WORLD TRADE ORGANISATION
Third Participant Submission to the Appellate Body

EUROPEAN COMMUNITIES – EXPORT SUBSIDIES ON SUGAR

(AB-2005-2)

THIRD PARTICIPANT SUBMISSION OF NEW ZEALAND

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I EXECUTIVE SUMMARY

1.01 The European Communities ("EC") appeals certain issues of law arising from the Reports of the Panel on *European Communities – Export Subsidies on Sugar*. With the exception of those findings of the Panel that are the subject of appeal by Australia, Brazil and Thailand, New Zealand considers that the Appellate Body should uphold the Panel's findings.

Export Subsidies (Article 9.1(c) of the Agreement on Agriculture)

1.02 The Appellate Body should uphold the Panel's finding that C sugar receives export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. The arguments of the EC which endeavour to distinguish its sugar regime from the situation in *Canada – Dairy*, and which attempt to alarm the Appellate Body with predictions of "sweeping and totally unintended consequences", are without foundation and should be rejected.

1.03 The EC claims the Panel's interpretation of Article 9.1(c) would turn that provision into a broad prohibition on export sales below cost of production and would create a sort of blunt anti-dumping instrument. The EC also claims that the *Agreement on Subsidies and Countervailing Measures* ("the *SCM Agreement*") contains no such rule.

1.04 The Panel's interpretation of Article 9.1(c) does not give rise to a broad prohibition on exports below cost of production. The Panel's interpretation finds, correctly, that when there is a spill-over in production arising from domestic support, and those quantities must, by law, be exported, the scenario has moved from one of domestic support to one of export subsidies. If the EC were to remove the requirement to export C sugar then the Article 9.1(c) export subsidy would indeed no longer be in place. Removing the requirement to export C sugar would not prevent the EC from continuing to support its domestic production. Indeed, it would not stop some exports

potentially taking place. But any decision to export would be in the hands of the exporters as opposed to being a governmental requirement.

1.05 No-one is suggesting that in a 'normal' domestic support situation there should be a "broad prohibition on export sales below costs of production". The *Canada – Dairy* jurisprudence does not imply that and neither does the Panel decision in this case. But where the governments decide that certain quantities of sugar are 'surplus' to national requirements and oblige producers to export that sugar (at below the average total cost of production) the realm of 'normal' domestic support and 'normal' spill-over effects is well past.

1.06 The EC's reference to a "blunt anti-dumping mechanism" is without foundation. Dumping reflects a choice on the part of an individual exporter to sell at below its cost of production. In the situation in this dispute, however, governmental action creates strong incentives to produce sugar deemed surplus to national requirements, governmental action requires that such sugar be exported to the world market, and governmental action, therefore, leaves producers of C sugar with no choice but to export C sugar at below the average total cost of production.

1.07 Furthermore, in deeming, by law, sugar to be surplus to national requirements and requiring the disposal of those surpluses through exports regardless of the fact that those exports are at below the average total cost of production and are financed by high-priced domestic sales of sugar 'in no real sense, differs from practices normally followed by governments' under Article 1.1(a)(1)(iv) of the *SCM Agreement*.

1.08 The factual findings made by the Panel clearly support the conclusion that C sugar receives 'payments' 'on the export' that are 'financed by virtue of governmental action'.

(i) "Payments"

1.09 The Appellate Body should uphold the Panel's conclusion that C sugar receives 'payments' within the meaning of Article 9.1(c). The Panel rightly drew on *Canada – Dairy* jurisprudence. In that case the Appellate Body found that the word 'payment' denotes a transfer of economic resources, and that 'payments' under Article 9.1(c) of the *Agreement on Agriculture* encompassed payments made in forms other than money, including revenue foregone. To determine whether a payment has been made requires a comparison between the price actually charged by the provider of the goods or services and "some objective standard or benchmark which reflects the proper value of the goods or services to their provider". The Appellate Body found that objective standard to be the average total cost of production.

1.10 The Panel in this case examined two types of 'payment' in the EC sugar regime: one in the form of below cost sales of C beet to C sugar processors/exporters (payment (a)); and one in the form of cross-subsidisation resulting from the profits made on sales of A and B sugar used to cover the fixed cost of production/export of C sugar (payment (b)).

1.11 The EC has not appealed the factual basis for the Panel's finding with regard to payment (a), but appeals the Panel's conclusion on payment (b). In fact, the basis for finding that a payment exists is the same for payments (a) and (b). The Panel considered that the benchmark used in *Canada – Dairy*, the average total cost of production, was the appropriate benchmark in this case. The Panel found, as a matter of fact, that producers were able to "sell exported C sugar above average variable costs but below the average total cost of production". Under Article 9.1(c) 'payment' can be payment in kind by way of revenue or value foregone when the price actually charged for C sugar is compared to its proper value. The proper value of C beet is not reflected in its price, and therefore involves a 'payment' within the meaning of Article 9.1(c). The Panel drew the correct conclusion in finding that both payments (a) and (b) were payments within the meaning of Article 9.1(c).

1.12 In the case of payment (b) the EC argues that no 'transfer of resources' exists. This argument is a decoy and must be rejected. The fact that the producers, processors and exporters of A, B and C sugar are in some cases the same entities is of no relevance. Whether it be called a 'transfer of resources' or 'cross subsidisation' does not detract from the fact that C sugar is being exported at a price that is considerably lower than its average total cost of production. There is a clear transfer of resources to the production and export of C sugar, without which sugar producers would be unable to produce and export C sugar without making a loss. Therefore there is a 'payment' for the purposes of Article 9.1(c).

1.13 The EC also argues that payment (b) confers no benefit on sugar producers. This argument is baseless. First, as the Panel rightly noted, there is no basis for importing the notion of 'benefit' into an analysis of Article 9.1(c) of the *Agreement on Agriculture*. But even if there were such a requirement, the findings of the Panel clearly show that benefits do exist. For example, sugar producers have an incentive to overproduce (and consequently sell C sugar at below its average total cost of production) in order to reap maximum benefit from their A and B sugar quotas and guarantee their share of those quotas for the subsequent year.

