of the CAP in domestic fora, rather than in the Uruguay Round", Vol 1 p178.

28 On the EEC proposal, see Gavin, Brigid, "A 'Super-Rule' Proposal for Liberalization of Agriculture in GATT - Implications for the EEC" in Petersmann & Hilf (1991) p271-283 at 280-283.

4.3 THE CAIRNS GROUP PROPOSAL OF 1987

The proposal of the Cairns group was more explicit than those of either the USA or the EEC.²⁹ It was similar to the USA proposal in that it provided for a transition period of 10 years. However, the Cairns Group proposal was more specific than the USA proposal both in terms of describing the commitments to be made during a transition period and also in proposing the rules that would apply during and at the end of the transition period. In respect of the final set of rules that should apply, the proposal specified that:

- there should be a prohibition of measures not explicitly provided for in the GATT, including variable levies;
- all existing provisions for exceptional treatment should be terminated, including under waivers, protocols of accession, or other derogations and exceptions (clearly contemplating an end to the USA waiver, and Swiss and Japanese derogations under their accession protocols);
- bindings on all tariffs on agricultural products at low level or zero;³⁰
- prohibition on all subsidies affecting agriculture with limited exceptions including direct income support which is decoupled from production and marketing.³¹

In respect of the transition, the proposal called for a reduction in overall support levels as did the USA and the EEC proposals but referred to a target level rather than a zero level as the USA proposal had done. The proposal described a possible role for a PSE-type measure. The Cairns group proposals for scheduled commitments were more precise. The proposal called for country schedules of commitments to reduce and eliminate trade distorting policies and called for priority to be given to:

- a phase out of direct export subsidies and other production increasing subsidies;³²
- a phase out of non-tariff measures;
- tariff reductions; and
- the enlargement of minimum access arrangements.³³

29 "Cairns Group Proposal to the Uruguay Round Negotiating Group on Agriculture" MTN.GNG/NG5/W/21, 26 October 1987.

30 MTN.GNG/NG5/W/21 at p2.

31 MTN.GNG/NG5/W/21 at p3, para 20.

32 MTN.GNG/NG5/W/21 at p5, para 20 paraphrasing the words of Article XVI:1.

Like the USA proposal, the Cairns group proposal allowed for certain policies to be excepted from the reduction program, including direct income support decoupled from production.³⁴ The Cairns group proposal also introduced the concept of a minimum access arrangement. However, the proposal did not give precise details on how this concept should be used. It merely mentioned "enlargement of minimum access arrangements as applicable" as one of the ways of enlarging import access along with phasing out non-tariff barriers and reducing tariffs.³⁵ It was not entirely clear from the proposal but it appeared that the Cairns group envisaged that these minimum access quotas would only be a temporary arrangement for the period of the implementation period.

4.4 THE DISTANCE BETWEEN THE INITIAL PROPOSALS

It is clear that the initial EEC and USA proposals were poles apart. The EEC member states had not yet decided what to do as amongst themselves on reform of the CAP, so they regarded any discussion of the proposal to reduce support to zero as quite impossible. Consequently, they rejected the reduction to zero support as being completely unacceptable. From the absence of agreement among themselves two things followed. First, they were unable to make commitments on reductions in the support given by the dual price systems. Secondly, they were unable to foresee the future state of their stockpiles and therefore it was also impossible for them to make commitments about the volume of subsidized exports. They argued that the closing of the gap between internal and external prices would be achieved within their internal negotiation and would then be able to be reflected internationally as the closing gap reduced protection in each area:

- the effective rate of protection given by border instruments would fall;
- internal support measured in terms of producer subsidy equivalents or some other measure of support would also fall;
- as production fell the exportable surplus would also fall and with it the use of export subsidies.

33 MTN.GNG/NG5/W/21 at p5, para 20.

34 MTN.GNG/NG5/W/21 at p5, paras 21 & 22.

35 MTN.GNG/NG5/W/21 at p5, para 20.

From the USA point of view, the mere undertaking to bring internal and external prices together was insufficient. It carried no guarantee as to any resulting fall in subsidized exports. The USA was not convinced that the internal negotiation of the EEC would result in reductions of support prices in a way which would reduce stockpiles and in a way which would, in the event of further falls in world prices, actually result in a closing of the gap between domestic and world prices.

The more cynical observers have speculated as to whether the US offer of zero support was made more as an exercise in negotiation than as a genuine offer.³⁶ It was almost certain to be rejected. Such rejection might have freed the USA from having to liberalize its own agricultural sector and, in particular, from having to give up the benefits of the agricultural waiver. However, one should not ignore the fact that, under its 1985 farm legislation (*Food Security Act* of 1985), the USA had already introduced some steps to reduce its own levels of support reversing the escalation of recent years.³⁷ Also, one should remember the attitude of the Presidential administration from which the offer emerged. It was the second term of the Reagan administration which was devoted to a resurgence of free enterprise and free trade economics.³⁸ Whether it was genuine or was game-playing, the zero offer by the USA coupled with its rejection of the EEC proposal to manage prices and stocks, enabled the USA to take the high moral ground³⁹ and to win the public relations battle. It positioned itself as asserting free trade against protectionism and market driven trade against managed trade.

36 Eg, the statement of the West German trade negotiator, Mr Wedige von Dewitz, that the USA zero subsidies position was merely a negotiating position, see Stewart, *The GATT Uruguay Round* (1993) p196 citing "OECD Officials Attempt to Down-Play US-EC Farm Conflict as Ministerial Ends", *Daily Rep Exec (BNA)* A-4 (1 June 1990). Also see Hillman, Jimmie S., "The US Perspective" chapter 3 in Ingersent, Rayner & Hine, *Agriculture in the Uruguay Round* (St Martins Press, Basingstoke & New York, 1994) pp26-53 at p33 ("... there was much talk that its opening position in the Uruguay Round was a 'bluff.'").

37 See Spitze, Robert G.F. & Flinchbaugh, Barry L., "Evolution of US Food and Agricultural Policy: 1970s to 1990s" ch3 in Hallberg, Milton C., Spitze, Robert G.F. & Ray, Daryll E. (eds), *Food, Agriculture, and Rural Policy into the Twenty-First Century - Issues and Trade-Offs* (Westview Press, Boulder & Oxford, 1994) pp41-54 at 50-51 (noting that the *Food Security Act* of 1985 (USA) (PL99-198, 99 Stat 1354) mandated a gradual lowering of price-support and target price levels reversing the escalation that had occurred under the *Agriculture and Food Act* of 1981).

38 For an interesting discussion of the people involved in the formulation of the USA proposals and their ideology, see Preeg, Ernest H., *Traders in a Brave New World* (University of Chicago, Chicago & London, 1995) p96-97.

39 A similar view is expressed by Josling, Tangermann & Warley (1996) pp141-142.

The significance of the US waiver should not be overlooked. Under the protection of the waiver, the US was maintaining quantitative restrictions on a range of products including many dairy products, and some nut, chocolate, fruit and cotton and other products.⁴⁰ If the waiver was to go as part of the Uruguay Round package then it would be necessary to convince Congress to repeal s22(f) of the *Agricultural Adjustment Act* which would require that the Congress be presented with an extremely satisfactory package from the agriculture negotiation and also from the round as a whole. It was in the USA's interest to renegotiate the waiver. The USA had maintained the waiver for so long as a consequence of the position it took in 1955 that unless the waiver was granted, it would leave the agreement. However, the USA could not be content that a two thirds majority could never be mustered to terminate the waiver and would not have wished to be put in a position of having to choose between the termination of the waiver or withdrawing from the Agreement. Even in the event that the USA's zero protection was unachievable, the government still needed the package to be put to Congress to contain favourable elements if it was also to include the amendment of the *AAA* in conformity with giving up the waiver. By negotiating the termination of the waiver, it might be able to obtain some other form of GATT legal protection. Importantly, the level of such alternative protection might be obtained by using the negotiating ammunition given by policies which but for the waiver would have been illegal. An outcome which involved reductions for every one else but which gave the USA new GATT legal protection which could not be removed by a two-thirds majority vote might also convince the Congress to repeal s22(f).

One should give the EEC credit for recognizing that there were two aspects of the problem to be dealt with. First, the distorted price signals given to producers. Secondly, the disposal of the stockpiles. The EEC view that the convergence of prices does operate to remove distortions from import barriers, export competition and domestic production was clearly right even if it would not be sufficient to solve all of the problems particularly the stockpiles. By refusing to negotiate the convergence of the price signals without additional measured commitments to abolish export subsidies, the USA was clearly placing the responsibility for the disposal of the EEC's stockpiles squarely upon the EEC. Judged in

⁴⁰ See GATT, *Trade Policy Review, United States, 1992*, Table AIV.6 at page 264, "Quantitative restrictions maintained under the United States' GATT waivers to Article XXV:5".

terms of legal entitlements, one might well argue that the EEC had caused its own problem and had done so by implementing policies which were arguably illegal. However, in terms of the interests of all contracting parties and the benefits to be derived from change, the EEC surplus was not only the EEC's problem. One might question the wisdom of negotiating as if it were. The positions of the EEC and the USA were a reversal of the positions they had taken in 1955 during the attempt to negotiate rules to regulate subsidies; in 1955, it had been the USA which had surplus agricultural produce and it was the European countries asking the USA not to inflict the consequences of its overproduction on the rest of the world and it had been the USA which had refused to bear the burden of the problem it had caused for itself and instead had insisted on weaker regulation of export subsidies on agricultural products than on other products.⁴¹

Both proposals lacked adequate differentiation between instruments. The USA could have asked for specific commitments reducing import barriers without insisting that domestic subsidies had to be similarly reduced. A middle way could have been suggested for export subsidies, perhaps a binding on the per unit amount without a binding on the volume. Similarly, the EEC could have asked for a right to protect its existing levels of protection and a right to use exports to reduce its stockpiles but still made an offer to bind import tariffs. One was asking for too much and the other was offering much too little, but neither was prioritizing their efforts appropriately to the instruments that did the most damage. The Cairns Group proposal was a little better. It did give priority to the removal of non-tariff barriers but it detracted from a focussing of attention on the level of tariffs by introducing the notion of minimum access opportunities. In addition, it proposed subjecting both export subsidies and domestic subsidies to the same level of reduction, a complete phase out.

The Cairns Group suggestion of minimum access quotas was a response to various problems that could arise in the reform process. First, there would be the situation where there was an existing prohibition. A conversion of a prohibition to a tariff based on the difference between internal and external prices could result in a tariff across which no trade would flow. It was possible that this could be addressed though the formula for tariff reduction. Another possibility would be to require that a minimum quantity of imports be permitted at

41 See the discussion of their roles in 1955, above, in chapter 12 at p362.

a low tariff rate. A second problem would arise in the situation in which there was an existing import quota. There was a choice between leaving the import quotas in place and gradually increasing them or requiring the replacement of the import quotas with bound tariffs and then reducing those. In the event of tariffication, as long as the new bound tariff rate was approximately equal to the difference between the internal and external prices applying under the quota, then the volume of import trade would be the same and could be increased as the tariff rate was reduced. The second choice was preferable because it would remove the discriminatory elements of quotas and would place agricultural tariffs in a situation where further bargaining could be done on the basis of simple tariff exchanges whether in negotiations on agriculture or on all goods. However, one complication was that the exporters who already had access under pre-existing quotas might lose their export share to lower price suppliers. Those exporting countries might be able to complain that their preferential export access had been gained as a result of some other concession which they had given the importing country. Therefore, the issue arose as to whether the unwinding of these former preferential arrangements was something that should be allowed for, or compensated for, in some way within the scope of the agriculture negotiation. It would have been preferable that the disadvantaged countries sought compensation through non-discriminatory liberalization in agriculture or in another sector but that would not have satisfied the particular exporters involved. Some resistance could also be expected from those importing under the pre-existing quotas who were able to skim off a large mark-up for themselves and would not be able to continue to do so if the whole of the difference between internal and external prices went to the government in the form of a tariff. A further problem was that there might be an incentive to cheat in any process of conversion of non-tariff barriers to tariffs and that perhaps this might be less of a problem if the conversion was accompanied by an obligation to maintain the pre-existing level of imports. It is clear that the simplest solution to these problems was a simple conversion to tariffs, which if done correctly would have preserved existing access at the same time as removing discrimination from that existing access, accompanied by a formula for tariff reduction that would have reduced the highest tariffs more significantly. However, there were significant pressures to complicate the process to accommodate existing interests and to create a perception of fairness in the exchange of obligations. At this stage of the negotiation, the only

accommodation of these problems in the USA, EEC or Cairns group proposals was the reference in the Cairns groups proposal to "enlargement of minimum access arrangements as applicable".

5 THE MONTREAL MID-TERM AGREEMENT

Given the vast difference of the EEC proposal from those of the USA and the Cairns group, there was little common basis for a fruitful negotiation. Therefore, the Agriculture group was confined to receiving submissions and identifying problems. Since there was a fairly widespread consensus that the use of an aggregate measure of governmental support might be a useful basis for negotiation, the group established a Technical Group to develop the idea. There was also a consensus that some improvement in sanitary and phytosanitary rules was necessary and feasible, so a sub-committee was established to formulate new rules in this area. However, during the first two years, the Group did not reach any agreement at all on the major issues.⁴²

The TNC decided to hold a ministerial meeting in Montreal from 5 to 9 December 1988 to conduct a mid-term review of the Uruguay round.⁴³ In addition to reviewing progress, the purpose of the ministerial meeting was to give the necessary political commitment to complete the round by the end of 1990. It was envisaged that the ministers would issue clear guidelines for the remainder of the negotiation. The GNG requested each negotiating group to prepare draft decisions for consideration by ministers.⁴⁴

At the beginning of October, as the mid-term review approached, the USA backed off a little from its zero protection in 10 years proposal by indicating that it was prepared to consider the Cairns group proposal as a basis for agreement at the mid-term review.⁴⁵ However,

42 See Croome p116-117,

43 Decision of the TNC of February 1988, see Petersmann, "The Uruguay Round Negotiations 1986-1991" in Petersmann & Hilf, *The New GATT Round of Multilateral Trade Negotiations - Legal and Economic Problems* (Volume 5 in *Studies in Transnational Economic Law*) (Kluwer, Deventer, 2nd ed, 1991) pp511- 577 at 511.

44 Decision of the GNG of September 1988, see Petersmann, "The Uruguay Round Negotiations 1986-1991", p.511

45 See Murphy, Anna, *The European Community and the International Trading System* volume I in *Completing the Uruguay Round of the GATT* (Centre for European Studies, Brussels, 1990) p119 describing the statement of Clayton Yeutter at the meeting of trade ministers in Islamabad held from 1 -3 October 1988 though stating "No change in the US long-term goal of elimination of trade-distorting measures was implied".

there was still a wide gulf between the positions of the Cairns group and the EEC. By the time of the Mid-term review, the agriculture group had not reached sufficient agreement to submit a draft decision to the ministers. The meeting did reach agreement upon 11 of the 15 negotiating subjects, but agriculture was one of 4 groups upon which no agreement was reached at the Montreal meeting.⁴⁶ The Latin American members of the Cairns group insisted that there would be no agreement on other elements of the mid-term package without an agreement on agriculture.⁴⁷ Consequently, no commitment was made to any of the agreements. They were held over to a meeting of the TNC scheduled for April 1989. The ministers requested the chairman of the TNC at official level, Mr Arthur Dunkel (the Director-General of the GATT) to undertake consultations on the four remaining areas.⁴⁸

In March 1989, Mr. Dunkel presented a draft text of the Mid-Term Agreement. However, the differences between the two major parties persisted until the beginning of the meeting of the TNC in Geneva on 5 April 1989. At that stage, it became clear that the entire Uruguay round would proceed no further unless agreement was made at least in a limited way on some guidelines for further negotiations in the agriculture group. A last minute negotiation finally reached agreement on agriculture and, agreement having been reached in the three other difficult areas, on 8 April, the TNC was able to adopt the whole of the Mid-term package of agreements that had been put on hold at the Montreal meeting.⁴⁹

That part of the Mid-Term Agreement⁵⁰ which dealt with agriculture was divided into three sections:

- A. Long-Term Elements and Guidelines for Reform;
- B. Short-Term Elements; and
- C. Sanitary and Phytosanitary Regulations.

46 The others were textiles and clothing, protection of intellectual property rights and reform of the safeguard system, see Petersmann, "The Uruguay Round Negotiations 1986-1991" at p512.

47 See Oxley, *The Challenge of Free Trade* 169-170.

48 See Australia, Department of Foreign Affairs, *Trade Negotiations Brief*, Issue No 5, Feb 1989, p1.

49 See Croome (1993) p178.

50 "Midterm Review Agreements" adopted by the Trade Negotiations Committee 8 April 1989, GATT doc. MTN.TNC/11; (1989) 28 *International Legal Materials* 1025; GATT, *Activities in 1988* (GATT, Geneva, 1989) at p.138-167.

Part B set out a standstill agreement with reporting obligations. Part A dealt with the main areas of contention. The language adopted cleverly steered a conciliatory course so as to maintain consistency with both the USA and the EEC attitudes. It referred to a reform process "through the negotiation of commitments on support and protection"⁵¹ but said nothing on the issue of whether the commitments would relate to specific policies or to some more general measure of support and said nothing about the magnitude of the commitments. It referred to "strengthened and more operationally effective GATT rules and disciplines"⁵² quoting the words of the Punta Del Este Declaration but did not contain a single reference to a particular GATT article or legal issue. On the subject of an aggregate measure of support, it referred to the "negotiation of commitments",⁵³ but on the issue of specific policies and measures it referred only to "negotiations".⁵⁴

However apart from confirming the breadth and purpose of the negotiations as set out in the Punta Del Este declaration, very little in the mid-term agreement indicated any useful agreement. There were perhaps three exceptions to this.

The first area of agreement was the solitary mention in the midterm text of the magnitude of liberalization. This was the reference to "substantial progressive reductions". It is understood that the choice of the words "substantial" and "progressive" was the subject of an intense multilateral negotiation. Some parties were insisting that the EEC and Japan should commit to major reductions in protection. They refused to commit themselves to much more than a commitment to negotiate. However, no doubt with the whole Uruguay Round at stake and perhaps the preservation of the GATT system as well,⁵⁵ there was considerable pressure for the officials involved to agree on a suitable public announcement on the progress of the agriculture negotiation. The choice of words was difficult: major, significant, substantial, progressive. Does the word 'substantial' mean merely more than

51 "Midterm Review Agreements" MTN.TNC/11, Agriculture, para 5 in GATT, *Activities in 1988* at p143.

52 "Midterm Review Agreements" MTN.TNC/11, Agriculture, para 5 in GATT, *Activities in 1988* at p143.

53 "Midterm Review Agreements" MTN.TNC/11, Agriculture, para 6 in GATT, *Activities in 1988* at p143.

54 "Midterm Review Agreements" MTN.TNC/11, Agriculture, para 6 in GATT, *Activities in 1988* at p143.

formal or does it carry an indication of magnitude? Even among people whose first language is the same a word can carry shades of meaning. Among an international forum the problem is increased. This negotiation being a continuation of the Montreal meeting was carried out with all parties represented. While there surely were some side-meetings between the USA and the EEC and between and among various other groupings, it was quite clear that the form of words had to be agreed by all parties to the negotiation and that it had to be done within a few days. As days reduced to hours, the reduction of the negotiation to one over choice of words became stark. It is almost amusing that in what was essentially a question of reaching agreement between the EEC and the USA and occasionally also the Cairns Group, virtually the only genuine international multilateral negotiation in the entire negotiation on agriculture was engaged in over the words "substantial" and "progressive". Apparently, there were even people running around the corridors of the Centre William Rappard⁵⁶ looking for thesauruses⁵⁷ to look up synonyms for "substantial".⁵⁸

The second area of substantive agreement in the mid-term agreement was the work programme set out in clause 11. Parties were invited to submit "by December 1989 detailed proposals for the achievement of the long-term objective, including the following:

- the terms and use of an aggregate measurement of support;
- strengthened and more operationally effective GATT rules and disciplines;
- the modalities of special and differential treatment for developing countries;
- sanitary and phytosanitary regulations;
- tariffication, decoupled income support, and other ways to adapt support and protection;
- ways to take account of the possible negative effects of the reform process on net food-importing developing countries."⁵⁹

Thirdly, the agreement did maintain the breadth of the negotiation by stating that the commitments to be negotiated "should encompass all measures affecting directly or

55 See, eg, Preeg, *Traders and Diplomats in a Brave New World* (1995) p89 noting doubts of many as to the continued relevance of the GATT at this time and the statement by Lester Thurow (Dean of the Sloan School of Management at MIT), in January 1989, that "GATT is dead".

56 The building which houses the GATT Secretariat and GATT meeting places.

57 The Collins dictionary gives the plural of thesaurus as either thesauri or thesauruses.

58 Interview by the author of GATT Secretariat Official, 12 May 1992.

59 "Midterm Review Agreements" MTN.TNC/11, Agriculture, para 11 "Work Programme".

indirectly import access and export competition".⁶⁰ On import access, the Mid-term Review Agreement made particular reference to:

quantitative and other non-tariff access restrictions, whether maintained under waivers, protocols of accession or other derogations and exceptions, and all matters not explicitly provided for in the General Agreement, and the matter of conversion of the measures listed into tariffs;"⁶¹

Thus, it confirmed that the US waiver, grandfathered policies, and grey areas measures like variable levies and minimum price schemes were all on the negotiating table.

On the question of subsidies and export competition, it significantly elaborated upon the words of the Punta declaration which referred to:

increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade.⁶²

The EEC was particularly concerned that it should not have to undertake reduction commitments on export subsidies that would not apply equally to US deficiency payments. The EEC argued that even though its own export subsidies were conditional upon export and the USA's deficiency payments were not conditional upon exports that the deficiency payments should still be treated as export subsidies when they were paid on products that actually were exported. The parties agreed that the negotiations would embrace:

internal support measures (including income and price support) which directly or indirectly affect trade;⁶³

Arguably that covered deficiency payments, but the EEC did not want any distinction between internal support and export subsidies to result in different treatment of its export subsidies from the USA's deficiency payments. They agreed to refer to:

"direct budgetary assistance to exports, and other forms of export assistance",

but the EEC and the USA disagreed on the inclusion of a specific reference to deficiency payments. Finally they agreed on the insertion of the words: "other payments on products exported" to change the text to

60 "Midterm Review Agreements" MTN.TNC/11, Agriculture, para 7 in GATT, *Activities in 1988* at p143.

61 "Midterm Review Agreements" MTN.TNC/11, Agriculture, para 7 in GATT, *Activities in 1988* at p143.

62 *Punta Del Este Ministerial Declaration*, Agriculture GATT *BISD* 33S/19 at 24.

63 "Midterm Review Agreements" MTN.TNC/11, Agriculture, para 7 in GATT, *Activities in 1988* at p143.

direct budgetary assistance to exports, other payments on products exported and other forms of export assistance.⁶⁴

Thus, the negotiation of the mid-term agreement was completed.

Soon after, in July 1989, the TNC met and agreed on a three stage plan for the completion of the Round: first, the period until the end of 1989, for parties to make further proposals, giving further details or proposing compromises; second, in the period until July/August 1990, for negotiators to reach compromises so as to reach broad agreement; and third, for the remainder of 1990 to attend to the details of the legal instruments in readiness for a final meeting of the Round to be held in Brussels.⁶⁵

6 THE 1989 PROPOSALS

In accordance with the mid-term agreement, participants submitted detailed proposals during 1989. These proposals did move the parties closer together but only slightly. None of the proposals had shifted much from the relevant participant's opening position, even though they were elucidated in considerably greater detail.

6.1 THE USA PROPOSAL OF 25 OCTOBER 1989

The USA proposal⁶⁶ made much clearer proposals about permanent changes to the rules to apply to agriculture and about the plan for transition to the improved rules to some extent borrowing from the earlier proposal of the Cairns Group. The proposal submitted a plan for reform which classified support instruments into four categories:

- (1) import access;
- (2) export competition;
- (3) internal support; and
- (4) sanitary and phytosanitary measures (which are not dealt with here).

64 "Midterm Review Agreements" MTN.TNC/11, Agriculture, para 7 in GATT, *Activities in 1988* at p143.

65 Croome (1995) p179.

66 "Submission of the United States on Comprehensive Long-Term Agricultural Reform" to the Negotiating Group on Agriculture, dated 25 October 1989, MTN.GNG/NG5/W/118.

6.1.1 The USA's Proposed Long Term Rules

The proposal envisaged that the long term rules applicable to agriculture would be:

- (i) a prohibition on quantitative restrictions; the proposal referred to a prohibition on variable levies, minimum import prices, VERs, to the elimination of existing waivers, derogations and grandfather clauses and to the removal of Article XI:2(c);⁶⁷
- (ii) tariff bindings on all agricultural products and for those tariff bindings to be at zero or very low levels with some tolerance for developing countries to have tariffs bound at "moderate levels" which would over time be reduced to similar levels to other parties;⁶⁸
- (iii) no specific proposals were made with respect to the rules governing quotas applied by state trading entities but it was implicit in the proposal for comprehensive binding that all state trading operations would become subject to the Article II:4 rule limiting mark-ups;
- (iv) a complete prohibition on export subsidies;⁶⁹ the proposal was ambiguous as to whether some latitude would be allowed to developing countries in respect of export subsidies;⁷⁰
- (v) a complete prohibition on subsidies either in the form of dual price policies that raise domestic prices or in the form of deficiency payments that increase the return from production;⁷¹ (However, the proposal was ambiguous as to whether this prohibition would apply to subsidies in the form of deficiency payments as used by the United States, for the prohibited deficiency subsidies were defined as those income support payments to producers which would not meet the criteria for permitted policies; it was arguable that the USA's deficiency payments with their set aside requirements might fit into a category of permitted policies relating to payments "to remove land

67 MTN.GNG/NG5/W/118, pp3-4.

68 MTN.GNG/NG5/W/118, pp3-4.

69 MTN.GNG/NG5/W/118, pp5-6.

70 MTN.GNG/NG5/W/118, p16 (referring only to "certain subsidies").

71 MTN.GNG/NG5/W/118, p9, para A "Policies to be Phased Out".

or other production factors from agriculture or to facilitate the transition process");⁷² Some latitude was to be allowed to developing countries in respect of these subsidies as long as they progressively reduced such subsidies as their agricultural sector or their overall economy improves.⁷³

- (vi) there would be a binding in terms of Aggregate Measure of Support on those subsidies that were neither prohibited nor permitted;
- (vii) there would be no constraints at all on permitted subsidies which included direct income payments not linked to production, bona fide domestic food aid, general services that did not provide income or price support; and "programs to removing land or other production factors from agriculture or to facilitate the transition process".⁷⁴

No doubt the USA administration would have denied that their proposal was an ambit claim. However, clearly, it was. If they had succeeded in eliminating and prohibiting all manner of non-tariff import barriers, then the damage that could be caused by export subsidies would be unlikely to be large enough to require negotiation of a complete prohibition and if they had succeeded in eliminating and prohibiting all manner of non-tariff barriers and even halving export subsidies, then the damage that could be caused by other types of subsidies would be unlikely to be large enough to require negotiation of a complete prohibition of production or price linked subsidies.

The real problem was that the USA was aware that a reduction of tariff barriers to near zero was extremely unlikely and that with the EEC having significant import barriers still in place, the EEC would still be producing large exportable surpluses. Hence, there was a need to resort to other ways of containing that surplus and its effects on world markets. Clearly, they thought it would be better to negotiate on all strategies at once rather than to argue first on the level of import barriers and then to raise the regulation of subsidies. It is submitted that they were wrong. They could have argued for across the board tariffication, binding and reductions and some not too restrictive binding of export subsidies without worrying at

72 MTN.GNG/NG5/W/118, pp9-10, paras A & B.

73 MTN.GNG/NG5/W/118, p16.

74 MTN.GNG/NG5/W/118, p10.

all about other kinds of subsidies and without risking much difference in the end result. It was likely that the EEC would determine what level of support prices they wanted and that that would determine their offer on total support which would determine their offers on import barriers, export subsidies and domestic support.

6.1.2 The USA's Proposal for Transition

The Proposal called for a transition period of 10 years during which the parties were to be required to comply with specific undertakings to change policies.

(a) Import Access

The USA's implementation submission on import access had a number of key elements most of which were later adopted in the final Agriculture Agreement. The proposal was a complicated mixture of tariff reductions and the conversion of existing import quotas to tariff rate quotas.

(i) Prohibition of Quantitative Restrictions:

From the beginning of the implementation period, no new non-tariff measures would be permitted.

(ii) Tariff Binding

All goods covered by the agriculture agreement would be subject to bound tariffs. On products upon which non-tariff barriers existed, the tariff should be based upon the difference between world prices and domestic prices using a 1986-1988 average.

The proposal implied that in the situation where there existed both a bound tariff and a non-tariff measure then the pre-existing bound tariff would be replaced by the new tariff. The old tariff rate would not even enter into the calculation of the new tariff rate. The calculation would be based solely upon the difference between world price and domestic price. This process would occur regardless of whether the pre-existing non-tariff barrier had been legal or not. The process would leave considerable scope for barriers of doubtful legality to be converted into legal tariffs, though at least they would become bound.

Another significant consequence of the rewriting of tariff bindings relates to nullification or impairment complaints. In such disputes, the relevant date for determining "reasonable expectations" would be the date of the Uruguay Round binding. Effectively only subsidies greater than those existing on that date could constitute nullification or impairment. This might leave scope for subsidies which before the Uruguay round might have nullified or impaired a tariff binding to become unchallengeable from the date of the Uruguay Round binding. However, this would depend on whether the old bindings were deemed to survive the Uruguay Round and would coexist with the new bindings.

(iii) Reductions in Tariffs

The USA proposed that over a ten year transition period, the new tariff rates would subject be to progressive annual reductions to final bound rates which would be zero or low rates.⁷⁵

(iv) Tariff Quotas for Existing or Minimum Access

The USA proposal elaborated a role for tariff rate quotas in the transition process. In addition to the binding and reduction of tariff rates, it was proposed that for a given volume of trade, a lower tariff should apply. These tariff quotas would apply only for the ten year transition period after which the final bound tariff would be the only import barrier.⁷⁶

The USA proposed that all existing non-tariff measures would be replaced with tariff rate quotas. This would apply to all non-tariff barriers including variable levies and VERs, those applying under waivers, grandfathering and under Article XI:2(c). The volume under the quotas would be set at the level "existing in 1990 or some recent historical period" or, in cases in which no trade previously flowed, at a negotiated minimum level. The tariff rate to apply within the quota would be set at a negotiated rate which would be bound.⁷⁷

75 MTN.GNG/NG5/W/118, p5.

76 See MTN.GNG/NG5/W/118, p5: "At the end of the ten-year transition period, Contracting Parties would remove any remaining quotas and the final bound tariffs would be the only form of import protection.

77 MTN.GNG/NG5/W/118, p4

(v) *Enlargement of Tariff Quotas*

The initial quotas would be expanded by agreed minimum volumes during the 10 year transition period.⁷⁸

(vi) *Safeguard Mechanism*

The final element of the import access proposals related to a special safeguard provision to apply only for the transition period. It proposed that in the case of certain quantified increases in the volume of imports, a party would be able to "revert back a specified level of tariff protection for the remainder of the year" before having to resume implementation of the liberalization programme.

(b) Export Subsidies

The USA proposed a phase-out of export subsidies to be followed by a complete prohibition. "Export subsidy" was not defined but was illustrated by the inclusion of the list of illustrative subsidies comprised in the Tokyo Round Subsidies Code. This refers to direct subsidies "contingent upon export performance". Deficiency payments were not specifically on the list, nor did any of the items on the list include them.⁷⁹

The phase-out period was to be five years. It was proposed that reduction commitments be measured in terms of either government expenditures or volume of subsidized product.

(c) Internal Support

As set out above, the USA proposal on domestic subsidies elaborated a traffic light approach to most, less and least trade distorting domestic subsidies that was contained in its 1987 proposal. It was proposed that the prohibition on the red category was to come into effect after a 10 year phase out process. There would also be a 10 year process of reductions to the amber category of subsidies.

78 MTN.GNG/NG5/W/118, p5.

79 With the possible exception of paragraph (l) which refers to: "Any other charge on the public account constituting an export subsidy in the sense of Article XVI of the General Agreement." The words "in the sense of Article XVI" are ambiguous since Article XVI contains no definition of subsidy and in the different paragraphs of Article XVI the references to export subsidies use different wordings. On one view, the words might extend along the lines suggested by Article XVI:3 to "any form of subsidy which operates to increase the export" of a product.

(i) *Policies to be phased out*

For the red category of subsidies including dual price policies which raise domestic prices above world prices and direct payments linked to current production, the USA proposed reductions in 10 equal annual steps culminating in their complete elimination. Parties were to be able to choose their own method of implementing the phase-out which might either be by reducing internal prices or by reducing volumes eligible for support or both. At the end of the phase out period, these policies would be prohibited.⁸⁰

(ii) *Policies to be disciplined*

For the amber category of policies which were not required to be phased-out but did not meet the criteria for permitted policies, reductions of an aggregate measure of support ('AMS') were proposed. The term AMS was used in a narrow sense. It was used to refer only to those kinds of support as would not be prohibited or permitted under the rules to apply at the end of the transition period. Therefore, it did not include support from import barriers, export subsidies or production linked domestic subsidies. The proposal did not quantify the reductions to be implemented.⁸¹

6.2 THE CAIRNS GROUP PROPOSAL OF 27 NOVEMBER 1989

Like the USA proposal, the Cairns group proposal also divided the subject matter into the three areas of import access, internal support and export subsidies.⁸² It expanded on its earlier proposals comprising both a programme for reform and proposals for long term rules. It presented the programme for reform first and the proposals for long terms rules took a subservient position.

6.2.1 The Cairns Group Proposals for Long term Rules

With respect to import access, the proposals were substantially a restatement of the 1987 proposals. Therefore, the United States and the Cairns Group were united in calling for a prohibition on quantitative restrictions, the termination of existing derogations and the

⁸⁰ MTN.GNG/NG5/W/118, p11.

⁸¹ MTN.GNG/NG5/W/118, p11.

⁸² Cairns Group, "Comprehensive Proposal for the Long-Term Reform of Agricultural Trade" dated 27 November 1989, MTN.GNG/NG5/W/128.

binding of all tariffs at zero or low levels.⁸³ The one point of difference related to Article XI:2(c). The Cairns Group proposal called for:

a prohibition on the introduction or continued use of all measures not explicitly provided for in the GATT, including non-tariff barriers and other measures such as variable import levies and minimum import prices;⁸⁴

but it did not mention Article XI:2(c), neither proposing any amendments nor proposing that it be abolished. Within the Cairns group, Canada had indicated that it preferred that Article XI:2(c) be retained and improved.⁸⁵ In addition, this proposal also indicated that, for developing countries, the final bound rates might be higher.⁸⁶

With respect to subsidies, the new Cairns group proposal distinguished between export subsidies and other subsidies. With respect to export subsidies, it repeated its call for a prohibition on export subsidies as made in its earlier proposal and also in the USA proposal.⁸⁷ However, a point of difference between the USA and the Cairns group was that the Cairns group proposal called for appropriate amendments to Article XVI and relevant articles of the *Subsidies Code* in clear contemplation that a new Uruguay Round Agreement on Subsidies would be applicable to agriculture. The Cairns group also called for an amendment to the Agreement to require food aid to be in grant form but did not specify the terms of the amendment, though the suggestion seemed to be that food aid in any other form should be prohibited as an export subsidy.⁸⁸

With respect to internal support, whereas the 1987 proposal had called for a phase out of all production related subsidies, now, the Cairns group adopted the 'traffic light' division between prohibited measures, permitted but disciplined measures and permitted measures. However, it backed away a little from its call for a complete phase-out of all production related subsidies, by failing to specify which subsidies would fall within the prohibited category and which would fall within the permitted but disciplined category. It also

83 MTN.GNG/NG5/W/128, at p5, para 16.

84 MTN.GNG/NG5/W/128, at p5, para 16.

85 See Stewart, p184. Canada subsequently submitted a separate proposal on Article XI:2, "Canadian Proposal on GATT Article XI" MTN.GNG/NG5/W/159, 19 March 1990).

86 MTN.GNG/NG5/W/128, at p9, para 40.2(a).

87 MTN.GNG/NG5/W/128, at p8, para 33.

88 MTN.GNG/NG5/W/128, at p8, para 34.

proposed that the new rules would have to bind the results of the reform programme but did not specify an end point for the reform programme.⁸⁹

It confirmed that the permitted category would include direct income support decoupled from production and marketing. It proposed that the permitted category would have to be subject to tightly circumscribed criteria.⁹⁰ The proposal also indicated that, for developing countries, the permitted category might be broader than for other countries.⁹¹

An interesting addition was a proposal for amendment of CVD rules and proposing that redress for violations must be pursued through GATT dispute settlement procedures.⁹² This proposal was not clear. It seems to have been suggesting that some domestic subsidies ought not to be countervailable and the proposal would have been consistent with making all domestic subsidies actionable only under multilaterally authorized remedies rather than under countervailing duties.

6.2.2 The Cairns Group Reform Programme

The Cairns group proposed that the reform process span 10 years or less during which liberalization commitments must be made. It stressed that the liberalization commitment must apply to all measures, all products and all parties.

(a) Import Access

The Cairns group also proposed that non-tariff barriers be replaced with tariffs and it also proposed a role for tariff quotas. However, the mechanism for instituting this change was different.

(i) *tariffication and prohibition of quantitative restrictions:*

The Cairns Group proposed that all non-tariff barriers not expressly provided for in the GATT be prohibited and that all such existing non-tariff barriers be converted into equivalent ad valorem tariffs subject to a maximum ad valorem level. Apart from use of the words "tariff equivalents" and a specification that "the conversion process must not increase

89 MTN.GNG/NG5/W/128, at p7, paras 27-28.

90 MTN.GNG/NG5/W/128, at p7, para 28.

91 MTN.GNG/NG5/W/128, at p10, para 40.2(b).

92 MTN.GNG/NG5/W/128, at p7, para 30.

protection levels for any product", no method of calculation of tariffs was proposed. The conversion was to apply to all non tariff barriers. Particular mention was made of variable levies and minimum import prices but no mention was made of quotas maintained under Article XI:2(c) leaving open an interpretation that these might not be required to be tariffed.⁹³

(ii) *Binding*

It also proposed the binding of all tariffs on agricultural products regardless of whether or not the tariff rates result from the conversion of non-tariff measures.

(iii) *Reductions in Tariffs*

The Cairns group also proposed that tariffs be reduced over a ten year period to low levels or zero. The proposal made separate proposals for tariffs that would result from tariffication of non-tariff barriers and other tariff rates. This distinction seems to have been made so that any product wide tariff reduction agreement arising from the Round could apply to the existing tariffs on agricultural products and to ensure that it could do so without having its application softened for agricultural products. In practice though, this distinction made the proposal too complicated. For existing tariffs, it proposed that they should be reduced to rates "in line with the average rate for industrial products".⁹⁴ These rates were to be not less than those specified in a product wide tariff reduction agreement and were to accord with a formula which should deal with tariff peaks and achieve lower and more uniform rates. For tariffs resulting from tariffication, the proposal made no further elaboration of what was meant by low rates; for these tariffs, the reductions were to accord with "an agreed formula with a harmonizing effect".⁹⁵ In all cases, the formulas could be supplemented by request and offer negotiations. The proposal indicated that for developing countries, the size of reductions might be smaller and the transition time might be longer.⁹⁶

93 MTN.GNG/NG5/W/128, at p3-4, para 12.

94 MTN.GNG/NG5/W/128, at p4, para 15.

95 MTN.GNG/NG5/W/128, at p4, para 13.

96 MTN.GNG/NG5/W/128, at p9, para 40.

(iv) *Tariff Quotas for Existing or Minimum Access*

Like the USA proposal, the Cairns group proposal also described a role for tariff quotas.⁹⁷ It specified that tariff quotas might be part of the transition process but would be removed at the end of the transition to final bound tariffs. However, whereas the USA proposal contemplated the conversion of all existing non-tariff barriers to tariff quotas, it appears that the Cairns group was proposing the use of tariff quotas in more limited circumstances:

- (1) in the situation, where the tariff equivalent would be too high to permit any trade at all; in this situation, it was proposed that the initial tariff quota should be set by reference to a specified level of domestic consumption or production; this idea of fixing a level of volume of import access, though only proposed as part of a transitional plan, was contrary to the general object of the negotiation which was to enhance the operation of market forces; and
- (2) in the situation where there was pre-existing country specific access, the enlargement of the country specific access on a global basis was proposed as a way to phase out the country-specific access.

(v) *Expansion of Global Tariff Quotas*

The Cairns group proposal also referred to progressive expansion of the tariff quotas.

(vi) *Safeguard mechanism*

The Cairns group merely indicated a readiness to explore an additional safeguard mechanism for agricultural products but stipulated that any such mechanism would be available only in the case of products upon which non-tariff measures have been tariffed.

(b) Export Subsidies

Like the USA, the Cairns group proposed a phase-out of export subsidies to be followed by a complete prohibition. "Export subsidy" was not defined. No timetable for the phase-out was proposed but it was implied that the phase out would occur within the 10 year implementation period.

⁹⁷ MTN.GNG/NG5/W/128, at p4, para 13.

The proposal called for a freeze on export subsidies followed by annual progressive reductions. The group proposed that the limits be measured in terms of both the per unit amount and the total outlay.

(c) Internal Support

The Cairns group's proposal for reduction of internal support was broader than that of the USA. It envisaged reductions that would deal with policies that raise prices to consumers and producers as well as those that raise prices to producers without raising prices to consumers, proposing that the reductions should reinforce commitments on import barriers and export subsidies. The Cairns group reform proposal called for progressive annual reductions based on both

- (i) producer support prices; and
- (ii) Aggregate Measure of Support ('AMS').

Each of these measures should be calculated on a commodity specific basis. Therefore, the Cairns group proposal contemplated that the internal support reductions would apply to all support including that provided by import barriers and export subsidies. Reductions were proposed to start from a base calculated on the average support in the years 1986-1988.⁹⁸

The proposal made provision for the parties to define 'permitted policies' which would not be subject to the reduction commitments. The permitted policies would be restricted to those that are not linked to production or trade.⁹⁹ The proposal indicated that for developing countries this permitted category might be broader. In addition, the proposal indicated that, for developing countries, the size of the reduction commitments would be less.¹⁰⁰

As mentioned, the Cairns group proposal also suggested that the transition period would result in new rules under which policies would be categorized as: (1) prohibited policies, (2) policies that are permitted but disciplined and (3) permitted policies. However the proposal did not set out any criteria for distinguishing between category (1) and category (2). Nor did

98 MTN.GNG/NG5/W/128, at p5-6, paras 17-24.

99 MTN.GNG/NG5/W/128, at p6, para 23.

100 MTN.GNG/NG5/W/128, at p10, para 40.2(b).

the proposal provide for any details of any distinction between these two categories in the way that reduction commitments would be made.

6.3 THE DECISION IN THE OILSEEDS PANEL REPORT GIVEN 14 DECEMBER 1989

The submission of the EEC proposal was conveniently delayed until after the report of the panel in the Oilseeds dispute was handed down.¹⁰¹

In the discussion of the Oilseeds case in chapter 13, reference was made to the relationship between the oilseeds market and the grain market in the EEC. The enormous quantity of USA exports of oilseed to the EEC was facilitated by the zero binding given by the EEC in the Dillon round in 1961. At that time, US-EEC trade in this sector was small. However, as the EEC lifted the price of cereals there had been a shift in demand for animal feeds from cereals to oilseeds and a consequent increase in the quantity of oilseeds demanded. The USA exploited this demand by increasing exports to the EEC which had responded by establishing subsidies for the use of EEC oilseeds. These subsidies were the subject of the oilseeds dispute.

One of the objectives of the EEC's internal reform of the common agricultural policy was to shift some of the demand for animal feeds back from oilseeds to cereals. This would help to control the surpluses in cereals. Such a shift could be achieved by decreasing the price of cereals or by increasing the price of oilseeds. Decreasing the price of cereals was a very sensitive issue which was under consideration. Increasing the price of oilseeds was not feasible without renegotiating the tariff bindings. The EEC internal price to consumers was essentially determined by the price of imports from the US. The price of the oilseeds from the USA was affected by deficiency payments based on a reference price a little less than 10% above the world price.¹⁰²

101 Report of the panel on European Economic Community - Payments and Subsidies Paid to Processors of Oilseeds and Related Animal-Feed Proteins, L/6627, dated 14 December 1989, adopted by the GATT Council on 25 January 1990, GATT *BISD* 37S/86.

102 GATT, *Trade Policy Review, United States, 1992*, Table AV.12, "Trade measures applied in the United States to oilseeds, fats, oils, 1991", p.292; Also see under "Production subsidies" at p135; and Table AV.3 "Summary of Producer subsidy equivalents for the United States, 1982-1990", p.281.

One possible strategy for the EEC was to negotiate a reduction in its own oilseeds subsidies in exchange for a reduction in US deficiency payments and a reduction in the USA's tariffs on oilseeds. The EEC proposal would be expected to divide the negotiation into sectors with reciprocal cuts to be made by both the USA and the EEC in each sector. However, the decision of the Panel was that the subsidies did infringe Article II and did impair the tariff binding. The Panel recommended that the subsidies be brought into conformity with Article III and abstained from making any recommendation relating to the impairment of the tariff binding. The panel decision had two effects on the EEC. First, due to the finding under Article III, the EEC would have to change its CAP for bound products from purchase subsidies into deficiency payments. Secondly, the finding on nullification or impairment, was a threat to the EEC's ability to use its deficiency payments on oilseeds and other grain substitutes as negotiating ammunition in the Uruguay Round.

