

19 May 1983

EUROPEAN ECONOMIC COMMUNITY - SUBSIDIES ON EXPORT OF PASTA PRODUCTS

Report of the Panel (SCM/43)

1. Introduction

1.1 In pursuance of the decision of the Committee on Subsidies and Countervailing Measures taken at its meeting of 7 April 1982 concerning the establishment of a panel to examine a complaint by the United States, the Chairman of the Committee, after securing the agreement of the Signatories concerned, set, on 14 June 1982, the following terms of reference and the composition of the panel:

A. Terms of reference

"To examine, in the light of the relevant provisions of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade and of the discussion in the Committee, the United States' contention that the export subsidies on pasta products manufactured from durum wheat are being granted by the European Community in a manner inconsistent with Article 9 of the Agreement, and to present to the Committee its findings concerning the rights and obligations of the Signatories party to the dispute under the relevant provisions of the General Agreement as interpreted and applied by this Agreement."

B. Composition

Chairman: H.E. Ambassador E. Nettel (until 9 March 1983)
Mr. D.M. McPhail (from 15 March 1983)

Members: Mr. F. Laschinger
Mr. D.M. McPhail
Mr. M. Pullinen
Mr. H.S. Puri

1.2 On 9 March 1983 Ambassador Nettel informed the Chairman of the Committee that he had been transferred from Geneva and was no longer available to serve as Chairman of the Panel. The Chairman of the Committee, after securing the agreement of the Signatories concerned, nominated Mr. D.M. McPhail as Chairman of the Panel. The work of the Panel, with the agreement of the parties, was then concluded with the new Chairman and the three other members.

1.3 The Panel met with the parties to the dispute on 12 July 1982, 8 October 1982, 29 March 1983 and 19 April 1983. The Panel met without the parties on 9 November 1982, 2 December 1982, 19 January 1983, 25 February 1983, 14, 15, 18 and 19 April 1983.

1.4 In presenting its complaint the United States delegation claimed that:

- (a) the EEC practice of granting subsidies on the export of pasta was strictly prohibited under Article 9 of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (hereinafter referred to as "the Code");
- (b) the EEC practice could not be characterized as a subsidy limited to the primary component physically incorporated into pasta products which were exported.

1.5 Subsequently in his presentation to the Panel, the representative of the United States stated that he was not asking the Panel to decide on the question set forth in 1.4 (b) above which was not essential to the basic US legal position outlined in 1.4 (a). The Panel limited therefore its examination to the latter point.

II. Factual aspects

(a) EEC Regulations concerning export refunds on durum wheat exported in the form of pasta

2.1 Provisions relating to the modalities of application and criteria for fixing the amounts of export refund on durum wheat exported in the form of pasta¹ are part of the basic EEC regulations on the common organization of the market in cereals and cereal-based products.

2.2 After a transitional period from July 1962 to June 1967 (Regulation No. 19/62 EEC of 4 April 1962), the common organization of the market in cereals and cereal-based products was originally established by Council Regulation No. 120/67 EEC of 13 June 1967. The single market in cereals which provides, *inter alia*, for the free movement of the produce within the Community, came into force on 1 July 1967.

2.3 Council Regulation No. 120/67 (as amended) remained applicable until the marketing year 1974/75 when it was replaced by Council Regulation No. 2727/75, of 29 October 1975 which came into effect on 1 November 1975. This regulation (as amended) is still in force.

2.4 The common organization of the market provides for each of the basic cereals, including durum wheat, a single system of internal prices valid for the whole Community, and a common trading system with third countries which is designed, *inter alia*, to prevent price fluctuations of the world market from affecting cereal prices ruling within the Community.

2.5 The Community trade régime for cereals and cereal-based products also provides for export licensing and for application of export refunds under certain conditions and in a prescribed manner. Export licences are issued by Member States and are conditional on the lodging of a deposit guaranteeing that exportation will be made during the period of validity of the licence² (Regulation 2727/75 - Article 12). Export refunds may be granted when necessary to cover the difference between the established prices for cereals, exported in natural state or in the form of specified goods, within the Community and those prevailing on third markets. Pasta products are included in the list of specified goods (Regulation 2727/75 - Article 16 and Annex B).

2.6 Council Regulation (EEC) No. 3035/80 of 11 November 1980 establishes general rules for granting export refunds on durum wheat exported in the form of pasta and for fixing the amount for such refunds. Under this regulation, an export refund is fixed monthly by the Commission per 100 kgs. of durum wheat for use in making pasta.³ The amount of this refund is then multiplied by means of fixed coefficients which are stated by the EEC to be representative of the quantity of durum wheat required

¹The term "pasta" includes macaroni, spaghetti and similar products falling within CCCN heading 19.03.

²This period covers the month of issue plus four months (end of the fourth month).