(ii) "On the export"

1.14 The Appellate Body should uphold the Panel's conclusion that the relevant payments were 'on the export', within the meaning of Article 9.1(c). The Appellate Body has stated that it sees no reason to consider that 'contingent on export' has a different meaning under the *Agreement on Agriculture* and the *SCM Agreement*. The payments must be, to use the Appellate Body's language, "dependent" or "conditional" upon exportation of C sugar. In this case the Panel emphasised that once a payment is identified, the focus is on whether that particular payment is made *on the export*.

1.15 The EC argues that, as there is no requirement to produce C sugar, and producers receive returns for their A and/or B sugar production even though they make

no exports, the payments cannot possibly be contingent on exports. In doing so the EU is unnecessarily complicating the situation, effectively claiming that the requirement of export contingency applies to the measures that finance the payments, rather than to the payments themselves. Such an interpretation distorts the clear meaning of Article 9.1(c). The Panel found, correctly, that the emphasis of this provision is on whether the actual payment is on the export, not whether the EC's price support as a whole is contingent upon C sugar being exported.

1.16 The key fact in this case, which the Panel rightly identified, is that C sugar, unless carried forward, must be exported. Producers of C sugar are prohibited, under threat of heavy penalty, from introducing this sugar into the domestic market. Because of this export requirement, the Panel considered that any payment to C sugar must, by its very nature, be 'on the export'. The Panel correctly reached this conclusion on the facts before it, and the Appellate Body should uphold that finding.

(iii) "Financed by virtue of governmental action"

1.17 The Panel found on the facts before it that this element of Article 9.1(c) was satisfied, and the Appellate Body should uphold that finding.

1.18 The Panel in this case began its analysis with the Appellate Body's statement that governmental action "embraces the full-range" of activities by which government regulates, controls or supervises individuals, or otherwise restrains their conduct. The Panel correctly identified a variety of 'actions' through which the EC regulates, controls and supervises its domestic sugar market in a way that results in the financing of C sugar exports. While the EC claims that the 'governmental action' in the EC beet market is less pervasive that in *Canada-Dairy*, it is the similarities, rather than the differences, that are striking.

1.19 In *Canada – Dairy* "government agencies fix the price of domestic milk which renders it highly remunerative to producers"; in this case "the EC Regulation fixes the

prices of A and B beet that renders it highly remunerative to farmers/growers of C beet". In *Canada – Dairy* "[g]overnment action… controls the supply of domestic milk through quota"; in this case"[g]overnment action… controls the supply of A and B beet (and sugar) through quotas". In both cases financial penalties are used to ensure product destined for export is not diverted onto the domestic market. Furthermore, the EC attempts to downplay the degree of government involvement by attaching significance to the fact that "beet growers are totally free to decide whether or not to produce C beet", and that "prices are freely agreed between growers and producers". But again, the situation was precisely the same in the *Canada-Dairy* case, and similar arguments were rejected by the Appellate Body.

1.20 Moreover, the Panel rightly placed emphasis on the fact that the regime creates an environment in which growers/producers are encouraged to produce C beet and C sugar in order to maximise their quota value and ensure they fill their A and B production quotas and retain those quotas in subsequent years.

1.21 The Panel found on the facts before it that the EC, through EC Council Regulation No.1260/2001, controls virtually every aspect of domestic beet and sugar supply and management, and that the effect of its 'actions' was the financing of payments. The Panel rightly concluded that the requirement for a tight nexus between the mechanism by which payments were financed and governmental action had been amply demonstrated, and the Appellate Body should uphold that finding.

Judicial Economy (Articles 3.1(a) and 3.2 of the Agreement on Subsidies and Countervailing Measures)

1.22 The Panel, in an exercise of judicial economy, declined to examine claims of prohibited subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement*. New Zealand supports the arguments of Australia, Brazil and Thailand that such an examination is warranted because of the potential distinct course of implementation obligations that may ensue under Article 4.7 of the *SCM Agreement*, and because of the potential right of counter measures under Article 4.10 of that Agreement.

1.23 New Zealand therefore joins Australia, Brazil and Thailand in requesting the Appellate Body to complete the analysis and find that there are prohibited subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement*, and that they should be withdrawn without delay in accordance with Article 4.7 of that Agreement. The EC's counter-argument on this point should be rejected.

II INTRODUCTION

2.01 The European Communities ("EC") appeals certain issues of law arising from the Reports of the Panel in *European Communities – Export Subsidies on Sugar*.[1] The measures at issue in this dispute relate to the EC's common organisation of its markets in sugar, and specifically, export subsidies that provide support to the production and export of sugar.

2.02 New Zealand is neither a producer nor an exporter of sugar. However, New Zealand has a strong systemic interest in the preservation of the WTO disciplines on agriculture negotiated during the Uruguay Round. The present appeal goes to the heart of the disciplines on export subsidies, with significant implications for Members' rights and obligations. The dispute raises issues of interpretation and application of the provisions of the *Agreement on Agriculture*, including as described in the Appellate Body's findings in the *Canada – Dairy* cases.[2] It also raises issues over the scope of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*") in the context of cases involving agricultural products.

2.03 Two issues are central to this dispute: first, the status of the footnote inscribed by the EC in Section II, Part IV of its Schedule, and the corresponding impact on the EC's scheduled commitment levels; and second, the extent of subsidisation by the EC of its sugar exports. New Zealand limits its submission on appeal to the issue of whether exports of C sugar receive export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. New Zealand will put forward the grounds and legal

[1] Panel Reports on *European Communities – Export Subsidies on Sugar (Complaint by Australia)*, WT/DS265/R, 15 October 2004; *European Communities – Export Subsidies on Sugar (Complaint by Brazil)*, WT/DS266/R, 15 October 2004; *European Communities – Export Subsidies on Sugar (Complaint by Thailand)*, WT/DS283/R, 15 October 2004.