The outcome on oilseeds was also related to the EEC's capacity to enter into commitments to reduce export subsidies on wheat. If they could not find a way to increase the price of oilseeds then the EEC would be less able than it would otherwise be to effect a shift in demand from oilseeds to cereals. In consequence, it would be less able to control the surplus of cereals which would have to be either exported or accreted to stockpiles. Therefore, the EEC did not want to commit itself to policy specific commitments to limit subsidized cereal exports. However, if the EEC could negotiate an increase in the price of oilseeds, then it would be able to plan for an increase in the consumption of cereals for animal feed and it might become possible for it to make a commitment to limit export subsidies on cereals. The volume of imports of oilseeds was so large that it would have been almost impossible to renegotiate the oilseeds bindings under Article XXVIII because of the difficulty of finding products upon which there was or would be a comparable amount of trade. Therefore, the EEC wished to increase the import barriers for oilseeds without having to use Article XXVIII. This became a central element of the EEC's proposals in the agriculture negotiation. It sought to reorganize its CAP by lowering the support price for cereals at the same time as raising the support price for oilseeds and, to some extent, changing the mechanism of support for oilseeds from a subsidy to an import barrier. The EEC's ability to use the deficiency payments as negotiating ammunition to exchange for increases in import barriers was dependent on it having a legal right to maintain the

deficiency payments. This strategy of increasing protection on oilseeds products and other grain substitutes, the EEC called a 'rebalancing' of the CAP.¹⁰³ This became an important element of the EEC's position in the GATT negotiation.

6.4 THE EEC PROPOSAL OF 20 DECEMBER 1989

The EEC's proposal¹⁰⁴ began with a statement of general principles which demonstrated the vast difference between the approaches taken by the USA and the EEC to reforming agricultural trade. It stressed the special characteristics of agriculture which require special policies but acknowledged that existing policies had caused production which was not demanded by the market. It used the term "structural imbalance". The introductory part of the proposal uses the word "balance" or some derivative of it no less than 7 times.¹⁰⁵ This seemingly innocuous point of linguistics was to take on great significance as the negotiation progressed and the question of "rebalancing" became a major point of contention.¹⁰⁶

The EEC proposal was an insular one. The proposal was clearly driven by the internal EEC negotiation on the reform of the CAP. It was an external manifestation of the likely path of CAP reform rather than a plan for reform of the GATT. The EEC made no proposals for amendment of the long term GATT rules and expressed no concern with continuing to exclude agriculture from the application of the general rules of the GATT. To the extent that the proposal addressed rule changes at all, it was directed to arguing against the USA's tariffication proposal. There were no proposals for changes to Article XVI and there was a specific statement that the Article XI exception (appropriately formulated) should be retained.¹⁰⁷ One paragraph in the EEC's proposal particularly demonstrated the opposition to the USA's approach:

This leads to a very important conclusion: the aim of the negotiation can only be, to progressively reduce support to the extent necessary to re-establish balanced markets and a more market-oriented agricultural trading system. It is

103 See Hathaway, Dale E., "Agriculture", ch2 in Schott, Jeffrey J. (ed), *Completing the Uruguay Round - A Results Oriented Approach to the GATT Trade Negotiation* (Institute for International Economics, Washington DC, Sept 1990) pp51-62 at 54-55.

104 EEC, "Global Proposal of the European Community on the Long-Term Objectives for the Multilateral Negotiation on Agricultural Questions", MTN.GNG/NG5/W/145, dated 20 December 1989.

105 Including one quote from the Punta Del Este Declaration.

106 See McDonald, Bradley J., "Agricultural Negotiations in the Uruguay Round" (1990) 13(3) *World Economy* 299-327 at 306-308.

107 MTN.GNG/NG5/W/145, dated 20 December 1989, p7, para 6.

not to set "a priori" and "in abstracto", a final level of support. The polemic which seems to be resurfacing on such a final objective has a theoretical even an ideological flavour; it disrupts the negotiation by slowing it down and provokes pointless questions on the possibility of applying to the agricultural sector constraints which no one has previously contemplated imposing on other chapters of the negotiations.¹⁰⁸

The EEC proposed a reform programme consisting of reductions to be made in terms of a single aggregate measure of support called the Support Measurement Unit ('SMU').¹⁰⁹ The EEC did not propose any new prohibitions nor did it propose that the reductions should lead to complete phase outs. It proposed that reduction commitments be applied to "all measures which have a real impact on the production decisions of farmers."¹¹⁰ It did not employ the classification into import access, export subsidies and internal support. It argued against making separate commitments on import access saying that these could be adequately dealt with by reductions in aggregate support. It resisted any differentiation between export subsidies and other subsidies or between dual price policies and direct payment policies. The proposal was completely opposed to a distinction between border measures and non-border measures saying that it was:

appropriate to emphasize that any negotiation which focused in priority on frontier measures would in no way contribute ... to an improvement of trade.¹¹¹

No particular rate of reduction was proposed but sector by sector consideration was submitted with the most important sectors listed.¹¹² The Support Measurement Unit was to be calculated by reference to a fixed external price.¹¹³ This meant that reduction commitments would not apply to, nor have to take account of, that part of support which occurs in consequence of falls in the world price (including by virtue of exchange rate fluctuations). Reduction commitments were to be implemented over a period of five years with the possibility of negotiating further reductions.

In essence, the EEC was maintaining its original submission that the narrowing of the gap between domestic prices and world prices would be sufficient to deal with all protectionist

108 MTN.GNG/NG5/W/145, at p.2

109 MTN.GNG/NG5/W/145, pp3-4.

110 MTN.GNG/NG5/W/145, at p3.

111 MTN.GNG/NG5/W/145 at p2, para 3.

112 Cereals, rice, sugar, oilseeds, milk, beef, veal, pigmeat, eggs and poultrymeat; see MTN.GNG/NG5/W/145, p3, para 2.

113 MTN.GNG/NG5/W/145, p4, para 2.

policies. The proposal continued to be a reflection of the fact that there was still a continuing debate within the community as to how to achieve a reduction in agricultural protection and in the cost of the Common Agricultural Policy. Two concerns were important: that exports assisted by deficiency payments should be subject to the same reduction commitments as exports assisted by direct export subsidies; and that the reform process should cause a shift from oilseeds to cereals in the EEC market for animal feeds. However, the dominating factor was the preservation of the CAP. The proposal was almost the same as the Kennedy Round 'montant de soutien' proposal and the simple message was that the CAP was not negotiable.

The segmented approach of dealing with import barriers, export subsidies and internal support separately was a direct threat to the CAP. For that reason the EEC proposal attacked the focus on import barriers and particularly the proposals for tariffication. However, the EEC said that it could consider tariffication if two major elements were to be incorporated into the conversion process:

First, it said:

border protection for the products included on the list of Support Measurement Units, as well as their derivatives and substitutes, would be assured by a fixed component ... completed by a corrective factor in order to take into account exchange rate variations and world market fluctuations which went beyond certain limits to be agreed.¹¹⁴

There are three aspects of this: that border protection would not be reduced to zero but that a certain level of border protection would be assured; that use of something akin to a variable levy should be permissible in response to falls in the world price below an agreed level which would have the effect that the tariff reductions would not have to be greater than those which would have been required under the EEC proposal of disciplining tariff with an AMS calculated using a fixed external reference price; and also it appears to be submitting that in the process of converting a support measure to a tariff, consideration should also be given to imposing tariffs on "derivatives and substitutes" regardless of whether there was any existing support measure affecting those "derivatives and substitutes".

Secondly, it said:

deficiency payments would be treated in the same way and converted into tariffs;¹¹⁵

From these two statements, it appears that they were proposing that all products for which an aggregate measure of support can be calculated should have that support converted to a tariff regardless of whether the support is provided by a border measure or a non-border measure.

Both of these conditions reflect the EEC's negotiating objective of preserving the CAP. The assurance of a level of border protection was essential for preserving a margin for intra EEC preference, one of the fundamental foundations of the CAP, and for maintaining intervention purchase systems within which inter-member EEC cross subsidies were easiest to hide, thereby assisting in the political preservation of another fundamental foundation of the CAP, joint financing.¹¹⁶ These two conditions also reflect the EEC's wish to be able to rebalance protection by imposing tariffs on oilseeds. The second of these conditions also reflects a concern that USA deficiency payments would receive more lenient treatment than the EEC's export subsidies. The other contracting parties perceived the EEC proposal on 'rebalancing' as a backdoor attempt to increase its bound tariff rate on oilseeds without having to go through the normal Article XXVIII procedure.

The EEC's approach to the negotiation was rounded out by the final element of its proposal, the way in which its version of tariffication could apply to export subsidies. It proposed that export subsidies could not exceed the amount levied on imports.¹¹⁷ That would mean that export subsidies would be limited to the sum of the gap between an internal price and a fixed external reference price and also the corrective factor. This would mean that export subsidies could be increased to compensate for falls in the world price to the same extent that import tariffs could be supplemented by the corrective factor.

114 MTN.GNG/NG5/W/145 at p6.

115 MTN.GNG/NG5/W/145 at p.6

116 The three fundamental foundations of the CAP established at the Stresa meeting in 1958 were described above in chapter 10 at pp23. The first of the three foundations was that there should be a single market.

117 MTN.GNG/NG5/W/145 at p6, para 5.

6.5 JAPAN'S PROPOSAL¹¹⁸

With respect to import access and internal support, the proposal of Japan was similar to the EEC proposal and with respect to export subsidies was sympathetic with the USA and Cairns group proposals. This reflects Japan's position as a country whose interest in the Uruguay round lay mainly in areas other than agriculture but whose interest in the agricultural sector lay in wishing to be able to manage its own level of self-sufficiency. Japan maintains substantial protection for its own agricultural producers but does not itself subsidize agricultural exports. Japan was a leading proponent of a right of nations to protect agriculture for non-economic reasons. The Japanese asserted that food security is a fundamental concern which should be accommodated both in the formulation of permanent rules and in the formulation of rules for reduction commitments.

Japan's proposals for long term rule changes were a mixture of protection and liberalization. With respect to import access, Japan sought improved disciplines on variable levies and minimum import prices and on existing derogations and waivers but proposed the introduction of a new exception for import quotas where necessary for the protection of production of basic foodstuffs.¹¹⁹ On export subsidies, Japan proposed that eventually export subsidies on agriculture should be prohibited and that Article XVI would have to be amended accordingly.¹²⁰

Japan proposed a reform programme consisting of reductions in terms of an aggregate measure of support without any specific commitments on any particular types of policies. In relation to the internal support reductions, they submitted that subsidies might be exempt from reductions if they were for the purpose of achieving a particular level of self sufficiency in basic foodstuffs. Another suggestion was that the ratio of imports to consumption should be one of the factors determining the application and extent of reduction commitments.¹²¹

118 "Submission by Japan", MTN.GNG/NG5/W/131.

119 See Stewart (1993), p186.

120 See Stewart (1993), p187.

121 See "Synoptic Table of Negotiating Proposals Submitted Pursuant to Paragraph 11 of the Mid-term Review Agreement on Agriculture" MTN.GNG/NG5/W/150/Rev.1, 2 April 1990, pp4-5.

6.6 OTHER COUNTRIES' PROPOSALS

Many important proposals were made by other countries. Rather than describe them separately, it is analytically easier (even though a little simplistic) to group them.

6.6.1 The Other Agriculture Protecting Countries: EFTA countries, Israel and South Korea

The EFTA countries did not make a joint proposal and there are some important similarities and differences between the positions taken in the Nordic proposal,¹²² and in those taken in the proposals of Austria¹²³ and Switzerland.¹²⁴ All of their proposals together with those of Korea¹²⁵ and Israel¹²⁶ are fairly protectionist in regard to border access and internal support. Of this group, the Nordics were most amenable to comprehensive reform. The Swiss and Austrian positions were more protective than that of the EEC. The Swiss and Austrians were joined by the Israelis in proposals that border access and internal support negotiations be framed around commitments on a determined level of access. The Koreans took a similar position to Japan that favoured the abolition of export subsidies but the retention of domestic protection.

On export subsidies, the Nordics were close to the USA and the Cairns group position seeking gradual elimination.¹²⁷ They sought commitments in terms of government expenditures or volumes. The Swiss argued for a definition of prohibited export subsidies as those that affect price in the import market.¹²⁸ The Austrians took a less strict position, arguing for reductions rather than elimination of export subsidies.¹²⁹

On import access, the Nordics expressed rather ambiguous support for the USA's tariffication proposal by supporting tariffication but allowing for products to be excepted

122 "Submission by the Nordic Countries" MTN.GNG/NG5/W/143, 19 Dec 1989 (Sweden, Norway, Finland and Iceland) summarized in MTN.GNG/NG5/W/150/Rev.1 at p4-5, 17-19 & 30-31.

123 "Submission by Austria", MTN.GNG/NG5/W/144, 19 Dec 1989 summarized in MTN.GNG/NG5/W/150/Rev.1 at pp6-7, 20-21 & 32.

124 "Communication from Switzerland", MTN.GNG/NG5/W/114, 24 Oct 1989 summarized in MTN.GNG/NG5/W/150/Rev.1 at p4-5, 17-19 & 30-31.

125 "Submission by the Republic of Korea" MTN.GNG/NG5/W/130, 28 Nov 1989 summarized in MTN.GNG/NG5/W/150/Rev.1 at pp6-7, 20-21 & 32. See also Stewart at pp188-191.

126 "Communication from Israel" MTN.GNG/NG5/W/153, 13 Feb 1990 summarized in MTN.GNG/NG5/W/150/Rev.1 at pp11-12, 25-26 & 35.

127 See MTN.GNG/NG5/W/150/Rev.1 at p30.

128 See MTN.GNG/NG5/W/150/Rev.1 at p30.

and seeking to retain some quantitative restrictions in exceptional circumstances.¹³⁰ All of Austria, Switzerland, Korea and Israel sought to have Article XI:2 retained in ways that would probably have broadened it. They wanted Article XI:2 to permit quantitative restrictions consistent with a level of import access that would be either negotiated or determined in accordance with non-economic objectives.¹³¹

On internal support, the Nordic position was to support reductions on a specific policy basis, which presumably would enable them to hold out if necessary against reduction commitments on the most sensitive sectors. The other agriculture protecting economies gave very limited support to reducing internal supports. All of them argued that policies seeking non-economic objectives should be exempt from reduction commitments with the Swiss and Israelis also saying that an exemption should apply if negotiated access levels are adhered to, and the Koreans like the Japanese proposing that food security policies should be exempt.¹³²

6.6.2 Developing Country Agricultural Product Exporters

As well as contributing to the Cairns group proposal, Brazil and Colombia made a separate submission which took a harder line on export subsidies and was more demanding on special treatment for developing countries.¹³³ It called for an immediate ban on export subsidies rather than a gradual phase-out. It proposed that the commitments of developing countries in relation to reductions in border barriers and internal support should lag significantly behind reductions by developed countries in border barriers, internal support and export subsidies.

129 See MTN.GNG/NG5/W/150/Rev.1 at p32.

130 See MTN.GNG/NG5/W/150/Rev.1 at p17.

131 Perhaps it is unfair to categorise the Austrian proposal in this way. It concentrates more upon formulation of rules than upon negotiation of a level of access. Nevertheless it argues that policies aimed at limiting the supply on the local market should be protected by Article XI: see MTN.GNG/NG5/W/150/Rev.1 at p21.

132 See MTN.GNG/NG5/W/150/Rev.1 at p4-5 (on Switzerland), p6-7 (on Austria and Korea) & p11 (on Israel).

133 "Communication from Brazil and Colombia on Special Treatment for Developing Countries" MTN.GNG/NG5/W/132, 28 Nov 1989 summarized in MTN.GNG/NG5/W/150/Rev.1 at pp8-10, 22-24 & 33-34.

6.6.3 Developing Country Net Agricultural Product Importers

A significant group of developing countries, whilst supporting the removal of the distortions caused by developing country policies, were concerned particularly about the adverse effects of increased prices for their food imports. This group comprised Egypt, Jamaica, Mexico, Morocco and Peru.¹³⁴

They submitted that the negotiated outcome of the round should include commitments to compensate net-food importers for increased import prices which might result from the removal of developing country subsidies. They were concerned more with other areas of the negotiation and argued that the rules on subsidies should be the same across all products to ensure that they cover products of export interest to food importing countries. They also argued that developing countries should still have flexibility to protect agriculture in accordance with their development objectives.

6.6.4 Least Developing Countries

Bangladesh made a submission on behalf of the least developed countries.¹³⁵ It submitted that the least developed countries should be free to protect and support their agricultural sector with border barriers, internal support and export assistance. It also called for compensation for any increased cost of food imports for net-food importing least developed countries caused by the reform process.

6.6.5 Other Developing countries: India and Mexico

The Indian proposal¹³⁶ made some creative suggestions about the way in which special and differential treatment should apply to the rules governing trade in agriculture. It argued that applying the same obligations and reduction commitments to developing countries modified

134 See "Proposal from the Developing Countries" MTN.GNG/NG5/W/74, 13 Sept 1988, & "Consideration of the Effects of Agricultural Reform on the Net Importing Countries, Proposal by Egypt" MTN.GNG/NG5/W/119, 2 Nov 1989 both summarized in MTN.GNG/NG5/W/150/Rev.1 at pp8-10, 22-24 & 33-34. See also Awuku, Emmanuel Opoku, "How Do the Results of the Uruguay Round Affect the North-South Trade?" (1994) 28 *JWT* 75 at 89.

135 "Proposals on Behalf of the Least Developed Countries, Communication from Bangladesh" MTN.GNG/NG5/W/126, 13 Nov 1989 summarized in MTN.GNG/NG5/W/150/Rev.1 at pp8-10, 22-24 & 33-34. Of the countries which the United Nations classifies as "Least Developed", only Bangladesh, Myanmar, and Tanzania maintained active and continual participation in GATT activities and the Uruguay Round.

only by a time lag or slight reduction was not acceptable and that much greater concessions should be made to developing countries. India supported the elimination of all waivers, derogations, and grey area import barriers. However, it was argued that the obligations to bind all agricultural tariffs and reduce them ought not to apply to certain developing countries. It proposed that the application of these obligations could be made upon the basis of criteria such as per capita income, percentage average monthly income spent on food, and the percentage of population dependent on agriculture for employment. With respect to internal support, India asserted that it was necessary for developing countries to be able to use dual pricing policies and production linked policies.

In addition to supporting the proposal of the group of net-food importers, Mexico made a separate submission.¹³⁷ It is worth noting the position of Mexico because it occupied a unique position of a country in the transition from developing to developed country. It had already entered into negotiations for a free trade area with the United States and although its agricultural sector had been adversely affected by the EEC and USA policies, it had wider interests in the Uruguay round than a number of the developing countries in the Cairns group.

It took a clear position on the need for special and differential treatment to be considered at every stage of the negotiation. It stressed the fact that the greater part of the adjustment caused by reform must be carried by the developed countries that have caused the distortions. However, it did not make specific proposals about tariffication and binding, nor about the permissibility of production linked internal support. One senses that Mexico was caught between a genuine desire to maintain its allegiance to the developing countries by placing the obligation to reform squarely upon the developed countries and a desire to maintain the benefits that flow from its relationship with its northern neighbour.

7 THE DE ZEEUW TEXT

After receipt of the proposals, the Chairman of the Agriculture Negotiating group, Mr. Arthur De Zeeuw, attempted to find common ground between the parties. During the first

136 "Indian Proposal", MTN.GNG/NG5/W/84, 14 November 1988 summarized in MTN.GNG/NG5/W/150/Rev.1 at pp11-12, 25-26 & 35.

half of 1990, he met with many delegates to clarify their proposals and to ascertain their attitudes to other countries proposals. For the same purpose, he issued a list of questions to the parties. In addition, the secretariat prepared a synoptic table summarizing the various proposals.¹³⁸

The synoptic table was issued in April 1990. By then, the various discussions and the answers to the questions had led many participants to the conclusion that the parties' positions were so far apart that it was unlikely that the multilateral negotiating process was going to lead to a workable draft text of an agreement. Negotiations continued in a group of 8 to try to reach some common ground for negotiations.¹³⁹ It became clear that neither the USA nor the EEC was going to produce a proposal that the other would be prepared to use as a basis for negotiation. There was a growing feeling that the only way to progress the negotiation was for someone else to propose a draft agreement. Since De Zeeuw was the leader of the group, he was the one that various delegations approached with their suggestions. The schedule for the completion of the Round called for a draft text to be put forward by July/August. With that deadline approaching, eventually, De Zeeuw took it upon himself to prepare a draft agreement.

With the assistance of the agriculture department of the GATT Secretariat, Mr De Zeeuw prepared a 'Framework Agreement'¹⁴⁰ (also referred to as the 'De Zeeuw Text') which was circulated on 27 June 1990.¹⁴¹ It was hoped that the text would be the basis of a final agreement to be adopted at the proposed final meeting of the Uruguay Round in Brussels in December 1990.

Mention has been made of the dichotomy between two approaches: the rules approach, that of negotiating improvement in the substance and the application of rules; and the commitments approach, that of negotiating modifications to particular policies of particular

137 "Statement by Mexico on Special and Differential Treatment for Developing Countries", MTN.GNG/NG5/W/102, 21 July 1989.

138 "Synoptic Table Of Negotiating Proposals Submitted Pursuant To Paragraph 11 Of The Mid-Term Review Agreement On Agriculture, Note by the Secretariat"; MTN.GNG/NG5/W/150/Rev.1; 2 April 1990.

139 See Croome (1995) p235. The group of 8 consisted of USA, EEC, Japan, Canada, Australia, Argentina, Finland and New Zealand.

140 "Framework Agreement on Agriculture Reform Programme, Draft Text by the Chairman", MTN.GNG/NG5/W/170, 11 July 1990

countries. It is clear the framework of GATT 1947, consisting partly of legal obligations arising under general rules which apply to all products and all parties and partly of concessions in a country's schedule relating to particular products was capable of accommodating the rules approach or the reductions approach.

Until the presentation of the De Zeeuw text, the Uruguay round negotiation had not focussed on the choice between changing rules and making reduction commitments. Both approaches had been accommodated by the wording of the Punta Del Este declaration and the Montreal Mid-Term Agreement. However, the De Zeeuw text firmly laid the basis for progress in the round upon the commitments approach. The text required submission of "country lists". These lists were requested in a form that would facilitate rewriting them as concessions in each country's schedule of concessions.

The De Zeeuw Framework Agreement was divided in a way that clearly placed the negotiated changes to policies in the foreground and the possibility of negotiating changes to rules in the background. The divisions in the text included the following:

- (1) Parts A, B & C set out the general principles and the implementation method for changes to policies (but, apart from the words 'progressive' and 'substantial', nothing about the magnitude of any policy changes); Parts A, B, and C dealt in turn with internal support, border protection and export competition;
- (2) Part D referred to the negotiation of the extent and timing of changes; and
- (3) Part F referred to the negotiation of changes to GATT rules.

Only Parts A, B, and C had any detail. Part D did not suggest any particular rate of reduction in protection, nor any timeframe. Part F did not suggest any specific changes to GATT rules. In the more detailed provisions of Parts A, B, and C, it is noticeable that most of the text deals with the submission of country lists. Although the way in which the lists were requested implied a possibility that certain principles might be adopted, the request for lists was not in itself a statement of principle. This kind of drafting was a consequence of the state of the negotiation. The text (surely deliberately) permitted the EEC to go along with the procedure of submitting country lists without placing it in a position where it could

be alleged to have agreed with the principles which were arguably embodied in the text. It is clear that the text was designed to invite the EEC to nominate the magnitude of policy reductions but within the framework of specific commitments. The structure of the text was based on the USA and Cairns group proposals, in particular, appearing to bear the imprint of consultations with the Cairns group. The text began with internal support, the part which was most capable of being construed as consistent with the EEC's approach.

7.1 PART A - INTERNAL SUPPORT

On internal support, the text adopted the aggregate measure of support ('AMS') concept providing that the AMS was to be bound and reduced by agreed amounts over an agreed period. However, the AMS was defined with a major concession to the EEC proposal. The value of the AMS was to be calculated by reference to a fixed external reference price which would be based on 1986-1988 data.¹⁴² This was an acceptance of the EEC position that increases in the margin between internal prices and world prices caused by falls in the world price (including through exchange rate fluctuations) should not flow through into calculation of the AMS. This would have two effects: first, reductions in intervention purchase prices would not have to be augmented in response to falling world prices; and, secondly, deficiency payments could be increased to compensate for falling prices. The text provided that the fixed reference price might be reassessed.

In line with the omission of any specified rate of reductions, the Framework agreement discarded the requirement for a complete phase out of any type of internal support and, with it, the three way traffic light subdivision in favour of a two way division between internal support subject to AMS reductions (which became known as the 'amber box') and internal support not subject to AMS reductions (which became known as the 'green box'). The EEC, USA and Cairns group had been agreed that measures which raised prices to consumers or producers would not be in the exempt category. The De Zeeuw text utilized this agreement by providing that the AMS reduction commitments would apply to:

- "market price support, including any measure which acts to maintain producer prices at levels above those prevailing in international trade..."; and

142 MTN.GNG/NG5/W/170, para 5.

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- "direct payments to producers other than those which may be exempted on the basis of the agreed criteria, including deficiency payments".¹⁴³

Inclusion in the exempt category was dependent upon the policy not raising prices to consumers ("not involving transfers from consumers") or producers ("not have the effect of providing price support").¹⁴⁴ However, the limitation of the exempt category went further in ways drawn from the USA and Cairns group proposals and clearly contrary to the EEC proposal. The proposed further limitations on permitted policies were that they would:

- "not ... be linked to current or future levels of production or [even] factors of production, except to remove factors from production";
- not be product specific; and
- in the case of income safety-net programmes, ... not maintain producer incomes at more than [x] per cent of the most recent three year average".¹⁴⁵

Developing countries were to be given a broader permitted category but not so broad as to include policies which increased domestic prices above world prices.¹⁴⁶

Although a broad construction of "market price support" might be taken to include support from import barriers and export subsidies, the internal support proposal appears to contemplate that the AMS would be a mechanism for reducing support through measures other than border measures and export subsidies. In any case, the framework agreement provided separately for specific commitments on both import barriers and export subsidies.

7.2 PART B - BORDER ACCESS

On border access, requirements for the country lists were consistent with a contemplation that commitments would be made essentially in the manner proposed by the USA and the Cairns group. The country lists were to cover all products. The essence of the commitments was that:

- for products not subject to non-tariff barriers, existing tariff rates would be bound;

143 MTN.GNG/NG5/W/170, p2, para 4.

144 MTN.GNG/NG5/W/170, p3, paras 8(a) & (d).

145 MTN.GNG/NG5/W/170, p3, paras 8(b), (c) & (e).

- for products subject to non-tariff barriers, non-tariff measures would be converted to tariff equivalents equal to the difference between external and internal prices (based on the most recent prices available); tariffication was to apply to all products and to all measures (there was no reference to any possible exception for measures maintained under Article XI:2(c)); (The text followed the tariffication method of the Cairns groups 1989 proposal so that, under both proposals, non-tariff barriers were to be converted to simple bound tariffs rather than to tariff quotas as under the USA's 1989 proposal. In cases where tariff quotas would be established, the tariff equivalent of the pre-existing non-tariff barrier would become the out of tariff quota bound rate.)
- all tariff equivalents would be bound;
- all tariffs and tariff equivalents would be reduced "substantially and progressively" at a rate and over a timetable to be agreed; the rate would be an average rate to permit lesser rates for particular products.¹⁴⁷

The proposal also addressed the issues of current access and minimum access:

- parties would be required to maintain existing import access opportunities; the use of tariff quotas was proposed as one way to maintain the existing import opportunities (in addition, to binding tariff equivalents);
- in cases in which there was not any significant volume of imports, parties would be required to establish tariff quotas at a low or zero rate to permit a minimum level of access equal to a negotiated percentage of current domestic consumption.¹⁴⁸

The tariff quotas would have to be expanded at a average rate and over a timeframe to be agreed. All expansions of the tariff rate quotas would be on a MFN basis.¹⁴⁹

The framework agreement contemplated that developing countries might implement their commitments "in a way commensurate with their development needs" but did not indicate that their commitments would be any less than those of developed countries.¹⁵⁰

146 MTN.GNG/NG5/W/170, p3, paras 8(b), (c) & (e).

147 MTN.GNG/NG5/W/170, p4, paras 12(a), (b) & (e), & 14.

148 MTN.GNG/NG5/W/170, p4, paras 12(c) & (d).

The text also provided for a special safeguards provision to apply to agriculture. The provision would permit temporary tariff increases without compensation in case of import surges or falls in world prices beyond limits to be agreed. The text did not stipulate that the tariff surcharges had to be imposed on an MFN basis but nothing in the text was inconsistent with that.

7.3 PART C - EXPORT COMPETITION

On export competition, the text adhered closely to the words of the mid-term agreement calling for "direct budgetary assistance to exports" and "other payments on products exported" to be "substantially and progressively reduced".¹⁵¹ The text contained two matters of substance on the guiding principles: that commitments must relate to specific policies rather than to any aggregate measure of support, and that reductions on export assistance should be of greater magnitude than reductions of other support and protection.

The country lists were to disclose information on a list of measures impliedly regarding them as export subsidies without expressly saying that the list of measures was a list of export subsidies. The words of the Montreal mid-term agreement on "other payments on products exported" (which reflected the contention over whether deficiency payments should be treated the same as export subsidies) were manifested in the list of measures as

payments to producers of a product which result in the price or return to the producers of that product when exported being higher than world market prices or returns.¹⁵²

This strikes the author as a deliberate ambiguity. The words could be interpreted as meaning payments that give a higher price to the producer only when the product is exported (which would not include the USA's deficiency payments) or as giving a higher price to the producer, among other instances, when the product is exported (which would include the USA's deficiency payments).

The list also included:

149 MTN.GNG/NG5/W/170, p4, para 14.

150 MTN.GNG/NG5/W/170, p5, para 15.

151 MTN.GNG/NG5/W/170, p5, para 17; see also "Midterm Review Agreements" MTN.TNC/11, Agriculture, para 7 in GATT, *Activities in 1988* at p143.

152 MTN.GNG/NG5/W/170, p6, para 20(b).

subsidies on agricultural commodities incorporated in processed product exports.¹⁵³

However, the framework agreement said nothing more about the question that had had been the subject of the EEC Pasta dispute. Of course, it was in contention whether export subsidies on processed products incorporating agricultural products would be subject to the rules in the Subsidies Agreement or to the rules in the Agriculture Agreement. Although the submissions of the parties had provided for definition of the scope of products to which the Agriculture Agreement would apply, the framework agreement was silent on this issue. De Zeeuw had chosen to deal with this issue by keeping it on the agenda and providing a framework for gathering information about subsidies on processed products incorporating agricultural products. This was part of a broader question before both the negotiating group on agriculture and that on subsidies of whether the general Subsidies Agreement should apply to agriculture or whether it should exclude agricultural products from its application.

The framework agreement called for the lists to include information about all of the listed measures in three ways:

- financial outlays or revenue foregone;
- quantities of subsidized exports; and
- subsidies per unit of the quantity of subsidized exports.

7.4 STAGE 2 - NEGOTIATING THE REDUCTION TARGETS AND RULE CHANGES

The agreement provided that after the tabling of the country lists, then the parties would engage in two simultaneous negotiations:

- negotiation of the size of reductions and a timetable for them; and
- negotiation of changes to rules.¹⁵⁴

153 MTN.GNG/NG5/W/170, p6, para 20(h).

154 MTN.GNG/NG5/W/170, p7, para 24).

8 FROM DE ZEEUW TEXT TO BRUSSELS

The De Zeeuw text was accepted as a usable basis for negotiations by most parties including the USA and the Cairns group.¹⁵⁵ However, the text was rejected by the European Community.¹⁵⁶ It rejected the distinction between the three areas of border access, export subsidies and internal support. It held to its position that adjustment to aggregate levels of support was the appropriate way to implement reform. It rejected the use of specific commitments in terms of changes to specific policies. The EEC conceded to the text being used as a means of intensifying negotiations but did not accept the framework of the text.¹⁵⁷ The consequence of the EEC's rejection of the text was that it could not be used by the Agriculture Committee as a basis for further negotiation. However, even though the text was rejected, the supporters of the text including Mr De Zeeuw in his position as chairman were able to salvage the parts of the text that related to the submission of country lists. This at least kept the negotiation going and held out a faint hope that the country lists would facilitate an agreement by the time of the Brussels meeting in December. The "country lists" were due on 1 October 1990.¹⁵⁸ In addition to the country lists, the Chairman also called for any other negotiating proposals to be submitted by 15 October. The procedure established was that each country would receive other countries' lists only after submitting their own.

The EEC was opposed to the negotiation proceeding along the lines embodied in the De Zeeuw text. It opposed the separation of commitments into the three areas and it opposed the making of commitments specific to particular policies. Most of all, it opposed having to make larger reductions on export subsidies than on other policies.¹⁵⁹ In September 1990, the EEC submitted a draft agreement which amounted to a special subsidies code for

155 The 7th Ministerial Meeting of the Cairns group in July 1990 resolved to adopt the De Zeeuw text as a minimum basis for negotiations for the remainder of the round, see Cairns Group press release dated 5 November 1990 from their 8th Ministerial meeting. See also Croome (1995) p239.

156 See Stewart (1993) p197-198. Croome (1995) p239.

157 See Croome (1995) p239 on the meeting of the TNC in July 1990 agreeing that the text could be used as a means of intensifying negotiations adopting the words used in the communique of a the Houston Summit of the Group of 7 Industrialized nations earlier that month. See also McMahon, Joseph A., "The Uruguay Round and Agriculture: Charting a New Direction?" (1995) 29(2) *Int Lawyer* 411-434 at 421 citing GATT *Focus* No 72, July 1990 at 12 & GATT *Focus* No 76, Nov 1990 at 1.

158 "Framework Agreement" MTN.GNG/NG5/W/170 at p4, para 12.

159 See Stewart (1993) p198.

agriculture.¹⁶⁰ It included some proposals relating to Article XVI:3 with refinements of meaning of "equitable share" "representative period" and "special factors". Adoption of these rules may have made Article XVI more certain but it would also have legitimised the EEC export subsidies at their existing levels (or close to them). Switzerland also made a detailed proposal for changes to rules.¹⁶¹ They sought to amend the rules to allow countries to pursue non-economic goals within limits according to their trade-distorting effects.

Since the De Zeeuw text itself had been rejected, the "country lists" submitted were not entirely as contemplated by the text. They varied in the extent to which they were based upon the De Zeeuw text as did the additional proposals. Some of the proposals referred to the text, others were loosely based upon it, and others like those of the EEC and Japan did not refer to the text at all. The Cairns group (without Canada) and the USA proposals were submitted on 15 October.¹⁶² Canada, having parted company with the Cairns group on the issue of tariffing import restrictions maintained under Article XI:2(c), submitted a separate proposal the same day.¹⁶³ The EEC was about a month late on 7 November.¹⁶⁴ By then, less than a month remained before the scheduled commencement on 3 December of the Ministerial meeting in Brussels to conclude the Round.

160 EC, "Draft Agreement on the Interpretation and Application of Articles XVI and XXIII of the General Agreement on Tariffs and Trade with Regard to Agricultural Support", September 1990, see Petersmann, Ernst-Ulrich, "The Uruguay Round Negotiations 1986-1991" in Petersmann, Ernst-Ulrich & Hilf, Meinhard, *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (Volume 5 of *Studies in Transnational Economic Law*) (Kluwer, Deventer, 1st ed, 1991) pp501-577 at p538. See also the entry "Draft Agreement Submitted by the EC" MTN.GNG/W/200, 11 September 1990 in Stewart's Selected list of documents from the Uruguay Round Negotiation on Agriculture, see Stewart (1993) p242.

161 Switzerland submitted a draft "Agreement on Interpretation and Application of Articles XI, XVI, XIX and XXIII of the General Agreement on Tariffs and Trade with regard to Agricultural Products". September 1990: see Petersmann, "The Uruguay Round Negotiations 1986-1991" in Petersmann & Hilf (1991, 1st ed) p539.

162 The USA proposal was submitted on 15 October: see Stewart (1993) p202 citing "Agricultural Trade Snag" *NY Times*, 16 Oct 1990, at D8. The Cairns group proposals was submitted on 15 October: see Stewart (1993) p202 citing "US Wins Support on Farming Subsidies", *Fin Times*, 16 Oct 1990, p20.

163 See Warley, T.K., "The Canadian Perspective" in Ingersent, Rayner & Hine, *Agriculture in the Uruguay Round* (St Martins Press, New York, 1994) pp126-127 citing Government of Canada, "Canada tables offer for agricultural trade reform in multilateral trade negotiations" News Release, Ottawa, 15 October 1990.

164 The EEC proposal was submitted in the first week of November: see Croome (1995) p240 & Stewart (1993) p203 citing GATT, "European Communities Offer Submitted Pursuant to MTN.TNC/15".

In these proposals, there was a slight narrowing of the divergence between the parties' views of "progressive and substantial" reduction.¹⁶⁵ The USA¹⁶⁶ and the Cairns group¹⁶⁷ backed down from their demand for the complete elimination of export subsidies modifying it instead to a 90% reduction over 10 years.¹⁶⁸ For the first time, they quantified their demands for reductions in border protection and internal support with the specification of 75% cuts over 10 years (subject to some complications set out below).¹⁶⁹ The EEC adhered to its position that, in general, commitments could not be made in terms of specific policies but should only be made in terms of an aggregate measure of support, though allowing for a limited version of tariffication for some fruits and vegetables only. In general, the EEC continued to maintain that a single commitment would be adequate without the need for separate commitments relating to export subsidies, border protection and internal support. They offered a cut of 30% in aggregate support.¹⁷⁰ The parties were still a long way apart in approach to rules, to instrumentation and magnitude of reductions. One study calculated that to achieve a 90% reduction in export subsidies, the AMS would have to be reduced by 68%,¹⁷¹ more than twice the size of the reduction offered. As the study by Josling, Tangermann and Warley put it, "The EC was still not on the same page".¹⁷²

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- 165 For summaries of the 1990 proposals, see Stewart (1993) pp202-203; Croome (1995) p240; Josling, Tangermann & Warley (1996) p154-155.
- 166 On the USA proposal, see UNCTAD, "Efforts at Agricultural Reform: Issues in the Negotiations" in UNCTAD, *Trade and Development Report 1991* (UNCTAD, Geneva, 1991) ('*UNCTAD 1991*'). On the USA proposal, also see Hillman, Jimmye S., "The US Perspective" chapter 3 in Ingersent, Rayner & Hine, *Agriculture in the Uruguay Round* (St Martins Press, Basingstoke & New York, 1994) pp26-53.
- 167 "Cairns Group Proposal for a Multilateral Reform Program for Agriculture", 15 October 1990 ('Cairns Group Proposal, Oct 90'). On the Cairns Group proposal, also see Tyers, Rod, "The Cairns Group Perspective" chapter 5 in Ingersent, Rayner & Hine, *Agriculture in the Uruguay Round* (St Martins Press, Basingstoke & New York, 1994) pp88-109.
- 168 See Cairns Group Proposal, Oct 90, p7, para 19 & *UNCTAD 1991* p163.
- 169 "Cairns group proposal, Oct 90", p2, paras. 14 & para 5.2, p2. On the USA proposal, see *UNCTAD 1991*, p163.
- 170 EEC, "European Community Offer on Agriculture for the Uruguay Round of the GATT Negotiations", Bruxelles, 8 November 1990. On the EEC proposal, also see Ingersent, K.A., Rayner, A.J. & Hine, R.C. "The EC Perspective" chapter 4 in Ingersent, Rayner & Hine, *Agriculture in the Uruguay Round* (St Martins Press, Basingstoke & New York, 1994) pp55-87, esp at 71-73 and *UNCTAD 1991*, p163.
- 171 See O'Connor, H.E., Rayner, A.J., Ingersent, K.A. & Hine, R.C., "Aggregate Measures of Support in the Uruguay Round: Application to the EC Cereals Sector" (1991) 19(2) *Oxford Agrarian Studies* 91-103 at 99.
- 172 Josling, Tangermann & Warley (1996) p155.

8.1 THE USA AND CAIRNS GROUP 1990 PROPOSALS

There was significant convergence between the USA and Cairns group proposals so that it is convenient to describe them together, although attention must be drawn to some differences. Both the USA and Cairns Group proposals were based on the De Zeeuw Framework Agreement, adopting, among other things, the stipulation that export subsidies be reduced more than other forms of support.¹⁷³

8.1.1 Import Barriers

The USA and Cairns group proposals on import barriers were modified versions of the De Zeeuw text containing the same elements of tariffication, binding, current access tariff quotas, minimum access tariff quotas, tariff reductions and expansion of tariff quotas, and a special safeguards clause.

(a) *Tariffication and Prohibition of Quantitative Restrictions*

Both proposals, again, made comprehensive tariffication of non-tariff barriers a fundamental element of reform, in essence, following the De Zeeuw text. The tariff equivalents were to be calculated upon the basis of the difference between internal and external prices; the USA proposals specifying that these prices be based on averages for the years 1986-1988;¹⁷⁴ and the Cairns group proposal specifying that these prices be "based on the existing gap between external and internal prices",¹⁷⁵ in effect seeking to base the calculation on later data (than the USA) which would have resulted in lower tariff equivalents (than using the USA method). It was implied that after the tariffication process had occurred, quantitative restrictions would not be permitted.

(b) *binding*

Under both proposals, the tariff equivalents of non-tariff barriers would be bound. Any unbound tariffs on products not subject to non-tariff barriers would also be bound, the

173 The description of the USA 1990 proposal is drawn from: UNCTAD 1991, p163, O'Connor et al (1991), p92, Hillman (1994), p43 & Ingersent Rayner & Hine, "The EC Perspective", p70

174 See Ingersent, Rayner & Hine, "The EC Perspective", as above, at p70.

175 Cairns Group Proposal, Oct 90, p5, para 12(a).

Cairns Group proposal specifying that the bound rates should be the normal rates applying in September 1986.¹⁷⁶

(c) *Tariff Reductions*

Under both proposals, the bound tariffs were to be reduced by an average of 75% over 10 years to reach tariff rates no higher than a ceiling of 50% to apply from the end of the implementation period. The USA proposal included a formula for the tariff reductions.¹⁷⁷ The Cairns group stipulated that the average reduction of 75% should be calculated on a trade-weighted basis with a minimum cut of 50% to each individual tariff line. The Cairns group proposal also stipulated that the reductions should be made in equal annual steps.¹⁷⁸

Both the Cairns Group and the USA allowed for developing countries to implement the reductions over a longer period up to 15 years rather than 10 (though the USA proposal limited the availability of the longer time to net importers and by reference to level of per capita GNP).¹⁷⁹ The Cairns Group also allowed for rates of reduction of 75% on average and 50% per item to be reduced to 45% and 22.5% for developing countries.¹⁸⁰

(d) *Establishment of and Expansion of Current Access Quotas and Expansion*

Both proposals adopted the provision in the De Zeeuw text requiring existing import opportunities to be maintained. Any tariff rate quotas established for this purpose were to be expanded. The USA proposal required current access quotas to be expanded by 75% during the 10 years and then completely removed.¹⁸¹ The Cairns group proposal required current access quotas to be "expanded at the same rate in percentage terms and over the same period as the corresponding tariff is reduced" (thereby permitting developing countries to reduce their rates of expansion of tariff quotas to the same extent that they slow their reduction of tariff rates). They were to be removed when the out of tariff rate quota tariff rates reduced to 5%.¹⁸²

176 Cairns Group Proposal, Oct 90, p5, para 12(b) & (e).

177 See UNCTAD 1991, p163.

178 Cairns Group Proposal, Oct 90, p5, para 14.

179 Hillman (1994) p45.

180 Cairns Group Proposal, Oct 90, p6, para 15.

181 Ingersent, Rayner & Hine. "The EC Perspective", p70.

182 Cairns Group Proposal, Oct 90, p5-6, para 14.

(e) *Establishment of and Expansion of Minimum Access Quotas*

Both proposals adopted a provision along the lines of the provision in the De Zeeuw text requiring the establishment of a low tariff rate quota in cases where the level of imports is less than a certain minimum level. Under the USA proposal, the minimum level would be 3% of domestic consumption and, over the 10 year period, this would be expanded to 5%. Under the Cairns group proposal, the minimum level would be 5% of current domestic consumption and this would be expanded by same rate as the tariff on the relevant product would be reduced.¹⁸³

(f) *Special Safeguards*

Both the USA and Cairns Group proposals included a formulation of a special safeguards provision, to operate only during the implementation period, to permit tariff increases without compensation in response to certain triggers. The USA formulation extended its 1989 proposal for a special safeguard clause to provide for a tariff surcharge at specified level which after expiration of the year would revert back to the level required under the tariff reduction programme. Under the USA proposal, the triggers for resort to the special safeguard provision were either specified increases in the volume of imports or specified falls in the price of imports.¹⁸⁴ Under the Cairns group proposal, the triggers were in all cases linked to increases in volume but whereas generally a 30% increase in volume was required, a 15% increase in volume could be sufficient if it was accompanied by a specified fall in price.¹⁸⁵ The Cairns group also stipulated that any resort to special safeguard action would not diminish the obligation to maintain tariff rate quotas. Therefore, to some extent, both proposals made concessions to the EEC demand that any tariffication should be supplemented by a mechanism to adjust for falling world prices.

8.1.2 Export Subsidies

Both the USA and Cairns group proposals followed the outline in the De Zeeuw text calling for specific commitments on export subsidies rather than attempting to discipline them using the AMS and calling for larger reductions on export subsidies than on import barriers or

183 Cairns Group Proposal, Oct 90, p5, para 14.

184 Ingersent, Rayner & Hine. "The EC Perspective", p70.

185 Cairns Group Proposal, Oct 90, p6, para 16.1.

domestic support. Both called for reductions of 90% over 10 years. The USA and the Cairns Group proposed slightly different baselines for the reductions, with the USA using averages of data for the years 1986 to 1988 whereas the Cairns Group wanted the baseline based on data for the years 1987 to 1989.

Both the USA and Cairns group wanted the reductions to be made in terms of budget outlays and in terms of the total quantity of subsidized product. The Cairns Group also wanted reduction commitments to be made in terms of the amount per unit of each product.