³The EEC refund on export of durum wheat in its natural state is set weekly and differs from that used to calculate refunds on exports of pasta.

to produce one unit of pasta. These coefficients vary with respect to the ash content of durum wheat used in processing and refer, therefore, to different qualities of pasta.⁴

2.7 In the case of pasta products containing egg or egg products, these coefficients are adjusted downward to reflect the slightly smaller amount of durum wheat used in producing pasta. An additional refund is granted on the basis of the egg content in the pasta.

2.8 In practice, the Commission fixes the level of export refund in terms of durum wheat equivalent by taking as a basis the average of durum wheat import levies in the twenty-five first days of the preceding month.⁵ The import levy for durum wheat is calculated by subtracting the c.i.f. import price (Rotterdam) of durum wheat from the applicable threshold price for durum wheat. This threshold price, which is calculated each year and is subject to periodic adjustments, serves as the internal EEC price standard for purposes of the Community trading régime. It is established as part of the system designed to maintain an indicative or "target" price for durum wheat within the Community, on the basis of the Community intervention price for durum wheat, i.e. the floor price guaranteed throughout the Community at the wholesale stage in producing regions.

2.9 The level of export refund is normally that applicable on the day of exportation. However, when applying for an export licence, an exporter may request that the export refund be fixed at the level applicable on the date of the licence application. Such a refund could be applied, therefore, to a shipment at any time during the 5-6 month period of validity of the licence. Provisions are also contemplated for adjusting the rate of the refund during the period of validity of the licence, where durum wheat prices would evolve in such a way which would alter the basis on which the rate of the refund fixed in advance was calculated. In practice, this adjustment operates only downward when new internal reference prices of durum wheat are fixed at the beginning of each campaign year.

2.10 The funding of the export refund on durum wheat exported in the form of pasta is made by a public contribution out of the budget of the Community (EAGGF) from the same budget allocation used for the export refund on cereals. The refund is paid directly to the pasta exporters through Member States' competent agencies, after dispatching required customs formalities.

(b) Facts related to the legal aspects of the matter

2.11 The negotiating history of Article 9 of the Code starts from the Havana Charter. The corresponding Article (Article 26) prohibited export subsidies on any product except on primary commodities (which were subject to special provisions of Articles 27 and 28).

2.12 Article XVI:4 of the General Agreement corresponds to Article 26:1 of the Havana Charter. It also uses the same definition of the term "primary product"⁶ as that provided for in Article 56:1 of the Havana Charter.

⁴i.e. a conversion factor of 1.67 is used when the durum has an ash content of less than 0.95 per cent; 1.50 when the ash content is equal to or more than 0.95 per cent but less than 1.30 per cent; 1.33 when the ash content is equal to or more than 1.30 per cent.

⁵The Panel was informed by the EEC representative that in the final calculation of this refund the Commission systematically reduces, by approximately 10 per cent the amount obtained by taking the average of durum wheat import levies.

⁶A primary product is understood to be any product of farm, forest or fishery, or any mineral, in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade.

2.13 At the 12th Session of the CONTRACTING PARTIES in 1957 the United States sought clarification of the scope of Article XVI and proposed that Article XVI:4 should not prevent a contracting party, in this particular case the United States, from subsidizing exports of processed products (cotton textiles) if such subsidy was essentially the payment that would have been made on the raw material (cotton) used in the production of this processed product if the raw material had been exported in its natural form.

2.14 The US interpretation was not accepted by other contracting parties. No contracting party spoke in favour of it, while several contracting parties clearly rejected it. Some contracting parties proposed that the United States attach a reservation to its signature of the declaration extending the standstill provisions of Article XVI:4. The representative of the United States said that this proposal would be reported back to his Government (SR.12/22, pages 192-194).

2.15 The United States signed the Declaration extending the standstill provisions of Article XVI:4 on 21 November 1958 "with the understanding that this Declaration shall not prevent the United States as part of its subsidization of exports of a primary product, from making a payment on an exported processed 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, contained in the production of the processed product."

2.16 At the 13th Session of the CONTRACTING PARTIES in 1958 the Chairman stated that "the US Government had accepted the Declaration subject to a reservation the text of which had been distributed". Four contracting parties considered that "the reservation by the US Government considerably limited the importance of the 'United States' adherence to the Declaration." Consequently the Chairman said that "the US delegation would doubtless note the remarks which had been made." No other comments were made in this respect (SR.13/20).

2.17 At the 17th Session in 1960 the US representative announced that the United States intended to sign the Declaration Giving Effect to the Provisions of Article XVI:4 "subject to the United States' normal interpretation regarding the scope of subsidies on primary products" (SR.17/11, page 167). Consequently the signature by the United States on 19 September 1961 of this Declaration was accompanied by the same text as that attached to the Standstill Declaration (see paragraph 2:15 above). The United States has not, so far, withdrawn this text.