[2] Report of the Appellate Body, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, WT/DS113/AB/R, adopted 13 October 1999 ("*Canada – Dairy*"); Report of the Appellate Body, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products, Recourse to Article 21.5 of the DSU by New Zealand and the United States*, WT/DS103/AB/RW, WT/DS113/AB/RW ("*Canada – Dairy (21.5) I*"), adopted 18 December 2001 and Report of the Appellate Body, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products, Second Recourse to Article 21.5 of the DSU by New Zealand and the United States*, WT/DS103/AB/RW2, WT/DS113/AB/RW2 ("*Canada – Dairy (21.5) II*"), adopted 20 December 2002.

arguments to support the Panel's finding on this issue, including by rebutting arguments raised by the EC in its Appellant Submission.[3] New Zealand also addresses briefly the Panel's exercise of judicial economy in the examination of claims under Articles 3.1(a) and 3.2 of the *SCM Agreement*.

2.04 New Zealand considers that the Panel properly applied the disciplines of the *Agreement on Agriculture* and correctly concluded that C sugar receives export subsidies within the meaning of Article 9.1(c) of that Agreement. The EC goes to considerable lengths to distinguish its sugar regime from the situation in the *Canada – Dairy* cases, where the Appellate Body considered *inter alia* the scope of Article 9.1(c). But on closer inspection it is the similarities between the two systems, rather than any differences, which are striking. The factual findings of the Panel clearly support the conclusion that C sugar receives 'payments' 'on the export' that are 'financed by virtue of governmental action'.

2.05 New Zealand considers that the Appellate Body should uphold the finding of the Panel that C sugar receives 'payments' within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. In this submission New Zealand will argue that the Panel correctly interpreted the findings of the Appellate Body in the *Canada – Dairy* cases, and correctly determined that those findings were applicable to this case. The Panel rightly identified that the benchmark for establishing the existence of a payment was the average total cost of production, as the Appellate Body ruled in *Canada – Dairy*. The EC's arguments relating to 'transfer of resources' and 'benefit' to C sugar producers, should be rejected.

2.06 The Appellate Body should also uphold the finding of the Panel that the relevant payments were made 'on the export' within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. In this submission New Zealand will show that payments were indeed 'dependent' or 'conditional' upon exportation of C sugar.

[3] *European Communities – Export Subsidies on Sugar*, Appellant Submission of the European Communities, 20 January 2005 ("EC Appellant Submission").

2.07 New Zealand also considers that the Appellate Body should confirm the finding of the Panel that the relevant payments were 'financed by virtue of governmental action' within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. In this submission New Zealand will demonstrate that the EC, through EC Council Regulation No.1260/2001, controls virtually every aspect of domestic beet and sugar supply and management, and that the effect of this governmental action was indeed to 'finance' the relevant payments on the export of C sugar.

2.08 Finally, New Zealand considers that the Appellate Body should grant Australia, Brazil and Thailand's appeal on the Panel's decision to exercise judicial economy in respect of examining claims under Article 3.1(a) and 3.2 of the *SCM Agreement*.

III LEGAL ARGUMENTS

A The Panel correctly found that C sugar receives export subsidies in the form of payments financed by virtue of governmental action under Article 9.1(c) of the *Agreement on Agriculture*

3.01 New Zealand supports the conclusion of the Panel that exports of C sugar receive subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture.*[4]

3.02 As the Appellate Body has now established, Article 9.1(c) of the *Agreement on Agriculture* requires the demonstration of a number of elements. First, it requires that 'payments' be made. Second, it requires those payments to be made 'on the export' of an agricultural product. And third it requires that those payments be 'financed by virtue of governmental action'. After a careful examination of the facts the Panel found that each of those elements was met by the EC's exports of C sugar.[5] New Zealand endorses fully this conclusion.

3.03 The essence of the EC's appeal is that the Panel wrongly applied the Appellate Body's jurisprudence in *Canada – Dairy* to the facts of this case. The EC expends considerable energy attempting to distinguish exports of C sugar under the EC sugar regime from exports of dairy products in the *Canada – Dairy* case, that were found to be subsidised exports in the sense of Article 9.1(c) of the *Agreement on Agriculture*. The EC proclaims that the Panel has misapplied the jurisprudence, and that the result "has no equivalent in the SCM Agreement",[6] would have "sweeping and totally unintended consequences",[7] and creates in effect a "sort of blunt anti-dumping instrument".[8]

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[4] Report of the Panel on *European Communities – Export Subsidies on Sugar (Complaint by Australia)* ("Panel Report (Australia)"), Part VIII, specifically paras 8.1 – 8.4.
[5] For the Panel's findings on each element in relation to payment (a) and (b), see Panel Report (Australia), paras 7.270, 7.279, 7.292, 7.314, 7.322 and 7.334.
[6] EC Appellant Submission, Part V.A.3(e).
[7] *Ibid*., para 205.
[8] *Ibid*., para 180.

3.04 It is worth examining these claims at the outset. What this examination reveals is that, in fact, the Panel in this case has done no more than properly apply the disciplines of the *Agreement on Agriculture* to a government regime. This government regime encourages the production of C sugar and requires EC sugar producers to sell on a world market at prices that do not cover their average total costs of production.[9] Little wonder, then, that the EC must resort to groundless scaremongering.