In respect of the delineation of which types of subsidies would be subject to these reductions, both proposals set out a list which was substantially similar to the list in the De Zeeuw text.¹⁸⁶ However, the Cairns Group added a specific reference to deficiency payments to the words taken from the De Zeeuw text:

payments to producers of a product which result in the price or return being higher than world market prices or returns, *including deficiency payments*.¹⁸⁷

The approaches to the EC Pasta case problem were different too. The Cairns Group included "subsidies on agricultural products incorporated in processed exports" on the list of subsidies subject to the 90% reduction over 10 years. The USA proposed that this category be subject to a complete phase out over 6 years.¹⁸⁸

The USA and the Cairns Group also differed on whether food aid should be counted as export subsidies. The Cairns Group reiterated its 1989 position, which had not been adopted in the De Zeeuw text, that food aid should be given in grant form.¹⁸⁹ The USA kept to its 1989 position that bona fide food aid should not be included in the calculation of export subsidies for the purposes of the reduction commitments.¹⁹⁰

The Cairns Group also sought additional obligations not to use export subsidies on products or to markets in respect of which export subsidies were not provided in the baseline period.¹⁹¹

186 Framework Agreement, p6, para 20.

187 See Cairns Group Proposal, Oct 90, p7, para 20(b); the words not in italics were para 20(b) in the Framework Agreement.

188 See UNCTAD 1991, p163.

189 Cairns Group Proposal, Oct 90, p8, para 22.

190 See Ingersent, Rayner & Hine, "The EC Perspective", p71.

191 Cairns Group Proposal, Oct 90, p8, para 22.

8.1.3 Domestic Support

With respect to internal support also, the Cairns group and USA proposals followed the format of the De Zeeuw text providing for reductions utilizing an AMS which would only include support provided by measures other than import barriers and export subsidies but would not include policies within an exempt category which became known as the green box. Both proposals backed off from the earlier demands of a complete phase-out of certain types of internal support and called for a reduction by 75% of internal support not in the green box. Both groups wanted the commitments made on a commodity by commodity basis. For sector wide support measures, the Cairns group wanted the 75% reduction to apply but the USA sought only a 30% reduction (subject to them satisfying certain tests relating to delinkage from production).¹⁹²

The calculation of the baseline was complicated. The USA wanted the baseline to be based on averages for the years 1986 to 1988 while the Cairns Group wanted the baseline to be based on 1999 data. In calculation of the AMS, both the USA and the Cairns Group made some concession to the EEC demand that its proposed SMU (Support Measurement Unit) be calculated by reference to a fixed external reference price. The USA proposed that the AMS could be "based on the gap between the current support price and a fixed external reference price derived from 1986-8 base period data".¹⁹³ The Cairns Group proposal tried to limit the extent to which world prices used in calculating the AMS would be a fixed price rather than the current world price. It provided

In respect of commodity specific policies which directly affect trade then AMSs will be expressed by total monetary value for each product using the base year 1988 and where a fixed reference price is used, it will be based on 1986-1988 data.¹⁹⁴

It also provided for the fixed external reference price to be reassessed in 1995-9. In addition, it provided for a mechanism for parties to elect to calculate AMS on the basis of current world prices so that thereafter they would be unable to calculate AMS on the basis of

192 Cairns Group Proposal, Oct 90, p2, para 5.2.

193 Ingersent, Rayner & Hine, "The EC Perspective", p69.

194 Cairns Group Proposal, Oct 90, p2, para 5.

a fixed world price together with an exhortation that parties should move away from the fixed reference price after the early years of the implementation period.¹⁹⁵

In respect of policies for which calculation of an AMS was impracticable, both proposals also called for commitments based on producer support prices and budget outlays.¹⁹⁶

The proposals were similar in the way that they defined policies which would be subject to the AMS reductions. Both included policies which raised producer prices and direct payments to producers including deficiency payments. The Cairns Group referred to "deficiency payments on production consumed domestically" matching the way it had defined export subsidies to include deficiency payments on production that was exported.

Both proposals substantially followed the De Zeeuw text in defining the scope of the green box of policies to be exempt from any reduction commitments. The Cairns group inserted a figure of 75% in the item relating to income safety net programmes so that these programmes would only be exempt if they did "not maintain gross producer incomes at more than 75% of the most recent three-year average".¹⁹⁷

8.2 THE EEC 1990 PROPOSAL

I have referred to the difference in magnitude in the reductions that were offered by the EEC proposal and to the observation that the EEC was still not "on the same page". It is clear that the proposal was an outward manifestation of the internal EEC negotiation rather than a proposal for optimal international rules.

The EEC proposal did not even refer to the De Zeeuw text. It was arranged, without saying so, as an explanation of what the EEC planned to do to reform the CAP and the manifestations of those changes into GATT commitments were added on. It referred back to its December 1989 proposal for its conditional acceptance of tariffication and to its various earlier proposals for the details of calculation of the AMS.¹⁹⁸ As in its 1989 proposal, for the principal products, the EEC proposal was based on a reduction of AMS

195 Cairns Group Proposal, Oct 90, p2, paras 5 & 5.1.

196 *UNCTAD 1991*, p163; Cairns Group Proposal, Oct 90, para 6.

197 Cairns Group Proposal, Oct 90, p4, para 8.

198 EEC, "European Community Offer on Agriculture for the Uruguay Round of the GATT Negotiations", Bruxelles, 8 November 1990 ('EC Offer, Nov 90'), p2, para 4.

and, for the purposes of the EEC proposal, AMS included support given by import barriers and export subsidies. For these principal products, separate commitments on import barriers and export subsidies were to be given only to the extent that they were concomitant with the reductions of the AMS. The AMS was to be calculated as the total monetary value of support based on a fixed reference price based on 1986-1988 data.¹⁹⁹ It also allowed for a green box. The reduction in AMS was to be 30% over 5 years. For some other products, including cotton, hops and tobacco, the EEC offered to reduce production subsidies by 10%. For another category, consisting of fruits, vegetables and wine, the EEC offered to reduce border support by 10%.²⁰⁰

The EEC reserved to itself the right to reduce support either by reducing support prices, by reducing expenditures or by taking other measures. (In particular, the EEC would have contemplated that by using land set aside requirements, it might diminish the extent by which it would have to reduce support prices in order to achieve the same reduction in the AMS.) However, other elements of the proposal would severely constrain the ability of the EEC to meet its commitments otherwise than by reducing support prices. The EEC repeated its offer to tariffify non-tariff barriers subject to the three conditions: that a corrective factor be permitted to compensate for falls in the world price, that tariffication would also involve establishment of tariffs on derivatives and substitutes, and that deficiency payments be converted to tariffs. This time it added an offer to bind all tariffs.²⁰¹ It repeated its offer that it was prepared to limit export subsidies on a per unit basis to the import charge applied to the same product when imported. More detail was provided on rebalancing. The proposal named the products on which it was sought to establish tariffs and set out the proposed tariff rates.

It was mentioned above that most other parties regarded the EEC's rebalancing proposal as an attempt to achieve through the negotiation what it ought to have negotiated under Article XXVIII. The 1990 Proposal even proposed a maximum tariff rate quota for entitlement to the bound ad valorem rates on the list of products which were to have tariff rates raised.²⁰² If any element of the EEC proposal was merely a negotiating position intended to be given

199 EC Offer, Nov 90, p2, para 4.

200 EC Offer, Nov 90, p2, para 5.

201 EC Offer, Nov 90, p2, para 5.

away later, this must have been it. This suggestion must have been like a red rag to a bull to the USA and Cairns Group negotiators.

However, despite the completely different approach of the EEC proposal, if the aspect of rebalancing is ignored, it is possible to distil a certain amount of common ground between the EEC proposals and those of the USA and the Cairns group. Though there was a substantial disagreement on the rebalancing proposal, if that element is removed, then many elements of the EEC's proposal implied similar changes to GATT rules as the USA and Cairns Group proposals did. Of course, there would remain the difference between size of the reduction commitments. Subject to resolution of the rebalancing issue, the EEC proposal can be represented as follows.

8.2.1 Import Barriers

(a) *Tariffication and Prohibition of Quantitative Restrictions*

The prohibition on quantitative restrictions explicit in the USA and Cairns Group proposals was also implicit in the EEC proposal. However, the EEC's proposal was not perfectly clear on whether it still supported the retention of Article XI:2(c). It contained no mention of Article XI:2 unless one was embraced by the reference back to the conditions on tariffication set out in the December 1989 proposal. The EEC proposal listed the initial tariff rates in ECUs per unit of volume.²⁰³ Determining whether these were higher or lower than would have resulted from the USA or Cairns Groups tariffication formula was not simple. All parties proposed using 1986-1988 prices. However, for the USA and the Cairns Group, the tariff equivalent would be the difference between the internal and external prices, while for the EEC it would be the difference between the world price and the community support price plus 10%.²⁰⁴ In most cases, the community support price would be the intervention price which, being a margin below the threshold price used for purposes of calculating variable levies, might be lower than the internal price used under the USA or Cairns Group method of calculating the tariff equivalent.²⁰⁵ In some cases, the tariff

202 EC Offer, Nov 90, annex II.

203 EC Offer, Nov 90, annex II.

204 EC Offer, Nov 90, p2, para 5.

205 EC Offer, Nov 90, p3, para 9.

equivalents were above and in others below the average variable levies that had actually been charged in the period 1986 to 1988.

(b) Binding

The EEC proposal also agreed to binding of all tariffs.²⁰⁶ It did not say so but this would have involved binding the tariffs established as a result of tariffication and those on any other unbound products. Most of the bindings were expressed in ECUs per unit of volume rather than ad valorem. The bindings would be subject to a corrective factor explained in more detail below.

(c) Tariff Reductions

The EEC was agreeing to make reductions in the bound tariffs on an annual basis for 5 years (each of the years of the AMS reductions). However, it did not commit itself to a percentage figure. Instead, it proposed that the size of the reductions would accord with the fall in the support prices which would be implemented in order to meet the AMS reductions of 30% over 5 years.²⁰⁷ The reductions would have been some margin below 30% because total AMS would also be achieved by limiting the volume of production rather than reducing the support price. Allowing for the fact that some of the initial bound tariff rates were actually higher than the average variable levies that had been charged in the base period, the actual reduction in the bound tariffs could have turned out not to be a significant reduction of the protection provided by the pre-existing variable levies: in any case, certainly a reduction of less than 30%. With respect to the group of products including cotton, hops and tobacco, the rate of reduction was specified as 10%.

(d) Establishment of Current Access Quotas

The EEC proposal mentioned that it would continue giving existing tariff treatment within existing tariff quotas including those in effect under VERs. It made no commitments to enlarge these quotas.

206 EC Offer, Nov 90, p3, para 9.

207 EC Offer, Nov 90, p3, para 8

(e) *Establishment of Minimum Access Quotas*

The EEC made no commitments on minimum access other than the commitment to bind existing tariffs.

(f) *Special Safeguard*

It is useful to compare the EEC's proposal for a corrective factor on tariff bindings with the Cairns Group and USA proposals for a special safeguard provision. The EEC's proposed corrective factor would adjust for falls in the world price below the external reference price for the base period of 1986 to 1988. This was the price to be used to calculate the initial bound tariff rates in each of the proposals of the EEC and the USA which would have been higher than the existing prices used as the base in the Cairns Group proposal. The EEC proposed that the corrective factor should correct for all changes in price due to exchange rate fluctuations and for a proportion of non-exchange rate price falls. The corrective factor would be 30% of price falls within a margin of 30% below the reference plus 100% of price falls greater than 30 per cent of the reference price.²⁰⁸ In the USA proposal, there could have been some resort to a specified additional tariff if certain price falls occurred but the falls would have to be larger than a specified size regardless of whether they occurred as a result of exchange rate changes or not. Under the Cairns Group proposal, a fall in price (exchange related or not) without a increase in the volume of imports would never be sufficient to invoke the special safeguard provision. The Cairns Group limited the size of the tariff surcharge by permitting only that the party could revert back to the bound tariff rate for the previous year. There was also a difference in the time for which the corrective factor or safeguard measure could be implemented. The EEC's corrective factor could be implemented for as long as the price was below the fixed external reference price. The USA and the Cairns Group only permitted recourse to the special safeguard for a period of up to a year.

208 EC Offer, Nov 90, Annex IV. These paragraphs in Annex IV explaining the correction for non-exchange rate factors are not easy to follow. The statement in the text is the author's best attempt to interpret the paragraphs.

8.2.2 Export Subsidies

The EEC proposal repeated its previous proposals but did offer export subsidy reductions of any particular size. However, it was prepared to bind the per unit subsidies so that they would not be able to exceed either:

- the difference between the domestic price and the world price; or
- the import charge that could be applied to the same product when imported into the exporting country.

It indicated that these bindings would naturally become tighter as the AMS reductions came into effect, and it offered to quantify these reductions as the negotiation progressed.²⁰⁹ The EEC's offer did not include any commitments on export subsidies in terms of total outlays or volume of subsidized product. Naturally, any reductions made would come from the same baseline as the AMS commitments. The EEC also offered to "commit itself" not to introduce export subsidies on products upon which they had not been paid in the past.²¹⁰ (This is a good example of the insularity of the EEC's approach to the negotiation; the EEC referred to what it proposed to do rather than what it proposed all parties should do). This partially adopted the Cairns Group's suggestion though they did not adopt the part of the Cairns Group proposal that would have prohibited using export subsidies in markets in which they were not previously used.

The EEC's approach to the Pasta case problem was different to the approaches of the Cairns Group and the USA but was in line with its general approach to binding export subsidies. It proposed that these export subsidies would be limited to the difference between domestic and world prices of the agricultural products incorporated in the processed product.²¹¹

Export subsidies was the area where the proposals were furthest apart but, even here, there was some agreement. The parties were agreed that in circumstances in which the world price stayed stable, the amount of export subsidies should decrease in line with a reduction in support prices. The EEC wanted its reductions in export subsidies to be limited to the amount by which it reduced internal support prices. The Cairns Group and the USA were

209 EC Offer, Nov 90, pp4-5, para 14.

210 EC Offer, Nov 90, pp4-5, para 14.

not satisfied with the magnitude of reductions which would follow from using the EEC's approach.

8.2.3 Internal Support

The EEC used a definition of internal support which included support provided through import barriers and export subsidies so it would be extremely difficult to make a comparison with the Cairns Group and USA's proposal in relation to the internal support which excluded support provided through import barriers or export subsidies. There were a few similarities in approach though.

One similarity that emerged was that the baseline was fixed. This meant that additions to internal support to compensate for falls in the world price would not have any impact on the calculation of the AMS and therefore would be left unregulated by the AMS. However, the effect of this had to be considered in conjunction with the bindings on imports tariff and export subsidies. Import tariffs and export subsidies could only be increased to compensate for falls in the world price within the limits of the corrective factor. However, it would have the effect of permitting parties to increase production linked subsidies to compensate for falls in the world price without such production subsidies being counted in the AMS. This feature was common to all three proposals.

It was also common to all three proposals that they allowed for a green box. This meant that there was a consensus among all parties that some types of policies could be increased, regardless of changes in world prices, without having any effect on the AMS. The EEC proposed that the AMS would not include disaster assistance, domestic food aid, marketing support, general services, resource retirement programmes, investment aids, and programmes for stockpiling food reserves.²¹² There was substantial agreement from the USA and the Cairns Group in relation to most of the items listed in the EEC proposal. However, the USA and the Cairns group were in favour of the criteria set out in the De Zeeuw text for determining whether policies fell within the green box whereas the EEC had omitted these. In particular, the EEC's inclusion of retirement programmes without delinkage criteria would permit simple production subsidies to fall within the green box if

211 EC Offer, Nov 90, pp4-5, para 14.

they required some land set-aside for eligibility. The EEC had investment subsidies within the green box whereas the Cairns Group and the USA required these to be subject to reduction commitments. Income support payments were a point of difference with EEC prepared to submit these to reductions but the USA and the Cairns Group placing these within the green box within certain limits.

8.3 PREPARATIONS FOR BRUSSELS

By the time that the EEC had submitted its proposal, the Brussels meeting was less than a month away. The submission of the proposals showed that the divergence between the parties was still great. In addition, the exercise of making out country lists had uncovered other more technical areas of contention such as the calculation of tariff equivalents, and of aggregate measures of support. The time remaining before the Brussels meeting did not even allow enough time for parties to examine each others' country lists and to discuss the technical points which they raised. More important though was the divergence between the approaches taken by the USA and the EEC. Again, Mr Arthur Dunkel intervened in his capacity as chairman of the TNC. He issued some questions to participants.²¹³ The answers only confirmed that the differences between the parties were so great that the De Zeeuw text could not be used as the basis for an agreement at the Brussels meeting.

9 THE BRUSSELS MINISTERIAL MEETING & THE HELLSTROM TEXT

The ministerial meeting which had been planned to conclude the Uruguay Round was held in the Heysel exhibition centre in Brussels from the 3rd to the 7th of December 1990.²¹⁴ Each ministerial delegation was given a document of roughly 400 pages entitled the "Draft Final Act embodying the Results Of the Uruguay round of Multilateral Trade Negotiations".²¹⁵ The document contained a submission from each negotiating group but the content varied considerably. Some were detailed draft texts but even most of these

212 EC Offer, Nov 90, p2, para 4.

213 See Croome (1995) p241.

214 See Preeg (1996) p116 & Stewart (1993) p203.

215 The 1990 Draft Final Act is reproduced in Stewart (1993) Volume III: Documents, pp65-455.

contained many key issues still to be resolved. For a number of areas including agriculture, the package did not contain agreed negotiating texts.²¹⁶

For the Brussels meeting, the negotiating group on agriculture was chaired by the Swedish Minister for Agriculture, Mr. Helstrom.²¹⁷ The part of the draft final act which related to agriculture consisted of the De Zeeuw draft text on sanitary and phytosanitary measures, the De Zeeuw draft text on agriculture, a survey of offers prepared by the Secretariat and a short list of questions.²¹⁸ Mr. Dunkel invited the participants to submit answers to the questions on the first day to the chairman, Mr. Helstrom. Answers were received from only a few of the larger countries and in the main were repetitions of earlier offers. In summary the attempt to progress the negotiation by the question and answer procedure was unsuccessful.²¹⁹

The negotiating group broke up and various small group meetings occurred. In the course of these small group discussions a thin possibility of an agreement arose. The EEC, although without indicating whether it had authority from its member governments, hinted that it might be able to relax its position in a number of areas. An important area was the previously stated precondition for tariffication that there be a rebalancing (increase of bound rates) of some tariff rates. At this stage, it became apparent that the EEC might be concerned about increasing tariffs on a lesser number of products than had formerly been indicated. The members of the secretariat and the Cairns group members were particularly active in keeping a dialogue going and trying to find the basis for an agreement. As there appeared to be the possibility of salvaging the agriculture negotiation and with it the Brussels meeting, the chairman was urged to put forward a negotiating proposal.²²⁰

What has subsequently been referred to as the Helstrom text was drafted at enormous speed in about 40 minutes by the secretariat's agriculture department. The Helstrom text was

216 The other areas without an agreed negotiating text were dumping, trade related aspects of investment measures (TRIMS), and financial services.

217 See Josling, Tangermann & Warley (1996) p155.

218 The Agriculture section of the 1990 Draft Final Act is set out in Stewart (1993) pp203-245.

219 See Croome (1995) at pp278-279 on the answers given by the EEC.

220 Interview by the author of GATT Secretariat official, 12 May 1992.

brief.²²¹ It adopted the division into the three areas and proposed a 30% reduction in each area over 5 years. For export subsidies, it did require specific policy commitments rather than AMS reductions and the reductions were based on a 1988-1990 average baseline.²²² In respect of border protection, tariffication was one of a number of ways to reduce border measures rather than the only way. The text ignored the concept of "rebalancing". The reductions to internal support were to be made from a 1990 baseline.²²³ This was the first draft text to quantify the reductions. Noticeably the numbers adopted were in line with the EEC proposals rather than the USA or Cairns group proposals.

The Helstrom paper was presented to a meeting of a group of about 30 countries on the 6th of December 1990. After presenting the proposal to the meeting, the chairman gave everyone an opportunity to give their reactions to it by way of a tour of the table. The order of speaking was determined simply by the arrangement of the delegates at the table. The EEC's turn to speak came early in the round. It was represented by the EEC Minister for Agriculture, Mr. MacSharry. He indicated that it was possible that the text could be used by the EEC as a basis for negotiation. The round continued with each country making a similar indication. The USA was one of the last to speak. The tour of the table was completed with all countries making a positive comment on the text. Mr Helstrom might later have wished that, at that point, he had adjourned the meeting.

Mr. Helstrom chose to give everyone a second opportunity to speak so as to enter into a bit more detail. The first few speakers were a bit more demanding trying to assert some of their original positions into the text but they were at least arguing about the content of the text rather than whether it could be used as a negotiating text. Early in the round, came Mr. MacSharry. This time he indicated that the EEC would have certain conditions on the acceptance of using the text as a framework for negotiations. It was concerned about the size of the reductions to export subsidies. Significantly he did not reject tariffication completely. However the conditions suggested were perceived by many as too demanding.

221 See Josling, Tangermann & Warley (1996), p155; Preeg (1995) p119, Stewart (1993) p203. The plan is cited in Josling as GATT, "Elements for Negotiation of a Draft Agreement on the Agricultural Reform Programme" (Hellstrom Draft) (GATT, December 1990). The draft is reproduced in EC, Others Thwart Latest Effort to Save Uruguay Round, 9 *Inside Trade*, Dec 7, 1990, p1-2.

222 See Josling et al (1996), p155, fn36.

223 See Preeg (1995) p119.

Fairly soon after MacSharry, came the turn of Argentina and Brazil to speak. Each of their delegates expressed, with some firmness, their view that the EEC was reneging on its initial statement that it was prepared to use the Helstrom paper as a basis for negotiation. They expressed their disappointment that the EEC was trying to impose additional conditions on the negotiating framework and expressed doubt about the good faith of the EEC's desire to reach an agreement at all. The Japanese and Koreans took the opportunity to reexpress their opposition to tariffication of certain products. By the time that the USA representative, Mr Julian Katz took his turn to speak it was already apparent that the text was not going to be used as a framework for negotiations. The Latin Americans had already said everything that he might have otherwise said. He politely voiced his disappointment with the EEC. Mr. MacSharry defended himself by saying that he was risking exceeding the authority given to the EEC by its member governments, that he was doing the best he could given the positions of the EEC governments and that he was disappointed that the others did not appreciate his position. Helstrom closed the meeting saying that there appeared to be no basis for negotiation.²²⁴ Everyone blamed the EEC for the outcome. It was concerned about the extent of reductions of export subsidies, and that the method of tariffication did not allow for rebalancing.²²⁵

As a result of the failure to reach any agreement on agriculture, the Cairns Group members led by the Latin Americans withdrew from all of the other negotiating groups and there was no final agreement on any other part of the draft final act.²²⁶ The popular perception was that the completion of the round might have fallen into place if there had been agreement on agriculture. However there were still a number of contentious issues in the other negotiating groups, in particular, the services group. Whatever the outcome might have been, the other negotiating groups were spared the necessity of sorting out their differences.

The Ministers did not adopt any of the negotiating results of the meeting nor did they even formally agree to extend the Uruguay round into 1991.²²⁷

224 Interview by the author of GATT secretariat official, 12 May 1992.

225 See Stewart (1993) pp203-204.

226 See Croome (1995) p279.

227 Petersmann, (1993) p576.

CHAPTER 18

DISTINCTIONS BETWEEN POLICY INSTRUMENTS AND THE FAILURE TO REACH AGREEMENT IN BRUSSELS

1 THE DISTINCTIONS BETWEEN POLICY INSTRUMENTS AND THE PRIORITIES IN THE NEGOTIATION

Before describing the remainder of the negotiation of the Uruguay Round Agreement on Agriculture, I wish to break this narration to consider how the parties might have proceeded to reach agreement and, more importantly to this overall thesis, to consider how the ideas described in Part 2 of this thesis could have influenced the negotiation.

On the principles as I have set them out in Part 2, the negotiating objectives should have been, in order of importance, the following:

- (1) prohibit quantitative restrictions;
- (2) bind and reduce tariffs;
- (3) bind and reduce export subsidies;
- (4) bind and reduce production subsidies.

The question considered here is whether a better focus on the differences between policy instruments and on the order of priorities set out above would have helped to achieve an agreement at Brussels to conclude the agriculture negotiation.

2 THE DIFFERENCE BETWEEN THE PARTIES

Note that the difference between the parties in terms of the size of the annual reductions being offered was as follows:

 On Internal Support,

<i>USA/Cairns Group</i>	<i>EEC</i>
7.5% per year (excluding changes in export subsidies or import barriers)	6% per year (including changes in export subsidies and import barriers)
Baseline: 1986-88 or 1987-89	Baseline: 1986

 On Import Barriers:

<i>USA/Cairns Group</i>	<i>EEC</i>
7.5% per year with eventual maximum of 50%	3-4% per year (allowing for different baselines and the extent to which AMS reductions would be achieved through set aside rather than reduction in support prices) subject to Corrective Mechanism.
Baseline: 1988 (Cairns Group)	Baseline: 1986-1988

 On Export Subsidies:

<i>USA/Cairns Group</i>	<i>EEC</i>
9% per year	3-4% per subject to reduction according to operation of the Corrective Factor
Baseline: 1990	Baseline: 1986-1988

3 APPLYING THE NEGOTIATING PRIORITIES TO THE DIFFERENCES BETWEEN THE PARTIES

Surely, the difference between the rate of cuts to import barriers was not unbridgeable. A half way point would have been about 5.5% per year. The difference between the size of the reductions in export subsidies was more significant. On internal support, the proposals on

scope and measurement of AMS were so different that it was difficult to compare them. Consider what the parties might have done to achieve the objectives of the negotiation.

3.1 THE FIRST PRIORITY OBJECTIVE - PROHIBITING QUANTITATIVE RESTRICTIONS

The USA and the Cairns Group should have made the achievement of the prohibition on quantitative restrictions their first priority. They had already made tariffication a (,if not, the) central part of their proposal. They might have been able to capture the EEC's conditional willingness to adopt the principle of tariffication. The EEC was offering to meet the first objective, the prohibition and elimination of quantitative restrictions, but it was subject to some conditions. To finalize agreement on this, it was necessary to:

- (1) deal with the rebalancing issue;
- (2) insist that the tariffication would cover every product and every country;
- (3) design the 'corrective mechanism/special safeguard' to ensure that it did not facilitate the use of variable levies as virtual quantitative restrictions. This meant that the corrective factor had to have a volume trigger; that any availability of a price-based trigger should be accompanied by a requirement to satisfy a volume based trigger or to ensure that any availability of recourse to purely price-based triggers was on the basis of a transition to volume based triggers over time.

The viability of disposing of the rebalancing argument has to be considered in the context of the EEC's problem with surplus grain production and the substitution of grain substitutes for grain. It seems plausible that if the EEC had had an assurance that it could continue to pay export subsidies per unit up to the difference between the internal price and the world price, then the rebalancing issue would have gone away. If the USA and the Cairns Group had not insisted on specific commitments on export subsidies then the EEC would not have been so worried about shifting consumption from grains to non-grain feeds; and if the USA and the Cairns Group had not insisted on specific commitments on production subsidies, then the EEC would not have been so concerned about continuing to protect its domestic oilseeds industry. The effect might have been that the EEC backed down on how much protection it wanted on oilseeds and other grains substitutes. For a very small tariff increase, an Article XXVIII negotiation might have been possible. Therefore, it seems likely that a softer

approach on export subsidies and production subsidies would have captured the EEC's agreement with the tariffication and elimination of quantitative restrictions.

It would have been necessary to obtain the agreement of all of the other parties to the application of a prohibition on quantitative restrictions. However, reaching agreement on this point among the EEC, the USA and the Cairns group would have focussed pressure on those wishing to retain restrictions: especially Japan, Korea and Canada. The USA, Cairns Group and EEC together could have exerted considerable pressure on these countries to ensure that they complied with the prohibition of quantitative restrictions, forcing them if necessary to choose between being a party to the treaty and implementing the prohibition. We will return to this point when we describe what actually happened in the rest of the negotiation.

On that basis, the first objective was achievable.

3.2 THE SECOND PRIORITY OBJECTIVE - BINDING AND REDUCING IMPORT TARIFFS

On the second objective, the EEC was offering a cut of about 3-4% per year. Clearly, if the EEC was going to reduce support prices by more than that amount, there would be some political opposition. No doubt a partial replacement of support prices with deficiency payments would soften the political decision. Therefore giving some leeway to achieve this could be done by reducing the demand to cut the AMS to something smaller. This would have required the USA and the Cairns Group backing off substantially from their call for 75% reduction in production linked domestic subsidies.

If that had been done, then the EEC might have been able to make a better offer than 3-4% per year on tariff reductions. It also might have been possible to draw an offer of a higher reduction on the highest tariffs. This would not necessarily have achieved the maximum tariff rate of 50% but some reduction in the dispersion of the higher tariffs could have been achieved. Something closer to 7.5% per annum may have been possible.

There was already some common ground between the proposals for a corrective factor and for a special safeguards clause. However, there were some significant differences also. The Cairns Group and USA were suggesting a gradual bringing into effect of the ordinary

safeguards provision. In effect, the EEC was proposing that agriculture have its own permanent safeguard mechanism. A compromise was needed. The guiding criteria for the compromise could have been that the tariff surcharges could not be used as quasi quantitative restrictions. Therefore, price triggers alone should not have been permitted as sufficient for invocation of the special safeguard/corrective factor. Secondly, as long as the volume triggers were based on imports in a rolling recent period rather than a fixed period then some permanent adjustment would have to take place.

3.3 THE THIRD PRIORITY - BINDING AND REDUCING EXPORT SUBSIDIES

On the third objective, the binding and reduction of export subsidies, the Cairns Group and the USA governments had made the mistake of staking their stature in the domestic political constituency to the achievement of their third most important objective.

The EEC was already offering to bind export subsidies on a per unit basis to the lesser of the difference between internal prices and world prices and the amount of import duty that could be charged on the product and also to undertake not to pay export subsidies on products on which they had not been paid previously. On the basis of the EEC's offer on import barriers, this would have translated into a 3-4% per year reduction in per unit export subsidies though it would be subject to utilization of the corrective factor/special safeguard.

The EEC's real concern was that it could pay an export subsidy equal to the difference between its internal support prices and the world price. It was clear that the per unit export subsidies would be reduced by whatever amount the internal support prices were reduced by. Therefore, if the USA/Cairns Group had accepted a commitment on basis offered by the EEC together with a commitment to reduce tariffs, then it would be implicit that they would have achieved a reduction of per unit export subsidies below what they otherwise would have been.

If they had been satisfied with the EEC commitment on this basis, then the EEC might not have been so concerned to try to apply the same discipline to deficiency payments. There may not have remained any reason for deficiency payments and import barriers to be reduced at the same rate. This might have made it easier to argue for a much bigger rate of

reduction to be applied to import barriers while leaving the rate of reductions on internal support at a low rate.

If a commitment had been taken on this basis, it is doubtful whether additional commitments in terms of volume or budget outlays would have achieved anything significant in comparison to what might have been achieved as a result of an increase in the rate of reductions to apply to import tariffs. However, the reliability of this form of commitments on export subsidies was dependent on the special safeguards clause / corrective factor being drawn tightly enough.

A problem with taking a commitment in this form from the EEC would have been the decision as to how commitments should be taken from other countries. In particular, countries like the United States, which generally ran deficiency payment systems rather than dual price systems would on that basis have had to give bindings on export subsidies at near zero levels. However, there is no reason why bindings on export subsidies could not be taken in different ways for different parties. Parties not maintaining high internal prices could still have given reduction commitments in terms of per unit subsidies. This may have facilitated a trade-off between the rate of tariff reduction to be undertaken by the EEC and the rate of per unit export subsidy reduction to be undertaken by the USA.

3.4 THE FOURTH PRIORITY - BINDING AND REDUCING DOMESTIC SUBSIDIES

On the fourth objective, that of achieving a binding and reduction in the use of production subsidies and other production linked subsidies, the adoption of a less stringent position might have made it easier to maximize the size of the reductions on tariff rates. In addition, relaxation of this part of the negotiation may have made it easier to negotiate a sufficiently tight special safeguards clause/ corrective factor.

Both the Cairns Group and the USA had conceded considerable freedom to use domestic subsidies. They had agreed that increases in green box non-production linked subsidies would not be inconsistent with the internal support reduction commitments. They were also prepared to accept that the AMS should be calculated from a fixed external reference price: thereby permitting increases in production linked subsidies to compensate for falls in the

world price. As for the margin of support above the reference price, it was clear that, even without international obligations, governments would be subject to fiscal pressures to reduce this expenditure which would counteract to some extent the demands for subsidies. Nevertheless, there was some willingness to enter into commitments on domestic subsidies and it may have been possible to reduce the demands for reductions in this area so as to maximize the achievements on the higher priorities whilst still obtaining some commitments on domestic subsidies. Ceiling bindings could have been considered. Whilst there may be merit in pursuing commitments on domestic subsidies, they should not undermine the negotiation on import barriers. It would have been necessary with the Cairns Group to give in on its insistence that deficiency payments paid on products that are exported be regulated in the same way as export subsidies and to accept a definition of export subsidies as subsidies paid contingent on export.

3.5 POSSIBLE AGREEMENT

By the USA and the Cairns Group backing off on export subsidies and the Cairns Group backing off to some extent on deficiency payments, they might have been able to achieve:

- (1) a complete prohibition of QRs;
- (2) a reduction of import tariffs perhaps as high as 7.5 % per year, perhaps with a harmonizing effect;
- (3) a binding on export subsidies either to the amount of any import duty that could be charged on the same product or to another per unit amount.

It might have also been possible to obtain a ceiling binding on per unit production subsidies.

3.6 OTHER MATTERS TO BE AGREED

Some problems would have remained.

3.6.1 The Pasta Case problem

On incorporated products, the issue would have been whether to accept what the EEC was offering or to seek more. The EEC was offering to reduce export subsidies on products incorporating primary products as the gaps between the world and internal prices for those

primary products fell. The solution needed to be one that would permit adjustment rather than one which would permanently entrench these subsidies. It would have been preferable if the EEC assisted pasta producers with domestic subsidies rather than export subsidies. In the Pasta market, the objective of reducing the tariff on Pasta should have been a higher priority than reducing the export subsidies. Therefore, a transition could have been implemented by insisting on tariff reductions on the processed products, while binding the export subsidies to the value of the difference between internal and external prices for the incorporated primary products. The trade off for giving in to the EEC's position could have been tariff reductions. The tariff reductions could have been either accompanied by a reasonable expectation of a certain level of production or input subsidies on the processed product or by a formal limited immunity from non-violation nullification or impairment claims. The compensation for giving this immunity should have been the depth of the reduction in the tariff cut to the processed products.

3.6.2 Exposure of Export Subsidies to CVDs, and to Article XVI, Serious Prejudice and Non-Violation Complaints

An issue remaining would have been whether, apart from the definition of violations which would be inherent in the reduction commitments, there should be any change to the way that either countervailing duty or multilateral remedies could be taken against export subsidies or domestic subsidies.¹ Consider export subsidies first.

It is difficult to see any merit in relaxing the pre-Uruguay Round rules on countervailing duty remedies against export subsidies. They had been countervailable subject to an injury test and would continue to be so under the draft Agreement on Subsidies and Countervailing Duties included in the draft final act in Brussels ('1990 Subsidies Text').

As to multilateral remedies, the 1990 Subsidies Text had substantially varied the Article XVI tests. First, it made all export subsidies (those contingent on export performance) violations without incorporating the Article XVI distinction between primary and non-primary products. It also provided for remedies against non-export subsidies which caused

¹ See the suggestion by Baldwin that negotiation of reductions to subsidies should be accompanied by an immunity from CVD for the period of the reduction agreement: Baldwin, Robert E., "GATT Reform: Selected Issues" in Kierzkowski, Henryk, *Protection and Competition in International Trade* (Blackwell, Oxford, 1987) pp204-214 at 208.

serious prejudice. Though the complete prohibition of export subsidies made application of the concept of serious prejudice to non-export subsidies unnecessary, most of the difficulties with fitting into the Article XVI:3 criterion of 'more than an equitable share' were dealt with in the way that serious prejudice was defined. One of the ways in which serious prejudice was defined was a new version of the more than an equitable share test which replaced the criterion of 'more than equitable' with the simple criterion that party achieved a world market share in excess of a defined past share. One of the other ways in which serious prejudice was defined related to subsidies displacing or impeding exports of another signatory into a third country market but with a clear requirement to demonstrate trade effects in order to establish displacement or impediment.² It was clear that the EEC would not accept that the general prohibition on export subsidies could apply to export subsidies on agricultural products that were in conformity with the reduction commitments under the Agreement on Agriculture. It was necessary for the parties to reach agreement on whether the rules on serious prejudice would apply to subsidies in conformity with the reduction commitments.

Arguments had been made in the past that the non-violation nullification or impairment principles could apply to export subsidies impairing the benefits of access to third country markets.³ There was also an issue as to whether the parties should try to clarify whether the non-violation nullification or impairment principles could be used in that way against export subsidies in conformity with reduction commitments.

3.6.3 Exposure of Other Subsidies to CVDs, and to Serious Prejudice and Non-Violation Complaints

The application of CVDs to subsidies other than export subsidies was a problem that had arisen mainly as a result of the practices of the USA in applying its CVD law to various forms of domestic subsidy. This practice had caused significant friction. This had been partly resolved in the 1990 Subsidies Text by providing that domestic subsidies would only

2 See 1990 Subsidies text, article 6.5.

3 Eg, see Barcelo III, John J., "Subsidies and Countervailing Duties - analysis and a Proposal" (1977) 9 *Law & Policy in International Business* 779-853 at 847 making the argument that there would be a reasonable expectation that access to an export market will not be impaired by a production subsidy in a third country. Though he refers to a production subsidy, the argument would apply (a fortiori) to an export subsidy.

be countervailable if they were specific to an industry and by a strengthening of the injury test.⁴ Under the specificity test, most of the types of subsidies under negotiation in the agriculture negotiation would have continued to have been exposed to CVDs. In the subsidies negotiation, there was some disagreement about whether additional types of domestic subsidies should be immune from CVDs.⁵ The participants would have had to decide whether any immunity from CVDs should be applied the same way to domestic subsidies in agriculture as in other sectors or whether, in agriculture, the scope of the immune class of domestic subsidies should be broader.

Under the 1990 Subsidies text, domestic subsidies on agricultural products might also have exposed parties to the possible multilateral authorization of countermeasures where the subsidies caused serious prejudice, nullification or impairment or injury to a domestic industry of another party. At the Brussels meeting, some aspects of the draft subsidies text were still contentious: whether multilaterally authorized countermeasures against domestic subsidies should be subject to proof of minimum trade effects, and the negotiation of a green box of domestic subsidies which would not be exposed to multilaterally authorised countermeasures at all.⁶ Participants would have had to decide whether any immunity from multilaterally authorized remedies should apply the same way to domestic subsidies in agriculture as in other sectors or whether, in agriculture, the scope of the immune class of domestic subsidies should be broader.

These matters could have been resolved with a focus on the differences between the instruments and on what priorities in the negotiation might have been based on those differences between instruments. The guiding principle should have been that disciplines be tougher on export subsidies than domestic subsidies. The parties could have made export subsidies conforming to reduction commitments subject to both countervailing duties and multilaterally authorized remedies and made domestic subsidies immune from both tracks of remedies. The immunity could have been limited to the period of the implementation period leaving open the way to impose a stricter regulation of domestic subsidies in the future.

4 1990 Subsidies text, Article 1.2.

5 See the opening "Commentary" to the 1990 Subsidies text in Stewart (1993) Vol 3, p147.

6 See the opening "Commentary" to the 1990 Subsidies text in Stewart (1993) Vol 3, p147.

4 THE CONTINUATION OF THE NEGOTIATION

The above possible ways to resolve the negotiation were not adopted at Brussels. The Cairns Group and the USA remained committed to obtaining specific undertakings relating to the budget outlays of export subsidies and to the volume of subsidized exports. The Cairns Group was trying to apply such regulation to products exported with the aid of deficiency payments. It appears that neither of them had reached the stage of offering any immunities for agricultural products from the remedies under the Subsidies text.

It is submitted that giving in on some of these matters may have facilitated an agreement on import barriers on more favourable terms than the eventual outcome. We return to review the completion of the negotiation and the final rules contained in the Final Act.

CHAPTER 19

FROM BRUSSELS TO MARRAKESH - THE CONCLUSION OF THE URUGUAY ROUND NEGOTIATION ON AGRICULTURE

1 POST-BRUSSELS

The political developments which eventually led to the close of the agriculture negotiation have been well and elegantly documented by Croome, by Preeg and by Stewart.¹ It is not intended to repeat their work but only to outline the progression toward the final text and the resolution of the important variables. In addition, the focus of this work is the framework of rules and the principles embodied in them and in the last phase of the negotiations, there was little new input in the way of ideas. Rather the last phase consisted of the mustering of the political will to complete the negotiation in combination with a willingness to modify original positions.

The negotiation within the EEC over the reform of the CAP broke new ground in January 1991. The European Commission Agriculture Minister, Mr MacSharry announced proposals for major changes to the CAP. It was proposed that the CAP would move away from price support in favour of direct payments which would not be paid on the basis of output.² This would involve a transitional process under which support prices would be significantly reduced, for example by 35% on cereals, by 10% on dairy products and by 15% on beef.³ However, the EEC was still far from agreement on the reform.⁴

1 See Croome, *Reshaping the World Trading System* (1993) esp. pp294-297, 328-329, 338-341, 367-368 & 379; Preeg, *Traders in a Brave New World* (1995) chapter 6 "Farm Subsidy Showdown, 1991-1992" pp127-147 & Stewart, *The Uruguay Round Negotiations 1986-1991* (1993) pp204-228.

2 Preeg, (1995) p127, Stewart 205. These proposals were subsequently documented in, inter alia, EC, "The development and future of the common agricultural policy" (document drawn up on the basis of COM(91) 100 and COM(91) 258 in EC, *Bulletin of the European Communities*, Supplement 5/91.

3 See EC, *The development and future of the common agricultural policy*", as above, pp23, 30 & 31.

The USA governments' 'fast-track authority', under which it could present the trade negotiation package to congress for a yes or no vote, was due to expire on 31 May 1991 and it was required to allow for a consultation period of 90 days. Therefore, the latest date at which an agreement could be made for presentation to Congress under the fast track authority was 1 March. The USA government would need to seek an extension of fast track from Congress. However, the prospect of approval was diminished by the lack of progress in the agriculture negotiation and the President indicated that he was not prepared to seek approval unless some progress was made.⁵

After the Brussels meeting, De Zeeuw resigned as chairman of the negotiating group on agriculture. After that time, Dunkel acted as chairman. Until then, the EEC's position had been that there would be a global commitment on the AMS rather than separate commitments in the three areas. Dunkel proceeded with consultations with the parties on the basis that there would be commitments in each of the three areas. On 20 February 1991, Dunkel informed a meeting of the TNC that all participants had agreed to negotiate specific binding commitments in each area. Thus the agriculture negotiation recommenced and with it the whole of the Uruguay round.⁶

Despite the EEC's acquiescence to the division into the three areas, the EEC was still unprepared to make any undertakings that went in advance of their internal negotiation of reforms to the common agricultural policy.⁷ Thus the EEC wanted to be able to maintain whatever border protection was necessary to defend the producer prices that it set and did not want to make specific commitments on export subsidies that would require them to absorb additions to stockpiles.

Over 1991, the broader issues were put to one side to some extent and the parties proceeded with negotiations on the more technical issues. The entire negotiating group on agriculture

4 Eg, see, Ingersent, Rayner & Hine, *The EC Perspective*, ch4 in Ingersent, Rayner & Hine *Agriculture in the Uruguay Round* (1994) at 75-77.

5 Preeg, Ernest, *Traders in a Brave New World* (1995) pp127-128.

6 See Stewart, *The GATT Uruguay Round* p206. See also Petersmann, "The Uruguay Round Negotiations 1986-1991" in Petersmann & Hilf (eds), *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (Studies in Transnational Economic Law, volume 5) (Kluwer, Deventer, 2nd ed, 1990) pp501-577 at p576.

did not meet. Instead, meetings were held in various smaller groups, the group of 8 and the group of 36. The meetings covered a range of technical issues such as:

- the calculation of tariff equivalents and the inherent problems of obtaining measurements of world and domestic prices;
- the calculation of aggregate measures of support including the choice of base statistics, and the measurement of the support provided by various instruments;
- the delineation of the green box;
- the definition of export subsidies;
- the technical issues involved in measuring reductions to export subsidies; and
- the operation of a special safeguard mechanism which involved consideration of the various proposals to insulate reduction commitments to some extent from fluctuations in exchange rates and world prices.

As Preeg observes,

All of this technical work dealing with "instruments" set the stage for later decisions on the "numbers" (i.e., the percentage cuts in support) to be taken at the political level.⁸

During the year, bilateral negotiations continued between the EEC and the USA but differences persisted. There was little urgency in the negotiations until late in the year. The future of the negotiations was not assured until June when the United States congress extended the President's "fast track" authority to 31 March 1993. It was not until then that each of the outstanding negotiating groups recommenced substantial negotiations. In the latter half of the year, the likelihood of the USA and the EEC reaching agreement appeared to be low. Dunkel continued with negotiations and consultations as did the Secretariat staff. As had happened in early 1990, the participants looked to the chairman to make a proposal.

7 See Preeg's observation that the EC delegate remained silent during Dunkel's announcement on 20 February 1991 thereby not "having to state any formal change in the EC position": Preeg (1995) p128.

8 Preeg (1995) p134.

On 20 September 1991, Dunkel announced that he would put forward a text, a complete draft final act, including a draft agreement on agriculture, on a "take it or leave it basis".⁹

One essential element that Dunkel had to incorporate into his draft text was the numbers. In November, it became possible for him to choose some 'numbers'. In the preceding month, the disunity among the EEC had become more pronounced as the German Minister for Economics had announced in October that the EEC had to change its position on agriculture and on export subsidies. It began to be clear that, in the final analysis, even though no-one wanted to put the matter to a vote, France would not have enough support to block a decision on CAP reform. In November, USA President Bush met with the European Commission President Delors. They did not reach any agreement on advancing the negotiation. However, Mr Bush focussed the negotiation by putting forward some new 'numbers'. Instead of the previous demands for cuts of 90% and 75 % over 10 years, Bush offered to limit the USA's requests for reductions over 5 to 6 years of 35% on export subsidies and 30% on import barriers and internal support. These were roughly the same as the 'numbers' in the Hellstrom text with which the USA had indicated reluctant agreement at Brussels. However, with Bush's formal offer, the pressure was now firmly on the EEC.¹⁰

The USA and EEC continued to try to negotiate in the three areas but were still unable to reach agreement.¹¹ The Cairns Group, perhaps sensing that the USA and the EEC were going to reach a deal that would achieve only a very limited result in agriculture warned both that any bilateral deal between the USA and the EEC would have to be agreed multilaterally and also that negotiating on the basis of a lesser reduction over a 5-6 year period would only be a first step and would have to be supplemented by a commitment to continue the process.¹² Agreement could still not be reached during bilateral EEC-USA negotiations hosted by Dunkel on 19 and 20 December. However, Bush's offer to Delors and the subsequent progress must have been enough for Dunkel to make up his mind on the 'numbers' to be inserted into his draft agreement. The following day, on 20 December 1991,

9 See Preeg (1995) p135 citing "Journal of Commerce" August 19, 1991, quoting a statement of [US Trade Representative] Mrs Hills of July 31."