2.18 In the 1963 notification of subsidies (L/1948/Add.4) the United States notified the equalization payment on cotton contained in exported cotton products. This notification was made in a chapter entitled "Subsidies on Primary Products". The subsequent notifications under Article XVI:1 did not contain any reference to this practice.

2.19 In 1970 the EEC notified (in L/3178/Add.14) refunds on processed products such as macaroni, spaghetti, etc. manufactured from agricultural products. The EEC notification explained that "to the extent necessary in order to allow export of agricultural products in the form of certain processed products on the basis of quotations or prices for the said products on the world market the difference between those quotations or prices and the prices in the EEC may be covered by an export refund. The amount of the refund is equivalent, as a general rule, to the quantity of each basic product utilized, multiplied by the rate of the refund applicable thereto." The same notification was repeated in 1972 (L/3655/Add.10). Subsequently the EEC notifications have not contained a separate chapter to deal with such processed product but "goods processed from agricultural products" have been enumerated under "Export Refunds".

2.20 At least one other Signatory (Switzerland L/5102/Add.9, pages 30-31) notified, under Article XVI:1, a like practice consisting in subsidizing the primary agricultural input in exported processed agricultural products.⁷

2.21 The Code provides, in Article 9:1, that "Signatories shall not grant export subsidies on products other than certain primary products". As relevant to the present case, Article 9 compared with Article XVI:4 of the General Agreement, imposes an increased discipline in that the scope of the prohibition has been increased by inclusion of minerals into the category of products other than certain primary products. Consequently the definition of primary products under the General Agreement covers minerals whereas minerals are excluded from the definition of certain primary products under the Code.

2.22 The Code contains, in the Illustrative List of Export Subsidies, the following paragraph:

"(d) the delivery by governments or their agencies of imported or domestic products or services for the use in the production of exported goods, on terms or conditions more favourable than for delivery of like or directly competitive products or services for use in the production of goods for domestic consumption, if (in case of products) such terms or conditions are more favourable than those commercially available on world markets to their exporters."

2.23 There is no record of any discussion or understanding as to the interpretation of Article 9 nor has any such interpretation been notified to the GATT for the record or attached to any acceptance of the Code. The only reservations made to the Code in general and to Article 9 in particular were those by New Zealand and Spain but they concern only the right to maintain, over a limited period, certain export subsidy practices which are considered as clearly prohibited by the Code.

III. Main arguments

United States arguments

3.1 The representative of the United States quoted Article 9 of the Code and footnote 29 thereto and said that the rule set forth in Article 9 was unambiguous, strictly prohibiting the grant of export subsidies on any product other than certain primary products. Furthermore, the language of Article 9 did not qualify this prohibition in any manner. He further said that the EEC export subsidy fitted precisely within the rule set forth in Article 9. While durum wheat was a product of the farm and thus a primary product within the definition cited above, pasta was not. The transformation of durum wheat into pasta involved a complex, multi-staged process. The extent of processing was reflected in terms of cost estimates of the value added in the process of converting semolina flour into pasta products which, according to his calculations amounted to 44 per cent. This did not include any expense for brand name advertising which also added value to the finished product. Moreover, it did not include the separate 18.5 per cent value added factor necessary to grind durum wheat into semolina flour and its commercial by-products. The extensive amount of value added through two separate processing stages made it abundantly clear that pasta was not a primary agricultural product. Such treatment would render Article 9 meaningless.

⁷Australia has also notified a practice consisting in rebating part of the price of the sugar content of certain manufactured products exported L/5102/Add.8, pages 20-21). The Australian notification states that the cost of this rebate is borne by the Australian sugar industry.

3.2 He further said that in terms of the applicable definition of primary products processing durum into pasta was not customarily required to prepare durum for marketing in substantial volume in international trade. For example in the 1980/81 marketing year, 4 million tons of durum wheat was traded internationally. The level of trade in international durum wheat and the substantial amount of processing that was involved in converting durum to pasta led to the conclusion that for purposes of the GATT, pasta was a non-primary product and that a subsidy on the export of such product violated Article 9. As there was no question that the EEC granted a subsidy on the export of pasta, and there was no requirement to prove injury under Article 9, it was the position of the United States that all the elements necessary to demonstrate a breach of Article 9 have thus been met.

3.3 He disagreed with the EEC view that a practice had developed whereby contracting parties had granted export subsidies on certain processed agricultural products without claiming that the subsidized product was a primary product so long as the subsidy was granted only on the primary product component incorporated into the exported product and since the practice had never been challenged, it had developed into a legal right. Whatever weight or relevance a general practice of parties might have as an interpretive aid if a provision were ambiguous, neither the language nor the history of Article 9 of the Code or Article XVI:4 of the GATT was ambiguous on the question at issue. A contracting party or Signatory clearly did not gain a legal right to engage in a prohibited practice under the GATT, or the Code either by the passage of time or because others might engage in the same or a similar practice.