3.05 The EC states:

> *Canada – Dairy* stands for the proposition that the sale of inputs may involve a "payment" to the purchaser of those inputs if made at a price below a certain benchmark. This is in line with the rules on input subsidies under the *SCM Agreement.* In contrast, the Panel's interpretation of Article 9.1(c) AA would turn that provision into a broad prohibition on export sales below cost of production that would apply whenever the domestic price is higher than the export price and the price difference can, at least in part, be attributed to government action of any kind, regardless of whether it involves a subsidy. The *SCM Agreement* contains no such rule.[10]

3.06 First, the Panel's interpretation of Article 9.1(c) does not give rise to a "broad prohibition" on exports below cost of production. The Panel's interpretation finds, correctly, that when there is a spill-over in production arising from domestic support, and those quantities must, by law, be exported, the scenario has moved from one of domestic support to one of export subsidies. If the EC were to remove the requirement to export C sugar then the Article 9.1(c) export subsidy would indeed no longer be in place. Removing the requirement to export C sugar would not prevent the EC from continuing to support its domestic production. Indeed, it would not stop some exports potentially taking place. But any decision to export would be in the hands of the exporters as opposed to being a governmental requirement. The EC's attempt to create alarm by claiming that the Panel's interpretation of Article 9.1(c) blurs the line between domestic support and export subsidy disciplines is without foundation.

[9] See, for example, Panel Report (Australia), para 7.301.
[10] EC Appellant Submission, para 200. Original footnotes omitted.

3.07 Removing the requirement to export C sugar would make the EC sugar situation analogous to a 'normal' domestic support system. This is the system the Appellate Body was referring to when it talked about 'spill-over' effects of domestic support measures.[11] No-one is suggesting that in a 'normal' domestic support situation there should be a "broad prohibition on export sales below costs of production".[12] The *Canada-Dairy* jurisprudence does not imply that and neither does the Panel decision in this case. But where the governments decide certain quantities of sugar are 'surplus' to national requirements and oblige producers to export that sugar (at below the average total cost of production) the realm of 'normal' domestic support and 'normal' spill-over effects is well past.

3.08 Next, the EC dismisses the relevance of the *SCM Agreement* claiming that it "contains no such rule". This, of course, is not relevant to an examination under the *Agreement on Agriculture*. Nevertheless, New Zealand submits that the sort of situation that is represented by the EC sugar regime certainly does have a parallel concept in the *SCM Agreement*. In Article 1.1(a)(1)(iv) the *SCM Agreement* defines a subsidy as occurring when:

> a government makes payments to a funding mechanism, or *entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;* [emphasis added]

3.09 In the case at hand the EC deems a certain amount of sugar to be surplus to national requirements through establishing the A and B quotas, and requires that surplus sugar to be exported.[13] Normally when such surpluses are deemed to exist by governments the surplus products are exported using 'a financial contribution by a government' (in the sense of Article 1.1(a)(1)(i) of the *SCM Agreement*) in the form of

[11] See, for example, Report of the Appellate Body on *Canada – Dairy (21.5) I*, paras 89 *et seq.*
[12] EC Appellant Submission, para 200.
[13] It is not the EC market that is deciding the C sugar is surplus to national requirements. The Panel found the domestic price of sugar was well above the world price, implying that C sugar would have a ready home in the EC were producers allowed to sell it there.

an export subsidy. The only difference between a direct export subsidy system and the situation with the EC's sugar regime, therefore, is that in the latter case producers are obliged by the government to export product using their own funds (financed from high-priced domestic sales of sugar) in lieu of a government financial contribution. The deeming of sugar to be surplus is done by law by the EC and the required disposal of these surpluses through exports 'in no real sense, differs from practices normally followed by governments'.[14]

3.10 Finally, the EC's reference to a "blunt anti-dumping mechanism" is without foundation. As emphasised by New Zealand in its submission to the Panel,[15] dumping reflects a choice on the part of an individual exporter to sell at below its cost of production. In the situation in this dispute, however, governmental action creates strong incentives to produce sugar deemed surplus to national requirements, governmental action requires that such sugar be exported to the world market, and governmental action therefore, leaves producers of C sugar with no choice but to export C sugar at below the average total cost of production. Quite simply, they are required by law to export all C sugar. The facts of this case do not support the EC's claim of any form of an anti-dumping instrument, blunt or otherwise.

3.11 New Zealand will now address the EC's more specific appeals regarding each element of Article 9.1(c).

1 The panel correctly concluded that there was a "payment" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*

3.12 As emphasised in New Zealand's Third Party Submission to the Panel,[16] the Appellate Body has provided clear guidance on what 'payments' means in the context of Article 9.1(c). In *Canada - Dairy* it was recalled that that the word 'payment' denotes a transfer of economic resources, and that 'payments' in Article 9.1(c)

[14] *SCM Agreement*, Article 1.1(a)(1)(iv).
[15] *European Communities – Export Subsidies on Sugar*, Third Party Submission of New Zealand, 18 March 2004 ("Third Party Submission of New Zealand"), para 2.11.
[16] *Ibid*., paras 2.03 *et seq*.

encompasses 'payments' made in forms other than money, including revenue foregone. Revenue is foregone when the price charged by the producer of the product is less than the product's proper value to the producer.[17]

3.13 The Appellate Body held in *Canada – Dairy* that in order to determine whether a payment had been made required a comparison between the price actually charged by the provider of the goods or services and "some objective standard or benchmark which reflects the proper value of the goods or services to their provider".[18] The Appellate Body found that objective standard to be the average total cost of producing the product concerned.[19] The average total cost of production reflected the product's proper value to the producer in that a failure to recoup that amount would result in the producer making losses[20] and eventually going out of business. To the extent that the producer charges prices that do not recoup the total cost of production over time, then the loss must be financed from some other source.[21] Accordingly, where a producer sells a product at less than the average total cost of production, there is a payment. Whether this constitutes an export subsidy for the purposes of Article 9.1(c) depends on the satisfaction of other elements in that Article.

3.14 In this case the Panel examined two types of payment alleged by the Complainants, payment (a) and (b). They were:

(a) payment in the form of below cost C beet sales to C sugar producers/exporters; and

(b) payment in the form of cross-subsidisation resulting from the profits made on sales of A and B sugar used to cover the fixed costs of production/export of C sugar.

[17] Report of the Appellate Body on *Canada – Dairy (21.5) I*, para 73.
[18] *Ibid*., para 74.
[19] *Ibid*., paras 81-96.
[20] *Ibid*., para 87.
[21] *Idem*.