10 Preeg (1995) writes that in the weeks "through early December" the EC and the USA were engaged in negotiating commitments in all three areas: see p137.

11 See Preeg (1995) p138 & Stewart (1993) p212.

12 See Cairns Group, Communique, 9 December 1991.

Dunkel issued the 1991 Draft Final Act of the Uruguay Round.¹³ This time the draft final act included a draft agreement on agriculture which became known as the 'Dunkel Draft' or the 'Dunkel Text'.¹⁴ The whole text was put forward strictly on the basis that nothing would be agreed until everything was agreed.¹⁵

2 THE DUNKEL TEXT ON AGRICULTURE

A complete description of the Dunkel text would duplicate much of the material that follows in the next chapters which describes the content of the final Uruguay Round Agreement on Agriculture. The following chapters separately analyze those parts of the final Agriculture Agreement which deal with import barriers, export subsidies and internal support. What will be presented at this stage is a brief outline together with those important features of the Dunkel Text which will not be duplicated in the subsequent discussion and those aspects which were central to the final stages of the negotiation of the final agreement.

The Dunkel text was divided into 4 parts :

Part A: Uruguay Round Agreement On Agriculture

Part B: Agreement On Modalities For the Establishment of Specific Binding Commitments Under the Reform Programme

Part C: Decision By Contracting Parties On the Application Of Sanitary and Phytosanitary Measures

Part D: Declaration On Measures Concerning the Possible Negative Effects of the Reform Programme on Net Food-Importing Countries

This thesis does not deal with the matters dealt with in Part C. Part D was Dunkel's way of dealing with an important issue affecting some developing countries, clearly indicating that the issue had to be dealt with in a manner that did not undermine the reform programme.

13 "Draft Final Act embodying the Results of the Uruguay Round of Multilateral Trade Negotiations", GATT, MTN.TNC/W/FA dated 20 December 1991 ("draft Final Act 1991").

14 Which is part L of MTN.TNC/W/FA

15 Draft Final Act 1991, p1.

The principal part of the text on agriculture was divided into Part A, a draft Agreement, and Part B, an agreement on modalities. To some extent, the division reflected a separation of contentious from non-contentious matters. However, the principal function of the division was that Part B of the text served to facilitate the negotiation of the schedules of concessions which would come into effect in accordance with the provisions of Part A. Upon completion of the negotiation of the concessions, those concessions would be given legal force by the provisions of Part A and there would be no need for part B to remain in the agreement.

Part A contains provisions under which specific commitments on import access, export subsidies and domestic support could come into force. Part B contained rules for the way in which the specific commitments would be given. Therefore, the actual draft Agreement on Agriculture in Part A did not contain any detail about what commitments would be given: the terms of measurement, the size of reductions or the timeframe for reduction. All of that was in Part B. It was contemplated that the need to make changes to Part A would be minimal and that once the specific commitments had been entered into Schedules, then Part A could come into force without Part B. There was some possibility that there might be something from Part B that might have to be incorporated into Part A but generally, the strategy behind the Dunkel text was that Part B would not be necessary once the Schedules came into force. Effectively, this would place enormous pressure on parties not to push for amendments of Part A. It shifted the focus of negotiations onto the Schedules of Concessions. The structure of the agreement in two parts also meant that the EEC could negotiate upon the basis of part A without having to concede anything in the substance of the negotiation. It could still submit list of commitments that were in line with its previously stated position. The same can be said for the other countries too. Countries could submit lists of commitments that deviated from the guidelines in Part B whilst still being able to work within the confines of Part A. In that situation, there would be an argument over the commitments but not over the framework. The following description of the three areas is intentionally brief.

2.1 THE SPECIFIC COMMITMENTS

Part B called for parties to submit lists of commitments by 1 March 1992 on all of the products covered. The scope of coverage was defined by reference to the relevant part of the Harmonized System of customs classification which included some products processed from agricultural products as well as primary agricultural products.¹⁶ The text included 8 pro-forma tables in formats that could become part of the schedules of concessions incorporated in the agreement. The Tables contained lists of commitments in the various areas :

- (1) Lists relating to Ordinary Customs Duties, including those resulting from tariffication;
- (2) Lists relating to Current Access;
- (3) Lists relating to Minimum Access;
- (4) Product-Specific Aggregate Measurements of Support;
- (5) Domestic Support Equivalent Commitments [for circumstances where calculation of AMS would be impractical];
- (6) Non-Product Specific AMS;
- (7) Export subsidies: budgetary outlay and quantity reduction commitments;
- (8) Other commitments limiting the scope of export subsidies.

It also contained the format for 11 supporting tables which were supposed to contain information that would explain how the commitments had been arrived at. Later in January 1992, the Secretariat issued an 'informal technical note' to assist parties in preparation of their lists.¹⁷ The informal technical note contained detailed instructions on how to complete the supporting tables and the principal lists of commitments.

16 Dunkel text, Part B, Annex 1.

17 "Explanatory Notes on the Formats for the Establishment of Lists of Specific Binding Commitments under the Agriculture Reform Programme, Informal Technical Note by the Secretariat", dated 27 January 1992

2.2 IMPORT ACCESS

The agreement referred to schedules on tariff rates and also other market access commitments (allowing for tariff rate quotas). Apart from bringing the schedules of concessions into force, the draft also had to deal with imposing the prohibition on quantitative restrictions. It would not be sufficient to merely rely on Article XI:1 because it was arguable that some of the measures being tariffied (for example, variable levies) were not violations of Article XI:1. Therefore the text added the following:

Article 4(2): Participants undertake not to resort to, or revert to, any measures which have been converted into ordinary customs duties pursuant to concession under this Agreement.

The effect of that would be that if every country tariffied all non-tariff barriers on all products, then an effective prohibition would be in force. However, if any parties left certain products or measures out of their Schedules of Concessions, then that would leave holes in the application of a prohibition under Article 4(2). Arguably there were a few other loopholes in the provision, for example, whether it covered countries which resorted for the first time to a particular measure previously used by another country.

Part B contained the rules for tariffication, binding and reductions. It provided that tariffication should be applied to all border measures other than ordinary customs duties except those maintained under Articles XII, XXVIII, XIX, XX or XXI and gave a list of measures that should be tariffied including variable levies. Article XI:2 was not included in the list of exceptions.¹⁸ The calculation of tariff equivalents was to be based on the difference between a representative internal wholesale price and external cif prices¹⁹ using data for the years 1986-1988. The supporting tables were supposed to show the data for each year and the calculation of the average for 1986-1988.²⁰ The tariff equivalents were to be bound.²¹ The tariff rates on any unbound products on which there were no non-tariff barriers were to be bound at the 1986 rate for developed countries, with developing

18 See Dunkel Text, Annex 3, Section A, para 1 and the footnote to it.

19 Cif prices include freight and insurance to the port of destination.

20 See Dunkel Text, Supporting Table 1 "Tariff Equivalents: Tariff Equivalents Calculated Directly from Price Comparisons" and Table 2 "Tariff Equivalents: Derived Tariff Equivalents for Transformed and Processed Products".

21 Dunkel Text, Part B, para 7.

countries being able to bind at a rate to be negotiated (called a ceiling rate because it is higher than the rate actually charged).²²

All of the tariffs were to be reduced over a six year period between 1993 and 1999. Reductions were to be 36% on a simple average of tariff lines rather than a trade weighted average and with a minimum reduction of 15% for each tariff line. For developing countries, the rate of reduction was to be two thirds that applicable to developed countries and the reductions were to be implemented over 10 years instead of 6.²³

Roughly in line with the USA proposals, the text also provided for minimum access quotas and current access quotas and for their expansion.

The text contained a formulation of the special safeguards clause. In essence, it provided for two alternative safeguards clauses: one which could be resorted to in the case of increases in the volume of imports, and another which could be resorted to in the case of falls in price.²⁴ The tariff surcharges imposed under the volume trigger could not exceed 30% of the ordinary tariff rate and those imposed under the price trigger could not exceed a defined proportion of the difference between a 1986-1988 baseline price and the actual import price.

2.3 EXPORT SUBSIDIES

Part A contained an obligations not to pay export subsidies in excess of those set out in the export subsidy commitments.²⁵ The obligation applied to those export subsidies contained in a list.²⁶ In any given year, parties could not exceed the maximum levels of export subsidy expenditure specified for that year in budget outlay commitments nor the maximum quantity of subsidized exports specified for that year in quantity commitments.²⁷

Part B provided for commitments to implement a 36% reduction in budget outlays and a 24% reduction in quantity subsidized over a six year period from 1993 to 1999.²⁸ These

22 Dunkel Text, Part B, para 3 & 14 and Informal Technical Note, p9 on Table 1, column 3.

23 Dunkel Text, Part B, Article 16.

24 Dunkel Text, Part A, Article 5(1)(I) & (ii).

25 Dunkel Text, Part A, Article 8.

26 Dunkel Text, Part A, Article 9(1).

27 Dunkel Text, Part A, Article 9(2).

28 Dunkel Text, Part B, Article 11.

commitments were supposed to be given separately in respect of 22 product groupings.²⁹ The baselines were supposed to be the averages of outlay and quantities for the years 1986-1990.³⁰ After the first year, there was some limited flexibility to delay reductions until later years provided that the required end point were reached by the end of the implementation period.³¹ Developing countries could apply reductions of 24% to budget outlays and 16% to volume over 10 years.³²

2.4 DOMESTIC SUPPORT

Part A contained an obligation not to provide non-exempt domestic support in excess of that set out in the domestic support commitments.³³ The text contemplated commitments on each specific product relating to product-specific support and on total non product-specific support being made either in terms of an Aggregate Measure of Support or on an equivalent basis.³⁴ The obligation did not apply to measures within a green box category³⁵ or to support below de minimis levels related to the value of production (which were higher for developing countries).³⁶ The text contained elaborate definition of the policies contained within the green box. In particular, the green box rules only included direct payments which were decoupled from production as determined by a number of cumulative criteria:

- that payments were funded by government not involving transfers from consumers;
- that payments did not provide price support to producers;
- that eligibility was determined by criteria established in a base period;
- that payments were related to production in any year after the base year;
- that payments were not related to prices in any year after the base year; and
- that payments were not related to factors of production employed in any year after the base year.³⁷

29 Dunkel Text, Part B, Annex 8, Article 7.

30 Dunkel Text, Part B, Article 11 & Annex 8, Article 3.

31 Dunkel Text, Part B, Annex B, Article 6.

32 Dunkel Text, Part A, Article 15.

33 Dunkel Text, Part A, Article 6(1).

34 Dunkel Text, Part A, Article 6(3).

35 Dunkel Text, Part A, Article 6(1) & Annex 2.

36 Dunkel Text, Part A, Article 6(4).

37 Dunkel Text, Part A, Annex 2, paras 1,5 & 6.

Part B provided for the way that the domestic commitments were to be made.³⁸ It provided for the method of calculation of AMS in monetary terms based on volume of production supported multiplied by the per unit support. The per unit support was to be calculated upon the basis of support above the internal price used for determining support in the years 1986 to 1988 whether in the form of price support or deficiency payments.³⁹ Where calculation of AMS was impractical, commitments were to be reduced to a monetary value in a similar way. The commitments were to implement a reduction by 20% from the support calculated for the period 1986 to 1988.⁴⁰ For developing countries, the rate was to be 13.66% over 10 years.⁴¹

2.5 CONTINUATION OF REFORM

The Dunkel text acknowledged that the reforms which it envisaged would only be one step in a continuing programme of reform. Article 19 provided for negotiations on possible further reforms to be initiated one year before the end of the implementation period.

3 POST DUNKEL TEXT DEVELOPMENTS

3.1 ADOPTION OF THE TEXT FOR NEGOTIATIONS

Most parties, including the USA, were prepared to use the Dunkel Text as the basis for completing the negotiation. Some Cairns Group countries declared that they could accept the text as it was. However, the EEC immediately said that they wanted to change the text. On 23 December, a meeting of EEC trade and agriculture ministers declared that the text was unacceptable and had to be changed.⁴² The greatest objections of the EEC were that the green box did not include the new direct payments under the CAP, that rebalancing had not been addressed and the inclusion of export subsidy cuts in terms of volume.⁴³

It was clear that Dunkel would try to avoid changing the text. Dunkel took the view that all parties should be able to fit both their own commitments and those that they desired from

38 Dunkel Text, Part B, Article 8-10.

39 Dunkel Text, Part B, Annex 5, paras 8-11.

40 Dunkel Text, Part B, Article 8.

41 Dunkel Text, Part A, Article 15.

42 See Croome (1995) p328, Preeg (1996) p140, Stewart (1993) p215-216.

43 Stewart (1995) pp215-216.

other parties within the framework provided by the draft text and that there should be no need to change the text itself.

In the new year, Dunkel convened a the meeting of the TNC on 13 January 1992. The parties adopted a four track approach to concluding the Uruguay Round as follows:

- Track 1: specific commitments on goods
- Track 2: commitments on services
- Track 3: legal drafting group
- Track 4: substantive changes

They resolved that track 4 should not occur until tracks 1, 2, and 3 had been advanced as far as possible. This left the door open to suggestions for amendments to the text but it confirmed that consideration of amendments to the text would be deferred until after the negotiation of schedules of commitments. The situation created was that all negotiators were aware that if one party suggested a change in the text then other parties might do the same, which might lead to a breakdown in the negotiation. Therefore, the strategy created a reluctance on all parties to upset the progress of the negotiation of commitments by suggesting changes to the text.⁴⁴

3.2 FACTORS AFFECTING THE NEGOTIATION

There were a number of factors that affected the progress of the negotiation, the concessions that were made and the timing of them: the ongoing negotiation of CAP reform; the Treaty of Maastricht and the referenda in various EEC countries especially in France in September 1992, the Presidential elections in the USA in November 1992, the issue surrounding the secession of Quebec from Canada and the general elections in France in July 1993.⁴⁵ Of course, immediately after the TNC meeting in January 1991, the attention of world leaders was not directed toward completion of the Uruguay Round because of commencement of the Gulf war in Iraq. It is not intended to offer any narration of the effect of these matters. However, there are two important events that must be mentioned because of their direct

⁴⁴ See Croome (1995) p329.

⁴⁵ Some of these matters and others are addressed in Preeg (1996) p140ff, Croome (1995) p328ff.

relevance to the framework of rules under negotiation: the follow-up report of the Oilseeds panel; and the announcement of CAP reforms in May 1992.

3.2.1 The CAP Reform of May 1992

In May 1992, the members of the EEC completed negotiation of the reforms proposed by Minister MacSharry in January 1991 and in June 1992, the package was adopted by the European Council of Ministers.⁴⁶ This brought into effect the reduction in support prices and the compensation by direct payments. The reductions in support prices were in line with MacSharry's proposals except that the reduction for cereals was 29% instead of the originally proposed 35%.⁴⁷ Eligibility for the compensation payments was subject to compliance with a set-aside programme.⁴⁸ With agreement on these matters, the EEC was able to project the import barriers needed and was able to project what size reduction in the AMS would occur as a result of the reform. This would depend, of course, on whether the CAP payments were counted in the AMS. If the CAP payments were not counted, then the reform would account for a reduction in the AMS well in excess of the 20% required by the Dunkel text.⁴⁹ The reforms also gave the EEC the ability to predict the amount of grain production. However, the EEC was still not ready to commit itself to a limit on the volume of grain that could receive export subsidies because it could still not predict the EEC demand for grains. It could not do this until it tried all possibilities for shifting animal feed consumption from grains to grain substitutes. These efforts were still dependent on the outcome in the oilseeds dispute.

3.2.2 The Follow Up Report of the Oilseeds Panel

The discussion of the Oilseeds case in chapter 13 above described how the panel made the two findings, that the subsidies to purchasers of oilseeds were in violation of Article III and that they constituted non-violation nullification or impairment but refrained from making

46 Commission of the European Communities, *Our Farming Future* (Office for Official Publications of the European Communities, Luxembourg, 1993) p21.

47 EC, *Our Farming Future*, as above, p22.

48 The details of the regulations providing for the new support prices, set aside programmes and direct payments are set out separately for the various products in Ekemans, Jeanine, "Agricultural Markets: The New Regulations", *Green Europe* 1/93 (Office for Official Publications of the European Communities, Luxembourg, 1993).

49 See Josling, Tangermann & Warley (1996) p156 saying that the EC would be within the 30% reduction target that had been set out in the Hellstrom text.

any recommendation on the second finding upon the basis that removal of the violation might also remove the nullification or impairment. In the analysis of the first part of the agriculture negotiation, in chapter 16 above, the impact of this decision on the EEC negotiating position was considered. It meant that the EEC had to change the way it structured the CAP for bound products. It could no longer use subsidies to purchasers of these products as a way of maintaining price support to producers. Therefore, the EEC had to devise a new way of providing support to oilseeds producers.

The EEC's new scheme was enacted on 12 December, published on 24 December, four days after release of the Dunkel text, and came into effect three days later.⁵⁰ As mentioned in the analysis of the case in chapter 5, the panel reconvened in February 1992. As noted above the EEC presented arguments to the panel about whether the payments constituted "decoupled income support". These arguments seemed to be irrelevant to the question of nullification or impairment but rather were directed to drawing some comment from the USA and from the panel as to whether the new CAP payments would fall within the green box under the Dunkel text. As observed above, the USA took the bait. It responded with arguments on this point:

- (i) that the CAP payments were based on the type or volume of production because producers has to be engaged in production and payment was conditioned on harvest of a crop (contrary to paragraphs 6(ii) and (v) of Annex 2 of the Dunkel Text);
- (ii) that the CAP payments were based on factors of production since they were tied to use of land (contrary to paragraph 6(iv) of annex 2 of the Dunkel Text).

As observed above, after the EEC had drawn the USA into making these submissions, it responded by declaring them to be irrelevant.

Although, the panel was not drawn into commenting on whether the payments fell into the green box, one of the steps in making its finding that the subsidies caused nullification or impairment was that the subsidies were product-specific. To reach the finding that the

50 "Follow-Up on the Panel Report "European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins" DSR28/R, 31 March 1992, GATT *BISD* 39S/91, p2, para 3 & p3, para 7. See above, chapter 13, at section 8.3.

subsidies were product specific, the panel relied on the facts that the payments were paid in respect of oilseeds, they supplemented income from oilseeds, payment was almost always dependent on proof of harvest of oilseeds and the subsidies were linked with yields of oilseeds.

The panel decision had two consequences for the EEC in continuing negotiations on agriculture.

- (i) First, the type of payments the EEC had introduced for the CAP for oilseeds and was contemplating introducing into the CAP for other products did not fit into the draft of the green box. Not only would they be prevented from increasing payments of this kind as they reduced the support to producer prices but they would have to subject them to reduction commitments.
- (ii) Secondly, these payments exposed the EEC to actions based on non-violation nullification or impairment; and a similar exposure would exist in relation to other products if tariff bindings were given and the EEC switched from providing price support to direct payments.

On the second point, it is worth considering whether the USA might also have been concerned about the effect of the decision on nullification or impairment on any subsidies that the USA might pay in future. Under the Dunkel text, any deficiency payments in existence at the date of the UR bindings would be subject to the AMS reductions. In addition, such subsidies being product specific would also be exposed to non-violation nullification or impairment actions. In particular, for those products with non-tariff barriers then imposed under the *Agricultural Adjustment Act*, it would not be possible for the US government to use deficiency payments to compensate farmers for falling tariffs. It must be borne in mind that at this stage of the negotiation, the USA was facing an outcome that would leave world agriculture markets still substantially distorted by the effects of the CAP and, consequently, would leave the USA government still subject to pressure to protect farmers from the effects of the CAP.

The follow-up report of the panel was distributed on 31 March 1992. Consideration of the report was deferred by the GATT Council on 30 April. The USA threatened trade sanctions

and by 12 June had published a list of products upon which sanctions were proposed to be imposed.⁵¹ At the Council meeting of 19 June, the EEC sought and was given authorization to enter into Article XXVIII:4 ('closed season'⁵²) negotiations for modification of the relevant tariff bindings. The follow-up report itself was still not adopted. Either the EEC made known its objection to the adoption of the report or the USA did not press for its adoption but the end result was that no new recommendation was made to remove the nullification or impairment.⁵³ Therefore, the recommendation from the original panel report stood as the only finding of non-violation nullification or impairment caused by a subsidy adopted by the CONTRACTING PARTIES. That finding was subject to a reservation by the EEC and was based on the fact that the subsidy completely prevented world prices from having any impact on the competitive relationship between domestic and imported oilseeds.⁵⁴

The opening of the Article XXVIII negotiation provided a forum not only for the negotiation on the modification of the concessions but also for the related questions which were still unresolved between them in the agriculture negotiation: the rebalancing of protection for oilseeds and other non-grain animal feeds, whether the direct payments under the CAP would be subject to AMS reductions, and whether given the conditions existing in the oilseeds and grain markets, the EEC could make a commitment to limit the volume of grains receiving export subsidies.

4 THE REMAINING VARIABLES IN THE NEGOTIATION

By the time that the USA and the EEC engaged in the Article XXVIII negotiations, the process of making out lists under the Dunkel Text was well advanced. Everyone had had a chance to analyze the Dunkel Text and to work out if there was anything that they wanted to change. It had also become clear to everyone that, in respect of most areas of contention, in the end, the important thing would be the content of the schedules not the content of the text of the Agreement. However, many parties had failed to submit lists. In fact, by the middle

51 See Stewart (1993) p219.

52 See above in chapter 2 at section 4.6(c) "The Three Variant Article XXVIII Procedures".

53 Note that Josling, Tangermann & Warley (1996) at p159 record that the EC blocked adoption of the report.

54 See above in chapter 13, section 8.3.

of September 1992, only 43 participants had submitted lists.⁵⁵ As lists were composed and officially exchanged or as information was informally exchanged about the content of each others lists, there was evidence that many countries were completing draft schedules that deviated substantially from the guidelines of Part B of the text. There were products upon which tariff bindings were omitted and calculation of tariff equivalents which appeared not to be within the rules. The commitments on export subsidies and internal support varied largely because of different approaches to dividing the commitments into product areas. In particular, the lists submitted by the EEC set out baselines for reductions without the reductions.⁵⁶ The list submitted by Canada did not tariffy restrictions on certain products.⁵⁷ Negotiations continued on obtaining lists from those that had not yet submitted them. However, to some extent participants were able to avoid or delay conforming their commitments to the rules because of the lack of urgency in the negotiation. There was no point conceding anything until the USA and the EEC reached agreement. However, the matters in contention had all emerged and, arguably, the likely endgame was becoming to a large extent predictable. The passage below sets out the variables that remained.

4.1 IMPORT ACCESS

4.1.1 The abolition of Quantitative Restrictions

There was a question as to whether the tariffication of quantitative restrictions would be comprehensive, applying to all countries and all products. A number of countries were seeking to make exceptions for particular products:

- Japan on rice;
- Korea on rice and beef;
- Canada on dairy products and poultry;
- Switzerland on dairy products, particularly cheese;
- EEC on bananas.

55 See Preeg (1996) p168.

56 See Ingersent, Rayner & Hine, "The EC Perspective" ch 4 in Ingersent, Rayner & Hine, *Agriculture in the Uruguay Round* (1994) p80.

57 The author understands this to be the case. See Ingersent, Rayner & Hine, "Agriculture in the Uruguay Round: an Assessment" ch 12 in Ingersent, Rayner & Hine, *Agriculture in the Uruguay Round* (1994) p277 referring to Canada's 'maverick position' on the retention of some import quotas.

In some cases, these arguments for exceptions were based on an argument that the restrictions were justified under Article XI:2(c) and that that exception should be retained. By this time however, the adoption by the CONTRACTING PARTIES of the strict approach to Article XI:2(c) in the Japanese twelve products case had been followed by the adoption of the reports in the Canadian Icecream case, the EEC Apples case and the EEC Dessert Apples case.⁵⁸ It was reasonably clear that any of these countries would have a difficult task justifying their restrictions under that Article.⁵⁹ The Canadians supplemented their with proposals for improvements to Article XI:2. All of these countries arguing for exceptions based their position on the extreme political sensitivity of the protection for the particular products. For the Japanese and Koreans, the rice farmers had significant political influence and significant sympathy from the rest of the population.⁶⁰ The Canadian position was extremely sensitive because many of the protected farmers were in Quebec which was the subject of a political debate about secession from Canada.⁶¹ The EEC position on bananas was a consequence of the existing preferential import quotas which the EEC provided for former colonies.⁶²

4.1.2 The establishment of bound tariff rates

Apart from those countries seeking exemptions for their quantitative restrictions, other issues to be resolved related to the manner of calculation of the tariff rates and whether they had to be bound. As mentioned above, since it would be the schedules of concessions rather than the Text of Part B which would come into legal force, parties were able to take as much latitude with the calculations under Part B as they could get away with. Indeed, Annex 3

58 See above, chapter 11, at section 4.4 "Agricultural Exceptions" esp at 313.

59 Eg, with respect to Japan's rice prohibition, see Matsushita, Mitsuo, "Constitutional Framework of the Major Trade Laws in Japan: In the Context of the Uruguay Round" in Hilf, Meinhard, & Petersmann, Ernst-Ulrich, *National Constitutions and International Economic Law* (Kluwer, Deventer, 1993) pp275-297 at 283.

60 On the political sensitivity of protection from rice imports in Japan, see Hemmi, Kenzo, "The Japanese Perspective" in Ingersent, Rayner & Hine, *Agriculture in the Uruguay Round* (1994) pp140-156 and Jones, Randall S., "Political Economy of Japan's Agricultural Policies" (1989) 12(1) *World Economy* 29-39.

61 This point was put bluntly by Warley: "Canada's negotiating position on Article XI is driven in large measure by the imperative of preserving national political unity and ensuring the very survival of the country": see Warley, T.K., "The Canadian Perspective" ch6 in Ingersent, Rayner & Hine, *Agriculture in the Uruguay Round* (1994) pp110-139 at 123.

62 For a succinct description of the complicated regimes for bananas, see Raboy, David G., Simpson, Teri L. & Xu, Bing, "A Transition Proposal for Lome Convention Trade Preferences: The Case of the EU Banana Regime" (1995) 18(4) *World Economy* 565-581 at 567-568.

allowed a certain amount of latitude. Parties could choose a representative wholesale price thereby giving a certain scope to countries with different wholesale prices for different regions to choose a region with a higher price as being representative or to choose the highest of administered prices for different regions. Parties had to calculate an average cif price. Of course, it was intended that prices should not include freight within the importing country but no doubt there would have been cases in which it would have been difficult to separate external freight from internal freight costs. Annex 3 also sanctioned the use of an appropriate coefficient to adjust for quality or variety.⁶³ The agreement did not provide any detail on what was an appropriate coefficient so this would have become purely a matter of negotiation. In addition, developing countries were given the flexibility to use ceiling bindings as high as they could negotiate. Apart from the latitude given by the text of part B, there was room for parties to try to negotiate that particular products be omitted or that particular rates be higher.

A particular problem with respect to the calculation of tariff equivalents by the EEC had not been dealt with in the Dunkel Text. In keeping with the view that Community preference was a fundamental tenet of the common market, in 1990, the EEC had proposed that their tariff equivalents would be the Intervention Price plus a margin of 10%.⁶⁴ Prior to CAP reform, variable levies had been calculated as the difference between the world price and the Threshold Price. The Threshold Price had been set below the Target Price by a margin which was a rough allowance for the cost of transporting imports inland for sale.⁶⁵ The Intervention Price had been below both of the other prices, usually about 10% below the Target Price and below the Threshold Price by a smaller margin.⁶⁶ Therefore, the original proposal had been that the tariff equivalents would be approximately based on the Target Price. Since the Target Price was a margin above the Threshold Price, then the tariff equivalents thus calculated would in fact be higher than the average variable levies that had been in place. The Dunkel Text had ignored this demand for a 10% margin and had stated that the tariffication should be based on a representative wholesale price. After formulating

63 Dunkel Text, Part B, Annex 3, para 7.

64 European Community Offer on Agriculture for the Uruguay Round of the GATT Negotiations, 8 November 1990 (EC, Brussels, 1990), p3, para 9.

65 EC, *The Common Agricultural Policy and its Reform* (Office for Official Publications of the European Communities, 4th ed, 1987) pp19-20.

66 Kerr, Anthony, *The Common Market and How It Works* (Pergamon Press, Oxford, 1983) p72-73.

the plan for the reform of the CAP, the EEC still wanted to set the tariff equivalents at a 10% margin above the internal market price. Under the new CAP, the Target Price remained the price that EEC producers would receive from the market. However, now the Threshold Price became the total of the Target price, being the price that the producer would receive from the market, plus the direct compensation payment (exclusive of any additional amount paid for set-aside). The Threshold Price was set at a level of 10% above the Target Price.⁶⁷ The 10% margin was described as a margin for Community Preference.⁶⁸ The Intervention Price was set at 10% below the Target Price.⁶⁹ The EEC continued to maintain that the tariff equivalents should be based on the Target Price (which being 10% above the intervention price was roughly 10% above the EEC wholesale price). If the EEC could not use the Target Price as the basis of its tariff equivalents then it would have to increase the compensation payments in order to maintain the same returns to farmers. One can wonder why the EEC needed to place so much stress on maintaining community preference, for as soon as it became clear that proposals for reducing import barriers to zero would not be implemented then there was no threat to community preference. In fact, the stress placed on community preference appears to be more of a slight of hand to prevent the concept of community preference from obstructing further tariff reductions because by describing the margin above the Target Price up to the Threshold Price as community preference, the payment for the community preference was subtly shifted from transfers from consumers to transfers from taxpayers.

4.1.3 Tariff Reduction Rates

Obviously, the single biggest factor that would influence the tariff reductions would be the selection of the bound rate from which the reductions would commence.

Apart from that, in particular, in relation to developing countries, arguably, the text was ambiguous as to whether as well as being able to reduce tariffs by an average of 24% instead

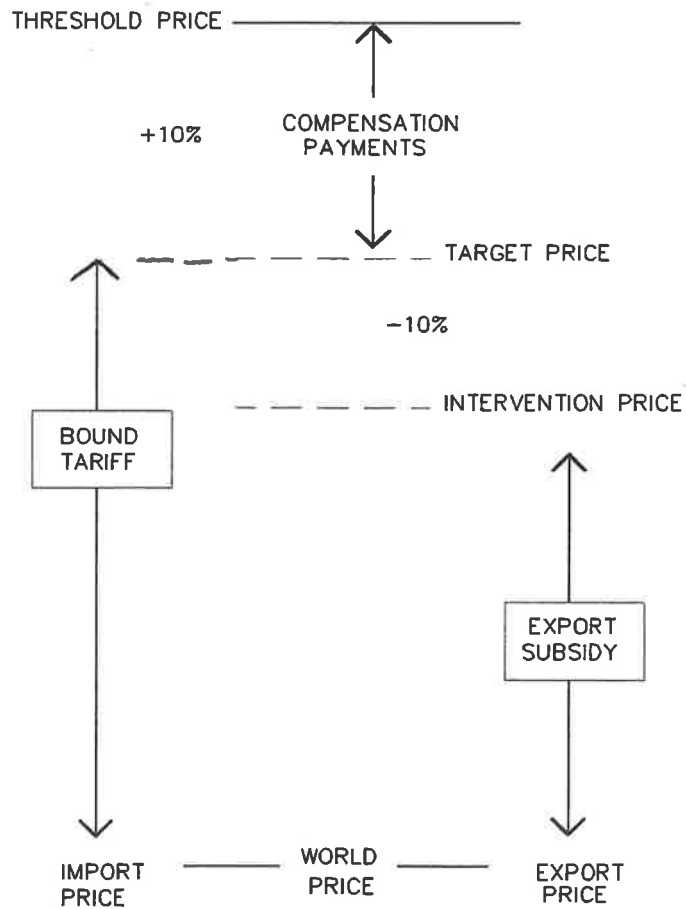
67 EC, "The development and future of the common agricultural policy" (document drawn up on the basis of COM(91) 100 and COM(91) 258 in EC, *Bulletin of the European Communities*, Supplement 5/91, p23, para B.1(a.1).

68 Eg, see Green Europe 1/93, as above, at p8, "The threshold price will be ECU 45 higher than the target price to ensure adequate Community preference.

69 EC, "The development and future of the common agricultural policy" (document drawn up on the basis of COM(91) 100 and COM(91) 258 in EC, *Bulletin of the European Communities*, Supplement 5/91, p23, para B.1(a.1).

COMMON AGRICULTURAL POLICY FOR WHEAT

POST MAY 1992 REFORM



Based on information in European Communities
"The development and future of the common
agricultural policy."

Bulletin of the European Communities, supplement 5/91

of 36%, they were also able to apply a minimum rate of reduction for any individual tariff line of 10% instead of 15%.⁷⁰

4.1.4 Tariff Rate Quotas

With respect to Current Access Quotas, there was room for negotiation over the size of the quotas. However, there was more disagreement over Minimum Access Quotas. The insertion of this element into the text did not reflect a broad consensus on the need for these quotas. Some parties disagreed with the concept. Others had concerns about applying the concept to particular products, particularly basic food products, or with the proposed size of the access requirement. Of course, the size of the minimum access quota would be dependent upon the data that was used for consumption.

The text seemed to be consistent with the view that current access imports could satisfy the minimum access quota. In particular, the EEC would have been concerned that imports from ACP countries could count to satisfy the minimum access quotas.

With the reduction in the extent of the proposed reforms, the earlier submissions that tariff rate quotas would be a temporary measure to be abolished when tariffs reached a low rate could not be maintained because the reform programme would not reach the point at which it had been anticipated that the tariff quotas would be abolished. Therefore, the negotiation over tariff quotas had to be considered in a new light. The tariff quotas could be abolished at the end of some future extension of the reform programme. However, they had to be negotiated on the basis that the tariff quotas in place at the end of the implementation period would remain in place until renegotiated under a continuation of the reform programme.

4.1.5 Special Safeguard Provision

The most significant aspect of import access contained in the text rather than the schedule was the formulation of the special safeguards clause. The Cairns Group was happy to accept the safeguards clause as it was. However, the safeguards clause had failed to accommodate all of the demands of the EEC for insulation from price and exchange rate movements.

70 Dunkel Text, Part B, para 15.

There remained a question as to whether the EEC would insist on any broadening of the clause.

4.2 EXPORT SUBSIDIES

There would have been some discontent as to whether the 36% reduction in export subsidies was too big or too small but, in general, this was regarded as being unlikely to change. In addition, those parties that had argued for export subsidy commitments on a per unit basis would have been disappointed by the failure to include this in the text and would not have been optimistic at having such obligations added.

However, the two areas where debate continued were the size of the volume reductions and the extent to which the commitments had to be made separately for different products or could be made on an aggregate basis. There was a possibility of a trade off between these two areas.

4.3 INTERNAL SUPPORT

Throughout the negotiation, the EEC had opposed having a higher rate of reductions applied to its export subsidies than that which would be applied to the USA deficiency payments. However, that was the position proposed by the Text with the choice of the rate of only 20% for internal support reductions. The EEC had not conceded agreement to this different treatment. However, any contention on this point had to be considered in the light of the different baselines adopted for the reductions of export subsidies and internal support. For internal support, the base line period was 1986-1988 whereas, for export subsidies, the baseline was the later period of 1986-1988.

The EEC insisted that the new direct compensation payment under the reformed CAP had to be exempt from reduction commitments. Therefore, an argument developed as to whether the green box could be expanded to include these payments or whether an additional category falling between the amber box and the green box should be created. Any category created to accommodate the CAP payments would be open to be utilized by any other party. Arguably, it was clear at the time (and certainly is clear in retrospect) that the USA would only make a concession to the EEC on this point if it resulted in similar treatment for the USA's deficiency payments.

Some other aspects of the scope of the green box would have to be decided. Whereas the Text had made provision for the use of production linked payments in situations where the payment was designed to encourage farmers to produce something other than drugs,⁷¹ the text did not make any provision for payments designed to encourage farmers to shift production from one food crop into another. Some parties still sought to use production linked payments in this way.

In addition, the parties would also have to decide whether some aggregation of different products would be permitted for the purpose of internal support commitments.

4.4 PEACE CLAUSE

The Dunkel Text already contained a partial peace clause which addressed some of the matters that were set out at the end of the last chapter:⁷²

- (i) Article 7(3) provided that the green box subsidies would not be countervailable;
- (ii) Article 12 provided that for both export subsidies and domestic subsidies applied in conformity with the agreement, there would be a presumption that they did not cause serious prejudice; and
- (iii) Article 18(2) provided that parties would exercise "due restraint in the application of their rights under the General Agreement in relation to products included in the reform programme".

These matters were probably accepted as a minimum peace clause. However, other aspects of the peace clause were still in dispute:

- (i) whether export subsidies conforming to reduction commitments would be exposed to:
 - (a) countervailing duties; or
 - (b) non-violation complaints;
- (ii) whether domestic subsidies conforming to reduction commitments would be exposed to:

71 Dunkel Text, Part B, Article 6(2).

72 See above, chapter 18, pp8-9.

- (a) countervailing duties; or
 - (b) non-violation complaints; and
- (iii) whether domestic subsidies in the green box would be exposed to non-violation complaints (the text already insulated them from CVDs).

5 THE BLAIR HOUSE ACCORD - NOVEMBER 1992

None of these matters could be finalized until the EEC and the USA reached agreement, a precondition for which was that they also reach agreement on resolution of the Article XXVIII negotiation on oilseeds. The EEC and the USA did not reach a conclusion on either of these matters until November 1992. The catalyst for the agreement was the threat by the outgoing USA administration to impose trade sanctions by 5 December of 200% tariffs on US\$ 300 million of imports from the EEC as the first step toward imposing sanctions on US\$ 1 billion worth of trade. The choice of products for the sanctions (including white wine) focussed substantially on France.⁷³ France threatened counter sanctions but most EEC members failed to support it.⁷⁴ The enormity of the amount of trade involved meant that the coming to pass of a trade war on this scale would threaten the possibility of concluding the Uruguay Round.⁷⁵ There can be little doubt that the raising of the stakes brought the dispute to a resolution. However, whether the application of pressure by the USA actually achieved any liberalization of trade is another question.

The threat of sanctions was made following an acrimonious breakdown on 3 November 1992 of a meeting between USA and EEC negotiators in Chicago after which EEC agriculture Minister MacSharry had resigned in protest at having his authority undercut by EC President Delors. Following the threat of sanctions, an emergency GATT meeting on 9 November instructed Dunkel to intervene. After the French President Mitterand expressed a willingness to make new concessions to avoid isolating France, MacSharry and Delors sorted out their differences with MacSharry continuing as Agriculture Minister. On 18 November, the negotiations resumed in Washington, being held at the President's guest

73 "EC/US Oilseeds dispute in a Nutshell", *European Report* No 1810, 7 November 1992, pp12-13.

74 "GATT: EC Ministers Refuse French Request for Counter-Reprisals", *European Report*, No 1811, 12 November 1992, pp7-8. (Germany, UK, Italy, Ireland, Netherlands, Denmark and Luxembourg opposing, and Spain, Belgium, Greece and Portugal supporting France's request.)

quarters, Blair House. This time, the pressure of sanctions focussed their minds. Two days later, on 20 November 1992, the USA and the EEC announced that they had reached substantial agreement on the oilseeds dispute and on the Uruguay Round agriculture negotiation.⁷⁶ The Agreement was immediately known as the 'Blair House accord'.

The Blair House accord was an agreement between the USA and the EEC only. It would be necessary for all other WTO members to agree on its content. The elements of the accord were as follows, dealing first with the oilseeds dispute and then with the Agreement on Agriculture.⁷⁷

5.1 OILSEEDS

The resolution did not require the EEC to remove the new direct payments but required it to limit the amount of land for which growers could be eligible to receive the payments and also to impose a minimum set-aside criteria for eligibility for the payments. In addition, the EEC gave a new reduced rate tariff binding on a quota of 500,000 tonnes of corn into Portugal.

The EEC per hectare payments were to be limited to 5.128 million hectares less the area necessary to comply with the EEC's set aside requirement. The amount could be adapted in the event of enlargement of the Community. The EEC undertook that the set-aside rate would not be reduced to below 10%.⁷⁸ In fact, this limitation corresponded to what the EEC had already decided to do. The existing EEC regulation had defined its base area for the per hectare payment as the average area planted during the years 1989-1991 which was 5.128

75 Generally, for a descriptions of these events, see Preeg (1996) pp142-147, Croome (1995) pp339-341, & Stewart (1993) pp223-226 & Tangermann, Josling & Warley (1996) pp160--161.

76 See "Joint Press Statement, The Commission of the European Communities and The United States of America, November 20, 1992, *European Report*, No 1815, 25 November 1992, pp10-11. Also see Stewart, (1993) p225.

77 The elements of the Blair House accord are set out in Commission of the European Communities, *The European Community and the Uruguay Round*, November 1992, p17-18; "Details of GATT Deal and Compatibility with CAP Reform", document supplement to *European Report* No 1815, 25 November 1992, pp3-5; "Outline of US-EC Agreement on Oilseeds and Uruguay Round Issues", *USA Text* 21 November 1992 (Public Affairs Office of the United States Mission to the European Communities, Brussels, 1992); & Hanrahan, Charles E., "Oilseeds, Agriculture, and the Uruguay Round" in *CRS Report for Congress* 92-904 S, 4 December 1992 (Congressional Research Service, The Library of Congress, 1992).

78 Commission of the European Communities, *The European Community and the Uruguay Round*, November 1992, p18.

million hectares. The regulation had provided for the setting of a set-aside rate which, in fact, had been set at 15%.⁷⁹

In addition, the EEC could use set-aside areas to produce oilseeds for industrial purposes. However, the EEC was to take corrective action if the by-products of oilseed meal exceeded a specified limit (one million tonnes in terms of soya meal equivalents).⁸⁰

The USA relinquished all claims based on the 1962 bindings.

5.2 THE AGRICULTURE NEGOTIATION

5.2.1 Acceptance of the Dunkel Text as the Basis for Negotiation

The USA and the EEC agreed to work to finalize agreements in all areas outlined in the draft "Final Act",⁸¹ so for the first time the EEC agreed to use the Dunkel text on agriculture as the basis of an agreement. The accord did not contain any undertaking not to push for any amendments to the text but it put the EEC in the position where it had to cooperate with the process of completing list of commitments subject to the specific matters agreed as part of the accord.

5.2.2 Import Access

The joint press statement records only that the parties agreed to "instruct their negotiators to complete as quickly as possible their country lists of proposed reductions".⁸² However, the EEC was able to reach the Blair House accord without having to concede anything on its method of tariffication and the baselines for current access quotas. Therefore, the tariff equivalents based on the Intervention Price plus a margin of 10% remained in the EEC list of commitments with the assent of the USA.⁸³ The EEC did not have to concede on its

79 Commission of the European Communities, *Agriculture in the GATT negotiations and the reform of the CAP*, Communication from the Commission (EC, Brussels, 25 November 1992) p4.

80 EC, *The European Community and the Uruguay Round* November 1992, p 18.

81 See "Joint Press Statement, The Commission of the European Communities and The United States of America, November 20, 1992, *European Report*, No 1815, 25 November 1992, pp10-11 at 10.

82 See also "Outline of US-EC Agreement on Oilseeds and Uruguay Round Issues", *USA Text* 21 November 1992 (Public Affairs Office of the United States Mission to the European Communities, Brussels, 1992) p2.

83 See EC, *Agriculture in the GATT negotiations and the reform of the CAP*, as above, p1. See Ingersent, Rayner & Hine, *Ex-Post Evaluation of the Uruguay Round Agriculture Agreement (1995)* 18(5) *The World Economy* 707-728 at 716 stating "Under the [Blair House Agreement], the EU

refusal to tariffy the import quotas on bananas imported from ACP countries.⁸⁴ Despite the failure to reach agreement on some issues, the EEC did agree to work within the framework of tariffying import barriers and reducing them by 36% over 6 years.⁸⁵

Implicitly, the EEC did concede that it would give minimum access quotas and enlarge them from 3% to 5% but the EEC's communication on the conformity of the CAP reform with the Blair House accord also recorded that the EEC would be able to set the tariff rate within the minimum access quotas at 32% of the out of quota tariff rate. It also recorded that there would be no scheduling of enlargement of current access quotas except as a consequence of enlargement of minimum access quotas.⁸⁶

No increase in the tariff rates on oilseeds or on other grain substitutes was agreed. However, a concession to rebalancing was made in the following agreed text:

If EC imports of non-grain feed ingredients increase to a level, in comparison with the level of imports 1986-1990, which undermines the implementation of CAP reform, the parties agree to consult with a view to finding a mutually acceptable solution.⁸⁷

This was reported by the Europe Information Service as

the US agreed to give the EC the option of increasing duties on cereal substitutes, if imports go above the reference or agreed quantities, and consequently threaten the competitiveness of the EEC's cereals market.⁸⁸

and the face saving was completed in the same report by a statement that

Commission sources have indicated that a form of rebalancing is already achieved under the CAP reform where a 29% cut in cereal price support should increase the competitiveness of grain in relation to cereal substitutes.⁸⁹

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- succeeded in winning an important concession from the US on market access when it was agreed that the EU's tariff equivalent calculations might include a ten per cent Community Preference margin.
- 84 EC, *Agriculture in the GATT negotiations and the reform of the CAP*, as above, p2 recording "The Commission explained to the US that the Agreement did not apply to bananas. The Commission's proposal to the Council is not based on tariffication".
- 85 See Hanrahan, Charles E., "Oilseeds, Agriculture, and the Uruguay Round" in *CRS Report for Congress 92-904 S*, 4 December 1992 (Congressional Research Service, The Library of Congress, 1992) p4.
- 86 EC, *Agriculture in the GATT negotiations and the reform of the CAP*, as above, p2.
- 87 EC, *Agriculture in the GATT negotiations and the reform of the CAP*, as above, p4.
- 88 "Details of GATT Deal and Compatibility with CAP Reform", document supplement to *European Report No 1815*, 25 November 1992, pp3-5 at 3.
- 89 As above, at 4.