3.4 He said that the history of the US reservation to Article XVI:4, in respect of subsidies on processed products calculated in relation to a primary component, to which the EEC had referred as supporting evidence of its interpretation of Article 9 was indeed instructive but it led to quite the opposite interpretation from that suggested by the EEC. The history clearly demonstrated that the prohibition on export subsidies on non-primary products did not allow export subsidies to be granted on a primary component of a non-primary product. Otherwise, the US would not have been required to make a reservation in order to continue its practice. He further noted that neither the United States nor any other Signatory had made such a reservation to the Code. Nor was there any difference in the language of Article 9 and Article XVI:4 which would make such a reservation unnecessary under the Code.

3.5 He further said that if the rule of the GATT and the Code were as suggested by the EEC, there would be enormous practical difficulties as well as an inequitable advantage given to processors of subsidized primary products. The theory espoused by the EEC was that subsidization would be limited to the primary component. By itself, such a rule would in fact provide no limits. For example, the subsidy could be set at 100 per cent of the value of the primary component, which would give the processor a huge advantage. Nominally, this defect could be "cured" by providing that the subsidy be strictly limited to the difference between the price actually paid for the primary components by the exporter and the price the exporter would have paid on the world market. The EEC claimed to observe this principle with respect to pasta, but had not, in fact, done so according to data comparisons developed by the United States. That rule, moreover, would have to be qualified still further to preserve equity, since at least freight and insurance costs were borne by competing producers who had to import the primary product. Such prices would be difficult to identify and compute without intricate accounting.

3.6 Finally, he noted that under the interpretation advanced by the EEC export subsidies paid on non-primary products in relation to the primary component would not only be exempt from Article 9 but also from Article 10 of the Code. Theoretically, the EEC asked that such subsidization be treated as subsidization of the export of a primary product, though the exported product was non-primary. The implication was that Article 10 would apply. However, the criteria for judging the consistency of a subsidy with Article 10, e.g. "more than an equitable share of world trade", displacement of the export of another Signatory and material price undercutting were measured in relation to trade in the primary product. For example, in this dispute the question of whether pasta export subsidies should

be disciplined would be determined by the degree to which the durum equivalent of EEC pasta exports had led to the effects prohibited by Article 10 in the durum market. Beyond the enormous technical difficulties of computing world and individual country trade in terms of primary product equivalence, it was also true that export subsidies concentrated on non-primary products might have a measurably greater distortive effect on the market for that non-primary product than would be evident if the market for the primary product input had to be examined as a whole. For example, subsidized paper products might be damaging competitors, while if such products were considered only in relation to their forest product component, little impact might be evident in world trade in forest products. Again, the United States did not believe that a rule requiring such technical elaboration and entailing serious equity problems could be implied from the practices of some parties, against the clear language and history of the GATT and the Code. Nor, in the view of the United States, could it be maintained that paragraph (d) of the Illustrative List applied to the subsidies at issue, which involved direct payments on the exports of pasta.

EEC arguments

(a) Absence of any allegation by the United States in respect of injury

3.7 The representative of the EEC said that at none of the various stages of the dispute settlement procedure had the United States alleged the existence of any injury whatsoever suffered as a result of imports of pasta from the Community. An examination of the facts of the situation clearly revealed the total absence of any injury caused by EEC exports of pasta to the United States. During the preliminary examination carried out by the US authorities (the domestic law phase under Section 301 of the Trade Act), the complainants, feeling obliged to allege the existence of injury had quoted figures showing that imports from the Community accounted for approximately 2 per cent of the US pasta market in 1979, 2.6 per cent in 1980 and could rise to 3.8 per cent in 1981. He further said that no such figures explained the silence of the United States on the question of injury in the international settlement phase, the United States being unwilling to deny or confirm those figures when they were raised by the EEC. It was, moreover, because of the absence of any serious injury that the complaint under Section 301 by the United States pasta manufacturers did not achieve its objective and normal effect, namely the introduction of countervailing duties on pasta products imported from the EEC, and that the US administration had to resort to the present complaint.

3.8 The representative of the EEC said that in his opinion pasta was essentially consumed in the United States by a small population sector more concerned with the quality and gourmet image of the product than with its price. In this connection, Italian pasta clearly offered, or in any case was considered to be of, better quality, particularly in the North-Eastern states with a large population of Italian origin and where these exports were concentrated. This was all the more true because exports of Italian pure durum pasta were the only ones increasing; mixed pasta was declining while the United States was producing mixed pasta to which vitamins and/or minerals were added, undoubtedly altering the flavour. The effect of the Community refund on the increase in Italian pasta exports to the United States was therefore very doubtful, all the more so because over the period considered the dollar/Italian lira exchange rate had deteriorated considerably.