3.15 Using the benchmark established in *Canada – Dairy* in its analysis, the Panel found that both (a) and (b) were payments under Article 9.1(c).[22] New Zealand supports fully this conclusion. The EC has not appealed the finding of the payment in (a), but has appealed the finding of the payment in (b).

(i) Payment (a): Payment in the form of below cost C beet sales to C sugar producers/exporters

3.16 The Panel began its examination of payment (a) by quoting the findings in the *Canada – Dairy* case where the Appellate Body found that "the word 'payments' embraces 'payments-in-kind'"[23] and "specifically contemplates that the export subsidy may be granted in a form other than a money payment",[24] "including revenue foregone".[25] The Panel went on to say that "[r]evenue or value may be foregone in instances when the price charged by the producer of the product is less than the product's *proper value* to the producer".[26] The Panel viewed the factual situation in *Canada – Dairy* as being relevant and similar to this case.[27] As such, the Panel was of the view that the Appellate Body's finding in *Canada – Dairy* of the average total cost of production as an appropriate benchmark to reflect a product's proper value was the appropriate benchmark to use in this case.[28] New Zealand agrees with this conclusion.

3.17 The Panel noted that there was "uncontested evidence that C beet is sold to C sugar producers at prices well below its cost of production".[29] The Panel found that there was "a payment-in-kind being made to the C sugar producers to the extent that the proper value of C beet is not reflected in its price and, hence, involves a "'payment' within the meaning of Article 9.1(c) of the *Agreement on Agriculture* by way of value

[22] Panel Report (Australia), paras 7.270 and 7.314.
[23] Report of the Appellate Body on *Canada – Dairy*, para 109.
[24] *Idem*.
[25] Report of the Appellate Body on *Canada – Dairy*, para 112.
[26] Panel Report (Australia), para 7.258.
[27] *Ibid*., para 7.262
[28] *Ibid*., para 7.264.
[29] *Ibid*., para 7.265.

foregone".[30] New Zealand agrees fully with the Panel's reasoning and conclusions on this point**.**

3.18 Significantly, while the EC argues that this finding of payment is outside the Panel's terms of reference,[31] it did not contest the reasoning behind this finding of 'payment' in its submission to the Appellate Body. The Panel made a factual finding that "the below total cost of production sales of C beet to C sugar producers involves a payment within the meaning of Article 9.1(c) of the *Agreement on Agriculture*".[32]

(ii) Payment (b): Payment in the form of cross-subsidisation resulting from the profits made on sales of A and B sugar used to cover the fixed costs of production/export of C sugar.

3.19 The Panel found that the cross-subsidisation taking place through the cumulative effect of various measures involved in the operation of the EC sugar regime enables C sugar producers to produce and sell C sugar at prices that do not cover their cost of production. It elaborated that:

> A, B or C sugar are part of the same line of production and thus to the extent that the fixed costs of A, B and C are largely paid for by the profits made on sales of A and B sugar, the EC sugar regime provides the advantage which allows EC sugar producers to produce and export C sugar at below total cost of production. For the Panel, this cross-subsidisation constitutes a payment in the form of a transfer of financial resources.[33]

3.20 The Panel's analysis of payment (b)[34] adheres to the test for establishing a 'payment' under Article 9.1(c) as articulated in *Canada – Dairy.* The fact that the producers, processors and exporters of A, B and C sugar are in some cases the same entities is of no relevance. As the Panel rightly noted, the EC sugar regime must be

[30] *Ibid*, para 7.269.
[31] EC Appellant Submission, Part II. New Zealand agrees with the conclusion of the Panel that the Parties' arguments relating to C beet are within its terms of reference.
[32] Panel Report (Australia), para 7.270.
[33] *Ibid*., para 7.310. Original footnote omitted.
[34] Panel Report (Australia), especially paras 7.299 – 7.303.

considered as a whole, since it comprises a single production line from the production and sale of A, B and C beet to the production and sale of A, B and C sugar.

3.21 New Zealand submits that the benchmark used in *Canada – Dairy* for determining whether a payment has been made in accordance with Article 9.1(c) of the *Agreement on Agriculture*, that benchmark being the average total cost of production, is relevant in this finding of payment. The EC did not challenge the use of that benchmark under the Panel's findings for payment (a). The focus of their appeal for payment (b) was on whether or not there was a transfer or resources to the sugar producers,[35] not on the use of the average total cost of production benchmark. The basis for finding a 'payment' in accordance with Article 9.1(c) is the same for payment (a) and payment (b), and the Panel's findings of a payment should accordingly be upheld. The Panel found, as a matter of fact, that producers were able to "sell exported C sugar over average variable costs but below the average total cost of production".[36] Under Article 9.1(c) 'payment' can be payment in kind by way of revenue or value foregone[37] when the price actually charged for C sugar is compared to its proper value – the total average cost of production.

3.22 The EC, in its submission to the Appellate Body, claims that payment (b) does not constitute a payment as there is no transfer of resources to the sugar producers.[38] The EC claims that the "payment identified by the Panel would be a purely notional one made by each sugar producer to itself from its own resources".[39]

3.23 There is indeed a transfer or resources here. C sugar is being exported at a price that is considerably lower than the average total cost of production. Without the transfer of resources to the production of C sugar – the cross-subsidisation to use the Panel's language – that production would not take place. Producers would not recoup

[35] EC Appellant Submission, para 170.
[36] Panel Report (Australia), para 7.310.
[37] Report of the Appellate Body on *Canada – Dairy*, para 112.
[38] EC Appellant Submission, para 170.
[39] *Ibid*., para 199.

their cost of production and they would not remain in the business of exporting sugar. There is a clear transfer of resources to the production and export of C sugar. Sugar producers would not be able to produce and export that C sugar without making a loss were it not for the transfer of resources. Whether it is called a 'transfer of resources' or 'cross-subsidisation' does not detract from the fact that C sugar is being sold at less than its average total cost of production. Hence revenue is foregone vis-à-vis the proper value and there is a 'payment'. Of course, whether or not this payment is 'on the export' and 'financed by virtue of governmental action' will determine whether it is an export subsidy under Article 9.1(c).