5.2.3 Export Subsidies

It was agreed that the commitments on the volume of export subsidies would implement reductions by 21% rather than 24%.⁹⁰ The time period of 6 years and the determination of the base line of 1986-1990, as specified in the Dunkel Text, were unaffected. Importantly, the agreement to abide by the reduction formula in the Dunkel Text meant that the first year's reduction would have to reduce expenditure and volume of export subsidies down to the base period level less one sixth of the total reductions required.⁹¹ Therefore, any increase in export subsidy levels since the base period would have to be removed in the first year together with the required reduction below the base level. One estimate made was that the EEC's 21% cut from the base year was equivalent to a cut of 37% from 1992 levels.⁹²

The USA made no concession upon the commodity specificity of the export subsidy reductions either the expenditure reductions or the volume reductions. However, the EEC's report on the Blair House Agreement made it clear it would not make its division into products any more specific than the 22 categories set out in the Dunkel Text thereby indicating that it considered itself as having complete freedom to allocate the reductions within those categories subject to reaching the agreed average reduction.⁹³

It was also agreed that the EEC would confirm the commitment made in 1985 not to subsidize beef exports to the Far Eastern market.⁹⁴

5.2.4 Internal Support

The parties agreed with the principal elements of the Dunkel Text on internal support reductions: that AMS would be reduced by 20% from a baseline from average levels for 1986-1988 with credit being allowed for reductions since 1986. However, the parties agreed to reduce the restrictiveness of the AMS reductions in two ways.

90 EC, *The European Community and the Uruguay Round*, November 1992, p17.

91 Dunkel Text, Part B, Annex 8, para 5 required the first years reduction to be the reduction that would have to be taken if reductions in equal instalments were required.

92 See Hanrahan, Charles E., "Oilseeds, Agriculture, and the Uruguay Round" in *CRS Report for Congress 92-904 S*, 4 December 1992 (Congressional Research Service, The Library of Congress, 1992) p5.

93 EC, *Agriculture in the GATT negotiations and the reform of the CAP*, as above, p6 stressing that the text referred to broad categories.

94 EC, *The European Community and the Uruguay Round*, November 1992, p17.

First, the internal support reductions were only to be made on a global basis and not on a product or even product-group basis. Therefore, there would not be any restriction on support to any particular product as long as the total support for all products was within the global limit.⁹⁵

Secondly, the new CAP compensation payments based on hectares and head of livestock would not be subject to the internal support reductions. The parties agreed that direct payments under production-limiting programmes would not be counted in the global AMS and, therefore, would not be subject to reduction commitments. This exemption would be limited, for crops, to payments based on fixed area and yields or on no more than 85% of base level production and, for animals, to payments based on a fixed number of head (number of animals).⁹⁶ This covered the EEC payments. Importantly, it also covered the USA deficiency payments which following the USA 1990 farm legislation had been limited to payments in respect of 85% of permitted planted areas which were determined from a base period.⁹⁷

The net effect of this change was that neither the EEC nor the USA would have to do anything further to comply with the obligations on internal support. If the USA's deficiency payments were excluded then the reductions under the 1985 and 1990 farm legislation would be adequate to meet the requirements of the internal support reductions. Similarly, for the EEC, if the direct compensation payments were excluded then the reductions to be carried out as a result of the changes to the CAP would be adequate to meet the internal support reductions.⁹⁸

95 EC, *Agriculture in the GATT negotiations and the reform of the CAP*, p3, para 2.

96 EC, *Agriculture in the GATT negotiations and the reform of the CAP*, p3, para 2. & "Outline of US-EC Agreement on Oilseeds and Uruguay Round Issues", *USA Text 21* November 1992 (Public Affairs Office of the United States Mission to the European Communities, Brussels, 1992) p2.

97 Roberts, I. & Andrews, N., *1995 US Farm Bill: A Turning Point?* ABARE Research Report 95.2 (Australian Bureau of Agricultural and Resource Economics, Canberra, 1995), p31 and at p18 describing other land set aside programs, noting that for some programs, the rate of payment was adjusted from 92% to 85% in the *Omnibus Budget Reconciliation Act of 1993*.

98 See Hanrahan, Charles E., "Oilseeds, Agriculture, and the Uruguay Round" in *CRS Report for Congress 92-904 S*, 4 December 1992 (Congressional Research Service, The Library of Congress, 1992) p4.

5.2.5 Peace Clause

The parties also agreed on amendments to the 'peace clause' to be adopted in the Agreement on Agriculture and, as necessary, in the Agreement on Subsidies and Countervailing Duties.

The parties also agreed that export subsidies and domestic subsidies conforming to the reduction commitments or to the rules for exemption from them were to be immune from challenge under GATT rules until the end of the 6 year implementation period.⁹⁹ Immunity from countervailing duties was not given but CVDs could only be imposed where the subsidies caused injury within the rules of the SCM Agreement.

The net result was that in consequence of agreeing to make export subsidy reductions, the EEC was given immunity from any further challenges under the 'equitable share' rule in Article XVI:3, from any other multilateral (track 2) complaints including the serious prejudice remedy (including the 'exceeding the share in a past period' component of the serious prejudice test), and also the non-violation nullification or impairment rules.

In consequence of agreeing to make AMS reductions, the EEC was given immunity from serious prejudice and non-violation complaints not only in respect of the subsidies that were actually being reduced under the AMS commitments but also in respect of subsidies that were not being reduced under the AMS commitments including increases of any subsidy subject to AMS reductions where the increase is covered by averaging with reductions to other such subsidies, and including increases in the per hectare or per head subsidies on a fixed number of hectares or head. In effect, it achieved an overruling of the decision in the oilseeds case relating to nullification or impairment, at least for 6 years, though possibly permanently.

5.3 THE SCOREBOARD ON THE BLAIR HOUSE ACCORD

In exchange for a tariff concession on a quota of corn (roughly equal to about half Portugal's corn imports) and agreeing to implement reductions on import barriers, export subsidies and internal support no greater than those which it had already internally resolved to implement,

⁹⁹ EC, *Agriculture in the GATT negotiations and the reform of the CAP*, p4, para 5. & "Outline of US-EC Agreement on Oilseeds and Uruguay Round Issues", *USA Text* 21 November 1992 (Public Affairs Office of the United States Mission to the European Communities, Brussels, 1992) p2.

the EEC was excused from having to compensate for a \$1 billion nullification or impairment of the 1962 tariff concession, it was excused from having to remove any of the subsidies which had caused the concession, it was given immunity for those domestic subsidies and any similar ones from any challenge for at least for 6 years, and it was given immunity for its still substantial export subsidies from any challenge for 6 years. The EEC received the right to maintain the CAP as reformed by its 1992 reform plan without having to worry about challenges to its export subsidies or its deficiency payments.

In the process, the internal reduction commitments were diminished sufficiently to release the USA from having to make any further reductions in internal support. Not only did the EEC release the USA from having to make reductions on deficiency payments that were smaller than those that the EEC had to make on its export subsidies but it released the USA from having to make any reductions on its deficiency payments at all.

The rest of the participants in the round still had not received tariffication of the EEC's banana quotas, faced the prospect of disruptive oilseeds exports from the USA because of the VER agreed by the USA in respect of the EEC (which they would not be able to challenge under serious prejudice rules), received tariff reductions from the EEC that were less than the 36% they would have to give themselves, received a commitment of reductions in export subsidies of 36% by outlay and 21% by volume but failed to obtain any obligation not to increase export subsidies on any particular product, and on internal support, received no reduction from either the USA or the EEC in excess of the reductions that had already been achieved by their domestic fiscal pressures. In losing the track 2 remedies, the other participants also lost the right to challenge either the USA or the EEC in virtually all situations in which the USA or EEC subsidies might cause either nullification or impairment of a tariff binding, serious injury to their exports or injury to their domestic industry.

6 RENEGOTIATING BLAIR HOUSE

The expectations that the Blair House Accord would lead to a quick closure of the Uruguay Round were disappointed when the French government announced that the European Commission had exceeded its negotiating authority and that it would oppose adoption of the elements of the Blair House Accord in the Council of Ministers. The continuing of

objections of the French to the Blair House Accord combined with other issues prevented the round being concluded in December.¹⁰⁰

Despite the uncertainty as to whether the EC Council would confirm the agreement, the EC proceeded to complete the submission of its schedules of commitments. The completion of the EEC's offer on agriculture raised more matters with which the USA (and presumably other parties) disagreed. These are reported by Stewart as:

- (1) "the EC's failure to offer a tariff rate quota on some products";¹⁰¹ the EC argued that the text didn't require them to offer minimum access quotas on products on which trade was already flowing across an existing variable levy which would be the basis of the tariff equivalent;
- (2) "the size of the tariff rates being imposed within the tariff rate quotas";¹⁰² and
- (3) "the EC's insistence on making market access commitments on the basis of aggregated product groups rather than on individual commodities (the bundling issue)";¹⁰³ The EC had aggregated groups of products together for the purpose of calculating the volume of the minimum import quotas rather than separately calculating 3% of domestic consumption for each product.

The delay in acceptance of the Blair House accord made it impossible for the round to be completed within the constraints of the USA fast track authority. President Clinton sought and obtained an extension of that authority under which the last day for completing an agreement was 15 December 1993.¹⁰⁴

In June, after France negotiated concessions from other EEC members on the oilseeds resolution, France permitted the EC Council of Ministers to adopt the oilseeds aspects of the Blair House Accord.¹⁰⁵ France was able to reach agreement with the other EEC members

100 On the obstacles still existing in December 1992, see Stewart, p226.

101 Stewart (1993) p226-227

102 As above.

103 As above.

104 Preeg (1995) p158; Croome (1996) p345.

105 See "EC Ministers approve Oilseed Accord After France Lifts Its Opposition", 9 Jun 1993, *BNi International Trade Reporter* Vol 10, No 23, Pg 938; "EC Foreign Ministers Adopt EC-US Oilseeds Deal" *Agra Europe*, 11 June 1993, pE/1-E/2.

that a certain proportion of the 5.18 million hectares of oilseeds would be in France and that the payment per hectare set aside would be increased.¹⁰⁶ However, France continued to object to the part of the Blair House Accord that dealt with the Dunkel Text on agriculture. France was still preventing the Council from adopting it, arguing (still) that France should not give export subsidy commitments in terms of volume; and that the peace clause should be permanent.¹⁰⁷ As could be expected, the USA was not receptive to giving further concessions. There could be little doubt that the USA would not have agreed to relinquish its rights under the Oilseeds panels and its rights under the 1962 bindings if the EEC had not agreed to the matters relating to the Dunkel Text.¹⁰⁸

As negotiation continued within the EEC and between the EEC and the USA, there were still other unresolved aspects of the negotiation, in agriculture and elsewhere.¹⁰⁹ In particular, a number of countries still refused to tariffy quantitative restrictions on certain products. These included Japan, Korea, Canada, and Indonesia. In August, Germany surprised by joining France in supporting a renegotiation of the Blair House accord. The USA response, in September, was an unequivocal 'no'.¹¹⁰

In the next two months, despite the little time left before 15 December, the urgency of the slipped to some extent while the participants watched to see if the USA congress would approve the North American Free Trade Agreement ('NAFTA'), for if NAFTA was rejected then it seemed likely that the any Uruguay Round result would also be rejected. Congress approved the NAFTA on 17 November 1993. Following that decision began a series of meeting between the EC Minister for Trade, Leon Brittan, and the USA Trade Representative, Mickey Kantor, that took the Round through to conclusion precisely on 15 December.

106 As above. Also see "EC Farm Price Package Should Clear Way for Oilseed Pact's Approval, Officials Say" 2 June 1993, *BNA International Trade Reporter* Vol 10, No 22, Pg 908.

107 See "EC/United States: The Blair House Agricultural Agreements are clearly Separated into Three Parts - Only the "Oilseeds" Section has been Approved by the EC - "Uruguay Round" Section in Suspense, Uncertainty over "Corn Gluten Feed", *Europe* No 5997 (n.s.), Thursday 10 June 1993, pp9-10.

108 See "EC Foreign Ministers Adopt EC-US Oilseeds Deal" *Agra Europe*, June 11, 1993, pE/1-E/2 at E/1.

109 On other contentious matters under negotiation at this stage, see Preeg (1995p153ff.

110 See Preeg (1995) pp164-165.

7 CLOSURE - DECEMBER 1993

In the last few months of the negotiation, more and more countries submitted lists of concessions on agriculture with the number of countries increasing from 43 in mid September to 84 by the end of the round on 15 December. The last minute negotiation on agriculture required the EEC and the USA to resolve their remaining differences and the time finally came for applying the pressure on those who sought exemptions from comprehensive tariffication. The main points were resolved between the USA and the EEC on 7 December¹¹¹ and a few other aspects specifically affecting other parties were resolved in the following few days. The results were as follows.

7.1 IMPORT BARRIERS

The USA agreed to accept the EEC's calculation of tariff equivalents which included the 10% margin above the Intervention Price. The bundling issue was resolved with a compromise whereunder the USA accepted to a limited extent the way that the EEC had scheduled minimum access quotas for groups of products rather than individual products. The EEC gave product specific minimum access quotas for certain products: maize, sorghum, pigmeat, cheddar and mozzarella cheese.¹¹²

The final deal also involved the EEC increasing its tariff cuts on some products: liver, turkeymeat, a range of fruits and vegetables (fresh asparagus, fresh grapes, fresh apples, walnuts, almonds and orange juice).¹¹³

The Dunkel Text safeguards clause had always had some leeway for parties to choose their own "reference price" as the price below which recourse to the safeguards clause could be made. This provision was not tightened during the final stage of the negotiation.¹¹⁴

111 "GATT" EU/US Strike a New Farm Deal - A Year on From Blair House" Report No 1906, 8 December 1993, pp3-4.

112 See "The GATT Uruguay Round Agreement - An Agra Europe special supplement" *Agra Europe Supplement*, December 1993, p6.

113 As above.

114 See "The GATT Uruguay Round Agreement - An Agra Europe special supplement" *Agra Europe Supplement*, December 1993 at p5 saying "for the EC, this 'reference price level' will be assessed as the intervention price for each product plus 10%".

7.2 EXPORT SUBSIDIES

The final change to the obligations on export subsidies related to the instalments by which the reduction had to be brought into effect. Although Part B of the Dunkel Text provided for some flexibility in the size of reduction instalments, it required that the maximum level to apply at the end of the first year's reduction be based on the reduction that would have to be applied if the reductions were required to be in equal annual instalments. Clearly, this provision was designed to prevent parties from receiving any latitude in the maximum outlays or volumes applicable to them as a result of increases in export subsidies made after 1990 or from gaining any additional latitude by continuing to increase their export subsidies during the remainder of the Uruguay Round negotiation. By 1993, the EEC had increased its level of export subsidies above the average for the 1986 to 1990 base line period. Therefore, under the formula proposed in the Dunkel Text, the EEC would have to make a large reduction in the first year. In the final stage of the Uruguay Round, the EEC demanded that the staging of the reduction instalments be made less restrictive.

The EEC won on this point. Parties were able to set their starting point for reduction commitments on the higher of the averages for the 1986 or 1988 period or the 1991-1992 period.¹¹⁵ There was no change to the maximum levels of expenditure and volume that would apply at the end of the implementation period. Therefore, the reduction commitments had to be implemented to change the level from the new baseline down to a level that was, for expenditure, 36% below and, for volume, 21% below the 1986-1988 baselines.¹¹⁶ As well as making a substantial change to the size of the first years' reduction, the amended rules permit more export subsidies during the implementation period. Agra Europe estimated that the revised reduction schedule would permit the EEC to subsidize the export of 8.1 million tons more cereals, 362,000 tons more beef, 253,000 more poultry and 102,000 tons more cheese and the USA to subsidize 7.4 million tons more wheat, 672,000 tons more

115 See "The GATT Uruguay Round Agreement - An Agra Europe special supplement" *Agra Europe Supplement*, December 1993.

116 As above, p14. See also "Progress Made in US-EC Trade Negotiations as of Dec 7", *BNA International Trade Reporter* Vol 10, No 48, Pg 2042.

rice, 1.24 million tons more vegetable oil and 46,000 tons more butter than would have been permitted under the original schedule.¹¹⁷

7.3 PEACE CLAUSE

The EEC was not happy with the Blair House peace clause enduring for only the term of the implementation period. The compromise struck was that it would last for 9 years instead of 6. Read in conjunction with the agreement to commence new negotiations by 1 year before the expiry of the agreement (31 December 1999), this would allow for 4 years (until 31 December 2004) for the EEC negotiate an extension of the peace clause.

7.4 LAST MINUTE DEALS ON TARIFFICATION

Between 8 December and 15 December, various other aspects of the negotiation were resolved, in some case, merely by deferring the matters for future resolution.¹¹⁸ One of the last issues in the whole negotiation to be resolved was the issue of the application of tariffication to all agricultural products. Thirteen countries had sought exceptions: including Canada, Indonesia, South Korea, Mexico, Norway, Japan, Switzerland and Venezuela.¹¹⁹ It was not until the last days of negotiations that some countries finally agreed to comprehensive tariffication for agricultural products. Finally, on the 14 December, Canada agreed to convert its import quotas on dairy products to import tariffs but submitted tariff equivalents in excess of 200%. Mexico and Norway also withheld their assent to tariffication until the last day.¹²⁰ However, Japan and South Korea flatly refused to tariffify their quotas on rice but reached a compromise that enabled them to outwardly support comprehensive tariffication. The negotiated compromise was that they had to provide minimum access quotas on rice of such a size that would provide an incentive to convert the quota into a tariff at some stage during the implementation period. Whilst other parties were required to have minimum access quotas of 3% of domestic consumption enlarging to 5% over 6 years, Japan was required to provide a 4% quota for rice enlarging to 8%. Somehow, South Korea managed to negotiate a minimum access quota for rice of only 1% enlarging to

117 "The GATT Uruguay Round Agreement - An Agra Europe special supplement" *Agra Europe Supplement*, December 1993.

118 See Croome (1995) p373ff.

119 See Preeg (1995) p168.

120 See Preeg (1995) p168.

4% over the implementation period and having maintained its classification as a developing country, this was 10 years. Both exemptions were written in non-country specific language¹²¹ and, ultimately, another two countries took advantage of these exceptions: the Philippines, also for rice, and Israel, for sheepmeat.

8 THE FINAL ACT, THE MARRAKESH AGREEMENT ESTABLISHING THE WORLD TRADE ORGANIZATION AND THE AGREEMENT ON AGRICULTURE

In the late afternoon of 15 December 1993, the Secretary General of the GATT, Peter Sutherland assembled delegates and the entire GATT Secretariat staff. At 7.30pm, the assembly of delegates approved the Final Act of the Uruguay Round.¹²² After 15 December, there were still some schedules of commitments to be completed though only improvements could still be added to schedules. A Ministerial meeting was arranged for governments to sign the Final Act of the Uruguay Round.

On 12-15 April 1994, at a Ministerial meeting in Marrakesh, Morocco, the Ministers signed the Final Act agreeing to submit the Agreement for Establishment of the World Trade Organization to their governments for ratification to bring it into effect.¹²³ The Agreement did come into force on 1 January 1995 with 81 territories becoming members on the first day, with another 8 having completed ratification but still having their schedules verified and another 38 still completing their ratification process.¹²⁴ Under the WTO Agreement, members of the WTO are bound by the General Agreement on Trade in Services, the Agreement on Trade Related Aspects of Intellectual Property, a number of Multilateral Agreements on Goods and a Dispute Settlement Understanding.¹²⁵ The Multilateral Agreements on Goods includes the General Agreement on Tariffs and Trade 1994 ('GATT 1994')¹²⁶ and a number of separate agreements on specific aspects of trade in goods.¹²⁷ The

121 See Annex 5 of the Uruguay Round Agreement on Agriculture.

122 See Croome (1995) pp379-380.

123 See, above, chapter 1, fn3. *Agreement Establishing the World Trade Organization*, 15 April 1994, Marrakesh ('WTO Agreement') in force 1 January 1995, Aust TS 1995 No 8, 33 ILM 1144. The text is also reproduced in WTO, *The Results of the Uruguay Round of Multilateral Trade Negotiations - The Legal Texts* (WTO, Geneva, 1995).

124 "The World Trade Organization is Launched with 81 Members", *GATTWTO News*, GW/13, 4 January 1995.

125 *WTO Agreement*, Article II:2.

126 *General Agreement on Tariffs and Trade 1994* in annex 1A to the *WTO Agreement*.

127 The Multilateral Agreements are:

GATT 1994 includes the provisions of the GATT 1947 (as in force immediately prior to 1 January 1995) together with protocols relating to tariff concession, and the accumulated decisions of the CONTRACTING PARTIES under the GATT 1947, six understandings on specific provisions of the GATT 1994¹²⁸ and the Marrakesh Protocol to the GATT 1994 under which the Uruguay Round Schedules of Concessions came into force. One of the specific multilateral agreements on goods is the Agreement on Agriculture.

The Members Schedules under the Marrakesh Protocol to the GATT 1994 contained a number of parts to provide for the various kinds of obligations that were undertaken in respect of agriculture. The Schedules comprised:

Part I	Section I-A	Agricultural Products - Tariffs
Part I	Section I-B	Agricultural Products - Tariff Quotas
Part I	Section II	Other Products
Part II		Preferential Tariffs
Part III		Non-Tariff Concessions
Part IV	Section I	Domestic Support: Total AMS commitments
Part IV	Section II	Export Subsidies: Budget Outlay and Quantity Reduction Commitments

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- (1) Agreement on Agriculture;
 - (2) Agreement on the Application of Sanitary and Phytosanitary Measures;
 - (3) Agreement on Textiles and Clothing;
 - (4) Agreement on Technical Barriers to Trade;
 - (5) Agreement on Trade-Related Investment Measures;
 - (6) Agreement on Implementation of Article VI of the GATT 1994;
 - (7) Agreement on Implementation of Article VII of the GATT 1994;
 - (8) Agreement on Preshipment Inspection;
 - (9) Agreement on Rules of Origin;
 - (10) Agreement on Import Licensing Procedures;
 - (11) Agreement on Subsidies and Countervailing Measures; and
 - (12) Agreement on Safeguards.

128 See GATT 1994, para 1. The Understandings are:

- (1) Understanding on the Interpretation of Article II:1(b) of the GATT 1994;
- (2) Understanding on the Interpretation of Article XVII of the GATT 1994;
- (3) Understanding on Balance of Payments provisions of the GATT 1994;
- (4) Understanding on the Interpretation of Article XXIV of the GATT 1994;
- (5) Understanding in Respect of Waivers of Obligations under the GATT 1994;
- (6) Understanding on the Interpretation of Article XXVIII of the GATT 1994.

Part IV Section III Commitments Limiting the Scope of Export Subsidies

Part B of the Dunkel Text, the draft Agreement on Modalities for the Establishment of Specific Binding commitments under the Reform Programme was updated to reflect the final agreement on the schedules.¹²⁹ However, the revised document was issued "on the understanding that the 'modalities' it contained would not be used as a basis for dispute settlement".¹³⁰ The document was not incorporated into the legally binding agreements.

9 CONCLUSION

It is not intended to pre-empt the final conclusion of this thesis on the role of the distinctions between policy instruments on the application of the GATT to agriculture and whether those distinctions have been appropriately embodied in the post Uruguay Round GATT applying to agriculture. A preliminary observation will be made.

Finally, the negotiation came down to a matter of political equilibrium. In the final stage of the negotiation, it appears that political factors swept aside any consideration of ideas. It is certainly partly true. However, such an analysis would fail to observe that the final political end game was played out in the context of the structure created by the essential elements of the De Zeeuw text and the Helstrom text and the intellectual input from the USA and the Cairns group that had contributed to them. It remains to assess the extent to which the intellectual input held together in the face of so much (to use the trade negotiators' jargon) slippage.

129 Modalities for the Establishment of Specific Binding Commitments under the Reform Programme" MTN.GNG/MA/W/24, 29 December 1994.

130 McGovern, Edmond, *International Trade Regulation* (Globefield Press, Exeter, 1995) p14.21-2.

CHAPTER 20

THE URUGUAY ROUND RULES ON IMPORT BARRIERS

1 INTRODUCTION

The *Agreement on Agriculture* is the primary source of new obligations affecting import barriers for agricultural products. However a number of other Multilateral Agreements on Trade in Goods are also relevant.

Under the *Agreement on Agriculture*, obligations came into effect in two ways: by changes to rules and by alterations to schedules of concessions. The changes to the rules on import barriers effected by the actual text of the *Agreement on Agriculture* are limited. The text contains only two new substantive rules: one which is a supplement to Article XI and another that provides a temporary alternative to Article XIX. Outside of the agriculture text, there are new rules on a number of aspects of import barriers generally. The most important of these are the new Agreements which substantially change the exceptions for balance of payments restrictions, for technical barriers to trade, for sanitary and phytosanitary restrictions and for emergency safeguards. Almost all of the new obligations came into effect in the second way as new concessions. These new schedules of concessions are in force under the *Uruguay Round (1994) Protocol to the General Agreement*. Despite the limited rule changes in the text of the *Agreement on Agriculture*, the effect of the obligations in the schedules is that the whole framework of rules on import barriers can operate on agricultural products in a more effective manner than before.

It is clear from the analysis of the negotiation that the emphasis on the negotiation of schedules rather than general rules was crucial to enabling the parties to work with a common negotiating text. Since none of the general rules would become binding for any

particular party for any particular product until that party agreed to put that particular obligation in its schedule, then it was possible for the different parties to use the text as a negotiating text without having to concede agreement with any blanket application of any of the proposed rules.

I will arrange this description of the rules mostly by policy instrument concentrating on the *Agreement on Agriculture* and adding some references to other agreements where appropriate.

1 THE GENERAL RULES ON IMPORT BARRIERS

The most significant change to the general rules is that the general prohibition of quantitative restrictions can now operate in respect of agricultural products. The introduction of tariff quotas on agriculture is also a significant aspect of the post Uruguay Round rules.

1.1 THE PROHIBITION ON IMPORT QUOTAS

The process of tariffication has made it possible for the basic prohibition of quantitative restrictions in Article XI:1 to apply to agriculture. Many illegal restrictions have been removed. In addition, many restrictions of undetermined legality were also removed. The prohibition in Article XI:1 is supplemented by Article 4:2 of the *Agreement on Agriculture* which provides:

Members shall not maintain, resort to, or revert to, any measures of the kind which have been required to be converted into ordinary customs duties, except as otherwise provided for in Article 5 and Annex 5.

The words "measures of the kind which have been required to be converted into ordinary customs duties" are defined by an interpretative note which provides:

These measures include quantitative import restrictions, variable levies, minimum import prices, discretionary import licensing, non-tariff measures maintained through state-trading enterprises, voluntary export restraints, and similar border measures other than ordinary customs duties, whether or not the measures are maintained under country-specific derogations from the provisions of GATT 1947, but not measures maintained under balance-of-payments provisions or under other general, non-agriculture-specific provisions of GATT 1994 or of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement.

Any measures which arguably were not covered by Article XI previously but which were tariffied have been effectively brought within the scope of the prohibition of quantitative restrictions. Therefore the introduction or reintroduction of variable levies, minimum import price schemes, and voluntary export restraints is prohibited (at least in relation to agricultural products).

Some specific aspects of the wording of Article 4(2) deserve comment:

- (1) the word "maintain" manifests an intention that the prohibition should apply to any non-tariff barrier that should have been tariffied but was not;
- (2) the words "measures of a kind" manifest an intention to cover the situation where a country introduces a form of restriction which that country has never utilized before but which is a restriction of a kind that was tariffied by any other country, or even is a restriction of a kind that another country was supposed to tariffy;
- (3) the words "required to be converted" indicates that the other parts of the sentence apply not only to measures that were converted but to measures that were required to be converted.

It is clear that some of the possible loopholes in the wording of this article in the Dunkel Text have been addressed.

The interpretative note on the meaning of measures required to be converted indicates that measures formerly maintained under country specific derogations are included in the prohibition. This includes any measures maintained under Protocols of Accession or country specific waivers. (In any case, the only pre-WTO waivers which continued were those that were specified in Article 1(b)(3) of the GATT 1994.) The list of exceptions refers to measures maintained under other general, non-agriculture-specific provisions of GATT 1994, which does not include restrictions maintained under Article XI:2(c). Therefore, Article XI:2(c) has been effectively eliminated in respect of any product covered by the *Agreement on Agriculture*. It may continue to apply to fisheries products.¹

¹ *Agreement on Agriculture*, Annex 1 on "Product Coverage" excludes "fish and fish product". GATT Article XI:2(c) applies to "any agricultural or fisheries product".

1.2 THE RULES ON TARIFFS

The *Agreement on Agriculture* does not contain any new provisions to give effect to the obligations on tariffs. The tariff bindings and reductions come into force by virtue of being included in a Members Schedule which is annexed to the *Marrakesh Protocol to the General Agreement on Tariffs and Trade 1994*. Part I, Section I-A contains the tariff bindings on agricultural products. In addition, all tariff negotiations from earlier negotiations remain in force.²

The Schedules provide bound tariffs for all products except those for which an exemption has been claimed under Annex 5.³ Therefore, the rule in Article II:1(b) now applies to all those agricultural products: Members may not charge "ordinary customs duties" in excess of those in the Schedule and may not charge any other import charge in excess of that imposed on 15 April 1994.⁴ Another consequence of the binding of all agricultural products is that Article II:4 can operate with respect to those products. For all bound agricultural products, any import monopoly maintained or authorized by a members must not charge an average mark-up in excess of "the amount of protection provided for" in the Schedule.⁵

It is noteworthy that this is a major change from the pre-existing GATT rule that parties could voluntarily choose the products upon which they would give tariff bindings. The old rule will still apply to non-agricultural products. In this sense, a stricter rule applies to agricultural products than to other products.

The Schedules contain the bound rate for the beginning of the implementation period and the bound rate to apply at the end of the implementation period. The reductions must be implemented as specified in the Schedules.⁶ The final bound rates apply from 1 January 2000. Developing country Members were able to complete their Schedules so that the reductions were made over a period of 10 years.⁷ For them, the final bound rate must apply

2 See GATT 1994 Article 1(b)(i).

3 Note that the author has not actually checked every product line of every country's Schedule to check that a tariff rate is specified for every product by every Member.

4 See Marrakesh Protocol, Article 5(a) establishes the relevant date. The Understanding on Article II:1(b) required 'other charges' to be notified.

5 GATT, Article II:4.

6 Marrakesh Protocol, Article 2.

7 *Agreement on Agriculture*, Article 15(2).

from 1 January 2004. Least-developed country Members do not have to make any reductions, though they were still required to give bindings.⁸

Recall that developing countries were permitted to give ceiling bindings but that developed countries were required to follow guidelines for calculating tariff equivalents. As mentioned at the end of the previous chapter, the negotiating documents upon which tariffication was based are not incorporated into the binding agreements.⁹ Therefore, in any case in which a Member has Scheduled a tariff rate which is higher than the rate that ought to have been calculated under the negotiating documents relating to the modalities for making commitments, the legal obligation is based solely on the scheduled rate. It seems that the tariff equivalents embodied in the reduction commitments for many countries, including industrial as well as developing countries, did in fact exceed the actual tariff equivalents of the level of barriers applying in the base period. In addition, the method of reductions left scope for tariffs on the most sensitive products to be reduced by on 15%.¹⁰ As a result of the latitude given in the framing of tariff commitments, the rate of reduction actually achieved falls short of the negotiated rate of a 36% average and in some cases has resulted in an increase of the level of import barriers.¹¹

8 *Agreement on Agriculture*, Article 15(2).

9 See the end of the previous chapter, noting that Part B of the Dunkel Text, the Agreement on Modalities, was updated to reflect the December 1993 agreement but it was not incorporated into the Final Act.

10 See Tangermann, Stefan, "An Assessment of the *Agreement on Agriculture*" chapter 15 in OECD, *The New World Trading System: Readings* (OECD, Paris, 1994) pp143-169.

11 See Anderson, Kym, *Agriculture and the WTO into the 21st Century* (University of Adelaide, Centre for International Economic Studies, Policy Discussion Paper No 98/03, March 1998) Table 1 on "Dirty Tariffication" based on data from Ingco, M "Agricultural Trade Liberalization in the Uruguay Round: One Step Forward, One Step Back?" supplementary paper prepared for a World Bank Conference on *The Uruguay Round and the Developing Countries*, Washington DC, 26-27 January 1995 & also see Ingco, Merlinda D., "Tariffication in the Uruguay Round: How Much Liberalisation?" (1996) 19(4) *World Economy* 425-446; & Hathaway, Dale E. & Ingco, Merlinda D., "Agricultural Liberalization and the Uruguay Round" chapter 1 in Will Martin & L. Alan Winters (eds), *The Uruguay Round and the Developing Economies* (World Bank discussion paper 307) (The World Bank, Washington DC, 1995).

1.3 TARIFF QUOTAS

To whatever extent there was a doubt about the GATT legality of tariff quotas,¹² to the extent that they are scheduled under the *Agreement on Agriculture*, they have now been legitimized under that Agreement.

The Agriculture Agreement does not contain any obligation to introduce tariff rate quotas. The only reference to tariff rate quotas is Article 4(1) which provides:

market access concession contained in Schedules relate to bindings and reductions of tariffs, and to *other market access commitments as specified therein*.¹³

None of the modalities for the making of commitments on current access or minimum access opportunities are incorporated into the text of the *Agreement on Agriculture*. The obligations to maintain tariff rate quotas and to expand them are entirely dependent upon the schedules.

The modalities had provided that minimum access quotas should be provided in cases in which the tariffication of a non-tariff barriers would result in a volume of imports below 3%. These commitments should provide for a tariff quota of 3% of domestic consumption to be established and to be expanded to 5% by the end of the implementation period. The imports within the tariff rate quota were to be subject to a zero or low rate of duty. The minimum access quotas were to be administered on a most favoured nation basis.

The modalities had also provided that current access quotas could be maintained on a discriminatory basis. They could be expanded on a most favoured nation basis.

The commitments on tariff rate quotas are contained in Section I-B of Part I of the Members Schedules annexed to the Marrakesh Protocol. A perusal of various schedule items reveals that such commitments are recorded by the specification of the quota volume to apply at the start of the implementation period and the quota volume to apply at the end of the implementation period together with specification of the rate of customs duty to be applied.

¹² Generally, see Rom, Michael, *The Role of Tariff Quotas in Commercial Policy* (Macmillan for the Trade Policy Research Centre, London, 1979)

¹³ Emphasis added.

In some cases, notes to the schedules specify that part of the quota is to be allocated to particular parties.

A question arises as to what legal obligations come into effect as a result of these commitments. First, Article II:1(a) applies. Members cannot accord less favourable treatment than that specified in their Schedule. They cannot charge a rate higher than the specified in-quota rate on the specified quota volume. Secondly, Article II:1(b) applies, reinforcing that Members cannot charge any "ordinary customs duty" in excess of that set forth in the Schedule in respect of the specified volume. Thirdly, Article XIII governs the allocation of the quota (requiring that it be global and if not global then allocated on the basis of a previous representative period). However, the application of Article XIII is complicated by the fact that some schedules have specified discriminatory allocations of quotas.

Consideration should be given to whether the existence of tariff rate quotas has an impact on the application of Article II:4. The average protection afforded by a Member's state controlled or authorized import monopoly cannot exceed the protection provided for in the Schedule. The rule can be applied separately to the in quota volume and to the out of quota volume of imports. In respect of the in-quota volume, Article II:4 prohibits the charging of an average mark-up which exceeds the protection specified in the Schedule in respect of the in-quota volume. In most cases, the maximum level of protection is specified as a customs duty. However, in some cases, the Schedules provide that a price mark-up is to be charged in addition to the bound in-quota tariff rate.¹⁴ In respect of the out-of quota volume, Article II:4 prevents the charging of an average mark-up which exceeds the out of quota bound tariff rate.

The effect of Article II:1(b) on the in-quota tariff rates deserves further consideration. The parties may not charge more than the bound rate on the volume of the quota that applies at any given time. Therefore, the in-quota rate applies to the original volume and to the

¹⁴ Eg, see Schedule LX (of the Republic of Korea) in respect of rice reserving a right to charge an import mark-up in addition to the in-quota tariff & Schedule XXXVIII of Japan, in respect of rice specifying that an import mark-up of not more than 292 yen may be collected. Note that the Japanese Schedule also provides that if the mark-up system is abolished, then it may establish a new in-quota rate determined "with a view to affording substantially the same level of access opportunity".

enlargements that have been scheduled. However, the in quota rate has no application to any enlargement of the volume of the quota that goes beyond the scheduled volume. In respect of any such enlargement, the only legal constraint is that applied by the out of quota bound tariff rate. That is the only legal constraint on the rate that can be charged on additional enlargements unless some new entry is made in the Schedule.

Finally, although during the negotiation, the tariff quotas were often described as being temporary measures, the obligations in the Schedules are as permanent as any other obligation in the Schedules. The obligations will endure until the particular concession is withdrawn or modified.

1.4 RENEGOTIATION OF SCHEDULES - ARTICLE XXVIII

The WTO Agreement makes two changes to the renegotiation of concessions. These are contained in the *Understanding on Interpretation of Article XXVIII of the GATT 1994*. One change makes it easier for smaller countries to have negotiating rights. It confers negotiating rights for any particular product on the country for whom the exports of the product make up the highest proportion of its total export trade. This may have an impact on some agricultural trade.

Probably, of greater significance, is the impact that the proliferation of tariff quotas might have on renegotiations. Whereas the existence of tariff quotas was tolerated under GATT 1947, under GATT 1994, specific provision is made for tariff rate quotas in the market access opportunities under the *Agreement on Agriculture*. The tariff rate quotas are also formally recognized in the renegotiation rules. The *Understanding on Article XXVIII* makes specific provision for the amount of compensation that is appropriate in the situation in which an unlimited tariff concession is replaced by a tariff rate quota.¹⁵ Given the existence of that provision, we must contemplate the possibility of renegotiations of either the volume or the tariff rate in a tariff rate quota.

¹⁵ See *Understanding on the Interpretation of Article XXVIII of the GATT 1994*, para 6.

2 EXCEPTIONS TO THE RULES ON IMPORT BARRIERS

The GATT still contains exceptions to the general rules. Some of the exceptions pertain to the prohibition of quantitative restrictions, others to the rules on import tariffs and some to both. The tariffication process did not apply to "measures maintained under balance-of-payments provisions or under other general, non-agriculture specific provisions of GATT 1994". In addition, an exception to the prohibition on quantitative restrictions is contained in Annex 5 to the *Agreement on Agriculture* which relates to certain products excepted from the tariffication process. Exceptions will remain for quantitative restrictions for balance of payments reasons (Article XII and Article XVIII B), for economic development reasons (Article XVIII), for emergency safeguards (Article XIX), and for general exceptions (Article XX and XXI). Each of these provisions also provides for exceptions from the general rules on tariffs. In addition, Article 5 of the *Agreement on Agriculture* provides for the use of tariff surcharges under the special safeguards provision which can be utilized as an alternative to (though not at the same time as) the general safeguards provision.

The rules relating to some of the exceptions are subject to specific Uruguay Round multilateral agreements. There is a specific agreement on the balance of payments exception. Part B of the economic development exception relating to balance of payments will be subject to the same new text as the balance of payments exception under Article XII. The safeguards exception is limited by a new safeguards agreement. The waiver exception is subject to a new agreement on Article XXV.

The rest of the exceptions have not been modified by the Uruguay Round. Apart from Section B of Article XVIII, the economic development exceptions in Article VIII have not been altered. The general exceptions under Articles XX and XXI are unchanged. However, with respect to some of the provisions of Article XX, there are specific agreements, one dealing with technical barriers to trade and another specifically dealing with sanitary and phytosanitary restrictions on agricultural products. Little new discipline was introduced for state trading mechanisms apart from the fact the binding of agricultural products necessarily means that Article II:4 can operate with respect to those products.

2.1 ANNEX 5 TO THE *AGREEMENT ON AGRICULTURE*

The exceptions in annex 5 were drafted to accommodate exceptions given to Japan and South Korea in respect of tariffication of rice. Annex 5 contains two separate exceptions one of which was only available to developing countries. Recourse to these exceptions can only be made at the time of becoming a Member because the invocation of the exception with respect to a product requires the product to be designated in the Member's Schedule annexed to the Marrakesh Protocol.¹⁶

The first exception set out in Section A of Annex 5 can be invoked for products subject to special treatment reflecting factors of non-trade concerns. The exception can only be invoked if certain criteria are met: that imports in the base period 1986-1988 were less than 3% of domestic consumption, no export subsidies were provided since 1986, and production-restricting measures are applied to the product. The most important condition attached to the invocation of this exception is that minimum access quotas must be provided which are larger than those required in respect of products for which Annex is not invoked. The minimum access quotas were required to start, at the beginning of the implementation period, at 4% of base period domestic consumption and to be increased by 0.8% per year until the level of 8% is reached. The continuation of the special treatment is required to be negotiated before the end of the implementation period. In the event that special treatment is continued, invoking countries will have to continue to provide an 8% minimum access quota. In the event that special treatment is not continued, then the non-tariff barriers must be converted to an ordinary tariff. The rate of the tariff must be calculated in accordance with the guidelines in the Attachment to Annex 5 using the difference between world and domestic prices in the base period and reduced by 15%.

The exception provides for an option to convert the non-tariff barriers to an ordinary tariff before the end of the implementation period and for the product to become subject to the rule in Article 4(2). If the option is exercised, the tariff equivalent is to be calculated in accordance with the guidelines in the Attachment to Annex 5 and reduced by the amount that the tariff would have been required to be reduced had it been applied from the beginning of the implementation period. Even where the special treatment ceases, the

16 *Agreement on Agriculture*, annex 5, para 1(d).

minimum access quota existing at the time must be maintained and be increased by 0.4% for each remaining year of implementation period.¹⁷ The effect of this is that the longer the invoking country defers the tariffication of the import quota then the larger is the minimum access quota that must be provided. This exception was invoked by Japan.¹⁸

The Developing Country exception which is restricted to a primary agricultural product that is the predominant staple in the traditional diet of a Developing Country Member was subject to less stringent requirements as to the enlargement of the minimum access quota. Under this provision, the opening minimum access quota was only required to be 1% of base period domestic consumption in the first year increasing by only 0.2% per year for the next 4 years so as to reach 2% by the beginning of the fifth year and then to increase by 0.4% per year for the next 5 years so as to reach 4% by the beginning of the tenth year.¹⁹ Under this provision, there is a lesser incentive to tariffy the non-tariff barrier because it is not until the eighth year that the invoking country is required to provide a minimum access quota that is larger than that which would have to be provided if the special treatment had not been invoked. Korea and the Philippines invoked this exception for rice.²⁰

2.2 ARTICLE XI:2

As mentioned above, Article XI:2(c) has been effectively limited to fisheries products. The continuing application of paragraphs XI:2(a) and (b) must be considered separately. Article 4(2) does not apply to export restrictions so it has no effect on the continuing application of Article XI:2(a). With respect to Article XI:2(b), it is arguable whether import restrictions for applying regulations on standards, grading or marketing were required to be tariffied. If such restrictions could not be regarded as "quantitative import restrictions" within the meaning of the interpretative note, then they cannot be regarded as having been required to be converted into ordinary import restrictions. Therefore, Article XI:2(b) continues to apply at least to some extent.

17 *Agreement on Agriculture*, annex 5, para 1(d).

18 See GATT 1994, Schedule XXXVIII, Section 1A, under product 1006 setting an in-quota rate of zero but qualifying this by providing that a mark-up was also to be applied.

19 *Agreement on Agriculture*, annex 5, para 2.

20 See Schedule LX for the Republic of Korea, under product 1006 setting an in-quota rate of 5% but qualifying it by providing that a mark-up was to be charged in addition to the in-quota tariff.

2.3 RESTRICTIONS FOR BALANCE OF PAYMENTS REASONS

The tariffication process removed the "residual restrictions" whose justification under the balance of payments exceptions had expired. With respect to "residual restrictions" on non-agricultural products, parties were required under a Uruguay Round *Understanding on the Balance-Of-Payments Provisions of the GATT 1994*²¹ to announce time schedules for their removal.²²

Restrictions on agricultural products genuinely justified under either Article XII or under Article XVIII B were exempt from the obligations to tariffy and recourse can still be made to these provisions to justify new restrictions. Any such restrictions are subject to the abovementioned *Understanding on the Balance-of-Payments Provisions*. The Understanding affects the review and removal of existing balance of payments restrictions and also upon the introduction of new ones.

With respect to the introduction of new restrictions, the Uruguay Round Understanding remedies the pre-existing anomaly which made it easier to impose quantitative restrictions than tariffs. Parties are expected²³ to give preference to price based measures such as tariff surcharges²⁴ and to use quantitative restrictions only where price-based measures are insufficient.²⁵

The Understanding also improves the procedures for consultations and review. However, it does not change the tests for justifying balance of payments restrictions under either Article XII or Article XVIII B. Therefore, under Article XVIII B, it will still be necessary for the IMF to decide under the old test which, although like the Article XII test is based on the size of monetary reserves, is qualified by the ambiguous requirement that the size of adequate reserves is to be determined by reference to the country's programme of economic development. As discussed in chapter 11,²⁶ this test effectively removes the element of

21 WTO, *Results of the Uruguay Round*, p27ff.

22 *Understanding on the Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994*, Article 1.

23 I refrain from using the word "obliged" because the two obligations are worded as "confirm their commitment to" (Article 2) and "shall seek to avoid"(Article 3).

24 *BOP Understanding*, Article 2.

25 *BOP Understanding*, Article 3.