3.9 He further said that it was unprecedented in the history of GATT to see one party attacking another party without its legitimate interests being at stake. The existence of injury (or the threat of injury) was so essential that the dispute settlement procedure even envisaged the application of the procedure in cases where there was no actual infringement of the rules (Article XXIII:1(b)). The dispute settlement procedure in the General Agreement and in the Code was designed, and has always been applied, to resolve substantive disputes between the parties; the search for a mutually satisfactory solution, i.e. an honest compromise to eliminate or reduce the possible injury, was a fundamental feature governing all the phases of that procedure, including that of the Panel. However, the failure of the United States

to allege any material injury deprived this procedure of its normal practical effect and paralysed its proper operation. The representative of the EEC indicated that during the conciliation phase, the Community had to insist vigorously that compromise proposals aiming to reduce any injury should be put forward. The United States could only reply that it wished the Community to acknowledge that its subsidies on exports of pasta products were incompatible with Article 9. It was therefore very clear that the US complaint had exclusively legal motives and aims: the recognition of the validity of the unilateral American interpretation of Article 9 with all the consequences that would result for all processed agricultural products.

(b) Applicability of Article 9

3.10 The representative of the EEC said that the nature of the Community refund called into question was of decisive importance in the examination of the United States' complaint since it had very precise legal effects on the applicability of Article 9, both as regards the beneficiary product and as regards the very existence of an export subsidy. It was clear from an examination of the facts that the EEC refund was indeed a cereals refund (durum wheat) which was granted in respect of durum wheat whether it was in the unaltered state or has been combined with or processed into another product. It was important to stress, in the case of pasta, that only the raw material was taken into account and that no other component, for example the cost of processing, was taken into consideration. Thus the refund was granted not in respect of the pasta products but only on the durum wheat that had been used and the refund did not include any component by way of processing aid.

3.11 He further said that durum wheat was undeniably a primary product within the meaning of the General Agreement (Article XVI:3) as well as one of the primary products referred to in the Code (Article 10). It followed from the above provisions that exports of products falling within this category could be subsidized on the condition that the disciplines laid down to this end were respected ("equitable share of world export trade" and "price undercutting"). No other restrictions were laid down; in particular, there was no obligation to restrict such a subsidy to only those cases where the primary product was exported in the unaltered state, i.e. in its natural form. A large number of Signatories other than the Community subsidized exports of primary products even where those products were no longer in their natural form. Consequently as soon as it was established that Article 10 made it possible, on certain conditions, to subsidize exports of commodities or primary products, even if not in their natural form, it was clear that the EEC refund challenged by the United States fell within Article 10 and not Article 9 since it involved only a durum wheat refund. In these circumstances, to claim the applicability of Article 9 for a primary product, on the pretext that it has been processed - and without the processing itself being subsidized - was to recognize a superiority of Article 9 over Article 10, but this was not authorized by anything in the Code or the General Agreement.

3.12 He also said that it was wrong to contend, as the United States did, that the meaning of Article 9 was perfectly clear and that the only question was whether one could validly set against that clear meaning a contrary practice that could develop into a legal right. In this context he recalled that Article 9 did not emerge suddenly from the Tokyo Round but followed on from the 1960 Declaration retaining almost the same wording. Various statements had been made regarding the Declaration, and in particular the United States had made clear their understanding that the meaning of the Declaration should be taken as allowing subsidization of exports of a primary product even if the latter was contained or incorporated in a non-primary product. It was on the basis of that statement by the United States - which was indeed an interpretation and not a reservation as that country was alleging today - that an interpretative practice developed of the prohibition of export subsidies on non-primary products. When the standstill Declaration was translated into Article 9 of the Code, it had been understood in that sense by many Signatories which had accepted it in good faith. Indeed, nobody could reasonably believe that the EEC - and with it other Signatories which likewise were granting subsidies and aids on exports of processed primary products - would have been so heedless and inconsistent as to accept a wording

that condemned earlier practices in respect of which there had been no negotiations and no stated intention of abandoning them. There existed, therefore, a legitimate right for certain contracting parties or Signatories of the Code, of which the EEC was one, to avail themselves of the interpretation established through a certain practice until such time as a determination has been made on this point by the bodies competent to give an authentic interpretation, such as the CONTRACTING PARTIES or the SIGNATORIES of the Code. Otherwise, it was clear that the good faith of certain contracting parties or Signatories would be abused.