3.24 The EC also claimed in its Appellant Submission that there was no benefit to C sugar producers and in order to find a subsidy there needed to be a corresponding benefit.[40] A benefit is clearly not an element that needs to be considered in Article 9.1(c). The Panel was of the clear view that demonstration that a benefit existed was not required in the analysis of that Article:

> The Panel is of the view that Article 9.1(c) of the *Agreement on Agriculture* does not require the demonstration of a benefit for a measure to constitute a payment within Article 9.1(c) of the *Agreement on Agriculture.* The special nature of Article 9.1(c) is such that once an advantage or payment has been demonstrated, there is no need to prove separately that such an advantage provide "benefits" to the producers. The only additional requirements are that the advantage or payment is on export and is financed by virtue of government action.[41]

3.25 New Zealand agrees with the Panel that 'benefit' is not a necessary element to find an export subsidy within the meaning of Article 9.1(c). Nevertheless, the evidence and arguments produced by the Complainants, and the findings of the Panel clearly show that benefits do exist. Producers of C sugar are able to charge a price for their exports of C sugar below their total average cost of production and not make a loss. [42]

[40] *Ibid*., para 193.
[41] Panel Report (Australia) para 7.312.
[42] The Complainants have shown that over the eleven years to 2002/2003, export market returns from C sugar have been significantly lower than the average total production costs for C sugar. *European Communities – Export Subsidies on Sugar*, Submission of Australia to the Panel, paras 109 –111; Submission of Brazil, paras 36-41; Submission of Thailand, paras 75-76.

Also, sugar producers want to guarantee their profitable A and B quotas for the following year. In order to do so they will overestimate the amount of sugar beet they need for the following year's A and B sugar production to ensure they retain their maximum allowable quotas. The Panel noted this point saying that "failure to produce up to maximum quota levels could lead to reductions in the quotas assigned to individual processors".[43]

3.26 For these reasons, New Zealand submits that the Appellate Body should uphold the Panel's conclusion that C sugar receives 'payments' within the meaning of Article 9.1(c) of the *Agreement on Agriculture*, whether those 'payments' are characterised as the sale of C beet by producers to processors at below its cost of production or the cross-subsidisation of C sugar through a transfer or resources that results in the sale for export of C sugar at below its total average cost of production.

2 The Panel correctly concluded that the "payment" was "on the export" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*

3.27 New Zealand recalls its submission to the Panel on this issue.[44] Article 9.1(c) requires that the payments must be 'payments on the export of an agricultural product', in this case, sugar. The Appellate Body has stated that it sees no reason to consider that 'contingent on export' has a different meaning under the *Agreement on Agriculture* and the *SCM Agreement*.[45] The payments must be, to use the Appellate Body's language, "dependent" or "conditional" upon exportation of C sugar.[46] In this case the Panel emphasised that once a payment is identified, the focus is on whether that particular payment is made *on the export*.[47]

[43] Panel Report (Australia), para 7.305.
[44] Third Party Submission of New Zealand, paras 2.12 – 2.15.
[45] Report of the Appellate Body, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R ("*US-FSC*"), adopted 20 March 2000, para 141.
[46] Report of the Appellate Body, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R ("*Canada – Aircraft*"), adopted 20 August 1999, para 166.
[47] Panel Report (Australia), para 7.273.

3.28 The Panel made a careful factual assessment and found that the payment on C sugar is 'on the export' within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.[48] The key fact in the Panel's analysis was that C sugar, unless carried forward (in which case it would be reclassified and would no longer be C sugar), *must* be exported.[49] Producers of C sugar are prohibited, under threat of heavy penalty, from introducing this sugar into the domestic market. Because of this export requirement, the Panel considered that any payment to C sugar must, by its very nature, be 'on the export'.[50]

3.29 The Panel correctly placed great emphasis on the crucial fact of a legal requirement to export C sugar.[51] If C sugar is not exported, no payments are made *on the export.* The Panel emphasised that "if the producer had a choice to either sell on the EC domestic market or on the world market, the former would be more attractive, given that the EC regime delivered a domestic price of some 3.5 times the world price of A quota sugar and 2.5 times that of B quota sugar".[52]

3.30 The EC argues that as there is no requirement to produce C sugar, and producers receive returns for their A and/or B sugar production even though they make no exports, the payments cannot possibly be contingent on exports.[53] In doing so the EU is unnecessarily complicating the situation, effectively claiming that the requirement of export contingency applies to the measures that finance the payments, rather than to the payments themselves. Such an interpretation distorts the clear meaning of Article 9.1(c). The Panel untangled this confusing reasoning and correctly identified that an analysis of the wording of Article 9.1(c) clearly indicates that the emphasis of this provision is whether the actual payment is on the export, not whether the EC's price

[48] *Ibid*., para 7.322.
[49] *Ibid*., para 7.318.
[50] *Ibid*., para 7.321.
[51] *Idem*.
[52] *Idem*.
[53] EC Appellant Submission, paras 247 – 248.

support as a whole is contingent upon C sugar being exported.[54] The Panel then had no choice but to conclude that the relevant payment was on the export of C sugar.

3.31 The EC criticises the Panel's emphasis on the fact that *all* companies that produce C sugar participate in the domestic market through production of A or B sugar.[55] The EC suggests that this is irrelevant for the purpose of establishing export contingency. This criticism is misguided, as this observation misses the point that the fact that some producers do not make any exports of C sugar is irrelevant to the Article 9.1(c) analysis. What is important is that the system is set up so that when producers *do* export C sugar, there are payments on these particular exports. The Panel recognised this when it emphasised that the "requirement is not that every single producer be involved in receiving or transferring payments but rather that the system provides for or even encourages such an occurrence".[56] As the facts of the present case demonstrate, C sugar is produced and exported in plentiful quantities and there are payments 'on the export' of every tonne of that C sugar.