26 See above, chapter 11, at pp60-62.

temporariness from the justification to depart from the rules and fails to require any remedial macroeconomic policies in response to a balance of payments problem. The Understanding does nothing to remedy this situation. This may have some impact on agricultural trade if developing countries continue to use Article XVIII B even after their stage of development passes to a stage at which the agricultural sector becomes politically strong.

2.4 ARTICLE XX AND THE SPS AGREEMENTS

The resort to the exceptions in Article XX to justify quantitative restrictions on agricultural products is limited by the *Agreement on the Application of Sanitary and Phytosanitary Measures* ('SPS Agreement'). Under the *SPS Agreement*, measures which are otherwise in conformity with Article XX are still violations if they are based on standards which do not conform to an international standard or if they are higher than international standards and cannot be justified on scientific grounds.

2.5 SAFEGUARDS MEASURES AND THE SPECIAL SAFEGUARDS CLAUSE IN THE AGRICULTURE AGREEMENT

Two safeguard provisions are important for agricultural products. The rules in Article XIX have been substantially modified by the Uruguay Round *Agreement on Safeguards*. In addition, for agricultural products upon which non-tariff barriers were tariffied, there is the special safeguards clause in the *Agreement on Agriculture*. The importance of both of these safeguards clause was enhanced by the strengthening of other rules. The strengthening of regulation of residual restrictions and the tariffication of agricultural quantitative restrictions will have the effect of making it more difficult to justify the introduction or maintenance of quantitative restrictions so parties will not be able to avoid resorting to the safeguards procedures by justifying a quantitative restriction under another provision.

Further, parties cannot avoid using the safeguards procedure by negotiating a voluntary export restraint (VER). The introduction of voluntary export restraints is prohibited under the *Agreement on Safeguards*.²⁷ This prohibition is reinforced by the prohibition in Article

²⁷ Agreement on Safeguards, Article 11(1)(b). For products not subject to the *Agreement on Agriculture*, VERs were to be phased out by 1 January 1999 with Members able to choose one VER to be phased out by 31 December 1999: see Article 11(1)(c).

4(2) of the *Agreement on Agriculture* against resorting to any measure of a kind that has been converted to an ordinary customs duty. This prevents the reintroduction of any VERs against agricultural products that are tariffed under the Agriculture text.

2.5.1 Article XIX and the Agreement on Safeguards

Article XIX is substantially amended by a Uruguay Round *Agreement on Safeguards*. Safeguard measures can still take the form of import quotas instead of tariffs but ordinarily any import quota should not reduce imports below the three year average.²⁸ In the case of use of provisional safeguards in situations where delay in implementing the safeguard measure might result in damage that would be difficult to repair, only import tariffs may be used. The Agreement confirms that safeguard measures may not be adopted in a discriminatory manner (with a limited exception).²⁹ A major change is that the right to retaliate against most safeguard measures will not be exercisable for the first three years.³⁰ This removes the disincentive to use safeguard measures that arises from the potential retaliation by countries other than the country whose exports prompted the imposition of the safeguard measure.

2.5.2 Special Safeguards Provision for the Implementation Period

For the duration of the reform process,³¹ a special safeguards procedure for those agricultural products in respect of which non-tariff measures have been converted into tariffs in the tariffication process.³² Where parties utilize the special safeguards procedure, they cannot use other safeguards procedures under the General Agreement³³ (that is, under Article XIX, or para 17 of the new *Agreement on Safeguards*). The special safeguards clause in the *Agreement on Agriculture* differs from that which was in the Dunkel Text in that it relaxed the volume trigger in markets in which imports constituted more than 10% of domestic consumption. The volume triggered special safeguards clause and the price triggered special safeguards clause must be considered separately.

28 Agreement on Safeguards, Article 5(1).

29 Agreement on Safeguards, Article 5(2)(b).

30 Agreement on Safeguards, Article 8(3).

31 *Agreement on Agriculture*, Article 5(9).

32 *Agreement on Agriculture*, Article 5(1).

33 They cannot use safeguards under GATT Article XIX or under Article 8(2) of the Agreement on Safeguards: see *Agreement on Agriculture*, Article 5(8).

The provisions providing for special safeguards on the basis of volume triggers are convoluted. The special safeguard measure can be resorted to when the volume of imports during any year exceeds a required percentage ("the trigger level") of the "minimum access opportunity". The "minimum access opportunity" is defined to mean "imports as a percentage of the corresponding domestic consumption during the three preceding years for which data are available".³⁴ The base level trigger is:

- 125% of the minimum access opportunity, if the minimum import opportunity is less than 10%;³⁵
- 110% of the minimum access opportunity, if the minimum access opportunity is less than 10% but not greater than 30%;³⁶ and
- 105% of the minimum access opportunity, if the minimum access opportunity is greater than 30%.³⁷

This means that, in cases in which imports were not greater than 10% of domestic consumption during the preceding 3 years, then the special safeguard measure can be imposed when the volume of imports in any year exceeds 125% of the percentage that the previous three years imports were of domestic consumption. In cases in which imports were more than 10% but not greater than 30% of domestic consumption in the preceding three years, then the special safeguards measure can be imposed when the volume of imports in any year exceeds 110% of the percentage that the previous three years imports were of domestic consumption. In cases, in which imports were greater than 30% of domestic consumption in the preceding 3 years, then the special safeguard can be imposed when the volume of imports in any year exceeds 105% of the percentage that the previous three years imports were of domestic consumption. Therefore, the trigger level is lower when imports were previously a higher percentage of domestic consumption.

The special safeguard measure imposed in consequence of a volume trigger cannot exceed one third of the bound ordinary customs duty for the year in which the measure is imposed.

34 *Agreement on Agriculture*, Article 5(1)(a) & Article 4.

35 *Agreement on Agriculture*, Article 5(4)(a).

36 *Agreement on Agriculture*, Article 5(4)(b).

37 *Agreement on Agriculture*, Article 5(4)(c).

The special safeguards measure cannot be maintained beyond the end of the year in which it is imposed.³⁸

The provision for special safeguards on the basis of price triggers provides for safeguards when the import price falls by more than 10% below a trigger price, generally, the average cif price for 1986 to 1988.³⁹ The additional duty is determined on a scale depending on the size of the excess of the trigger price over the import price :

- 30% of the amount by which the difference exceeds 10% but does not exceed 40% of the trigger price; plus
- 50% of the amount by which the difference exceeds 40% but does not exceed 60% of the trigger price; plus
- 70% of the amount by which the difference exceeds 60% but does not exceed 75% of the trigger price; plus
- 90% of the amount by which the difference exceeds 75% of the trigger price.⁴⁰

The trigger price must be the 1986 to 1988 average of a reference price for the product concerned. In general, the reference price should be the cif price but there is some scope for parties to use another price that is appropriate. The reference price must be publicly specified following its initial use.⁴¹ Some parties made advance notifications of their reference prices.⁴²

There is no requirement to give compensation and countermeasures cannot be instituted against a measure applied under Article 5.⁴³

2.6 ARTICLE XXV - WAIVERS

Of principal importance on the question of waivers is the fact that, under the Agriculture Agreement, the quantitative restrictions imposed by the United States under its 1955 waiver have been converted to tariffs.

38 *Agreement on Agriculture*, Article 5(4).

39 *Agreement on Agriculture*, Article 5(1)(b).

40 *Agreement on Agriculture*, Article 5(5)(a) to (e).

41 Interpretative Note to Article 5(1)(b) of the *Agreement on Agriculture*.

42 For example, the EEC in WTO doc G/AG/N/EEC/2, the USA in WTO doc G/AG/N/USA/1.

43 *Agreement on Agriculture*, Article

Unfortunately, the Uruguay Round *Understanding on Waivers*⁴⁴ does little to make it any harder to obtain a waiver for either tariff surcharges or quantitative restrictions. A draft in the Dunkel text which would have required an annual review of whether exceptional circumstances exist was not retained in the wording of the Understanding which came into force. Determination of "exceptional circumstances" will continue to be determined by what two thirds of the parties vote for. It would not be surprising if the operation of the article is not significantly improved.

2.7 STATE TRADING & ARTICLES II:4 & XVII

Although import restrictions on agricultural products implemented by state trading bodies were supposed to be tariffed and although Article II:4 can now operate with respect to agricultural products by virtue of the existence of tariff bindings, there is some uncertainty as to what scope remains for the imposition of import barriers by state run or authorized import monopolies. The Uruguay Round added an *Understanding on Interpretation of Article XVII* but it contains only transparency improving measures and no substantive improvements to either Article II:4 or Article XVII.⁴⁵

With comprehensive tariffication, Article II:4 will restrict the charging of markups in on average in excess of the bound tariff. The question is whether import monopolies can still provide additional protection by restricting quantity. The interpretative note to Article II:4 may become important. It requires Article II:4 to be interpreted "in the light of Article 31 of the Havana Charter. This requires an import monopolist to

import and offer for sale such quantities of the product as will be sufficient to satisfy the full domestic demand for the imported product⁴⁶

though account is required to be taken of "any rationing to consumers of the imported and like product which may be in force at [the] time and "regard [should] be had for the fact that some monopolies are established and operated mainly for social, cultural, humanitarian or revenue purposes".⁴⁷

44 Understanding in Respect of Waivers of Obligations under the General Agreement on Tariff and Trade 1994, in WTO, *Results of the Uruguay Round*, p34-35.

45 Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994, in WTO, *The Results of the Uruguay Round*, pp25-26.

46 *Havana Charter*, Article 31(5).

47 *Havana Charter*, Article 31(6).

Thus Article II:4 could be interpreted to mean that an import monopoly must import the quantity that is demanded by consumers at a price equal to the world price plus the margin of markup that is implicit in the bound tariff rate. However, given the softness of the words "in the light of" and the various qualifying factors in the provision of Article 31, that interpretation might not be adopted. If a strict interpretation is adopted, there will be some practical difficulties in establishing that the quantity that has been imported and made available for sale was less than sufficient to satisfy full domestic demand. If a less restrictive interpretation is adopted then there may be considerable scope for import monopolies to limit the quantity of imports. In such a situation, the import monopolist could comply with Article II:4 by limiting its mark up to that permitted by Article II:4, but the market place would bid up the price so that additional mark ups could be charged by entities at subsequent stages of the distribution chain. Therefore, depending on the way that Article II:4 is interpreted, it may not be sufficient prevent import monopolies from imposing *de facto* quantitative restrictions.⁴⁸

2.8 ANTI-DUMPING DUTIES

Given that the use of other avenues for imposing or maintaining restrictions have been closed off, the anti-dumping exception may become more important to agricultural trade. The closing of the possibility of recourse to voluntary export restraints means that, apart from limited scope under the safeguards agreement, the anti-dumping exception is the only avenue left for imposing an import barrier on imports from a particular source. Under post-WTO rules, anti-dumping duties must conform to the *Agreement on Implementation of Article VI of the GATT 1994* ('*Anti-Dumping Agreement*'). The *Anti-Dumping Agreement* imposes disciplines on the calculation of normal price, on the findings of material injury and of causation. Since, anti-dumping duties were not a major factor influencing agricultural trade under the GATT 1947, contentious aspect of anti-dumping law were not dealt with in chapter 11. One observation that can be made is that the *Anti-Dumping Agreement* does not substantively change the price thresholds relevant to determining whether anti-dumping duties can be imposed. Before, the Uruguay Round, it was possible to impose anti-dumping

⁴⁸ See the discussion of this point in Tangermann et al, "Implementation of the Uruguay Round Agreement on Agriculture and Issues for the Next Round of Agricultural Negotiations" (International

duties on sales being made at a profit and after the Uruguay Round it is still possible to impose anti-dumping duties on sales made at profit.

3 SUMMARY

The post-Uruguay Round rules applicable to agriculture have made a substantial change to the existing import barriers on agriculture and have changed the rules that continue to apply.

For the first time since 1948, it has been possible for the prohibition on quantitative restrictions to apply. The changes achieved the end of the quantitative import restrictions or quantitative import restrictions imposed under country specific waivers, under residual balance of payments restrictions, under voluntary export restraints, under Article XI:2(c) and under variable levies and minimum import rules. The new *SPS Agreement* should help to ensure that protective measures are not taken under the guise of sanitary or phytosanitary controls. However, the use of quantitative restrictions will still be possible under balance of payments, particularly for developing countries, and also under the safeguards exception.

The binding of all tariffs has made it possible for the rules on tariffs and also the rules on mark-ups by import monopolies to apply to agricultural trade. The actual degree of tariff reduction achieved in the round was small. The de-linking of the agricultural tariff reductions from the other reductions in the Round and the use of averaging in the calculation of tariff reductions on agricultural products has failed to ensure that tariffs were reduced on the most protected products. The overall dispersion in rates of protection applicable to different products may have increased.⁴⁹

The introduction of tariff quotas is a problem. They have not been introduced as a temporary measure as originally intended. They will protect the interests of certain traders

Agricultural Trade Research Consortium, Commissioned Paper No 12, October 1997) (available from <http://www.umn.edu/iatrc>), pp144-145.

49 See, eg, Hathaway, Dale E. & Ingco, Merlinda D., "Agricultural Liberalization and the Uruguay Round", chapter 1 in Will Martin & L. Alan Winters (eds), *The Uruguay Round and the Developing Economics* (World Bank discussion paper 307) (World Bank, Washington DC, 1995) pp1-24 at 15.

CHAPTER 21

THE URUGUAY ROUND RULES ON EXPORT SUBSIDIES

1 INTRODUCTION

Like the area of import barriers, the area of export subsidies is affected by the Uruguay round texts in two ways: by rule changes and also by measured commitments to change. As described in previous chapters, the difficulties in reaching agreement on rule changes, led to the approach of negotiating measured changes to existing policies. The implementation of those measured changes resulted in some rule changes.

As with border access, the differentiation between agricultural products and other products is significant in the way the Uruguay Round agreements apply to export subsidies. For border access, the parties have amended rules of general application and have then gone on to make even stricter rules for agricultural products by making tariff binding compulsory and comprehensive rather than negotiable as it is for non-agricultural products. For subsidies, by negotiating an *Agreement on Subsidies and Countervailing Measures ('SCM Agreement')*, the parties have made the rules of general application more rigorous but they have exempted agricultural products from those rules, making some less stringent rules for agricultural products.

Most of the changes to rules on export subsidies on agricultural products come into force through the specific commitments. Those commitments are given in the Members' Schedules annexed to Marrakesh Protocol. Section I of Part III of the Schedules contain commitments on the reduction of budgetary outlays and quantities. Section III of Part III contains commitments on limiting the scope of export subsidies. In addition to the scheduled commitments, export subsidies on agricultural products are affected by both the

Agreement on Agriculture, and the *SCM Agreement*. However, specific provision has been made to exempt agricultural products from many of the important provisions of the *SCM Agreement*, at least, for the duration of the reform process. Nevertheless, the rules established under the *SCM Agreement* are important so they will be described before describing the rules on export subsidies under the *Agreement on Agriculture* and the effect of the specific commitments on export subsidies.

2 EXPORT SUBSIDIES UNDER THE AGREEMENT ON SUBSIDIES AND COUNTERVAILING DUTIES

The *SCM Agreement* makes the Article XVI rules redundant by applying a new prohibition, and by introducing new rules on Track II (multilaterally authorized) remedies against subsidies (including export subsidies) that cause adverse effects. It also regulates the imposition of track I remedies (countervailing duties).

2.1 THE PROHIBITION OF EXPORT SUBSIDIES

Article 3.1(a) prohibits export subsidies.¹ There is no differentiation between primary and non-primary products and there is no dual price test. The prohibition applies to all subsidies that are contingent upon export performance.

The prohibition in Article 3.1(a) applies to "subsidies, within the meaning of Article 1". In Article 1, subsidy is defined (non-exhaustively) as a benefit conferred by either a financial contribution (including revenue foregone) by a government or by any form of income or price support.

The prohibition is expressed to apply to: subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I.

The list is similar to the list in the old *Subsidies Code*. The last item is:

- (I) Any other charge on the public account constituting an export subsidy in the sense of Article XVI of the General Agreement.

The adoption of the "contingent upon export performance" criteria for defining export subsidies removes the ambiguity contained in the words of Article XVI relating to subsidies

¹ Phase-in provisions apply, under Article 27, for developing countries and, under Article 29, for countries in the transition to a market economy.

that increase exports or subsidies on export. The "contingent upon export performance" criteria makes a clear distinction between subsidies that are paid only on exports and subsidies paid more broadly. Clearly the payment of production subsidies is not prohibited regardless of whether some of the products receiving the benefit of the production subsidy are exported. This brings the definition into line with the economic difference between export subsidies and production subsidies as set out above in chapter 4.

2.2 TRACK 2 - COUNTERMEASURES AGAINST ACTIONABLE SUBSIDIES

There are dispute settlement provisions in Part III of the Agreement which affect "actionable subsidies".² Export subsidies may fall within the scope of these provisions. Part III provides for the possibility of countermeasures against subsidies that cause either injury to the domestic industry of another party, nullification and impairment of benefits, or serious prejudice.³

Generally, there would be no need to resort to these provisions against export subsidies. However, where any particular parties or particular types of subsidies are not subject to the prohibition due to phase in periods or particular exceptions, then they may be subject to these rules. As regards the discipline of the effect of export subsidies in third markets, the remedy against causing serious prejudice provides is presumed to exist where the subsidy exceeds 5% of the value of the product but that it can be rebutted if the subsidizing country can demonstrate an absence of trade effects.⁴

2.3 TRACK 1 - COUNTERVAILING DUTIES

Countervailing duties against export subsidies must comply with the *SCM Agreement* as well as with Article VI of the GATT 1994.⁵

Countervailing duties cannot be imposed against a subsidy the amount of which is less than 1% of the value of the product.⁶ This exception is broader for developing countries. Countervailing duties cannot be imposed against a subsidized export from a developing

2 These provisions are more described in the next chapter.

3 *SCM Agreement*, Article 5.1.

4 *SCM Agreement*, Article 6.

5 *SCM Agreement*, Article 11.1

6 *SCM Agreement*, Article 11.9.

country if either the amount of the subsidy is less than 2% of the value of the product or the volume of the subsidized imports is less than 4% of the volume of imports of the product in the importing country (unless together with subsidized exports from other developing they constitute 9% of the import volume).⁷

2.4 THE EXCEPTION OF AGRICULTURE

The prohibition of export subsidies is expressed "Except as provided in the *Agreement on Agriculture*". The *Agreement on Agriculture* exempts export subsidies from the prohibition in the *SCM Agreement* until 1 January 2004, provided that they conform to reduction commitments under the *Agreement on Agriculture* (which are described below).⁸

Export subsidies conforming to the reduction commitments under the *Agreement on Agriculture* are also exempt from the track 2 remedies under the *SCM Agreement*.⁹ It is stressed that, since pasta and various other incorporated products are included with the definition of products for the purposes of the *Agreement on Agriculture*, export subsidies on those products are exempted from the prohibition provided that they conform to reduction commitments under the *Agreement on Agriculture*.

The Track 1 countervailing duty remedy can be applied against export subsidies on agricultural products even if they conform to the reduction commitments under the *Agreement on Agriculture* provided that any CVDs are based on a "determination of injury or threat thereof based on volume, effect on prices, or consequent impact in accordance with Article VI of the GATT and Part V of the Subsidies Agreement".¹⁰

3 EXPORT SUBSIDIES UNDER THE *AGREEMENT ON AGRICULTURE*

The *Agreement on Agriculture* implements a reform programme for export subsidies. The Agreement makes an important distinction between export subsidies and domestic subsidies. The reform programme applied to export subsidies is more severe than that imposed for other subsidies. The definition of "export subsidies" is limited to subsidies that are

7 *SCM Agreement*, Article 27.10 & 27.11.

8 *Agreement on Agriculture*, Article 13(3)(b).

9 See *SCM Agreement*, Article 5 & *Agreement on Agriculture*, Article 13(3)(b).

10 *Agreement on Agriculture*, Article 13(3)(a).

contingent upon export performance and, therefore, excludes domestic production subsidies that indirectly increase exports.

Almost all of the obligations on export subsidies under the *Agreement on Agriculture* come into force pursuant to the scheduled commitments which are annexed to the Marrakesh Protocol. The obligations under commitments come into force under two provisions, Articles 3(3) and Article 8 which, respectively provide:

Article 3(3): ... a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products listed in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule.

Article 8: Each participant undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with its commitments as specified in its Schedule of export competition commitments.

None of the provisions of the draft Agreement on Modalities specifying the guidelines for the commitments are incorporated into the Agreement. The contents of the Schedules are regarded as part of the GATT 1994 by virtue of Article 3(1) which provides:

The domestic support and export subsidy commitments in Part IV of each Member's Schedule constitute commitments limiting subsidisation and are hereby made an integral part of GATT 1994.

As an integral part of the GATT 1994, the contents of the Schedules must be taken into account in interpreting the provisions of the *Agreement on Agriculture*.¹¹

3.1 TERMS OF EXPORT COMPETITION COMMITMENTS

The scheduled commitments contain specifications in respect of products or product groups of budget outlays and volume of product. The effect of these export subsidy commitments is described in Article 9(2)(a) of the Agreement. The specifications in a Member's schedule in respect of a product or product group for a particular year are for that Member:

¹¹ In accordance with Article 31 of the *Vienna Convention on the Law of Treaties* (done, Vienna, 23 May 1969, in force generally 27 January 1980, ATS 1974 No 2, UKTS 1980 No 58, UNTS1155 p331) which requires the treaty to be considered in its context which includes any Annexes to a treaty.

- the maximum level of expenditure that can be incurred in connection with export subsidies on that product or product group in that year;¹²
- the maximum quantity of that product or product group that can receive the assistance of export subsidies in that year.¹³

Therefore, the commitments create maximum amounts for outlays and quantities to apply for each year of the implementation period and at the end of the implementation period.¹⁴

The obligations on the products which come into force under Article 3(3) apply to the degree of product specificity that the commitments have been made but no further. It is possible for budget outlays or volumes to be juggled provided that the aggregates for the product group for which a commitment has been made do not exceed the commitment. In respect of any product on which no commitment has been given, the effective maxima are zero.

The Agreement also allows for the Schedules to contain commitments relating to the markets to which subsidized exports are to be sold.

The text does not refer directly to commitments on the amount of export subsidy applied per unit of product. However, for each product group there should be commitments relating to both the maximum outlay and the maximum volume. The combined effect of those two commitments is that there is a maximum average outlay per unit of volume. It is only an average though and does not restrict the outlay on any particular product. Further, it is only a restriction on average outlay per unit of volume not on average outlay per unit of value.

3.2 QUANTUM OF EXPORT SUBSIDY COMMITMENTS

As described in chapter 19, under the terms of the Agreement on Modalities, the maximum amounts for export subsidies were supposed to be calculated by reference to baseline amounts and a required rate of reduction. As described in chapter 19, the parties were able to choose a baseline level on either the average of the relevant amounts for the years from

12 Article 9:2(a).

13 Article 9:2(b).

14 Paragraph 6 of Annex 8 to Part B.

1986 to 1990 or for the years 1991 and 1992.¹⁵ The required rates of reduction to be achieved by the end of the implementation period were supposed to be 36% for outlays and 24% for quantities below the 1986-1990 baselines.¹⁶ For developing countries, the rates are 24% and 16% respectively.¹⁷ However, during the implementation period, the obligations under the Agreement derive from the actual maxima that are specified in the commitments not from the Agreement on Modalities regardless of whether the commitments actually do not conform to the agreed baselines and rates. In general, the content of the Agreement on Modalities is not incorporated into the text of the *Agreement on Agriculture*. However, the text of the *Agreement on Agriculture*, itself, does specify the maxima to apply at the end of the implementation period. Article 9(2)(b)(iv) provides that:

the Member's budgetary outlays for export subsidies and the quantities benefiting from such subsidies, at the conclusion of the implementation period, are no greater than 64 per cent and 79 per cent of the 1986-1990 base period levels, respectively. For developing country Members these percentages shall be 76 and 86 percent, respectively.¹⁸

Nothing in the text of the Agreement defines the meaning of the phrase "1986-1990 base period levels". However, in practice, in the Schedules on outlay and volume commitments on export subsidies, Members have specified a base level of outlays and of volume which would be regarded as representing the base levels for the purposes of this Article.¹⁹

A small margin of deviation is permitted in respect of the specified maximums during the implementation period but not in respect of the maxima to apply at the end of the implementation period.²⁰

As mentioned above developing countries reduction commitments can be for a lesser percentage reduction. They can be implemented over a period of 10 years ending on 1 January 2004.²¹ Developing countries are also exempt from reducing two types of export subsidies: subsidies to the cost of marketing including international transport costs and

15 Dunkel Text, Part B, Agreement on Modalities, paragraph 11.

16 Dunkel Text, Part B, Agreement on Modalities, paragraph 11.

17 Dunkel Text, Part B, Agreement on Modalities, paragraph 15.

18 *Agreement on Agriculture*, Article 9(2)(b)(iv).

19 See the reference above to the Schedules forming part of the context for the purposes of interpretation in accordance with the *Vienna Convention*.

20 *Agreement on Agriculture*, Article 9(2)(b)(i) & (ii).

21 *Agreement on Agriculture*, Article 15(2).

subsidies to the costs of internal transport.²² The least developed countries are exempt from all of the reduction commitments including the export competition commitments.²³

3.3 SCOPE AND DEFINITION OF EXPORT SUBSIDY

The Agreement draws a distinction between 'export subsidies' for the purposes of the commitments and 'export subsidies' for the purposes of some other provisions of the Agreement. The general definition of "Export subsidies" is in Article 1(e) which defines them as:

subsidies contingent upon export performance including the export subsidies listed in Article 9 of this Agreement.

Article 9(1) contains a list of government measures that must be covered by reduction commitments. It lists:

- (a) direct subsidies from governments contingent on export performance;
- (b) export sales by governments at prices lower than the domestic buying price;
- (c) payments on exports financed by government action even if there is no direct charge on the public account;
- (d) subsidies for costs of marketing exports including the costs of handling, processing, international transport and freight;
- (e) subsidies or concessions on costs of internal transport and freight of exports;
- (f) subsidies on agricultural products contingent on their incorporation in exported products.

For the purposes of the reduction commitments, this list in Article 9(1) is an exhaustive list of the export subsidies that have to be counted in determining whether the commitments have been complied with. The list does not include financing costs so assistance with financing and subsidies to the cost of financing of exports are not counted for the purposes of determining whether export subsidy reduction commitments have been met.²⁴

²² *Agreement on Agriculture* Article 9(4).

²³ *Agreement on Agriculture*, Article 15(2).

²⁴ Note that Article 10:2 provides that export credits, export credit guarantees or insurance programmes will not be given otherwise than in conformity with internationally agreed disciplines.

However, for the purposes of some other provisions, the definition in Article 1(e) applies. and for the purposes of the definition of export subsidies in Article 1(e), the list in Article 9 is a non-exhaustive list.

3.4 PRODUCTS INCORPORATING AGRICULTURAL PRODUCTS

The *Agreement on Agriculture* does apply to all of the products incorporating agricultural products as fall within the parts of the harmonized system that are covered by the Agreement.²⁵ All of these products are subject to export subsidy commitments under the Agreement which means that export subsidies in conformity with those commitments are exempt from the prohibition in the *SCM Agreement*. In addition to any other commitments, export subsidies on products incorporating agricultural products are also subject to Article 11 which provides:

In no case may the per unit subsidy paid on an incorporated agricultural primary product exceed the per unit export subsidy that would be payable on exports of the primary product as such.

3.5 OTHER OBLIGATIONS ON EXPORT SUBSIDIES

The reduction commitments only apply to those export subsidies that are listed in Article 9(1). Members are obliged not to use export subsidies other than those listed in Article 9(1) in a manner which actually does or threatens to circumvent the reduction commitments. This obligation applies a some discipline, perhaps too nebulous to be effective, to subsidies other than those listed in Article 9(1). It seems that the principal type of export subsidies that are not covered by the are government provided or subsidized export credits, export credit guarantees, or export credit insurance. Coverage of food aid is limited. It is included in the reduction commitments if it constitutes disposal of non-commercial stocks at below the normal price in the domestic market. No definition of non-commercial stock is provided. These two matters of export credits and food aid are connected because much food aid can be supplied by invoicing in the normal way but lending the purchase price. Food aid provided in that way to purchase commercial stocks is not be covered by the reduction commitments.

25 See *Agreement on Agriculture*, Annex 1.

Article 10 attempts to provide some discipline to these type of transactions. Members assumed an obligation "to work toward" international disciplines on export credits. In respect of food aid, Members must not tie food aid to commercial transactions and must comply with standards established by the Food and Agriculture Organization.

3.6 ONLY INDIRECT PER UNIT CONSTRAINTS ON EXPORT SUBSIDIES

The Schedules of Commitments do not contain specific commitments on the maximum per unit subsidy. However, the combination of limits on both outlays and volumes does create constraints on per unit subsidies within the limits of averaging of the outlay and volume commitments on the product groups. There is still considerable scope for increasing the per unit amount of an export subsidy on a particular product but it must be offset by reductions on some other subsidy so that the permissible maximum outlays and volumes for the relevant product group is not exceeded.

4 SUMMARY

The Uruguay Round created a new system of regulation of export subsidies on agricultural products. They are disciplined by a system of quantitative bindings. For so long as the bindings are complied with, then the subsidies are exempt from the discipline of track II remedies whether pursuant to Article XVI:3, the new Article 3 of the *SCM Agreement* or under the remedies against subsidies causing adverse effects. It is still permissible to introduce a new export subsidy but only if the resulting level of subsidies subject to commitments is within the maximums specified in the applicable Scheduled commitments.

The system of export subsidy bindings does not necessarily apply as the tariff bindings do to particular products identified by reference to a single line on the customs classification. It applies only to the degree of product specificity to which the export competition commitments have been made.

The exceptions from the *SCM Agreement* will expire unless agreement is reached to extend them. This will be the most significant incentive for export subsidizing Members to negotiate an extension of reduction commitments that is satisfactory to other Members.

CHAPTER 22

THE URUGUAY ROUND RULES ON DOMESTIC SUPPORT

Only if [countries] are able to identify common interests in having the freedom to pursue certain subsidy goals without adverse reactions from trading partners is agreement likely to emerge.

John J. Barcelo III, "An "Injury-only" Regime (For Imports) and Actionable Subsidies" in Don Wallace, Jr, Frank J. Loftus & Van Z. Krikorian (eds) *Interface Three: Legal Treatment of Domestic Subsidies* (The International Law Institute, Washington DC, 1984) pp19-27 at 25.

1 INTRODUCTION

The agriculture reform programme under the Uruguay Round *Agreement on Agriculture* also applies to domestic support. For domestic support also, there is a programme of measured reductions to be implemented. For domestic support more so than for import barriers and export subsidies, the Uruguay Round agreements expressly make major rule changes.

The most significant rule change is the delineation of permissible subsidies. Both the *Agreement on Agriculture* and the *SCM Agreement* create a class of subsidies that are non-actionable both for the purposes of multilaterally authorized countermeasures and for countervailing duties. This is a significant restriction or at least a clarification of the scope of the nullification and impairment rule. It reflects a more lenient treatment of certain types of domestic subsidies and a stricter treatment of others. The distinction is made upon the basis of the trade distortion caused by the subsidy. The criteria for the non-actionable subsidies are based on them having no or minimal trade distorting effects.

The reduction commitments for domestic supports apply to the actionable subsidies and not to the non-actionable subsidies. The reduction programme applied to the actionable domestic subsidies is less severe than that applied to export subsidies. A lesser rate of

reduction is required, although from a lower base period. The reduction commitments are in the form of commitments on total Aggregate Measure of Support and are contained in Section 1 of Part IV of the Members Schedules annexed to the Marrakesh Protocol.

Participants in the negotiation tended to use a traffic light terminology which will be followed here. Under the *SCM Agreement*, the prohibited subsidies are called the red box, the actionable subsidies are called the orange box and the non-actionable subsidies are called the green box. Under the *Agreement on Agriculture*, there are no prohibited subsidies and, therefore, is no red box but there are subsidies subject to reduction commitments and those that are not. The former group that is subject to reduction commitments is called the amber box and the latter group that is exempt from reduction commitments is called the green box. The traffic light classification is complicated by the creation of the additional category made to accommodate the CAP direct payments containing the direct payments on fixed areas or head (that is, number of animals). This category known as the blue box is also exempt from reduction commitments.

As with the rules on export subsidies, domestic subsidies on agricultural products are affected by both the *Agreement on Agriculture* and the *SCM Agreement*. However, specific provision has been made to exempt agricultural products from many of the provisions of the *SCM Agreement*, at least, for the duration of the reform process. The rules under the *SCM Agreement* will be described briefly before describing the rules on export subsidies under the *Agreement on Agriculture* and the effect of the specific commitments on domestic support.

2 DOMESTIC SUBSIDIES UNDER THE AGREEMENT ON SUBSIDIES AND COUNTERVAILING DUTIES

As mentioned in the previous chapter, the *SCM Agreement* established rules on Track II (multilaterally authorized) remedies against subsidies that cause adverse effects and also regulates track I remedies. Some classes of domestic subsidies are exempted from both tracks of remedies.

2.1 OVERVIEW OF THE SCHEME

In overview, the *SCM Agreement* creates classifications of subsidies. There are some similarities and also some differences between the classes of subsidies created under the *SCM Agreement* and the classes created under the *Agreement on Agriculture*.

The classes created under the *SCM Agreement* are:

- (1) a class of non-actionable subsidies that are not subject to countervailing duties and only subject to multilaterally authorized countermeasures if they cause damage that would be difficult to repair; this class consists of subsidies that are not specific to an enterprise or industry and also certain specific subsidies relating to research, regional development, or adaptation to environmental standards; or
- (2) a class of actionable subsidies that are subject to countervailing duties under ordinary rules and are subject to countermeasures if they cause either injury to domestic industry, nullification and impairment, or serious prejudice to the interests of another party.

2.2 THE ARTICLE 3.1(B) PROHIBITION OF DOMESTIC SUBSIDIES CONTINGENT UPON USE OF DOMESTIC PRODUCTS

In addition to prohibiting export subsidies, Article 3.1 also prohibits domestic subsidies that are contingent upon the use of domestic over imported products. This kind of measure is already subject to Article III of the General Agreement. It is a clear *prima facie* violation of the national treatment rule. However as the Oilseeds case¹ demonstrated, the question of whether such subsidies fit within the exception to the national treatment rule in Article III:8(b) can be a complicated legal issue. Article 3.1(b) makes clear that this type of subsidy is prohibited.

2.3 DEFINITION OF NON-ACTIONABLE SUBSIDIES

The key concept in the definition of a non-actionable subsidy is that of specificity. Subsidies that are not specific to a particular enterprise or industry are non-actionable.² In

1 "EEC - Payments and Subsidies Paid to Processors of Oilseeds and Related Animal-Feed Proteins", Report of the Panel adopted on 25 January 1990, (L/6627), GATT, *BISD*, 37S/86.

2 *SCM Agreement*, Article 8.1(a).

addition, three other types of subsidies can be non-actionable even if they are specific: subsidies for research and subsidies to assist disadvantaged regions.³

2.3.1 "non-specific subsidies"

Under Article 2, specificity refers to whether a subsidy is "specific to an enterprise or industry or group of enterprises or industries".⁴ Article 2 sets out certain principles for determining specificity. The dominant principles are:

- that a subsidy is specific if it is explicitly limited to certain enterprises;⁵
- that a subsidy is not specific if eligibility for it is based on objective criteria which do not favour certain enterprises;⁶

Article 2.1 also lays down some additional criteria which can be used if the first two criteria do not satisfactorily determine that a subsidy is not specific. The additional criteria include a review of the actual recipients of the subsidy and of the manner in which the discretion has been exercised by the granting authority.

2.3.2 Research Subsidies

The status of non-actionability is also given to specific subsidies which assist research activities.⁷ There are restrictions on the type of research and the type of costs.

2.3.3 Disadvantaged Regions

Specific subsidies which assist disadvantaged regions as part of a regional development policy can also be non-actionable.⁸ To qualify they must relate to a clearly defined geographic region.⁹ The status of disadvantaged must be determined on the basis of objective criteria which includes either the income level or the unemployment rate.¹⁰

3 *SCM Agreement*, Article 8.1(b).

4 *SCM Agreement*, Article 2.1.

5 *SCM Agreement*, Article 2.1(a).

6 *SCM Agreement*, Article 2.1(b).

7 *SCM Agreement* Article 8.2(a).

8 *SCM Agreement* Article 8.2(b).

9 *SCM Agreement* Article 8.2(b)(i).

10 *SCM Agreement* Article 8.2(b)(ii) and (iii).

2.3.4 Adaptation to New Environmental Standards

Specific subsidies to promote adaptation of existing facilities to new environmental requirements which impose financial costs can be non-actionable. Other requirements must be met including that the subsidy is a one-time non-recurring measure and is limited to 20% of the cost of the adaptation.¹¹

2.4 TRACK 2 - APPLICATION OF MULTILATERALLY AUTHORIZED COUNTERMEASURES

2.4.1 To Non-Actionable Subsidies

Countermeasures cannot be authorised against a non-actionable subsidy except in very narrow circumstances.¹² It is required that the Committee¹³ find that the subsidy "has resulted in serious adverse effects to the domestic industry of [another] signatory, such as to cause damage that would be difficult to repair"¹⁴ and the relevant party has failed to modify a subsidy programme to remove these effects.¹⁵

2.4.2 To Actionable Subsidies

The Committee can authorise countermeasures against specific subsidies (other than the two exempted categories referred to above) if they cause certain adverse effects and the relevant party fails to meet a request to take appropriate steps to remove the adverse effects of the subsidy or the subsidy itself.¹⁶ (There is a general exemption for subsidies that are part of a privatisation programme in a developing country.¹⁷)

Adverse effects can be caused in the same three ways that they could be caused under Article 8 of the Tokyo Round *Subsidies Code*:

- (a) injury to the domestic industry of another signatory;

11 *SCM Agreement*, Article 8.2(c).

12 *SCM Agreement* Article 9. By virtue of footnote 35 to the heading of Article 10, the procedure for multilaterally authorized remedies of Article 7 can not be invoked against non-actionable subsidies.

13 The Committee on Subsidies and Countervailing Duties established under Article 24. .

14 *SCM Agreement*, Article 9.1.

15 *SCM Agreement*, Article 9.4.

16 *SCM Agreement*, Article 7.6

17 *SCM Agreement*, Article 27.12

-
- (b) nullification or impairment of benefits accruing directly or indirectly to other signatories under the General Agreement,....;" or
- (c) serious prejudice to the interests of another signatory."¹⁸

Each of these three effects is explained further. However, the amendments are concentrated upon a complicated delineation of the notion of serious prejudice. The first category of injury to a domestic industry of another signatory is explained to have the same meaning as for the purpose of countervailing duties.¹⁹ The second category of nullification or impairment is explained to have the same meaning as under the non-violation provisions of GATT 1994.²⁰

Serious prejudice is explained in detail. There is a specification of some effects, one of which must exist for serious prejudice to exist. The onus of proof is different for developed countries and developing countries. For developed countries, serious prejudice is deemed to exist if the subsidy:

- exceeds 5% of the value of the product;²¹
- covers operating losses of an industry;²²
- covers operating losses of an enterprise;²³
- is a forgiveness of debt.

The presumption may be rebutted by demonstrating the absence of trade effect in any of the listed ways:

- a displacement or impediment to imports into the subsidizing country;²⁴
- a displacement or impediment to exports from a 3rd country;²⁵
- a significant price undercutting, price suppression, price depression or lost sales occurring in a market;²⁶ or

18 *SCM Agreement*, Article 5.1.

19 Interpretative footnote 11 to Article 5.1(a).

20 Interpretative footnote 12 to Article 5.1(b) refers specifically to Article XXIII:1(b).

21 *SCM Agreement*, Article 6.1(a)

22 *SCM Agreement*, Article 6.1(b)

23 *SCM Agreement*, Article 6.1(c); This paragraph includes an exception for one-off measures.

24 *SCM Agreement*, Article 6.3(a).

- an increase in world market share compared to the average over the previous 3 years.²⁷

For developing countries the scope of "serious prejudice" is significantly narrowed. For them, there is no presumption and serious prejudice can only occur if the complainant establishes that there are trade effects and the presence of:

- a displacement or impediment to imports into the subsidizing country so as to constitute nullification or impairment under the General Agreement;²⁸ or
- there is injury to a domestic industry in the same sense as is required for the imposition of countervailing duties.²⁹

In effect, for challenges against subsidies by developing countries, the serious prejudice head adds nothing to the other two heads of adverse effects.

2.5 TRACK 1 - APPLICATION OF COUNTERVAILING DUTIES

2.5.1 To Non-Actionable Subsidies

Countervailing duties cannot be imposed against non-actionable subsidies.³⁰

2.5.2 Against Actionable Subsidies

The Committee can authorise countermeasures against specific subsidies (other than the three exempted categories referred to above) if they cause injury within the meaning of Article VI of the General Agreement.

There is an exemption from exposure to countervailing duties for *de minimis* subsidies (whose size or effects are less than a defined level). The threshold level is defined differently for developing countries and for other countries.

25 *SCM Agreement*, Article 6.3(b)

26 *SCM Agreement*, Article 6.3(c)

27 *SCM Agreement* Article 6.3(d)

28 *SCM Agreement* Article 27.8. Curiously, instead of referring to nullification or impairment of a benefit under the Agreement, it refers to the nullification or impairment of an obligation under the Agreement. (".. nullification or impairment of tariff concessions or other obligations under the General Agreement ...").

29 Article 27.8.

30 This rule is not to be found set out expressly in the text of the Agreement. Footnote 35 to the heading of Article 10 provides that the provisions of Part V (which deals with countervailing duties cannot be invoked against non-actionable subsidies).

For countries that are not developing countries, CVDs cannot be imposed if :

- the amount of the subsidy is less than the *de minimis* level of 1% ad valorem; or
- the volume of subsidized imports is negligible; or
- the injury is negligible.³¹

For developing countries, CVDs cannot be imposed if :

- the amount of the subsidy does not exceed the *de minimis* level which is generally 2% ad valorem but is 3% for the first 8 years of the agreement for those developing countries that have implemented the ban of export subsidies or that (being among the Annex VII countries) are exempt from the ban;³²
- the volume of subsidized exports makes up less than 4% of the volume of imports (of the like product) in the importing country unless in aggregate with subsidized exports from another country they account for more than 9% of the volume of imports in the importing country.³³

In the assessment of whether the subsidy is causing the injury, the cumulative effect of more than one country's subsidy may only be considered if both the amount of the subsidy and the volume of the subsidized imports exceed the levels defined above as being applicable to the relevant country.³⁴

2.6 THE EXCEPTION OF AGRICULTURE

The application of the remedies under the *SCM Agreement* to subsidies on agricultural products is limited by the provisions of the *SCM Agreement* and the *Agreement on Agriculture*.

The prohibition of subsidies contingent upon the use of domestic over imported goods does apply to agricultural products.³⁵

31 *SCM Agreement*, Article 11.7

32 *SCM Agreement*, Articles 27.9(a) and 27.10.

33 *SCM Agreement*, Article 27.9(b)

34 *SCM Agreement*, Articles 15.3 and 27.11

35 *SCM Agreement*, Article 3.1(b). None of the exemptions in Article 13 of the *Agreement on Agriculture* exclude this article.

The application of track 2 remedies under GATT or the *SCM Agreement* is limited by the *Agreement on Agriculture* until 1 January 2004. These remedies cannot be applied against domestic subsidies that:

- fall into the green box under the *Agreement on Agriculture*;³⁶
- fall into to the amber box or blue box under the *Agreement on Agriculture* provided that the subsidies are in conformity with reduction commitments under that Agreement and do not exceed the level of support provided to a particular commodity in 1992;³⁷
- fall within the de minimis levels set out in the *Agreement on Agriculture*.³⁸

The application of track 1 countervailing duty remedies under GATT and the *SCM Agreement* are also limited by the provisions of the *Agreement on Agriculture*. CVDs cannot be applied against domestic subsidies on agricultural products in the green box under the *Agreement on Agriculture*.³⁹ CVDs conforming to the requirements of the *SCM Agreement* can be applied against other types of domestic subsidies on agricultural products including the subsidies subject to the reduction commitments and also some non-green box subsidies that are not subject to reduction commitments.⁴⁰

3 DOMESTIC SUBSIDIES UNDER THE AGREEMENT ON AGRICULTURE

The *Agreement on Agriculture* provides for domestic support measures to be subject to reduction commitments unless they fit within certain categories. The category of subsidies subject to reduction commitments has been called the amber box. The categories of subsidies that are exempt from reduction commitments are the following:

- (1) subsidies maintained in accordance with specified criteria (defining the 'green box');
- (2) subsidies kept below the specified *de minimis* levels;
- (3) subsidies under production-limiting programmes based on fixed areas, production or headage;

36 *Agreement on Agriculture*, Article 13(a)(ii) & (iii) and *SCM Agreement*, Articles 5 & 6(9).

37 *Agreement on Agriculture*, Article 13(a)(ii) & (iii) and *SCM Agreement* Article 5 & 6(a).

38 As above.

39 *Agreement on Agriculture*, Article 13(a)(i) and *SCM Agreement*, Article 5 & 6(9).

40 *Agreement on Agriculture*, Article 13(a)(ii) and *SCM Agreement*, Article 5 & 6(9).

- (4) and for developing countries only, certain investment subsidies, input subsidies or subsidies to encourage diversification from growing narcotics.

The commitments on domestic support are contained in Section I of Part IV of the each Member's Schedule annexed to the Marrakesh Protocol. The commitments are made in terms of an Aggregate Measure of Support ('AMS') or using Equivalent Measures of Support. The rules for calculating these measurements are contained in annexes 3 and 4. The criteria exempting domestic subsidies from the reduction commitments are contained in Article 6 with the criteria for inclusion in the green box set out in Annex 2. The parts of Part B of the Dunkel Text which specified the quantum of the reduction commitments is not included in the Agreement. This aspect of the commitments is wholly dependent on the entries in the Members' Schedules.