3.13 He added that apart from its highly disputable interpretation of Article 9, the United States contended that if export subsidies on primary products were to be granted even when the product had undergone processing, "enormous practical difficulties" would result because of the inadequacy of Article 10 of the Code for the case of such products and in particular for defining the "relevant market" and application of the rules established by that Article. He considered it a curious legal approach to contend that because one rule (Article 10) was too complicated to apply to the case under reference, one should look for another one (Article 9) to apply.

3.14 He referred to another aspect of the inapplicability of Article 9 in the present case and said that given that the Community refund related solely to the raw material component used in the manufacture of the pasta products without taking into account the actual production costs, the effect of the refund was merely to procure a raw material at more favourable price conditions for the production of pasta for export than for those produced for the domestic market. This price advantage merely served to reduce the cost of the raw material used to the level of the costs on the world market given the method of calculation of the refund, which was equal to the (positive) difference between the domestic prices and those on the world market. In this relation he quoted paragraph (d) of the Illustrative List of Export Subsidies and said that it clearly resulted from it that the supply of an imported or domestic raw material at more favourable price conditions for export production than for production intended for domestic consumption was an export subsidy only if those price conditions were more favourable than those on the world market. At present this was not the case, since the Community refund, because of the way in which it was calculated, simply resulted in aligning the price of raw material on the world level and thereby putting exporters in the same situation as if they obtained the same raw material commercially on the world market. Consequently this refund could not, under the terms of paragraph (d) quoted above, be considered as an export subsidy in that its effects were merely to reduce the price of the durum wheat to the level of world market prices.

IV. Findings and Conclusions

4.1 The Panel carried out its consideration of the matter referred to it by the Committee for examination in the light of the terms of reference as expressed in paragraph 1.1. It based its consideration on:

- (a) the facts of the matter as presented by the parties to the dispute, and the information which was available to it;
- (b) arguments presented to it by the parties to the dispute;
- (c) records of the discussion in the Committee;
- (d) the relevant provisions of the Code.

4.2 The first question the Panel considered was whether or not pasta was a primary product within the meaning of footnote 29 to Article 9 of the Code. It noted that neither party had finally contended that pasta was a primary product. The Panel was of the opinion that pasta was not a primary product but was a processed agricultural product.

4.3 The Panel noted that under the relevant EEC Regulations the EEC system for granting refunds to exporters of pasta products was financed from public funds and that it operated to increase exports of such products from the EEC. The Panel concluded that this system of granting refunds must be considered a form of subsidy in the sense of Article XVI of the General Agreement. Moreover, the EEC had recognized this and had, pursuant to Article XVI:1, notified its system of refunds to exporters of pasta products since 1970.

4.4 The Panel further considered whether the subsidies in question were granted on exports of a primary product (durum wheat), which was incorporated in the processed product (pasta products), and therefore would fall under the provisions of Article 10 of the Code. The Panel noted the view of the EEC that the refund was a cereals refund granted and calculated exclusively in respect of the raw material component (durum wheat) with the intention of placing EEC exporters of pasta products who were using domestic durum wheat in the same competitive position as manufacturers using durum wheat, including subsidized EEC durum wheat used in third countries, bought at world market prices. However the Panel considered that the definition of "certain primary products" in Article 9 of the Code, footnote 29, included only a product of farm, forest or fishery "in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade". The Panel was of the opinion that durum wheat incorporated in pasta products could not be considered as a separate "primary product" and that the EEC export refunds paid to exporters of pasta products could not be considered to be paid on the export of durum wheat. In the Panel's view, the ordinary meaning to be given to the terms of Article XVI of the General Agreement, as interpreted and applied in Articles 9 and 10 of the Code, in their context and in the light of their object and purpose excluded the possibility of considering the export of a processed product in terms of the export of its constituent components, be they primary or processed products. The Panel therefore concluded that the EEC export refunds were granted on the export of pasta products and operated to increase exports of pasta products by refunding a part of the cost of these processed products.

4.5 The Panel then examined whether the language of Article 9 of the Code or its negotiating history gave any indication that would permit the granting of subsidies on exports of processed products, to the amount which would have been granted on one or various primary components, had these components been exported in their natural form. Apart from the discussions in the Committee arising from the present dispute, the Panel noted that there was no record of any discussion or understanding as to the interpretation of Article 9 nor had any such interpretation been notified to GATT for the record or attached to any acceptance of the Code. It also noted that the first draft of the Code circulated in MTN/NTM/W/168 considered a possibility that the prohibition of Article 9 would apply to non-agricultural products (instead of to products other than certain primary products) while agricultural products would be subject to what became Article 10 of the Code. In all subsequent drafts this possibility had been dropped and replaced by differing obligations with respect to "products other than certain primary products" and "primary products". The drafters used the term "certain primary products" instead of "primary products" because minerals had been excluded from the scope of Article 10 and subjected to the disciplines of Article 9. Consequently Article 9 covered all products other than products of farm, forest or fishery in their natural form or which have undergone such processing as was customarily required to prepare them for marketing in substantial volume in international trade. The Panel concluded that the drafters of the Code had clearly recognized that the terms "primary product" and "agricultural product" were not synonyms and that an agricultural product, if it was not a primary product as defined above, should be subjected to different obligations (Article 9) than a primary product (Article 10).

