TRADE HOT TOPICS
Commonwealth

Issue No.17

WTO complaints by Australia and Brazil regarding the EU Sugar Regime

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1 INTRODUCTION

On 27 September 2002, the Governments of Australia and Brazil (the "Complainants") filed requests for consultations with the European Communities ("EC") alleging that the structure of its sugar market violates its obligations under certain agreements of the World Trade Organisation ("WTO"). If the Complainants are successful in their challenge, the EC may find itself obligated to change the nature of its sugar market in order to bring it into compliance with WTO obligations. Such changes could result in a significant reduction in price supports from which domestic and certain African, Caribbean and Pacific ("ACP") suppliers benefit.

2 THE EU COMMON MARKET ORGANISATION (CMO) FOR SUGAR

2.1 General Structure

The EU's Common Market Organisation ("CMO") for sugar has the following five principal features:

- *production quota scheme*
- *guaranteed price and intervention mechanism*
- *export refund programme*
- *production levies*
- *preferential import programme*

2.2 Quota Scheme

Under the CMO, processors are required to pay growers a guaranteed minimum beet price, and the EC will pay producers a fixed "intervention price" for a certain quantity (quota) of refined white sugar per EC Member state. National quotas are allocated to individual sugar-producing factories. There are two types of quota: A and B, the main difference being the level of the production levies applied to them. Only "quota sugar" can be sold in the EC; sugar produced in excess of quota ("C-sugar") must be exported without any export refund. Thus, the quota system acts as a limitation on the supply of sugar on the EC sugar market.

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2.3 Prices

Quota sugar in excess of EC consumption is eligible for price support through the intervention mechanism and export refunds. The "intervention price" is the price at which the EC is prepared (and obligated) to buy white quota sugar. The intervention price therefore acts as a guaranteed minimum price. It is fixed annually by the EC Council of Ministers of Agriculture based on a proposal by the Commission. Producers may either sell their surplus quota sugar to an Intervention Agency at the fixed price, or they may export it and obtain a refund of the difference between the EC intervention price and the world market price. Producers pay a levy on the production of quota sugar to cover the cost of refunding these losses.

Raw sugar and "basic beet" and cane prices are derived from the intervention price. The basic beet price guaranteed to the farmers is about 58% of the intervention price, while processors receive 42%, plus the difference between the higher EC market prices and the intervention price.

2.4 Export and Production Refunds

Under the export refund programme, surplus quota sugar and preferential sugar are exported with the support of export refunds. Losses incurred on the world market are recouped by receipt of export refunds paid out of production levy proceeds. The Commission manages this programme by deciding weekly on the refund rates based on offers made by sugar traders and taking into account the world price of sugar and the total quantity of sugar that might qualify for refunds during the marketing season. Approved export refunds will never exceed the maximum export refund, which is equal to the intervention price (plus storage and shipping costs), minus the export price obtained on the world market.

In addition, the EC makes available to domestic chemical and pharmaceutical producers "production refunds" in connection with their use of highly priced sugar products as raw materials. The production refund level is derived from the average of the awarded export refunds and fixed on a quarterly basis.

2.5 Production Levies

The EC charges producers "production levies" that are intended to recover from the sugar industry the cost of the export refunds and production refunds. Thus, the export refund support system is "self-financing" and therefore, arguably, not a direct subsidy from the EC. The levies are paid by the sugar producers who reclaim 58% of the levy from the farmers by a discount on the beet price.

Each Member State has a national Paying Agency and Intervention Agency that collects the production levies, pays the export refunds and buys the sugar at the intervention price, should it be offered to them. In practice, there has only been one intervention purchase (by a German Intervention Agency in the mid-eighties). Apparently, the option of exporting surplus quota sugar with the support of export refunds is more attractive than selling the sugar to an Intervention Agency.

2.6 Preferential Import Programme

The UK has historically imported large quantities of raw cane sugar from ACP countries for refining in the UK. When the UK joined the EC, provision for importation of sugar from the ACP countries was incorporated into the 1975 EC/ACP (IVth Lomé) Convention and embodied in the CMO. This protected the interests of the UK refiners and supplying countries, and ensured that supply channels were not disrupted. Under the 8th Protocol (Sugar Protocol) to the Convention, the EC guarantees that it will buy annually a fixed quantity of white sugar equivalents from the ACP countries for an indefinite period. These imports are exempt from import duties. India was also added to the list of countries for preferential treatment. This imported sugar is referred to as "preferential sugar".

Prices to be paid for preferential sugar are negotiated annually between the EC and the ACP countries. Under the Sugar Protocol, the price is to be "within the price range obtaining in the Community, taking into account all relevant economic factors". In practice, the price for ACP raw cane sugar has always been equivalent to the intervention price for EU-produced raw sugar, and the guaranteed price of white sugar has been equivalent to the derived intervention price in the UK. The EC guarantees that price and is prepared to buy through the Intervention Agencies in case no other buyer is prepared to buy at the guaranteed price (which has never happened). In practice, therefore, the ACP countries receive the same guaranteed price as Community sugar producers.

3 BASIS FOR WTO COMPLAINTS

The Complainants present two main claims: firstly, that the EC has provided export subsidies in excess of its WTO commitments, and secondly, that the provision of a guaranteed intervention price is a violation of the national treatment obligation in that it is available only to EC producers. Little elaboration is provided in the request for consultations, and we can only surmise that the following is the approach that Brazil and Australia will pursue in potential dispute settlement proceedings.