3.32 The EC also objects to the Panel's observations on the discrepancy between the world market price for sugar and the cost of production of C sugar, and the fact that C sugar accounts for between 11 and 22 per cent of the production of sugar, on the ground that these factors are irrelevant to the determination of export contingency.[57] This argument is without foundation. A careful reading of the Panel's report suggests that the Panel did not base its 'on the export' analysis on these issues. Instead, it noted these points to answer a suggestion by the EC that the financing below cost of production of C sugar exports had mere "incidental effects".[58] The Panel did not suggest that it was relying on these factors to form a view of 'on the export'. It is clear that the key component in the Panel's analysis was the fact that C sugar *must* be exported.

[54] Panel Report (Australia), paras 7.273 and 7.317.
[55] EC Appellant Submission, paras 248 – 249.
[56] Panel Report (Australia), para 7.319.
[57] EC Appellant Submission, paras 250 – 251.
[58] Panel Report (Australia), para 7.320.

3.33 For these reasons, New Zealand submits that the Appellate Body should uphold the Panel's conclusion that the payments on C sugar are 'on the export' within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

3 The Panel correctly concluded that the "payment" "on the export" was "financed by virtue of governmental action" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*

3.34 The Panel analysed the evidence before it and concluded that the payments in this case were indeed 'financed by virtue of governmental action' for the purposes of Article 9.1(c) of the *Agreement on Agriculture*. The Panel based this finding largely on its assessment that the EC, through EC Council Regulation No.1260/2001, controls virtually every aspect of domestic beet and sugar supply and management.[59]

3.35 The EC appeals the Panel's finding that payments of type (a) (in the form of below cost C beet sales to C sugar producers/exporters) are 'financed by virtue of governmental action'. But the EC has not appealed the Panel's finding that payments of type (b) (in the form of cross-subsidisation resulting from the profits made on sales of A and B sugar being used to cover the fixed costs of production/export of C sugar) are also 'financed by virtue of governmental action'. In reality it has no grounds to appeal in relation to either type of payment.

3.36 The Panel concluded on the evidence before it that revenues for C beet were persistently less than the average total cost of production.[60] Similarly, the Panel drew on undisputed evidence to conclude that C sugar prices have been well below the average total cost of production every year, from 1992/1993 to 2002/2003.[61] As New Zealand noted in its submission to the Panel,[62] where producers consistently sell products at less than the costs of production, they must finance that portion of their costs of production another way, or else make a loss and go out of business.

[59] *Ibid*., para 7.291.
[60] *Ibid*., para 7.265.
[61] *Ibid*., para 7.301.
[62] Third Party Submission of New Zealand, para 2.16.

3.37 In the *Canada – Dairy (21.5)* case the Appellate Body deemed it useful to break the third limb of Article 9.1(c) into its component parts – 'financed', 'by virtue of' and 'governmental action' – and analyse them separately. The Appellate Body confirmed that the words 'by virtue of' in Article 9.1(c), require a "demonstrable link" to be shown between the financing of the payments and the relevant governmental action.[63] In cases where the relevant payments are not financed directly from the public account, "there must be a tighter nexus between the mechanism or process by which payments are *financed*, even if by a third person, and governmental action".[64]

3.38 On the element of governmental action, the Appellate Body noted that the text of Article 9.1(c) did not "place any qualifications on the types of 'governmental action' which may be relevant under Article 9.1(c)".[65] The Appellate Body went on to say:

> In the original proceedings, we stated that "[t]he essence of 'government' is … that it enjoys the effective power to 'regulate', 'control' or 'supervise' individuals, or otherwise 'restrain' their conduct, through the exercise of lawful authority. In our opinion the word "action" embraces the full-range of these activities, including governmental action regulating the supply and price of milk in the domestic market.[66]

3.39 In the second recourse on implementation in the same case, the Appellate Body added the following:

> We observe that Article 9.1(c) does not require that payments be financed by virtue of government '*mandate*', or other '*direction*'. Although the word 'action' certainly covers situations where government mandates or directs that payments be made, it also covers other situations where no such compulsion is involved.[67]

3.40 In New Zealand's view the Panel in this case correctly identified a variety of 'actions' through which the EC regulates, controls and supervises its domestic sugar

[63] Reports of the Appellate Body on *Canada – Dairy (21.5) I*, para 113 and on *Canada – Dairy (21.5) II*, para 130.
[64] Report of the Appellate Body on *Canada – Dairy (21.5) I*, para 115.
[65] *Ibid.*, para 112.
[66] *Idem.*
[67] Report of the Appellate Body on *Canada – Dairy (21.5) II*, para 128.

market in a way that results in the financing of C sugar exports. These actions range from fixing high minimum prices at which A and B beet can be sold to processors and the maximum quantities of such sugar;[68] to the prescribed framework for inter-trade agreements between growers and processors;[69] to the activities of the EC Sugar Management Committee which overview, supervise and protect EC domestic sugar through, *inter alia*, supply management.[70] And, most significantly, the requirement that sugar produced in excess of the A and B quantities – C sugar – be exported (unless carried over to a subsequent year when it is no longer considered C sugar). Indeed, as the EC itself notes, the provisions "lay down a regulatory regime of great complexity, which includes many different intervention mechanisms and types of support to both the sugar producers and the beet farmers".[71]

3.41 The EC claims that the 'governmental action' in the EC beet market is less pervasive than in *Canada – Dairy*.[72] Yet it is the similarities, rather than the differences, that are striking. In *Canada – Dairy* "government agencies fix the price of domestic milk that renders it highly remunerative to producers";[73] in this case "the EC Regulation fixes the price of A and B beet that renders it highly remunerative to farmers/growers of C beet".[74] In *Canada – Dairy* "[g]overnment action… controls the supply of domestic milk through quota";[75] in this case "[g]overnment action… controls the supply of A and B beet (and sugar) through quotas".[76] In both cases financial penalties are used to ensure product destined for export is not diverted onto the domestic market. Furthermore, the EC attempts to downplay the degree of government involvement by attaching significance to the fact that "beet growers are totally free to decide whether or not to produce C beet", and that "prices… are freely agreed between