4.6 The Panel noted the differing views of the parties to the dispute concerning the status of the text attached by the United States to the Declaration Giving Effect to the Provisions of Article XVI:4 of the General Agreement. The Panel recognized the well-established principle that the determination of whether a unilateral statement, however phrased or named, was an interpretative declaration or a

reservation was dependent not on the particular label attached to the statement by the country concerned but on whether the statement intended to exclude or modify the legal effects of certain provisions of the agreement in their application to that country. The Panel was of the view that the US understanding was intended to limit the legal obligations of the United States under Article XVI:4 and had to be recognized as a reservation rather than an interpretation. This conclusion was confirmed by the history of this understanding, and in particular by the fact that it was referred to as a reservation by the Chairman of the CONTRACTING PARTIES at the 13th Session in 1958 as well as by four contracting parties and that these statements were not challenged by any other contracting party.

4.7 The Panel then considered whether the US reservation to Article XVI:4 had any relevance to the US rights and obligations under the Code. The Panel noted that the United States had not made a formal reservation on its acceptance of the Code. The Panel was of the opinion that the US reservation previously made to Article XVI:4 was not relevant to the US position under the Code since it could not be automatically carried over to the Code. In order for a reservation to be valid under the Code, the United States would have had to make the reservation in compliance with the provisions of Article 19:3 of the Code, which had not been the case. The Panel also noted that the United States had recognized in its submission to the Panel that "the United States gave up the legal right to engage in this practice when the United States signed the Subsidy Code without a reservation". Since the Panel found that there was no US reservation with respect to the US rights and obligations under the Code, it concluded that the United States was not estopped from challenging the EEC practice in question.

4.8 The Panel noted, however, that during the discussion in the Committee some Signatories were of the opinion that such practices as the one under consideration had not been perceived by them as being inconsistent with Article XVI of the General Agreement and these Signatories were therefore of the opinion that these practices could not be inconsistent with Article 9 of the Code. It was possible that some Signatories, when signing the Code, might have believed that they could continue their existing practices of subsidizing exports of some processed agricultural products to the extent that this subsidization was confined to the primary product components. The Panel, however, noted that these beliefs, if they existed, were never transformed into formal, legally effective statements and could not therefore have the effect of changing the meaning of the Code or obligations of Signatories under the Code.

4.9 The Panel examined whether or not there was evidence available which would establish a generally accepted practice which might have permitted the subsidization of exports of processed agricultural products to the extent that this subsidization was confined to the primary product components. The Panel noted that the EEC had, since 1970, notified under Article XVI:1 its subsidies on exports of pasta products and certain other processed agricultural products. At least one other Signatory had regularly notified a similar practice. There were also elements in notifications of some other Signatories which might indicate the existence of similar practices; however, these latter notifications were made, in the view of the Panel, in too general terms to permit any analysis of their scope and nature. The Panel found that the notifications under Article XVI:1 and other evidence available to it did not establish that there was such a generally accepted practice. The Panel viewed the wording of Article 9 as clear and unambiguous and therefore considered that even if the actual practices of some Signatories had become generally accepted, these practices would still have been inconsistent with the provisions of Article 9.

4.10 The Panel considered that the notifications under Article XVI:1 of certain export subsidies on processed agricultural products did neither require nor preclude contracting parties from challenging the legality of such practices. As contracting parties were under no legal obligation to challenge the legality of export subsidies of other contracting parties, the mere abstaining from such a legal challenge could not be relied upon as acquiescence to or construed as approval of the legality of such export subsidies. In this context the Panel noted that another Panel had concluded that the fact that certain

practices had been in force for some time without being the subject of complaints was not, in itself, conclusive evidence that there was a consensus that they were compatible with the General Agreement (BISD 23S, page 114, paragraph 79).

4.11 The Panel considered the practical effect of the EEC interpretation of Article 9 of the Code. The Panel was of the view that if this interpretation had become a general rule, it would have radically altered the meaning of this Article thereby substantially reducing its scope and impact. Such an interpretation, if generally followed, would have permitted the subsidization of exports of almost all processed products within the purview of Article 9 which contained primary product components which were the product of farm, forest or fishery.

4.12 The Panel considered that paragraph (d) of the Illustrative List of Export Subsidies was not relevant to the case under consideration because the EEC system under examination involved the payment of refunds to exporters of pasta products whereas paragraph (d) related to the delivery by governments or their agencies of inputs for use in the production of exported goods.