3.1 THE DOMESTIC SUPPORT COMMITMENTS

The reductions of domestic support must be implemented over the same period as is applicable for the reform programme for import barriers and export subsidies. These commitments are undertakings to reduce the level of support. They are incorporated into the Schedules to the General Agreement by annexation to the Uruguay Round Protocol and are an integral part of the GATT.⁴¹

The obligations under the domestic subsidy commitments come into force by virtue of two provisions:

Article 3(2):

Subject to the provisions of Article 6, a Member shall not provide support in favour of domestic producers in excess of the commitments levels specified in Section I of Part IV of its Schedule.

Article 6(3):

A Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of its Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule.

41 *Agreement on Agriculture*, Article 3.2.

The schedules contain amounts in monetary value specifying the AMS for the base period and the AMS for the end of each year of the implementation period. The Schedules also contain references to documents containing supporting material showing how the AMS was calculated.⁴² Under Article 6(3), the Total AMS calculated at the relevant times may not exceed the monetary limit specified in the Members Schedule.

3.1.1 Calculation of the Current Total Aggregate Measure of Support ('AMS')

"Total Aggregate Measures of Support" is defined in Article 1 to be the aggregate of three components:

- (1) the sum of the separate AMS calculated for support which is product specific for each basic agricultural product;
- (2) the AMS calculated for support which is not product specific;
- (3) the monetary value in terms of Equivalent Measure of Support for support which cannot practicably be calculated in terms of the AMS.

It requires that a separate AMS be calculated for each product that is receiving support and that a non-product-specific AMS is to be calculated for the total of any other support that is non-product specific. The manner of calculation is set out in two annexes:

- Annex 3 on "Domestic Support: Definition of the Aggregate Measure of Support"; and
- Annex 4 on "Domestic Support: Definition of Domestic Support Equivalent Commitments".

Depending on the type of support, one of two methods of calculation of the AMS is prescribed. Either the AMS is the budget outlays (which includes revenue foregone) or it is the price gap multiplied by the relevant product volume. The rules distinguish between market price support, direct payments associated with a price support system, other direct payments and other support policies.

42 *Agreement on Agriculture*, Article 1(a). See the references in the entries in Part IV of the Members' Schedules to documents beginning with the prefix AGST. These documents are reproduced in the document series G/AG/AGST/Vol#. Much of the information in them is repeated in the annual domestic support notifications. The document numbers for these notifications are in the form: G/AG/N/abbreviation of the name of the country/number of the document.

- For market price supports, the AMS is the difference between the administered price and a fixed external reference price multiplied by the quantity of production eligible to receive the administered price;⁴³
- For direct payments which are dependent on a price gap, the AMS can either be calculated as the budget outlays or in the same way as for market price supports, the price gap multiplied by the quantity of production;⁴⁴
- For direct payments which are based on factors other than price, the AMS is calculated on the budget outlays;⁴⁵
- For other support policies, the AMS can be calculated as the budget outlays unless these do not fully reflect the value of the subsidy in which case the AMS is calculated as the volume of the subsidised good or service multiplied by the gap between the subsidised price and a representative market price.⁴⁶

Since the support provided by price based measures depends on the gap between the administered price and the world market price, the value of that support fluctuates as the world market price fluctuates. However, for purposes of calculation of the AMS, it is a fixed external reference price which is used rather than the world market price. It is the price gap above this fixed external reference price that is used to calculate the AMS. The fixed external reference price must be

based on the years 1986 to 1988 and shall generally be the average f.o.b. unit value for the product concerned in a net exporting country and the average c.i.f. unit value for the product concerned in a net importing country in the base period.⁴⁷

The fixed external reference prices used by each Member are described in documents containing supporting material that are referred to in each Member's Schedule.⁴⁸

The fixing of the reference price clearly distinguishes the AMS from the Producer Subsidy Equivalent developed in the OECD work. Whereas the measure of the Producer Subsidy

43 *Agreement on Agriculture*, Annex 3, para 8.

44 *Agreement on Agriculture*, Annex 3, para 10.

45 *Agreement on Agriculture*, Annex 3, para 12.

46 *Agreement on Agriculture*, Annex 3, para 13.

47 *Agreement on Agriculture*, Annex 3, para 9.

48 See the reference to a document beginning with the prefix AGST in Part IV of each Member's Schedule alongside the AMS commitments.

Equivalent increases if the gap between a supported price and the world price increases as the world price falls, the AMS is not increased. In the event that the world price does fall, parties are able to increase domestic subsidies subject to AMS commitments to compensate for the fall in world prices without affecting their compliance with their AMS obligations.

For circumstances in which a domestic support consists at least partly of price support but in which it is not practical to calculate a price gap, the Agreement provides for an alternative way of making commitments which are called "equivalent commitments".⁴⁹ These commitments consist of the two components: one for market price support and another for any other non-price-based support. The commitment in respect of the non-price-based support is calculated in the same way as for AMS commitments.⁵⁰ The commitment in respect of the market price support is made in terms of the administered price and the quantity of product eligible to receive that price, or if that is not practical, on the budget outlays.⁵¹ Therefore, whereas an AMS commitment will be an undertaking to implement a particular price gap for a particular quantity of product, the equivalent commitments will generally be undertakings to implement a particular administered price for a particular quantity of product.

3.1.2 Quantum and Timeframe for Reduction Commitments

Nothing in the text of the Agreement specifies the rate of reductions. The rate specified in the Agreement on Modalities was 20%⁵² except for developing countries for which the applicable rate was thirteen and two thirds per cent.⁵³ However, these rates are not specified in the *Agreement on Agriculture*. The rate of reduction is wholly dependent on the monetary amounts that are specified in the Schedules.

3.1.3 Product Specificity of Domestic Support Commitments

Whilst the calculation of the AMS involves a calculation of product specific support, the Agreement only contains an obligation with respect to the maximum total AMS. The Agreement does not contain any obligations with respect to the support that may be

49 *Agreement on Agriculture*, Article 1(d) & Annex 4.

50 *Agreement on Agriculture*, Annex 4, para 3.

51 *Agreement on Agriculture*, Annex 6, para 2.

52 Dunkel Text on Agriculture, Part B, para 8.

provided with respect to particular products. The support provided to particular products or producers can be increased provided that other adjustments are made so that total AMS remains within the scheduled limits.

3.2 DOMESTIC SUPPORT POLICIES EXEMPTED FROM REDUCTION COMMITMENTS

Certain domestic policies do not have to be included in the AMS calculation. As mentioned above these are:

- (1) subsidies kept below the specified *de minimis* levels;
- (2) subsidies under production-limiting programmes based on fixed areas, production or headage (defining the 'blue box');
- (3) subsidies maintained in accordance with specified criteria (defining the 'green box');
- (4) and for developing countries only, certain investment subsidies, input subsidies or subsidies to encourage diversification from growing narcotics (an extension of the 'green box' for developing countries).

3.2.1 De Minimis Subsidies

Domestic support measures which do not fit within the green box and are thereby subject to the reduction commitments can be exempted from them if they do not exceed a *de minimis* level.⁵⁴

For a product-specific AMS, the *de minimis* level is 5% of the value of production. For a sector-wide AMS, the *de minimis* level is 5% of total agricultural production for that sector. For Developing Countries, the applicable percentage is 10% for both product specific and sector wide AMS values.⁵⁵

3.2.2 Production Limiting Subsidies - The Blue Box

This is the exemption designed to exclude the direct payments under the 1992 reform of the EEC's common agricultural policy. The exception provides that direct payments under

53 Dunkel Text on Agriculture, Part B, paras 8 & 15.

54 Article 6(3).

55 Article 6(4) and Part B, para 10.

production limiting programmes are not subject to the AMS calculations if they satisfy one of three criteria. The three alternative criteria are that the payments are:

- (1) based on fixed area and yields;
- (2) based on 85% of the base level of production; or
- (3) based on a fixed number of head of livestock.

3.2.3 The Green Box - Non-Production Distorting Domestic Supports

The essence of the criteria is that only measures that do potentially cause overproduction can fit within the green box. The specified criteria for permissible domestic support measures are contained in Annex 2 headed: "Domestic Support: The Basis For Exemption From The Reduction Commitments".

Some of the listed items seem to include subsidies that would be regarded as non-specific and therefore would be exempt from track 1 or 2 remedies under the *SCM Agreement*. However, the items in the green box are exempt from those remedies even if they are provided specifically to agricultural industries or firms.

Paragraph 1 - the Fundamental Criteria

Annex 2 contains some general criteria in paragraph 1 and then lists criteria for 12 separate types of government measures or programmes in clauses 2 to 13.

All green box measures must meet the fundamental criteria in paragraph 1. These are that they have no, or at most minimal, trade distortion effect or effects on production and that the support measure:

- (a) must be government funded (not involving transfers from consumers); and
- (b) must not have the effect of giving price support to producers.

In addition to meeting these fundamental criteria, measures in particular categories must meet additional criteria as set out below in the 12 categories described in paragraphs 2 to 13.

Paragraph 2 Government Service Programmes - General Services

This category is the government funding of services or benefits to agriculture or the rural community including for

- research;
- pest and disease control;
- training services;
- extension and advisory services;
- inspection services;
- marketing promotion; and
- infrastructural services directed to the provision or construction of capital works.

The support measures must not involve direct payments. If the support is marketing promotion it must not be expenditure that could be used by sellers to reduce their selling price or confer a direct economic benefit to purchasers.⁵⁶ If the support is infrastructure services, it must be directed to the provision or construction of capital works and not to provision of on-farm facilities or not be a subsidy to inputs, operating costs or user charges.

Paragraph 3 Public Stockholding for Food Security Purposes

To fit within this category, the accumulation and stockholding must be done as part of a food security program set out in national legislation. The accumulation of stocks must "correspond to predetermined targets related solely to food security". Purchases must be made at the domestic market price and sales from stocks must be made at no less than the domestic market price.

Paragraph 4 Domestic Food Aid

This category deals with outlays related to the provision of food aid to sections of the domestic population in need. To fit within this category:

- eligibility must be subject to clear criteria related to nutritional objectives; and

56 *Agreement on Agriculture*, Annex 2, paragraph 2(f).

- aid must be by direct provision of food or vouchers to buy food.

Paragraph 5 Direct Payments to Producers

This is the first of the categories for direct payments to producers. Paragraphs 6 to 13 set out some specific categories of direct payments to producers. Paragraph 5 covers direct payments to producers that do not fall within any of paragraphs 6 to 13. All of paragraphs 5 to 13 apply to payments in kind and revenue foregone as well as to direct payments.

All direct payments whether falling within one of paragraphs 6 to 13 or falling within this paragraph 5 must meet the fundamental requirements of paragraph 1: that they are government funded (not involving transfers from consumers) and do not have the effect of giving price support to producers. In addition, direct payments must meet criteria which determine whether they are sufficiently delinked from production so as not to distort it.

These direct payments not falling within any of paragraphs 6 to 13 must meet the requirements numbered (b) to (e) in paragraph 6.

Paragraph 6 Decoupled Income Support

This category covers direct payments to agricultural producers to maintain a level of income.

The payments must conform to the following criteria:

- (a) that eligibility is determined by clearly defined criteria such as income, status as a producer or landowner, or factor use or production level in a defined base period;
- (b) the amount of the payment is not related to type or volume of production;
- (c) the amount of the payment is not related to prices (except for some relationship with prices in the base period);
- (d) the amount of payments is not related to the factors employed (except for some relationship with production, prices or factors employed in the base period); or
- (e) the payment is not contingent on production.

Paragraph 7 Income Insurance and Income Safety-net Programmes

For this category, the additional requirements are :

- that payments can only be made to compensate producers who earned at least 30 % of their income from agriculture in a defined reference period (the past three years or 3 of the past 5 excluding the highest and the lowest);
- that payments can only compensate for less than 70% of the producer's income loss; and
- that the amount of payments must relate solely to income.

Paragraph 8 Payments for Relief of Natural Disaster

For this category of natural disaster relief, the additional requirements are :

- (a) the formal recognition by governmental authorities of a natural disaster;
- (b) that payments only relate to losses of income or of production factors due to the natural disaster;
- (c) that payments do not relate to future production; and
- (d) payments do not exceed the level required to prevent or alleviate loss.⁵⁷

Paragraph 9 Structural Adjustment Assistance Provided Through Producer Retirement Programmes

This category facilitates the making of payments for shifting people out of agricultural production. The additional requirements are:

- (a) that eligibility is according to criteria in producer retirement programmes;
- (b) that payments are conditional upon the "total and permanent retirement of the recipients from marketable agricultural production".

Paragraph 10 Structural Adjustment Assistance Provided Through Resource Retirement Programmes

A similar category facilitates the making of payments for shifting resources including land or livestock out of agricultural production. The additional requirements are:

⁵⁷ Paragraphs 7 and 8 also provide that where a producer receives a payment under both categories, the total shall not exceed 100% of the producer's total income loss.(paragraphs 7(d) and 8(e)).

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- (a) that eligibility is according to criteria in resource retirement programmes;
 - (b) payments in respect of land are conditional upon retirement of land from agriculture for a minimum of 3 years and payments in respect of livestock are conditional on the slaughter or the definitive permanent disposal of livestock;
 - (c) eligibility does not involve any future production;
 - (d) eligibility does not involve production from resources remaining in production.

Paragraph 11 Structural Adjustment Assistance Provided Through Investment Aids

This category facilitates the making of payments to assist investment designed to shift production away from certain products that are being overproduced. It is expressed in terms of the "restructuring of a producer's operations in response to objectively demonstrated structural disadvantages." The additional requirements are:

- (a) that there are clearly defined eligibility criteria in government programmes designed to assist the change in the producer's business;
- (b) that payments do not relate to any production after the base period;
- (c) that payments do not relate to prices of any production undertaken after the base period;
- (d) that payments are not given for a longer period than is necessary for a return to flow from the investment;⁵⁸
- (e) that payments do not require production of any particular product; and
- (f) that "payments should be limited to the amount required to compensate for the structural disadvantage".

Paragraph 12 Payments under Environmental Programmes

This category facilitates the making of payments under environmental programmes. The additional requirements are:

⁵⁸ Paragraph 11(iv) says: "The payments shall be given only for the period of time necessary for the realization of the investment in respect of which they are provided."

-
- (a) eligibility is determined as part of a clearly-defined government environmental or conservation programme; and
 - (b) payments do not exceed the extra costs or loss of income involved in complying with the governmental programme.

3.2.4 Developing Country Extension of the Green Box

Developing countries also receive an exemption from reduction commitments in respect of:

- (1) investment subsidies generally available to agriculture;⁵⁹
- (2) agricultural input subsidies generally available to low-income or resource-poor producers;⁶⁰
- (3) any domestic support to producers to encourage diversification from growing illicit narcotic crops.⁶¹

The investment subsidies are permitted because they enable developing countries to help their agricultural industries adopt more modern technology and methods in a way that does not provide a price support or any other direct production incentive.

The domestic support to encourage diversification from narcotic crops deals with a special problem of a few countries, primarily Colombia and Thailand. In these countries, the economic incentives to grow narcotic crops are so strong that a wide exemption from the rules is given to permit them to institute programmes that encourage producers to grow products other than narcotics.⁶²

59 *Agreement on Agriculture*, Article 6(2).

60 *Agreement on Agriculture*, Article 6(2).

61 *Agreement on Agriculture*, Article 6(2).

62 An anecdote relating to past programmes instituted by the Colombian government demonstrates the need for an exemption. In one year the Colombian government guaranteed a price for a certain food crop. The growers swapped from drug production to the food crop but found that they were unable to sell all of their crop because of the difficulties involved in transporting the crop to market on poor quality roads and without modern means of transportation. In the following year they reverted to production of drug crops. The crop was much more easily sold. The drug barons collected it by helicopter.

3.3 LIMITATION OF REMEDIES AGAINST DOMESTIC SUBSIDIES ON AGRICULTURAL PRODUCTS

In the description of the *SCM Agreement*, above, mention has been made of the way that the application of the remedies under that Agreement has been modified in respect of domestic subsidies on agricultural products. The more lenient treatment, given until 1 January 2004, is stressed again here.

Green box subsidies are exempt from CVDs and from multilaterally authorized remedies.⁶³

The following subsidies are not exempt from CVDs but are exempt from multilaterally authorized remedies provided that the level of these subsidies for a particular commodity is not greater than the level set for the 1992 marketing year.

- (1) Amber box subsidies conforming to the reduction commitments.⁶⁴
- (2) De minimis subsidies.⁶⁵
- (3) The subsidies in the developing country extension of the green box.⁶⁶
- (4) Blue box subsidies.⁶⁷

It seems possible that an increase in a blue box subsidy to compensate for a fall in price might not disqualify the blue box subsidy from its exemption from multilaterally authorised remedies. To remain within the blue box and the exemption from reduction commitments would require that the subsidy continues to be fixed according to the level of yield, headage or production set out in Article 6(5). To maintain the exemption from multilaterally authorised remedies would require that it also does not provide support exceeding that set in the 1992 year. The question would be whether support based on the same support price as set in 1992 but which compensates for a larger gap between that price and the world price than that existing in 1992 would be a greater level of support. It is submitted that it would

63 *Agreement on Agriculture* Article 13(a)(i) & (ii) & *SCM Agreement* Article 5 & 6(9).

64 *Agreement on Agriculture*, Article 6(1) & 13(b)(ii) & (iii).

65 *Agreement on Agriculture*, Article 6(4) & (5) & 13(b)(ii) & (iii).

66 *Agreement on Agriculture*, Article 6(12) & 13(b)(ii) & (iii).

67 *Agreement on Agriculture*, Article 6(5) & 13(ii) & (iii).

be which would mean that such a blue box subsidy would not be subject to reduction commitments but would be exposed to both track 1 and track 2 remedies.

4 SUMMARY

The Uruguay Round made significant changes to the regulation of domestic subsidies. For some subsidies, regulation was made more strict and for others less strict.

For those domestic subsidies that have been exempted from the AMS calculation, regulation became less strict. Until 2004, Members are free to use these kinds of domestic subsidies without having to provide any compensation and without the risk of retaliation whether under CVDs or multilaterally authorized remedies. At the end of the exemption period, Members must renegotiate these exemptions.

For those domestic subsidies that are within the AMS calculation, regulation became more strict. However, the restriction is only on a global basis rather than on a more product specific basis. Therefore, there is no restriction on increasing price support to a particular product. The end position is that a global binding will apply. It leaves a framework for the negotiation of lower bindings in the future.

CHAPTER 23

SUMMARY OF PART 4, PREDICTIONS AND RECOMMENDATIONS

1 INTRODUCTION

Whereas Part 3 of this thesis was directed to the question of why the GATT 1947 was unsuccessful in relation to agricultural trade, this part has approached the question of whether the Uruguay Round solved the problems. Now, it should be possible to make an assessment of whether the Uruguay Round did remedy the problems with agricultural trade and to offer some suggestions as to how future negotiations could approach the liberalization of agricultural trade including what further changes to the rules might be helpful.

The conclusions drawn in Part 3 were that defects in GATT rules relating to the embodiment of economic theory relating to choice of policy instrument were a significant cause of the failures in applying the GATT. The analysis made out the case that the failure to construct the rules to reflect thoroughly the appropriate ranking of preference for non-border instruments over border instruments and price-based border instruments over quantity based instruments was a significant factor contributing to the inability of the rules to guide parties to a choice of policy with respect to agriculture that would have provided substantial economic benefits to the parties.

This chapter analyzes the result of the Uruguay Round negotiation on agriculture in the context of that same framework of analysis developed in Part 2 and applied in Part 3. Already, the description and analysis of the negotiation on agriculture and of the post-WTO rules applicable to agricultural trade has illuminated the way that the post-WTO rules change the framework of regulation of different policy instruments. This chapter makes a

more systematic assessment of the changes to the regulation of different instruments and the extent to which the post-WTO rules have remedied the pre-existing deficiencies in the embodiment of the economic theory relating to differences between instruments and from that makes an assessment of whether this factor will continue to contribute to difficulties in application of the rules to agriculture or whether the changes will lead to more effective discipline of agricultural policies.

2 REITERATION OF THE MAJOR PROBLEMS OF GATT 1947 IDENTIFIED IN CHAPTER 15

Chapter 15 identified a multiplicity of problems with applying the GATT to agriculture. The most serious problem arose from the fact that there were so many exceptions, official and unofficial, to the prohibition on quantitative restrictions: grandfathered restrictions, BOP restrictions, country-specific waivers relating to agricultural trade, BOP restrictions, Article XI:2 restrictions, VERs, quotas and mark-ups applied by government run or government authorized agricultural import monopolies, variable levies and other minimum price schemes. This factor alone significantly undermined the application of the rules regulating all policy instruments and made liberalization of trade impossible.

The ineffectiveness of the prohibition on quantitative restrictions undermined the negotiation of tariff bindings and the effectiveness of bound tariffs. The proliferation of quantitative restrictions on agricultural trade made it impossible to link liberalization of agricultural trade to liberalization of other sectors of trade. This factor contributed to the inability to agree on an across the board method of tariff negotiations which would have achieved some liberalization of agricultural trade.

The ineffectiveness of the prohibition of quantitative restrictions and the absence of tariff bindings and tariff reductions permitted over-production and the creation of surpluses which could not be controlled under the export subsidy rules. The rules on export subsidies for agriculture were defective both in adopting too lax standards of regulation and in formulating the standards in language that was too difficult for adjudication. Regulation of export subsidies on products processed from agricultural products was also unsuccessful in the face of the EEC's persistent argument that these should be treated as subsidies on the agricultural product rather than on the final product despite a panel decision to the contrary.

The lack of regulation of export subsidies deteriorated to the point where subsidized production had a significant effect on world agricultural prices and world agricultural trade patterns.

The regulation of domestic subsidies was not successful, there being persistent resistance to the establishment of indirect discipline through nullification and impairment principles.

It was submitted in chapter 15 that these problems arose to some extent because the framework of regulation and the attempts of the parties to improve it did not adequately distinguish between price-based and quantity-based border instruments and between border and non-border instruments.

3 DID THE URUGUAY ROUND SOLVE THESE PROBLEMS ?

3.1 THE PREFERENCE BETWEEN PRICE BASED AND QUANTITY BASED BORDER MEASURES:

3.1.1 Quantitative Restrictions

A number of improvements have been made. The most important improvement was the tariffication of quantitative restrictions. One of the significant features of the closing stage of the Uruguay Round negotiation on agriculture was that as significant concessions were made in other areas of the negotiation, the USA and the Cairns group held the line as far as possible on the tariffication of quantitative restrictions. They conceded much in the size of the tariff barriers, in the quantity and the timing of the export subsidy reductions, in the product specificity of the AMS reductions and in the exclusion of some partially production linked domestic subsidies from the AMS reductions, but they pressed for comprehensive tariffication of quantitative restrictions. The only exceptions given were constructed so as to give an incentive to tariffify at a later date. In itself, this indicates the importance that they attributed to the eradication of quantitative restrictions. That this insistence on the comprehensiveness of tariffication was achieved at the cost of some high tariff barriers indicates the priority given to the principle that the system must accord a clear preference to import tariffs over import quotas. One of the serious remaining problems is the creation of tariff quotas in a framework of rules that does not provide for the tariff quotas to be enlarged to the point where they can be phased out. This issue will be dealt with separately

after dealing with the other issues relating to the effectiveness of the prohibition on quantitative restrictions.

Balance of Payments Restrictions

The removal of the remaining residual BOP restrictions was one improvement and the alteration of the BOP exceptions so that they favour the use of import tariffs over quotas was another. Unfortunately, the situations in which recourse to this exception can be made has not been significantly narrowed.

Article XI:2 Agricultural Restrictions

Given that Article XI:2(c) had been introduced originally at the USA's insistence, it was ironic that one of the key areas of contention in the Uruguay Round was the USA's proposal that Article XI:2(c) should be abolished. In effect, the conversion of Article XI:2(c) quotas to tariffs and the existence of Article 4(2) of the *Agreement on Agriculture* has eliminated Article XI:2(c) from the Agreement (except in respect of fisheries products), thereby removing another source of quantitative restrictions affecting agricultural trade (other than fisheries products).

Grandfathering

The bringing of GATT 1994 into definitive force without grandfathering of quantitative restrictions removed another source of quantitative restrictions affecting agriculture.

Waivers

The cessation of country specific waivers also removed another source of quantitative restrictions affecting agricultural trade. Of particular significance was the removal of the USA's waiver which had affected a number of agricultural products. However, the price paid for the tariffication was that the quotas maintained under waivers, which ideally would have been simply removed, were replaced by tariffs. This permitted some quotas for which no concessions were paid to be converted into import tariffs which will be able to be used as bargaining chips in future exchanges of concessions. That this was tolerated is further confirmation of the importance placed on eradicating quantitative restrictions and the priority given to this objective over the objective of achieving tariff reductions.

As mentioned in chapter 20, the Uruguay Round missed the opportunity both to codify a preference for import tariffs over import quotas and to elaborate on the criteria for the grant of waivers. Therefore, it is still possible that this exception might result in an undermining to some extent of the prohibition of quantitative restrictions. However, the grant of waivers remains a political decision and as long as other aspects of the prohibition on quantitative restrictions are maintained, there will probably be a severe reluctance to sabotage the comprehensiveness of tariffication by voting to approve the use of quantitative restrictions.

State Controlled Import Monopolies

Control of state trading entities has been improved by the comprehensiveness of tariff binding on agricultural products. As a result of the bindings, the mark ups are bound on all products. There remain the limitations inherent in the wording of Article II:4, that the provision operates by reference to average levels of protection which can only be calculated in retrospect and with the collection of the appropriate data.

In addition, problems with discretionary quantitative restrictions may persist. In theory, import quotas imposed by state trading entities were subject to the tariffication process and, under Article 4(2) of the *Agreement on Agriculture*, such restrictions cannot be reintroduced. However, nothing in the *Agreement on Agriculture* or the Uruguay Round Understanding on Article XVII improves the regulation under the GATT of the ability of import monopolies to choose how much to import.¹ If import monopolies do restrict the quantity purchased, they cannot sell above the price dictated by the maximum mark up imposed by Article II:4. This restraint alone, however, cannot prevent the domestic market from bidding up the price as it passes through whatever chain of distribution or secondary market exists. In any case in which the discretionary limitation of the quantity of imports is more restrictive than the limitation on the mark-up, the price will be bid up above the margin of the mark-up over the world price. In the end, the restriction on the quantity imported will feed through into the price raising it to whatever margin above the world price is determined by the existence of that quantity of imports even if the mark-up received by the import monopolist itself is restricted. Therefore, in these situations, both the production effect and the consumption effect of the operations of the import monopoly will be determined by the limitation of

1 See chapter 20 under section 2.7 "State Trading and Articles II:4 & XVII".

quantity rather than by the mark-up. Whilst some consumers may be able to buy at the margin above the world price determined by the limited mark-up, others will not be able to do so and in aggregate the behaviour of consumers will be determined by the final price. Similarly, although domestic producers may be undercut by some sales by the importer at the limited mark-up, in general, the price that they have to compete with will be determined by the discretionary restriction on the quantity of imports rather than the limitation of the mark-up. As discussed in chapter 20, there must be some risk that article II:4 will not be interpreted strictly enough to prevent state trading monopolies from imposing de facto quantitative restrictions by limiting the quantity of purchases below the quantity demanded domestically at the world price plus the tariff.

Therefore, given that the use of import monopolies is common in the agricultural sector, particularly in developing countries, there is still significant scope for purchasing decisions to be exercised to have the same effect as quantitative restrictions. There is still significant scope for these arrangements to encourage over production and under consumption causing transfers from consumers to producers and deadweight losses that could be insulated from the effects of changing world prices and exchange rates, and changing domestic production costs and consumer demand.

Safeguards

The discipline of voluntary export restraints is greatly improved. All such measures were tariffed. Such measures cannot be reintroduced by virtue of the *Agreement on Safeguards* and by virtue of Article 4(2) of the *Agreement on Agriculture*.

The *Agreement on Safeguards* also limits the extent to which import quotas can be used as a safeguard mechanism.² Provisional safeguard measures in emergency situations cannot be in the form of import quotas. Generally, parties are required to choose safeguard measures which are "most suitable for the achievement" of the objectives of preventing or remedying serious injury and facilitating adjustment.³ This obligation encourages instruments other than quotas but clearly falls short of requiring the parties to use instruments other than

2 *Agreement on Safeguards*, Article 5.

3 *Agreement on Safeguards*, Article 5(1).

quotas. If quotas are used, then generally, they cannot be set at a quantity less than the level of imports during three previous representative years.⁴

For the duration of the implementation period under the *Agreement on Agriculture* (and any extension of it under Article 20), one would expect that recourse will not be made to safeguards under Article XIX and the Agreement on Safeguards because recourse can be made to the special safeguards provision under the *Agreement on Agriculture* without the requirements of having to establish the existence of serious injury or threat of serious injury or of having to negotiate compensation as is necessary under Article XIX and the *Agreement on Safeguards*.

The special safeguards provision permits import tariffs and does not permit import quotas. However, the way in which import tariffs are permitted under the special safeguards provisions means that they can have some of the characteristics of quantitative restrictions. Under the quantity-triggered safeguards mechanism, additional tariffs can be imposed whenever the volume of imports exceeds 125% of the average volume of imports in the three preceding years. As set out in chapter 20, in situations in which the level of imports exceeds 10% of domestic consumption, then the threshold percentage is lower. If imports constitute more than 30% of domestic consumption, then additional tariffs can be imposed whenever the volume of imports exceeds only 105% of the average volume of imports in the three preceding years. To some extent, this mechanism can be used to increase the level of protection in the face of changes to world prices, exchange rates, domestic demand and domestic production costs. The fact that the trigger is set by the 3 preceding years rather than by a fixed period means that the baseline trigger level of volume can gradually increase meaning that the safeguard measure cannot be imposed to avoid completely the effects of changes in market conditions. One problem seems to be that if the special safeguard measure is imposed then the volume of imports that flows with the special safeguard tariff in place will be the volume that will be used for purposes of calculating the quantity-based trigger for the next 3 years. Therefore, in the face of an increase in the volume of imports, the situation may occur in which a party can impose a tariff surcharge which has the effect of holding the trigger level at the same volume. This depends on whether the maximum

4 *Agreement on Safeguards*, Article 5(1).

tariff (one third of the ordinary bound tariff rate) that can be imposed under the quantity triggered safeguard is high enough to keep volume down to the original trigger level volume. If so, then there would be a range within which the level of protection could be increased to keep the quantity of imports within the original trigger level regardless of any changes in price, exchange rate, domestic production costs or domestic demand. A Member could insulate its market from such changes except when the maximum permissible tariff surcharge is insufficient to bring the volume of imports back to the original percentage of domestic consumption. The ability to remain insulated from such changes is also limited by the time limit on the special safeguard measures.

Under the price-triggered safeguards mechanism, parties can limit the increase in imports that would otherwise occur in response to a fall in the world price or an appreciation of the domestic exchange rate. The tariff surcharge can only compensate for a part of the fall in the (domestic currency denominated) world price which part increases the larger is the fall in the world price ranging from none of the first 10% of the margin below the trigger price to 90% of the amount in excess of 75% below the trigger price. Therefore, the safeguards mechanism can only partially limit the increase in the volume of imports that occurs in response to a fall in the world price. However, the mechanism can limit almost all of the increase in the volume of imports that would occur in response to that part of any price fall which exceeds 75% of the trigger price. Whilst such price movement would be rare in product markets, they would be less rare in foreign exchange markets. The capacity to remain partially insulated from the effects of price falls is not diminished if the price falls in a long term downward trend because the trigger price is fixed by reference to 1986-1988 prices. In any resort to the price-based safeguard provision, there is no need to establish any increase in the volume of imports. Therefore, to a significant extent, the price-triggered safeguard mechanism can be used to achieve some of the effects of an import quota or a minimum price scheme by increasing the level of protection to offset reductions in the world price. This mechanism can be used to prevent exporters from gaining sales by reducing their price thereby having the same effect as a quantitative restriction.

3.1.2 Import Tariffs

The regulation of quantitative restrictions was combined with comprehensive binding of import tariffs and across the board tariff reductions. Together, these elements remove what was one of the greatest problems with applying the GATT to agriculture. That was the inability to generate exchanges of tariff concessions on agricultural products. In the future, the absence of quantitative restrictions should create a vastly improved situation in which it will be possible to negotiate further tariff reductions on agricultural products. The absence of quantitative restrictions will mean that it will be possible to create a linkage in negotiations between reductions of tariffs on some agricultural products with reductions on other agricultural products, between reductions on agricultural products and on other products and, with the GATS now part of the system between reductions on agricultural products and liberalizations of services sectors. This is the second great benefit from the achievement of comprehensive tariffication of quantitative restrictions. It makes it possible to have a genuine negotiation on tariffs on agricultural products. The comprehensive binding facilitates future negotiations.

The cost of the priority given to the concept of tariffication was laxity in its application resulting in dirty tariffication. The import barriers on agricultural barriers at the end of the Uruguay Round were lower than those applying at the start of the Uruguay Round but not much lower as the following table discloses.

Nominal Rates of assistance to agriculture (and processed food) via trade policies (%)⁵

	Advanced industrial economies	Newly industrialized economies	Low and middle income economies
1992	39	43	7
Post Uruguay Round	33	33	6

One consequence of the existence of inflated tariff equivalents is that parties may choose to adjust the tariff rate to facilitate a higher volume of imports than would flow with the tariff

5 Data extracted from Table 1, (sourced from an unpublished compilation from the GTAP Version 3 data base prepared by Anna Strutt) Nominal rates of assistance to agriculture and other industries via trade policies, 1992 and post-Uruguay Round implementation" in Hoekman, Bernard & Anderson,

set at the ceiling level. To do so, they may charge tariff rates below the bound tariff rate. When they wish to increase or decrease the volume of imports, they may increase or decrease the tariff rate. Provided that the rate charged is below the bound rate, the charging of such tariffs would not be not in conflict with Article II. A question would arise as to whether such tariff rate adjustments would be in violation of Article 4(2) of the *Agreement on Agriculture*, for arguably, adjustments of the tariff rates might constitute a variable levy which is a measure of a kind required to be tariffed within the meaning of the prohibition in Article 4(2).⁶ A second way in which parties might increase the volume of imports might be to open tariff rate quotas. Provided that the rates charged for such tariff quotas are below the bound rate then there is no violation of Article II. Tariff quotas have not previously been regarded as violations of Article XI:1 and in the light of the express recognition of tariff quotas in the Members' Schedules on agricultural products, it would be extremely difficult to argue that a tariff quota is a violation. Therefore, through the use of variable levy-like tariff changes and tariff quotas, it is possible to control the level of imports within the constraint of the bound tariff.

In order to facilitate liberalization of trade, future tariff reductions will need to be of a significant size. In order to achieve some reduction in the most important areas, it is imperative that future reductions are not negotiated on a request and offer basis but are negotiated on an across the board formula and, in order to achieve significant liberalization of the high tariffs caused by inflation of the tariff equivalents resulting from tariffication, it would be preferable that a harmonization formula is used. The Uruguay Round has set a precedent for across the board reductions within the agricultural sector. The comprehensive binding may also facilitate a formula approach to tariff reductions in all sectors and in negotiation of a formula reduction across all sectors, there is a reasonable likelihood that the formula could be a harmonizing one.

The agreement mandates further negotiations on agricultural trade: However, in the past rounds of negotiations, once the agricultural sector has been severed from other sectors, separate negotiations did not achieve anything. The liberalization in the Uruguay Round

Kym, "Agriculture and the New Trade Agenda" paper prepared for the American Economic Association Annual Meeting, New York, 3-5 January 1999.

was only achieved because of the insistence of some parties that liberalization in other areas would not proceed without a satisfactory result on agriculture. There is a significant possibility that further reductions in tariffs on agricultural products will not be achieved except by linking them to negotiations in other sectors.

One possible problem with the tariff reductions that have been negotiated is that the round achieved little discipline on antidumping duties. In the past, anti-dumping duties had not been a problem in agricultural trade largely because the ease of resort to other measures diminished the demand for Antidumping Duties. However, the position may change. As set out in chapter 20, the Uruguay Round *Agreement on Anti-Dumping* does not significantly change the price threshold for the introduction of anti-dumping duties.

3.1.3 Tariff Rate Quotas

The existence of tariff rate quotas is less than optimal. The tariff rate quotas have been introduced without ensuring that rules are in place to ensure that they are phased out. There is a risk that they will become entrenched. In order to remove the impact of the tariff quotas, it will be necessary that the out of tariff quota tariff rates are reduced to a point at which the resulting volume of trade is not less than the size of the quota or that the quotas are enlarged to the point where the out of quota tariff binding has no effect.

The creation of the tariff rate quotas means that the same negotiations that used to take place in allocating import quotas must still take place to allocate the tariff rate quotas. The process is subject to the constraints of Article XIII. There may be difficulty in reaching agreement and in the case of new quotas reference to share of trade in past periods will be impossible so some other means of deciding on allocation would have been necessary.⁷ In general, the process of allocation of the quotas and their maintenance would inhibit the ability of exporters to compete on the basis of price which was the objective of tariffing import quotas.

The tariff rate quotas create or maintain a set of vested interests and lobby groups that will oppose further reform. Those having the benefit of access quotas can sell to the public at

6 See Ingo, Merlinda D., "Tariffication in the Uruguay Round: How Much Liberalisation?" (1996) 19(4) *World Economy* 425-446 at 427.

prices determined by the combined effect of the size of the tariff rate quotas and the out of quota tariff bindings. It is in their interest to keep the out of quota tariff rate as high as possible and to keep the extension of the tariff rate quota to parties other than themselves to a minimum.

The existence of the tariff quotas will increase the practical difficulty of negotiating further liberalization in agriculture. It can be assumed that parties may seek both reductions in the out of quota bound tariffs and enlargements of the tariff rate quotas. Enlargements could be negotiated upon the basis that the tariff rate applying to the existing volume of the tariff rate quota would apply to the enlarged tariff rate quota. However, this need not be the case. The existing rates in the schedules applicable to tariff rate quotas only apply in respect of the volume set out in the schedule. For any volume in excess of that set out in the schedule, the only constraint imposed by Article II is the out of quota bound tariff. Therefore, the tariff rates applicable to any enlargements of the tariff quotas will in fact be a matter for negotiation. It would be possible that parties could offer cascading tariff rates applicable to a series of tariff rate quotas. If such offers were accepted then even more trade would become subject to the disadvantages inherent in having to negotiate the allocation of quotas. However, the fact that the tariff quotas were permitted in a framework which did not provide for obligations to phase them out completely leaves the situation where anything is possible. It will require a substantially more complicated negotiation than one simply on the rate of tariffs.

It is submitted that it would have been preferable not to create either minimum or current access quotas and to have focussed the negotiation on the level of bound tariffs. This would be in keeping with a first priority of eradicating import quotas. For current access quotas, a margin of preference could have been permitted. For minimum access, a supplement to the tariff reduction formula could have been added. It may have been necessary to sacrificed some of the meagre trade liberalization that was achieved but at least future negotiations would have been possible upon the simple exchange of tariff reductions. The preoccupation of achieving reductions in protection at the expense of achieving the appropriate preference

for price-based rather than quantity-based measures creates the problem that the eradication of quantitative restrictions has to be renegotiated in the next round of negotiations.

3.1.4 Export Subsidies

The regulation of export subsidies has fallen into line with the desirable ranking of instruments by adopting a less restrictive means of regulation and subordinating achievement of disciplines in this area to the achievement of the more important objective of abolishing quantitative restrictions. All previous attempts to negotiate an effective prohibition of export subsidies on agricultural products of export subsidies having certain effects were unsuccessful. Similarly, the attempts in the Uruguay Round to negotiate a complete phase out of export subsidies were unsuccessful. The final result was the negotiation of the quantitative bindings of outlays and volumes of subsidized product.

Unfortunately, the method of binding export subsidies did not include a binding of the ad valorem subsidy. Such a binding would have achieved a better discipline over export subsidies on particular products than that which is achieved by the combination of the outlay and volume commitments in the limited product specificity of the product groupings. In particular, the offer of the EEC to bind the level of export subsidies on a product to the amount of import duty that could be charged on that product was not taken advantage of. Such a binding would have been easy to renegotiate in conjunction with negotiations on the import charges.

Without the per unit bindings, there is a possibility that where the world price for a product falls, then the per unit export subsidy can increase provided that there is a reduction of the export subsidy on some other product within the product group from which the commitments are given.

The insulation of export subsidies from both CVD and Article XVI:3 claims, non-violation nullification or impairment claims and serious prejudice claims is limited to the duration of the implementation period. In the absence of the negotiation of further liberalization and of the immunity of export subsidies on agricultural products, then those export subsidies will become subject to the prohibition in Article 3 of the *SCM Agreement*. This should provide sufficient incentive for the negotiation of some further liberalization of agricultural trade.

3.2 THE DISTINCTION BETWEEN BORDER INSTRUMENTS AND NON-BORDER INSTRUMENTS

3.2.1 Domestic Subsidies

The discipline of domestic subsidies does fit within the desirable ranking of instruments. The discipline is less stringent than that applied to all of the border instruments.

For production linked subsidies, the rate of reduction is less than the rate applied to export subsidies although there was an earlier baseline for the reductions of domestic subsidies.

The question is whether it really is necessary to apply such disciplines to domestic subsidies. There has always been contention over the extent to which domestic subsidies should be regulated. In the Uruguay Round, some ground has been made in clarifying that parties are free to adopt certain types of domestic subsidies without having to consider any possible need to negotiate compensation or to face the risk of retaliation. By creating those categories, the agreement does provide an incentive for members to provide domestic subsidies that fit within those categories. Therefore, the agreement does implement a preference for non-border instruments over border instruments. The clear insulation of certain domestic subsidies from CVDs and actions under the *SCM Agreement* is an important change. Prior to the Uruguay Round, if domestic subsidies were used as an escape valve from the effects of commitments on import barriers, then there was the possibility of having to negotiate compensation or face retaliation.

Under the post WTO GATT, parties can introduce or increase green box subsidies without losing the immunity of the subsidy from either track 1 or track 2 remedies. In addition, under the post-WTO GATT, parties can introduce or increase certain non green box domestic subsidies in a number of situations without affecting the immunity of those subsidies from track 2 remedies. This would apply to

- the increase of a production linked subsidy that is subject to the AMS reductions to the extent that it is contained within the maximum applicable to the maximum of subsidies on all products (that is, within the global AMS commitment);

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- can increase a domestic subsidy within the de minimis limits (for industrial countries, up to 5% of the value of the product and, for developing countries, up to 10% of the value of the product);-
 - can increase a production linked subsidy that is subject to the AMS reductions to the extent necessary to compensate for a fall in the world price (provided that it doesn't exceed the level of support set for 1992); and
 - can increase the per unit amount of a blue box subsidy to compensate for a fall in the world price provided that the number of hectares and yield, the production base or the number of head of animals does not exceed the prescribed limit (and provided that it doesn't exceed the level of support set for 1992).

All of these subsidies can still be subject to countervailing duties. It is submitted that the rules would be more effective to guide parties to adopt these less damaging subsidies instead of more damaging subsidies if an immunity from countervailing duties was also given. Ideally, all domestic subsidies should be immune from CVDs. Such an immunity would help the rules to encourage abstinence from export subsidies. Domestic subsidies could still be subject to track 2 remedies when they exceed negotiated limits.

If a production linked subsidy subject to AMS reductions is increased outside the limits of the maximum AMS then that is open to compensation or retaliation. However, the basis of the exposure to compensation or retaliation is quite different to the situation existing under the pre-WTO GATT. Now the exposure to retaliation arises from an express negotiated commitment on the level of the subsidy rather than as a secondary consequence of the negotiation of a tariff binding.

The immunities from remedies last only as long as the implementation period. This factor, together with the limitation on the duration of the immunities for export subsidies provide an incentive to negotiate further reforms of agricultural trade. The importance of this immunity in encouraging reductions of tariffs is important. Clarity on the freedom that parties have to introduce domestic subsidies may reduce the reluctance to reduce import tariffs.

The regulation under the *Agreement on Agriculture* goes a step further in distinguishing between instruments than I did in Part 2 of this thesis. It also distinguishes between :

- production linked domestic subsidies; which are subject to reductions and
- non-production linked subsidies which are unregulated.

It could be demonstrated that where the market failure to which the policy is directed is anything other than too small a quantity of domestic production, then a measure linked to the quantity of production will not be the least cost way to correct the market failure. For example, if the market failure is the underutilization of local labour, then a subsidy for employment of local labour would remedy that market failure without introducing price effects affecting all of the other inputs in production that would be introduced by a subsidy on production in the industry in which the labourers were employed. In all of those instances, the embodiment of this distinction between production linked and non-production linked subsidies would have the effect of guiding parties toward the choice of the lower cost instrument. Therefore, in all of those instances, this distinction between production linked and non-production linked subsidies would be consistent with the rationale between instruments proposed in part 2 of the thesis: to guide parties toward choice of the least costly instrument whilst leaving them a freedom to adopt the least costly first best instrument to deal with any market failure.

However, in those few instances in which the market failure might actually be the level of domestic production then the distinction between production linked and non-production linked subsidies might actually be putting parties in a position in which they cannot adopt the least costly first best instrument to deal with the market failure without having either to offer compensation or risk retaliation. However, there are a number of reasons why parties might be better off binding their right to use production linked domestic subsidies:

- (1) it is likely that the level of production necessary to correct the market failure would be limited and would not be as high as the level of production that might be stimulated by a production linked subsidy on all units of production;
- (2) the principles discussed in chapter 7 about the political asymmetry between producers and taxpayers would mean that the political process would have a

tendency to adopt a higher level of production linked subsidies than is necessary to remedy any market failure relating to the level of production;

- (3) the instances in which the source of a market failure is the level of domestic production would be rare, for the source of a market failure would more frequently relate to the use of an input; and the owners of that input may be able to obtain greater transfers to themselves by obtaining a production linked subsidy than they could if the subsidy was a transparent transfer to the owners of the relevant input; therefore failing to discipline production linked subsidies leads to a situation in which governments would respond to market failures related to the level of inputs by paying subsidies on the level of production, thereby imposing a greater cost on the community than was necessary to remedy the market failure.
- (4) in instances in which the source of the market failure is the level of domestic production, the decision whether to pay a production linked subsidy to remedy the market failure may place the parties in a prisoners dilemma situation. It may be that the first best outcome is that the single country pay a production linked subsidy to correct the production linked market failure (assuming that it makes the subsidy the right size so that it doesn't overcorrect the market failure), the second best outcome is that the country tolerate the production level market failure, and the third best outcome is that the country pays the production linked subsidy to correct the market failure but that other countries also pay production linked subsidies. In this situation, a rule regulating production linked subsidies would prevent parties from choosing the 3rd best outcome over the 2nd best outcome.