[68] Panel Report (Australia), para 7.283.
[69] *Ibid.*, para 7.284.
[70] *Ibid.*, para 7.291.
[71] EC Appellant Submission, para 60.
[72] *Ibid.*, Part VI.C.3.
[73] Report of the Appellate Body on *Canada – Dairy (21.5) II*, para 144.
[74] Panel Report (Australia), para 7.291.
[75] Report of the Appellate Body on *Canada – Dairy (21.5) II*, para 144.
[76] Panel Report (Australia), para 7.291.

growers and the sugar producers".[77] But again, the situation was precisely the same in the *Canada – Dairy* case, and similar arguments were rejected by the Appellate Body.[78]

3.42 In addition, the Panel rightly placed emphasis on the fact that the regime creates an environment in which growers/producers are encouraged to produce C beet and C sugar in order to maximise their quota value and ensure that they fill their A and B production quotas and retain those quotas in subsequent years. In the words of the Panel:

> There is also evidence that C sugar producers *have incentives* to produce C sugar so as to maintain their share of the A and B quotas as well as the ability to profit from sales of C sugar even if those prices are below the total cost of production (fixed costs plus average variable costs). […] C beet growers have an incentive to supply as much as is requested by C sugar processors with a view to receiving the high prices for A and B beet and their allocated amount of over-quota beet (or C beet).[79]

3.43 Further, the Panel found that the price of sugar in the EC domestic market is some three times the world price for sugar.[80] These high domestic prices are a direct result of EC government action which among other things: fixes high minimum prices at which A and B beet must be purchased from beet growers; provides export refunds in excess of the world price offered for exported quota sugar; and creates restrictions on the domestic market supply by way of quota assignments, strict import controls and the obligation to export out-of-quota sugar.

3.44 Crucially, the *effect* of all this governmental action is exactly the same as that in the *Canada – Dairy* case, namely, the 'financing' of payments. In *Canada – Dairy* the Appellate Body stated that "[i]n turn, it is due to this [highly remunerative] price that a significant proportion of producers covers their fixed costs in the domestic market and, as a result, has the resources profitably to sell export milk at prices that are below the

[77] EC Appellant Submission, para 281.
[78] Report of the Appellate Body on *Canada – Dairy (21.5) II*, para 147.
[79] Panel Report (Australia), para 7.288.
[80] *Ibid*., para 7.249.

costs of production".[81] The same analysis applies equally to the facts of the present case. As the Panel found, "a significant percentage of farmers of C beet are likely to finance sales of C beet below the costs of production as a result of participation in the domestic market in selling high priced A and B beet".[82]

3.45 From this it is clear that the EC regime in this case does far more than simply provide a regulatory framework which 'enables' producers to produce and sell C beet – as the EC appears to imply.[83] Like *Canada – Dairy*, the EC sugar regime "provides producers with the *resources*"[84] such that large quantities of C beet are sold year in year out at below their average cost of production. Were it not for the EC regulation of its sugar regime, C sugar would not be produced, payments to export of C sugar would not occur, and export sales of C sugar would not occur. The Panel rightly concluded that the requirement for a tight nexus between the mechanism by which payments were financed and governmental action had been amply demonstrated. This is a case where government action is indispensable to the financing of payments.

3.46 New Zealand therefore submits that the Appellate Body should uphold the Panel's conclusion that the payments on C sugar are 'financed by virtue of government action' for the purposes of Article 9.1(c) of the *Agreement on Agriculture*.

[81] Report of the Appellate Body on *Canada – Dairy (21.5) II*, para 145.
[82] Panel Report (Australia), para 7.291.
[83] EC Appellant Submission, para 268.
[84] Report of the Appellate Body on *Canada – Dairy (21.5) II*, para 147.

B The Appellate Body should grant Australia, Brazil and Thailand's appeal on the Panel's exercise of judicial economy in respect of examining claims under Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*")

3.47 In their Other Appellant Submissions Australia, Brazil and Thailand argue that the Panel should have examined claims of prohibited subsidies under Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*").[85] New Zealand supports the arguments of Australia, Brazil and Thailand that such an examination is necessary because of the potential distinct course of implementation obligations that may ensue under Article 4.7 of the *SCM Agreement*, and because of the potential right of counter measures under Article 4.10 of the *SCM Agreement.*

3.48 New Zealand supports Australia, Brazil and Thailand's request that the Appellate Body complete the analysis and find that that there are prohibited subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement,* and that they should be withdrawn without delay in accordance with Article 4.7 of the *SCM Agreement.*

3.49 For these reasons, New Zealand submits that the Appellate Body should reject the EC's counter-argument on this point, and uphold the findings of the Panel.

[85] See, for example, *European Communities – Export Subsidies on Sugar*, Other Appellant's Submission of Australia, 28 January 2005.

IV CONCLUSION

4.01 In conclusion, New Zealand has a strong systemic interest in the preservation of the WTO disciplines on agriculture negotiated during the Uruguay Round. The present appeal goes to the heart of the disciplines on export subsidies, with significant implications for Members' rights and obligations.

4.02 New Zealand considers that the Panel correctly concluded that C sugar receives 'payments' 'on the export' that are 'financed by virtue of governmental action', for the purposes of Article 9.1(c) of the *Agreement on Agriculture*. The EC's arguments against this finding are without foundation. New Zealand accordingly requests that the EC's appeal be dismissed, and the findings and recommendations of the Panel upheld.

4.03 New Zealand also supports Australia, Brazil and Thailand's appeal against the Panel's use of judicial economy in declining to make a finding in respect of claims under Articles 3.1(a) and 3.2 of the *SCM Agreement*. New Zealand requests that the Appellate Body complete the analysis and find that that there are prohibited subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement,* and that they should be withdrawn without delay in accordance with Article 4.7 of the *SCM Agreement.*