4.13 The Panel did not find it necessary to reach a conclusion on the question of "absence of any allegation by the United States in respect of injury", which was raised by the EEC, because footnote 26 to Article 8:4 states: "signatories recognize that nullification or impairment of benefits may also arise through the failure of a Signatory to carry out its obligations under the General Agreement or this Agreement. Where such failure concerning export subsidies is determined by the Committee to exist, adverse effects may, without prejudice to paragraph 9 of Article 18 below, be presumed to exist. The other Signatory will be accorded a reasonable opportunity to rebut this presumption."

4.14 After having taken all the above considerations into account the Panel concluded that the EEC subsidies on exports of pasta products were granted in a manner inconsistent with Article 9 of the Code.

V. Dissenting opinion of one member

One member of the Panel dissociated himself from a number of aspects of the above conclusions and expressed the following dissenting opinion:

5.1 While this member agreed with the majority of the Panel on the conclusion contained in paragraph 4.2 to the effect that pasta was a processed agricultural product, he did not share the view of the majority regarding the nature of the refund. He considered that - as long as the refund merely equalized the differential between the world market price and the domestic price of durum wheat - the practical effect and the intent of the refund was to enable EEC pasta manufacturers to use domestic durum wheat in the production of exportable pasta products. The refund thus improved the competitive position of the EEC durum wheat producers rather than the processing industry and should consequently be considered as a subsidy on durum wheat. It followed from these considerations that this member disagreed with the majority of the Panel on the conclusion in paragraph 4.4 to the effect that "the EEC export refunds were granted on the export of pasta products".

5.2 This member also disagreed with the majority of the Panel, as far as the clarity and unambiguity of the relevant provisions of the General Agreement and the Code were concerned. "The ordinary meaning to be given to the terms of Article XVI" had clearly been interpreted at least in two ways, by a number of countries, including the United States, and for a long period of time. It was thus far from clear what was meant by Article 9 of the Code in this respect. While the wording might be clear in overall terms, it did not address the issue of the incorporation of subsidized primary product components, and could thus not be used as decisive guidance for the conclusions to be drawn on the present case.

5.3 This member agreed with the majority on the analysis contained in paragraph 4.6 of the background and nature of the US reservation to the 1960 Declaration, but he pointed out that the situation had decisively changed thereafter. A number of those contracting parties that had compelled the United States to present its interpretation of Article XVI:4 in the form of a reservation, had themselves adopted a similar interpretation of that provision. Thus it became widely recognized that the provision concerned was indeed open to interpretation, and a widespread practice among contracting parties was relevant thereto. This member consequently disagreed with the conclusion in paragraph 4.9, regarding the possible impact of a generally accepted practice on the interpretation of the relevant provisions of the Code. He also considered the conclusion of the majority of the Panel in the same paragraph, relating to the existence of such a generally accepted practice, to be based on insufficient information on the real situation, leading to an erroneous conclusion. He recognized that there was hardly anything the Panel could do in order to improve the information and data base available to it, but at the same time he emphasized that in a situation where absence of data obviously could lead to mistakes it would be appropriate to avoid drawing too firm conclusions.

5.4 Regarding the negotiating history of the Code this member was of the view that the absence of any record of discussion or understanding regarding this specific aspect of the Code should not be interpreted as implying an intent of the drafters to change the then prevailing status quo, rather the contrary. Given the importance of these kinds of export subsidies to a number of Signatories, notably the EEC, it would be only logical that a change in such a major issue would have been made explicit in the text of the Code, had it been the intention of the drafters to arrive at such a result. In defining the product coverage of "certain primary products" the only explicit change that was made was the exclusion of minerals from the coverage of that notion. Had it also been the intention of the negotiators to change their then prevailing interpretations regarding processed agricultural products, it would seem logical that this would have been made explicit in the text of the Code. According to the recollection of this member, the reason for replacing the term "agricultural products" by "certain primary products" related rather to the desire of the drafters to keep the terminology in line with the text of the General Agreement than to any other considerations. In the context of the drafting, as far as he was able to find out and recall, there was never any mention of possible implications on the treatment of processed agricultural products. The majority of the Panel was thus drawing a conclusion in paragraph 4.5, which in this member's view was not well-founded and deviated from the intentions of the drafters.

5.5 This member considered the absence of explicit reservations to Article 9 of the Code by a number of Signatories to have resulted simply from the fact that these Signatories had never considered such reservations to be necessary. According to their understanding the negotiation of the Code had in no way affected the status quo with respect to processed agricultural products, and established practices could continue. This was further confirmed by the fact that no changes to national laws and regulations were notified under Article 19:5(b) of the Code, and the issue was not raised in the Committee in the context of the examination of national legislation.

5.6 Against this background this member was not able to agree with the majority of the Panel on their final conclusion as contained in paragraph 4.14.