Therefore, the regulation of production linked domestic subsidies will almost always guide parties to a more efficient outcome. This is particularly so if the form of regulation is a binding which leaves some scope for a low level of production linked subsidies.

3.3 SUMMARY OF THE REMEDYING OF DEFECTS

The Uruguay Round did improve the way that the GATT rules applicable to agriculture embody the preference between price-based and quantity-based border instruments and the preference between border and non-border instruments. In doing so it also removed some of

the impediments to linking agricultural liberalization to other liberalization. The removal of quantitative restrictions also facilitated the across the board tariff reduction which limited the extent to which parties could take the most protected sectors out of the reductions. There are, however, some ways in which the preferences between instruments have still not been satisfactorily embodied in the rules, in particular:

- the scope for quantitative restrictions to be imposed by state import monopolies;
- the existence of tariff rate quotas;
- the lack of discipline over anti-dumping duties fails to encourage parties to use domestic subsidies to adjust to situations where competitors are selling at a profit or to use safeguard measures on an MFN basis;
- the retention of a right to resort to quantitative restrictions under the ordinary safeguards rules;
- the relative ease of resort to the special safeguards provisions;
- the absence of per unit export subsidy bindings permits some per unit export subsidies to be increased; and
- the continued application of CVDs to domestic subsidies especially to those domestic subsidies in categories that are exempt from track 2 remedies fails to encourage domestic subsidies instead of export subsidies.

The change to the framework of rules did not in itself achieve massive liberalization of agricultural trade. The liberalization of export subsidies and domestic subsidies was not significantly if at all greater than the reductions in those areas that would have been achieved if those commitments had not been taken at all but the commitments on import barriers had been given in isolation. In particular, for the EEC, the export subsidy commitments were diminished until they did not exceed the reduction that would flow from the negotiated reductions in import barriers and for both the EEC and the USA, the AMS commitments did not require any action at all. However, the Round did achieve some liberalization of trade and did significantly improve the prospects of maintaining discipline over agricultural policies and achieving further liberalization in future negotiations. However, it is submitted that the extent to which liberalization will be achieved will depend

on the extent to which negotiators maintain a focus on continuing to improve the way that the rules influence the choice of policy instrument and adopt priorities for negotiations that reflect the appropriate preferences between policy instruments. The extent to which the Uruguay Round will have solved the problems with agricultural trade depends partly on the way that further negotiations are carried out. Therefore, I would like to conclude with recommendations as to how the negotiations mandated to begin by 31 December 1999 should proceed.

4 RECOMMENDATIONS FOR FURTHER AGRICULTURE NEGOTIATIONS

It is submitted that the focus must be maintained on import barriers. There will be a temptation to repeat the approach in the Uruguay Round of simultaneously seeking phase outs of import tariffs, export subsidies and trade distorting domestic subsidies. This would be a mistake. It would probably lead to a prolonged negotiation which would be unnecessary and in the end unsuccessful. The lessons of economic theory and political economic theory are that political forces can be relied on to a much greater extent to discipline domestic subsidies than any other form of support and to discipline export subsidies more than import barriers. They tell us that the strength of political lobby groups must necessarily adjust to some extent to the pressure of the market as long as quantitative restrictions cannot be used. Our review of GATT 1994 indicated that unless we take into account the appropriate preferences between instruments then the rules will be ineffective to carry out the function of guiding parties to appropriate choice of policies to minimize self harming policies and in the process will prevent the rules from carrying out the function of the rules to manage external relations between states. It is submitted that the main object of the negotiation should be to continue the reduction of import barriers at the same rate. It is submitted that attempting to achieve further results on export subsidies and domestic subsidies will sabotage the possibility of continuing the reform of import barriers.

4.1 DURATION OF REDUCTION PROGRAMME

The approach to continuing the reform programme depends substantially on whether the new negotiations on agriculture are conducted in isolation or in conjunction with negotiations in other areas. So far, it is only known that services negotiation will take place at the same time. The duration of the extension of the reform programme will depend on

what happens in other areas of the negotiation. However, the date of expiration of the immunities given by Article 13, 1 January 2004 will be crucial. There will be some correlation between the extension of the immunity period and the length of the extension to the reform programme.

4.2 REFORM OF IMPORT QUOTAS

4.2.1 Annex 5

It is assumed that by the end of the reduction period, the quotas maintained under Annex 5 to the Agreement will have been removed.⁸ If not, Annex 5 should be removed. If it cannot be removed then the expansions of tariff rate quotas that accompany recourse to Annex 5 should be ramped up further to encourage tariffication.

4.2.2 Import Quotas through State Trading

The problem of discretionary limitation of quantity by state import monopolies is unlikely to be resolved in a negotiation only dealing with agriculture. In the long run, Article II:4 or Article XVII needs to be changed to ensure that the purchasing decisions are an appropriate market driven response to demand. One way to achieve this would be to require state import monopolies to establish bidding processes that cannot be manipulated to restrict the quantity of bids and for them to be required to conform their purchasing decisions to the quantity in respect of which they receive bids to buy. Whether in the context of an agriculture specific negotiation or in the context of a broader negotiation, this problem must be addressed, otherwise, there will be a risk that agricultural trade will continue to be significantly affected by quantitative restrictions. Another approach to this problem is the approach that has been taken in the negotiation for the accession of the China to the WTO. There, the parties have attempted to remove the monopoly power of incumbent import monopolies by imposing an obligation to permit other entities to buy and sell the relevant products.⁹

8 To 30 June 1999, Israel, South Korea and The Philippines had not tariffed their Annex 5 restrictions.

9 See Draft Protocol on Chinese Accession dated 28 May 1997, Article 5.

4.2.3 Quantitative Limitation through the Special Safeguards Provision

The aspects of the special safeguard clause that have the characteristics of quantitative restrictions should be adjusted. Therefore, the provision should be adjusted to limit the insulation the special safeguards clauses provide from changes in world prices, exchange rates, consumer demand and domestic production costs.

The quantity-based triggers should be adjusted, particularly the 105% threshold applying to parties for whom minimum access opportunities exceed 30% of domestic consumption. The price-based triggers should be supplemented with quantity-based triggers to ensure that some adjustment must take place.

4.2.4 General Safeguards Provision

The general safeguards provision in the *Agreement on Safeguards* should be amended so that it does not permit any form of quantitative restriction. It should only permit tariff surcharges in circumstances in which the other requirements of the agreement are met.

4.2.5 Special and Differential Treatment

In the Uruguay Round, no special treatment of developing countries with respect to the use of import quotas was permitted except the very limited exception in annex 5. A strict approach should be continued.

4.3 REFORM OF IMPORT TARIFFS

4.3.1 Reduce the Out of Quota Tariffs

The reduction of out of quota bound tariffs should continue at the same rate as provided for in the *Agreement on Agriculture* for non-prohibitive tariffs. However, a harmonization formula that works out at a rate of about 6% per year for tariffs at the average level of about 40% could be used to achieve a higher rate of reduction for higher tariffs. The formula should be applied to every tariff line. No averaging should be allowed.

4.3.2 Limitation of Tariff Surcharges under the Special Safeguards Mechanism

In addition to the adjustments to the special safeguards mechanism proposed above, the proportion of the falls in world price that may be compensated for should be adjusted

downwards. For example, for falls of greater than 75% of the trigger price, the permitted tariff increases could be equal to 70% instead of the current 90% of the amount by which the fall exceeds 75% of the trigger price.

4.3.3 Disguised Tariff Surcharges through State Trading

With bound tariff rates on agricultural products, the rules in Article II:4 can operate. In the absence of quantitative restrictions, the level of the mark-up becomes important. Because of the previous extensive use of quantitative restrictions, the problems in measuring the size of the mark-up did not fully emerge. The provision regulates the average protection rather than the level of protection given in any particular transactions. Unfortunately, Article II:4 does not specify how this calculation should be performed. This matter was not dealt with in the Uruguay Round. It needs to be dealt with. Whilst there may be various techniques that ingenious parties will devise to avoid the obligations, a very good first step would be to define the level of protection as the difference between average trade weighted import price paid by the importer and the average trade weighted sale price received by the importer over each 3 month period. Any excess in the rate in a three month period must be compensated for in the next 3 month period. There might be a problem with parties continually lagging behind their commitments, and always beginning each new period with a carryover of excessive protection provided in a past period. The ordinary dispute settlement procedures should be able to deal with this. However, consideration could be given to creating a mechanism whereby parties would be able to begin the next period without the carryover from past periods provided that they negotiate some compensation.

4.3.4 Anti-Dumping Duties

Now that other non-tariff barriers have been removed, there will be more pressure on governments to apply anti-dumping rules to agricultural trade.

The Uruguay Round did constrain the injury test for taking ADD but did little to constrain the price threshold test. The most significant change to the price threshold test was the prescription of *de minimis* levels of 2% of the export price.¹⁰ There still remains the

¹⁰ See *Agreement on Antidumping Duties*, Article 5.8. See for example, the impact of this on EU antidumping rules, Waer, Paul & Vermulst, Edwin, "EC Anti-Dumping Law and Practice after the Uruguay Round - A New Lease of Life?" (1994) 28(2) *JWT* 5-21 at 14.

problem that all methods of calculation of normal price result in a price at which the seller is making a profit. It is unlikely that a revision of the ADD rules can be achieved outside of a general round of negotiations. However, the rules should be structured so that parties resort to the special safeguards provision or the general safeguards provision rather than to ADD. It may be possible to guard against any proliferation of ADD undermining the agricultural liberalization process by adding a temporary and limited immunity from ADD to any extension of the peace clause. For example, a margin of 5% could be added to what would otherwise be calculated to be the normal price for any country that is meeting its import access commitments. For developing countries, the margin could be higher, say, a 7.5% margin. This could be achieved by adjusting the de minimis level of dumping margin. Least developing countries could also receive the benefit of the limited immunity from ADD but to do so they would have to comply with reduction commitments made on the same basis as other developing countries. The immunity could last only for so long as the implementation period lasts. Therefore, countries that are victims of ADD would have an incentive to continue the reduction programme.

4.3.5 Special and Differential Treatment

Any concession given to developing countries should relate to the timing of reductions rather than the size of reductions.

4.4 REFORM OF TARIFF RATE QUOTAS

The continuation of the reform programme should be directed at achieving a situation in which the only barriers are ordinary customs duties. Therefore, the object of the reform programme should be to phase out the tariff rate quotas.

4.4.1 Expand Tariff Rate Quotas

The expansion of the volume of the tariff rate quotas as a percentage of the volume of domestic consumption should be continued at the same rate as provided for in the *Agreement on Agriculture*: a rate of one third of one per cent of the volume of domestic consumption per year. It is essential that the negotiating rules should be based on a

requirement that the existing within quota tariff rates will be applied to the enlargements of the tariff rate quotas.¹¹

4.4.2 Reduce the In Quota Tariffs

Any cases in which tariff rate quotas have not been filled would indicate that the in quota tariff rates have been set too high to create a real opportunity for trade to flow. This can be addressed by applying a harmonization formula that works out to a rate of 6% per year for tariffs at a level of above, say 20%, and works out to a negligible reduction for tariffs below, say 10%. However, consideration should be given to whether trying to achieve these reductions makes it more difficult to negotiate the phase out of the tariff quotas. If so, this objective could be sacrificed.

4.4.3 Provide for an Option to convert the existing mixture of an Tariff Rate Quota and an Out of Quota Tariff with a Single Bound Tariff.

Provision could be made for parties to be able to have the option of abolishing their minimum access tariff rate quota in exchange for a significant one-off reduction in the out of quota tariff rate. The longer that parties delay taking advantage of this conversion, the longer they should have to keep expanding the tariff rate quota.

The calculation should offer an incentive for parties to take advantage of this sooner rather than later. If the new tariff equivalent were calculated as the weighted average of the within tariff quota rate multiplied by the size of the quota and the part of the volume of domestic consumption excluding the quota multiplied by the out of quota rate, then the new tariff equivalent would be lower than the pre-existing out of quota tariff by a margin. The size of that margin would grow as the size of the volume of the pre-existing tariff rate quota grew.

This option could also apply to the current access quotas. In cases, in which particular countries were receiving preferential access before the Uruguay Round, it would be feasible to permit a margin of preference in the tariff charged on imports from that country in the same way as such preferences were allowed in 1948 under Article I. Such preferences

11 See Tangermann et al, "Implementation of the Uruguay Round Agreement on Agriculture and Issues for the Next Round of Agricultural Negotiations" (International Agricultural Trade Research Consortium, Commissioned paper no 12, October 1997) p137 and also Hoekman, Bernard &

should be reduced progressively as tariffs are reduced. The calculation of the tariff reduction and the preference should offer an incentive to remove the current access quota.

4.5 REFORM OF EXPORT SUBSIDIES

4.5.1 Provide for a per unit binding of export subsidies

The attempt in the Uruguay Round to achieve an eradication of export subsidies cannot be regarded as having been almost successful. They were an abject failure. In the end, the reductions that were achieved were of the same order as those that would flow from the negotiated reductions in import barriers together with an agreement for restraint on disposal of surpluses. The greatest failure of the Uruguay Round in relation to export subsidies was the failure to obtain the legal obligation that the EEC offered, that is, a limitation of the export subsidy on any given product to the import duty that could be charged on an import of the same product.

Bindings should be negotiated on a per unit basis. For countries with significant tariffs, the level of the binding on the export subsidy should not be larger than import duty that could be charged on imports of the same product.¹² For countries with very low tariffs, the bindings should be at a negotiated level.

Apart from that, no further attempt should be made to reduce the global expenditure or volume levels. Any attempt to do so is likely to derogate from the success of negotiating reductions in import barriers.

4.6 REFORM OF DOMESTIC SUBSIDIES

As with the proposals to eradicate export subsidies, the initial Uruguay Round proposals to completely phase out production linked subsidies cannot be regarded as having been almost successful. They were also an abject failure. The achievement of a 20% reduction without any limitation of swing between commodities and excluding the most important types of subsidies was a meagre result. In particular, the Uruguay Round commitments on domestic

Anderson, Kym, *Agriculture and the New Trade Agenda* (November 1998) p18-19 both also suggesting that the tariff rate quotas be expanded.

12 McMahan makes the same point that export subsidies be limited to the level of import barriers, see McMahan, Joseph A., *Agricultural trade protectionism and the problem of development* (St Martins, New York, 1992) p256.

support achieved no change to either the EEC's direct payments or the USA's deficiency payments. One must wonder if the result achieved anything that fiscal pressures would not have achieved.

My recommendation would be to seek no further restrictions. It is submitted that attempts either to reduce the ceiling on the blue box, to reduce the amber box, or to confine the green box would derogate from the successful negotiation of reductions in import barriers. Whilst some reinstrumentation of domestic subsidies would be beneficial, this is a low priority issue. Negotiation on these matters should be left until a future time when the major problem of import barriers has been more substantially remedied. As the problems with import barriers are remedied, the fiscal pressure to reduce domestic subsidies will intensify. In the meantime, the WTO has a capacity to apply a 'Dracula' effect to these measures. The dissemination of information to taxpayers through modern multimedia may have more effect on these measures than intergovernmental negotiations. It is submitted that placing them into intergovernmental negotiations will sabotage attempts to create appropriate disciplines on the other measures which are impossible to address merely through increasing transparency.¹³

4.7 SPECIAL AND DIFFERENTIAL TREATMENT FOR DEVELOPING COUNTRIES

The absence of reduction commitments on export subsidies and domestic subsidies may cause some reluctance among developing countries to reduce import barriers. Their obligations to reduce import tariffs could be lagged behind the obligations of the subsidizing countries.

4.8 PEACE CLAUSE

The peace clause relating to export subsidies, and other subsidies should be extended if the above commitments can be agreed upon. Otherwise the peace clause should be withdrawn and Article 3.1 of the SCM Agreement applied to export subsidies on agricultural products.

¹³ See the similar view expressed in Tangermann et al, "Implementation of the Uruguay Round Agreement on Agriculture and Issues for the Next Round of Agricultural Negotiations" (International Agricultural Trade Research Consortium, Commissioned paper no 12, October 1997) p142 that "A case could therefore be made that it is better to concentrate negotiating efforts on the border issues of market access and export competition".

Any extension at all of the peace clause should be contingent upon the necessary reinforcements of the prohibition on quantitative restrictions:

- the eradication or substantial tightening of annex 5;
- the reform of the rules on import monopolies;
- the adjustment to the special safeguards clause to broaden the importance of increases in quantities of imports;
- the removal of recourse to quantitative restrictions under the *Agreement on Safeguards*;
- the continuation of the expansion of existing tariff rate quotas; and
- the creation of a mechanism for completely phasing out tariff rate quotas.

Each year of extension of the peace clause should be matched by satisfactory liberalizations of import barriers and an additional constraint limiting export subsidies on any product to the import tariff that could be charged. The annual reductions should be of a comparable size to those required under the Uruguay Round *Agreement on Agriculture*. This time the reductions should be dispersion reducing.

4.9 LINKAGE

The linkage of negotiation of liberalization to the continuance of the peace clause may not be enough to ensure that the liberalization programme continues. Members that are seeking liberalization of agricultural restrictions should negotiate on services and agriculture as a single package.

5 CONCLUSION

The analysis of the post-WTO rules applicable to agriculture does indicate that many of the problems in the ranking of instruments in the pre-WTO GATT that contributed to the problems in application to agriculture have been remedied. However, some defects in the embodiment of the economic theory remain and these may continue to cause problems with applying the rules to agriculture.

Further negotiations on agriculture will be more fruitful if Members prioritize their objectives in accordance with the principles set out in Part 2 of this thesis relating to the differences between policy instruments. The negotiation should be approached with:

- (1) a first priority of completing the removal of quantitative restrictions;
- (2) a second priority of achieving further reductions in tariffs including achieving those reductions in a dispersion reducing way;
- (3) a third priority of achieving further reductions in export subsidies;
- (4) a fourth priority of achieving further disciplines over other subsidies.

The achievement of the higher priorities should not be impeded by placing too much emphasis on the lower priorities.

The Importance of Disciplining the Choice of Policy Instrument to the Effectiveness of GATT as International Law Disciplining Agricultural Trade Policies

Part 5

The Thesis and Its Importance

Chapter 24 Conclusions On The Thesis, Its Importance and
Observations About Possible Wider Applications

CHAPTER 24

CONCLUSIONS ON THE THESIS, ITS IMPORTANCE AND OBSERVATIONS ABOUT POSSIBLE WIDER APPLICATIONS

1 INTRODUCTION

I have already drawn some conclusions at the end of parts 2, 3 and 4 of the thesis. I wish to reflect on those, to draw some conclusions from the thesis as a whole and to stress the importance of these conclusions. In addition, I wish to draw attention to the ways in which this work might be used in further work.

2 CONCLUSIONS ON THE THESIS

This work opened by emphasizing the role of ideas rather than merely political expediency or commercial interests in the founding of the GATT 1947. Without dismissing the importance of the political and commercial forces, part of the impetus for the foundation and for the continuation of the GATT was to help establish and maintain such conditions of freedom of economic and commercial interaction as are conducive to the maintenance of peace among nations and to the increase of global economic welfare. The foundation of the GATT was profoundly influenced by the notion of equality and non-discrimination as manifested in the most favoured nation clause. It was also profoundly influenced by the economic theory relating to the benefits to be obtained from the reduction of trade barriers and the appropriate choice of trade and commercial policy instruments.

In accordance with the plan established in chapter 1 (in Part 1), this thesis has analyzed the role in the GATT of certain ideas proposed by economic theory and public choice theory relating to the optimal rules on choice of policy instrument for guiding governments to

economic welfare enhancing decisions without limiting their capacity to attain non-economic objectives. It has examined whether there was a causal link between the lack of influence of those ideas on the construction of GATT rules and the failure of the GATT in its application to agriculture.

Part 2 showed the importance of economic theory and public choice theory relating to the differences between policy instruments. It argued that the two distinctions between price based and quantity based border instruments and between border and non-border instruments are critical to the construction of optimal GATT rules. Part 2 concluded that these distinctions between policy instruments are the key to reconciling, on the one hand, the need for GATT rules to be able to achieve gains in economic welfare despite the political pressure to adopt welfare reducing policies and, on the other, the need to be able to accommodate policies to achieve genuine non-economic objectives in a welfare increasing way. Therefore, it is possible to use this economic theory to create rules which being able to help states to achieve their own long term self interest by attaining economic benefits at the same time as retaining the capacity to achieve non-economic objectives, will be successful. I submitted that four criteria were necessary for the successful application of GATT rules generally in relation to all sectors:

- (1) GATT rules must modify political decision making so as to reduce the level of protection;
- (2) GATT rules must modify political decision making so as to make it more difficult to apply border instruments than non-border instruments;
- (3) GATT rules must modify political decision making so as to make it more difficult to apply quantity-based border instruments than price-based border instruments; and
- (4) GATT rules must leave parties substantially free to utilize non-border instruments.¹

Using those criteria, Part 3 addressed the question set out in chapter 1 of determining:

"whether there was a causal link between:

1 See above, chapter 8 under the heading "8 Embodiment of the Two Distinctions in GATT Rules" at p193.

-
- (a) the way in which GATT 1947 rules distinguished between different types of governmental trade and commercial policy instruments; and
 - (b) the failure of the GATT rules in application to agriculture".²

My conclusion in Part 3 was that the relevant economic theory relating to choice of policy instrument as embodied in those criteria was inadequately embodied in GATT rules and that the deficiencies in embodying that theory in the rules were one of the reasons for the failure of the GATT in application to agriculture.

Cognizant of the deficiencies in the rules that had been enumerated in the conclusion to Part 3, Part 4 addressed the second half of the question set out in chapter 1, the question of determining:

- "(a) whether any such deficiencies in the rules have been remedied in the Uruguay Round in the formation of the GATT 1994; and
- (b) what influence this will have on whether the post-Uruguay Round rules are likely to be successful."³

Part 4 concluded that the Uruguay Round had remedied a substantial portion of those pre-existing deficiencies in the embodiment of the economic theory relating to policy choice, but had not remedied all of them. It concluded that the remaining deficiencies in embodiment of the economic theory in the rules may still cause problems with the application of the GATT (now the GATT 1994) to agriculture and made some suggestions for improving the rules.

At each stage of the analysis of agriculture, the regulation of different policy instruments has been stressed. In order to maintain that focus, I excluded some other approaches to the analysis of the application of the GATT to agriculture. First, I excluded consideration of defects in the operation of the dispute settlement system. Some aspects of my analysis of problems with agriculture indicated that defects in the operation of the dispute settlement system were part of the problem with application of GATT to agriculture. However, my

2 See above, chapter 1 under the heading "An Approach to the Problem" at p14.

3 See above, chapter 1 under the heading "An Approach to the Problem" at p14.

analysis has highlighted that the operation of the GATT system fundamentally turns upon the extent to which it is able to expose protected sectors to the market to cause economic changes that reduce the financial strength and, therefore, the political strength of lobby groups in protected sectors. The ability of the system to achieve that result may be dependent also upon the workings of its dispute settlement system. However, it is crucial to the operation of the rules that the substantive content of the rules is in fact capable of diminishing the political influence of certain lobby groups over time, even if only in gradual increments. If the rules are not constructed to do that then the forces against which the dispute settlement system is opposed may become stronger and stronger. As in all areas of international law, as political forces become stronger, then the interaction between law and politics becomes more likely to result in the law giving in to political forces.

Secondly, I excluded consideration of the argument that the GATT's failures are caused by the failure to apply the rules directly in domestic legal systems so as to give rights to individuals against their governments. No doubt it could be argued in respect of many situations described in this work that if consumers had been able to challenge their governments under domestic law, then the rules would have operated more successfully. It is not intended to either support or deny such arguments. The important point is that the arguments that are made in this work are essential to the successful operation of the rules even if they may not be sufficient to ensure success.

Thirdly, I excluded the argument that agriculture is a special case that cannot be disciplined by the same rules as can discipline other sectors. The course of my analysis has not brought up any special characteristics of agriculture that are not adequately catered for by the economic and public choice theory. Agriculture is simply a sector in which there are extremely strong lobby groups. The economic and public choice theory accurately predicts behaviour in that sector. The way in which societies achieve non-economic objectives with respect to agriculture still should be constrained by the guidance provided by the economic and political distinctions between policy instruments.

The focus of this thesis on the distinctions between policy instruments has been shown to be justified. Part 2 of the thesis set out two reasons why the making of distinctions between the regulation of different policy instruments is important.

- (1) First, distinguishing between the regulation of different policy instruments helps to achieve economic benefits. Policy instruments can be ranked in order of their cost to achieve any given policy objective and a border instrument is never the least cost policy instrument to provide assistance to an industry or sector. In addition, the magnitude of protection is more likely to be reduced over time if protection is given by the least inefficient policy instruments rather than the most inefficient policy instruments.
- (2) Secondly, distinguishing between the regulation of different policy instruments helps to protect the capacity to achieve non-economic objectives. If recourse to the first best instrument for addressing any non-economic objective is not restricted then restriction of other instruments does not impair the capacity to achieve any non-economic objective.

The pursuit by a nation of its own objectives was recognized by Jackson as an integral factor in the appropriate construction of GATT rules

“I see a large problem which is pervasive. ... The problem is keeping decisions that have to do with people and their lives as local and close to them as possible so that they can shape their particular milieu in society, while maintaining an international system that will prevent the decisions of some local areas from harming other local areas. ... A system is needed with enough flexibility and enough difference and differentiation among countries that different countries can pursue different goals. ... An international economic system must allow a country to do that [i.e. pursue its own goals] without penalizing it to the extent of forcing it to extract itself from the world-wide system, which is not easy.”⁴

Jackson acknowledges that the latitude in the system must be balanced with constraints that prevent some nations from harming others. My thesis argues that equal emphasis must be placed on the necessity for constraints that prevent nations from harming some interests within the nation in order to benefit others. The need for constraints on both aspects of national behaviour must be balanced against the need for a nation to be able to shape itself. The key to achieving this balance lies in the economic distinctions between policy instruments.

4 Jackson, John H., “The Trade Reform Act” (1973) 6 *Case W Res J Int'l L* 107-115 at 114-115.

3 IMPORTANCE OF THE CONCLUSIONS IN AGRICULTURE AND BEYOND AGRICULTURE

The critical part of this thesis is chapter 15 at the end of Part 3 which links the theoretical criteria, set out in Part 2, for the successful application of GATT rules with the analysis in Part 3 of the actual application of the rules to the agricultural sector. Chapter 15 argued that, indeed, there was a causal relationship between the failure to embody appropriately the distinctions between quantity-based and price-based border instruments and between border and non-border instruments in the rules and the lack of success in applying the GATT to agriculture.⁵ This conclusion is important to the question of how future regulation of agricultural trade and future negotiation of agricultural trade liberalization should be undertaken. However, since this conclusion derives not from any factor which is unique to agriculture but from a factor that is relevant to the general construction of the rules for all sectors, then this conclusion is not merely important in the field of agricultural trade. It is important to the general construction of the rules and their application generally. In addition to establishing that the theory proposed in Part 2 did explain the failures in applying the GATT to agriculture, this conclusion in relation to the application of the rules to agriculture supports the general applicability of the theory proposed in Part 2 to achieving success in applying GATT rules to any sector. In Popperian terms, the empirical test of the hypothesis in the specific area of agriculture failed to falsify the hypothesis.⁶

Chapter 15 drew attention to two aspects of the conclusion drawn in relation to agriculture:

- (1) firstly, that the rules were unsuccessful in regulating relations between states in the field of agricultural policy because the rules were not constructed to guide individual

5 See chapter 15 "Summary and Conclusions from part 3" especially at "6. Conclusions" at p554 arguing that "the analysis has demonstrated that many of the problems with application of the GATT to agriculture arose because of the deficiencies in creating the desirable incentive structure in the rules" tying together the observations drawn at pp533ff in "3. Deficiencies in Embodiment of Distinctions between Policy Instruments" and at pp540ff in "4. Problems with Applying the GATT to Agriculture".

6 The term Popperian refers the work of Karl Popper who defined science consists as the process of making hypotheses and then trying to falsify them. See Popper, Karl, *The Logic of Scientific Discovery* (Hutchinson & Co Ltd, London, 1959) and *Conjecture and Refutations - The Logic of Scientific Knowledge* (Routledge & Paul, London, 1963). For a summary of Popper's approach, see Charlesworth, Max, *Science, Non-Science & Pseudo-Science* (Deakin University Press, Burwood, Vic, 1982) pp23-26.

states to the achievement of their internal long term interests embracing both economic objectives and non-economic objectives; and

- (2) secondly, that one of the reasons that the structure of the rules was inadequate was because it failed to embody appropriately the two distinctions between policy instruments.⁷

Similarly, in using the evidence provided by Part 3 to draw an inference that the theory proposed in Part 2 is also useful for achieving success in applying GATT rules to any other sector of trade, it is also useful to emphasize that there are two aspects to that inference.

The first aspect to emphasize is that the economic and public choice theories which this thesis has submitted are essential for the construction of GATT rules are not drawn from an analysis of the effects of states' trade and commercial policy instruments upon each other, but rather from an analysis of the effects of any single state's policies on those within that state. The theory in Part 2 was based on the premise that if the rules are not constructed with a view to influencing the regulation of relations within the state to modify the internal decision making processes to ensure that states can arrive at welfare enhancing decisions, then the rules will be ineffective to achieve their external function of regulating relations between states.

The application of the internal approach to the function of international economic regulation as a system for balancing relations between, rather than within, states has been argued not as a matter of 'morality' or 'rights' but a matter of practical relevance to the question of whether the system of rules can succeed in their function as a system for regulating relations between states. The argument made out in this thesis is that the failure to construct the rules with a view to enabling them to achieve their function as a system for regulating relations within states has caused the failure of those rules to achieve their functions as a system for regulating relations between states. Therefore, the function of the rules as a regulation of relations *within* the state cannot be regarded as an aspect of GATT rules which is subsidiary to their primary function as a regulation of relations *between* states. Instead, the function of the rules as a regulation of relations *within* states must be regarded as a primary function of

7 See above, chapter 15 pp554-555.

the rules. This is a challenge to the view that the rules must be constructed as an instrument of external policy and regulation as (I note respectfully is) manifested, for example, in Baldwin's statement:

maximizing the collective economic welfare of individuals making up either a country or the world is, however, not the main policy objective of the GATT. The GATT is an international legal document whose primary purpose is to promote or protect certain political goals of nation-states.⁸

Quite to the contrary, this thesis argues that the rules cannot function effectively and successfully as a regulation of external relations unless the rules are constructed to optimize their ability to achieve their function as a regulation of internal relations. They must be constructed to protect the interests of citizens within the states otherwise they cannot fulfil their function of regulation of external relations.

The second point to emphasize is that in order to construct GATT rules so as to optimize their ability to achieve their function as a regulation of internal relations, the rules (*it is stressed*) must be constructed in accordance with the guidance offered by economic and political economy theory. The correct embodiment of the ranking between instruments indicated by the economic and political-economy theory is essential to guiding the behaviour of states so that they can achieve economic objectives at the same time as maintaining the capacity to achieve non-economic objectives.

Together, these two aspects lead to the crucial conclusion of this thesis that the embodiment in the rules of the economic theory relating to relations within states is not merely relevant to the internal welfare of individual states. It is also a determinant of whether the rules will be successful in disciplining the behaviour of states in relation to each other, that is, whether the rules will be able to discipline the relations between states.

This conclusion has a serious implication for the question of whether it is satisfactory for international economic law to be determined upon the basis of political compromise rather than on the basis of economic theory. The history of the application of the GATT to agriculture illustrates that if the law is determined by a political equilibrium without a basis in economic theory, then the law will be ineffective to control the growth of the strongest

8 Baldwin, Robert E., "The Economics of the GATT" in Peter Oppenheimer, *Issues in International Economics* (Oriol Press, Stodksfield, England, 1980) p82 at 83.

political lobbies, and will fail to constrain the manipulation of government decision making by those strongest political lobbies in a manner which undermines the rules. The more general conclusion is that if the rules are constructed only by a political equilibrium and without adequate reference to economic theory, that is, in the language of the opening observations of this thesis, without adequate reference to ideas rather than political forces, then the rules will be ineffective to discipline the strongest of the political forces that the rules are designed to discipline and, to some extent, the rules will fail.

The inference that the theory can be extended beyond agriculture to other sectors implies that the predictions and suggestions relating to the future application of the GATT to agriculture can also apply to other sectors. The conclusion of Part 4 of this thesis was that in order to further improve the operation of GATT in relation to agriculture, it is necessary to perfect the improvement in the embodiment in the rules of the appropriate distinctions between instrument that was carried out in the Uruguay Round. The extension of the other conclusions of the thesis beyond agriculture to other sectors implies that this prescription can also be extended to the improvement of the operation of GATT in other sectors.

4 OTHER APPLICATIONS AND RAMIFICATIONS OF THE METHOD AND CONCLUSIONS OF THIS THESIS

There are other ramifications of the analysis contained in this thesis. Whilst I do not wish to enter into discussion here of matters that have not been raised earlier in this work, I do wish to advert to further enquiries that are raised by the conclusions of this thesis. The framework of analysis has been used in relation to agriculture, but it could also be used in other contexts. In addition, there are extensions of the analysis which could be explored.

First, the framework of analysis could be used to analyze the problems in application of GATT to other hard areas, for example, clothing, textiles and footwear or cinematographic screen quotas.

Secondly, mention has been made of the limited treatment in this work of the further distinctions that can be made between classes of domestic subsidies. However this framework of analysis could also be used to analyze the further regulation of domestic subsidies.

Thirdly, any analysis of the regulation of domestic subsidies can be applied to the regulation of regulatory subsidies. Therefore, the method used in this thesis is important for analysis of the relationship between trade and various matters in which arguments are made for harmonization of laws and standards including environmental regulation, labour standards regulation and the regulation of competition.

Fourthly, the methodology adopted in this thesis could be applied to an analysis of the framework of regulation of services under the General Agreement on Trade in Services. To some extent this has been done.⁹ However, the methodology applied in this thesis could be useful in further work. The making of the extension of the theory beyond agriculture to other sectors of trade covered by the GATT could be extended beyond trade in goods to trade in services. Analysis could be made of the proposition that if the rules are not constructed under the guidance of the economic and public choice theory relating to choice of policy instrument to create an appropriate quasi-constitutional restraint on government decision making with respect to provision of services, then the rules will not work to achieve either their internal dual objectives of increasing economic welfare and achieving non-economic objectives or to achieve their external objective of creating an environment in which nations can cooperatively pursue higher economic welfare.

Fifthly, the exploration of some analogies with human rights law could be interesting. In particular, it has been argued that there is an interdependence between economic development and civil and political rights and that there is a unity of economic rights and civil and political rights.¹⁰ The arguments made in this thesis do not frame the interests of consumers and producers in their sales and purchases as economic rights. However, the arguments made in this thesis do assign to those consumers and producers the protection that is given by a political decision making process that must weigh the possibility of costs imposed by and benefits received from trading partners. In that sense, while the argument made in this thesis does not relate to protection of particular economic interests, it does

9 Snape, Richard E., "Reaching Effective Agreements Covering Services" ch10 in Anne O. Krueger (with the assistance of Chonira Aturopane) (ed), *The WTO as an International Organization* (The University of Chicago Press, Chicago & London, 1998) pp279-295.

10 For example, see "World Conference on Human Rights - the Vienna Declaration and Programme of Action (1993)", article 8; reproduced in Ghandi, P.R. (ed), *Blackstone's International Human Rights Documents* (Blackstone's Press, London, 1995) p331.

relate to the protection of certain benefits derived from constraints on the way in which political decisions affecting economic interests can be made. This thesis argues that the protection of those benefits relating to the manner of making political decisions on the level of protection and the choice of policy instrument is a pre-requisite to the attainment of certain economic benefits for the state and the individuals within it. Therefore, the arguments contained in this thesis could be used to construct an argument that the protection of certain political benefits is a pre-requisite for economic development. These benefits could be assigned the status of rights.

5 THE '*THESIS*' AND ITS IMPORTANCE

This thesis asked important questions about the application of the GATT to agriculture, one of the areas in which political forces have most strongly resisted application of the rules. In response to the question of why the GATT had been unsuccessful in application to agriculture, the thesis advanced the possible answer that the rules were unsuccessful because they did not properly embody certain economic theory relating to choice of policy instrument. By a meticulous empirical examination of all of the legal difficulties in applying the GATT to agriculture, the thesis has demonstrated the plausibility and strength of that explanation. In response to the question of how this explanation facilitates predictions and suggestions for the future, the thesis has pointed out remaining problems and suggested that the GATT rules will not operate successfully in application to agriculture unless the embodiment of the economic principles in the rules partly improved in the Uruguay Round is perfected by further rule changes and negotiations.

However, the thesis has not only advanced a plausible explanation and some suggestions relevant to agricultural trade. The thesis provides empirical evidence in support of propositions that are applicable, not merely to agriculture, but to other sectors of trade and to all international economic law. In its most basic form, this thesis concludes that if international trade rules are constructed without due influence of ideas indicated by economic theory, then they will not work. Therefore, the assertion that rules can only be constructed upon the basis of a political equilibrium which will not necessarily be influenced by ideas must be answered with the response that the political equilibrium alone is incapable of constructing successful rules.

The establishment of the causal link between deficiencies in embodiment of economic theory and failure of rules supports propositions made before: that ideas are important in the construction of international economic law;¹¹ and that principles of international economics are important to international economic law.¹² To those ideas, this thesis adds an original contribution. The analysis contained in this thesis provides evidence in support of the additional two part proposition (*the thesis*):

- (1) that in order to make the GATT¹³ operate effectively as a regulator of economic relations *between* states, it is a necessary condition of success that the rules are constructed so that they can operate effectively as a regulator of the way governments regulate economic relations between entities *within* states; and
- (2) that in order to operate effectively as a regulator of the way governments regulate economic relations between entities within states, it is a necessary condition that the rules are constructed so as to properly embody the ranking of policy instruments that economic theory and public choice theory suggest, preferring *price-based border instruments* to *quantity-based border instruments* and preferring *non-border instruments* to *border instruments*.

Further, this thesis has supported that proposition with an examination of the application of the GATT 1947 to agriculture, one of the areas in which political forces have most strongly resisted the application of the rules. The observations drawn from that meticulous empirical examination of all of the legal difficulties in applying the GATT to agriculture were shown to be consistent with the above proposition. Thus this proposition is advanced as a plausible answer to the question posed in chapter 1 of this thesis as to why the GATT 1947 was unsuccessful in relation to agriculture. However, this proposition is advanced as a generally applicable proposition relevant to the successful application of the GATT to all sectors.

11 See, eg, and in relation to formulation of domestic economic law and international economic law, see Goldstein, Judith, "The Impact of Ideas on Trade Policy: The Original of US Agricultural and Manufacturing Policies" (1989) 43 *Int'l Org* 31, and Goldstein, Judith, *Ideas, Interests and American Trade Policy* (Cornell University Press, Ithaca, 1993).

12 See, eg, Hindley, Brian, "Negotiations for Overcoming Non-tariff Barriers to Trade" in Frank McFadzean et al (eds) *Towards and Open World Economy* (Macmillan for the Trade Policy Research Centre, London 1972) pp127-136.

13 And impliedly the GATS.

What of the future? This proposition has been applied to the post Uruguay Round rules applicable to agriculture to predict further difficulties, thereby answering the second question posed in chapter 1 as to whether the Uruguay Round had solved the problem, and also to suggest the appropriate path for future negotiations. At some stage in the future, it will be possible for someone to test the above proposition (*the thesis*) against the future experience in applying the GATT to agriculture. However, this proposition has ramifications which extend beyond agriculture. The corollary of this (two part) proposition (set out above) is that the GATT rules will not operate effectively in all trade sectors as a regulator of relations between states unless and until they are established with a proper embodiment of economic theory so as to be able to operate effectively as a regulator of the way that governments regulate relations between entities within states. This is a necessary condition to the future successful application of the GATT.

It will always be argued that political forces, not theories or ideas, determine the outcome of negotiations on the construction of rules. To prevent ideas from being overtaken by political pressure, it is necessary to devise means of turning political forces against each other so that the end result is the one that the ideas would dictate. In 1947, the negotiators devised a system of turning political forces against each other so as to prevent states from succumbing to the self harming and system harming 'sirens' of protectionism. However, the system devised did not harness sufficient political forces against the strong political forces in the agricultural sector. The rules were inadequate to help governments to restrain rent seeking within their own states, and inadequate to help them prevent rent seeking within other states and, ultimately, inadequate to restrain states from adopting policies that harm each other. In this thesis, I have argued that the system would have been more successful in harnessing political forces to prevent such damage if the rules had been a better embodiment of the economics on the ranking of policy instruments. The Uruguay Round negotiators have corrected some but not all of the problems.

The achievement of a convergence between the rules that a political equilibrium would dictate and the rules that ideas would dictate requires that additional factors be injected into the negotiation. Otherwise, we end up with a political compromise that makes the laws ineffective to counterbalance the strongest of political forces we are trying to control. One

way to modify the political process is to direct other political forces into the process, including by linking the negotiation to other factors.¹⁴ However, on occasions, the difference between an outcome determined by politics and one derived from ideas will be the intellectual input and leadership of the key political and diplomatic actors and advisers.

It is not only desirable but is essential that those involved in the construction of the rules must be guided by the important ideas contributed by economic and public choice theory.

Jan Tumlir's warning is apposite

If it was all a matter of power, there was nothing that we, powerless intellectuals, could do. But if leadership is indeed a matter of understanding, and if it decayed and coherence was lost because political and economic understanding became increasingly inadequate, then the ultimate responsibility will come to rest with us, the 'professionals'...¹⁵

My understanding of the public choice theory and economic theory set out in this thesis gives me the responsibility to point out to those who would assert their perceived national interest in derogation of the economic principles that the consequence of their derogation of economic principles *will be the construction of rules that will fail to protect their own long term national interest*. It may even be that they are not asserting the national interest at all but are asserting the interest of a particular section of society that has the resources to influence political decision-making at the expense of the rest of society which does not have the resources to influence political decision-making. Even if they are asserting genuine national interest, the principles of economics are crucial to the construction of rules that can make it harder rather than easier for those with the resources to influence political decision-making to do so at the expense of others. In the end, it is a question of protecting the weak from the strong. It may well be that it is greed rather than intelligence that determines how the world is run. My concluding responsibility is to plead that the economic theory of this century does tell politicians, diplomats, and lawyers how to use their intelligence to minimize the adverse effects of greed, and to give intelligence rather than greed a little more influence in determining how the world is run.

14 Consideration of linkage in political negotiations beyond the aspects already described is beyond the scope of this thesis. See the end of chapter 8 on the importance of linkage. For an introduction to the literature on linkage in political negotiations, see Hoekman & Kostecki (1995) pp82-83. ,

15 Tumlir, Jan, "The Contribution of Economics to International Disorder", (1980-81) 3 *World Economy* 387-401 at 399.

APPENDIX 1 - MEASUREMENT OF THE LOSS INCURRED BY CONSUMERS CHOOSING NOT TO CONSUME UNITS BECAUSE OF AN INCREASE IN PRICE

Measurement of this loss is determined by how much they were prepared to pay for each additional unit of Product A. Since they were prepared to buy these units at a price of \$100 but are not prepared to buy them at a price of \$120, then we know they are prepared to pay between \$100 and \$120 for each of these additional units. The loss is demonstrated by considering consumers who are prepared to pay a maximum of \$105, \$110 and \$115 respectively for a single unit of Product A. That they are prepared to pay a particular maximum amount for a unit of product A indicates that they are equally satisfied by having either that amount or one unit of Product A. Assume that for each of the three consumers we can rank in increasing order of preference the following positions of economic welfare, having: one unit of A; one unit of A plus \$5; one unit of A plus \$10; one unit of A plus \$15; and so on. So for a consumer prepared to pay \$105, one unit of A is equivalent to \$105 and one unit of A plus \$5 is equivalent to \$110. We consider the way that the three consumers would allocate a given amount of money between product A and other products both before and after the price of A increases from \$100 to \$120. From this, we can quantify the change in economic welfare of the three consumers measuring it in dollars (which of course represents dollars worth of other products). The example arbitrarily assumes that the consumers have \$120 to spend.¹ While the price is \$100, each of the three consumers choose to buy one unit of A and have \$20 left to spend on other goods. Now, consider their position after the price rise.

- for those prepared to pay \$105 per unit, the initial bundle of one unit of A plus \$20 is equivalent to \$125. After the price increase to \$120, these consumers choose not to buy any of product A. They keep the \$120. They have lost \$5.

¹ The measured changes in economic welfare would be the same if we allowed them any other amount to spend and even if we allow them different amounts to spend so long as for each of the three, it is the same amount before and after. Consideration of various possibilities will confirm this.

- for those prepared to pay \$110 per unit, the initial bundle of one unit of A plus \$20 is equivalent to \$130. After the price increase to \$120, these consumers choose not to buy any of product A. They keep the \$120. They have lost \$10.
- for those prepared to pay \$115 per unit, the initial bundle of one unit of A plus \$20 is equivalent to \$135. After the price increase to \$120, these consumers choose not to buy any of product A. They keep the \$120. They have lost \$15.

Therefore, for the consumers who, in consequence of the price rise, choose not to buy units of Product A, there is a loss because they are only able to purchase products which give them less satisfaction than they would have received from Product A. The loss of satisfaction per unit is equal to the amount in excess of the pre-tariff price that they were prepared to pay for a unit of Product A. This measures the incremental satisfaction that they miss out on by not being able to purchase the extra units at the pre-tariff price. Such a loss of graduated size occurs in respect of each unit of the 100 unit reduction in consumption, so there is a loss of between zero and \$20 for each of these 100 units. If we assume that the consumers' willingness to pay for each marginal unit decreases evenly through the extra 100 units (as we did above²), then we can use an average of \$10 per unit to calculate the loss on the 100 units at \$1,000.

² This assumption was made in chapter 4 see fn1,item (3) and in the accompanying text at paragraph (2).

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