3.1 Export Subsidies in Excess of Commitments

The Complainants assert that under the CMO for sugar the EC is, in two regards, providing export subsidies for sugar that exceed the reduction commitment levels set out in its Schedule. First, they claim that the *CMO for sugar, its intervention price system and regulatory mechanism*, taken as a whole, enable producers to export C-sugar at prices below the total cost of production. They argue that by guaranteeing a high domestic price for A-quota and B-quota sugar, the EC is subsidising exports of non-quota C-sugar on the world market, in excess of its reduction commitments.

Secondly, they claim that the "*export refunds*" provided to producers in relation to surplus A-quota and B-quota sugar are export subsidies in excess of the export subsidy reduction commitments of the EC. In support of these assertions, they cite certain provisions of the WTO Agreement on Agriculture, the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") and the GATT 1994.

3.1.1 SCM Agreement

Without demonstrating that the measures at issue are export subsidies, or subsidies at all, the Claimants cite Articles 3.1 and 3.2 of the SCM Agreement, which prohibit subsidies that are contingent upon export performance. A footnote to Article 3.1(a) makes clear that factual, as opposed to legal, contingency may suffice[2]. Importantly, however, Article 3.1 is expressly subject to the provisions of the Agriculture Agreement, which apply to agricultural products, including sugar, by reason of Article 2 and Annex I on Product Coverage. The Agriculture Agreement therefore supersedes the prohibition on export subsidies under the SCM Agreement.

The Complainants also contend that the alleged export subsidies are not exempt from challenge under Article 3 of the SCM Agreement, by reason of the "Peace Clause" in Article 13(c) of the Agriculture Agreement. This clause imposes restraints on countervailing duty actions against export subsidies and exempts them from actions under Article 3, 5 or 6 of the SCM Agreement during the implementation period, which expires at the end of 2003. Brazil claims that the Peace Clause does not apply because the alleged export subsidies do not "conform fully to the provisions of Part V of the Agriculture Agreement", based on the level of subsidies exceeding scheduled commitments.

3.1.2 Agriculture Agreement

In the WTO Agreement on Agriculture, Members have undertaken to *reduce* export subsidies and, further, that they will not provide export subsidies except in accordance with the Agreement and the commitments as specified in each Members' Schedule[3]. Article 8 is the basic foundation for the Claimants main claim.

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[2] FN 4: *"This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision."*

[3] Agreement on Agriculture - Article 8: *"Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule."*

3.1.2.1 Definition

The Agriculture Agreement does not define "subsidy". Article 1 of the SCM Agreement, which defines "subsidy" for the purposes of *that* agreement, deems a subsidy to exist if there is any form of income or price support (Article 1(a)2)…and (b) a benefit is thereby conferred. If Article 1 of the SCM Agreement applies to these claims, the first question is whether the CMO on sugar, or the export refund, even if they amount to price support, confer a benefit. If so, and they are therefore "subsidies", are they "export" subsidies?

"Export subsidies" are defined in Article 1(e) of the Agriculture Agreement as "subsidies contingent on export performance, including the export subsidies listed in Article 9 of this Agreement". This corresponds generally to the description of the prohibited subsidies in SCM Article 3.1, except that it includes no sub-text in relation to legal or factual contingency. Although that provision may be subordinated to the Agriculture Agreement, it is possible that a WTO panel might seek to harmonise the agreements in regard to the definition, thus adopting the standard of actual or anticipated contingency as a means of determining whether export subsidies exist.

With respect to the system as a whole, neither Brazil nor Australia identify precisely which element of the "intervention price system" is the benefit conferred, or how the alleged subsidisation of C-sugar is contingent upon export performance. From one perspective, the EC has never, with the exception of one incident, provided any intervention payment to producers, and EC market prices sustain themselves. This is not a government payment scheme: consumers pay the high prices. Neither is it clear that the industry-financed export refund, which *is* contingent upon export, is a benefit conferred by the government. Taken in isolation, the export refund regime may be interpreted as not price support at all, but a voluntary insurance fund to cover losses incurred by the industry.

3.1.2.2 Export subsidies subject to reduction

Certain types of export subsidies are positively identified, in Article 9.1 of the Agriculture Agreement, as being subject to reduction commitments. These are largely *direct* export subsidies, which are considered to cause the most distortion. The Claimants point to those export subsidies defined in sub-paragraphs (a) and (c) of Article 9.1[4].

Article 3.3 of the Agriculture Agreement states that a Member cannot provide these types of export subsidies in regard to any agricultural products or groups of products that are not specified in Section II of Part IV of the Member's Schedule. It may only provide Article 9.1 export subsidies in relation to those particular agricultural products/groups of products set out in its Schedule, and only to the extent of the budgetary outlay and quantity commitment levels specified therein.

3.1.2.3 Non-circumvention of export subsidy commitments

Article 10 of the Agriculture Agreement requires that "other" export subsidies, those not listed in Article 9.1, shall not be applied in such a way as to circumvent the export subsidy commitments. The fact that the Complainants rely on this provision implies that they may wish to demonstrate that the CMO in sugar amounts to another type of export subsidy, perhaps not as well-defined as those listed in Article 9.1, that allegedly circumvents the commitments of the EC. This view is supported by the fact that they have also cited provisions of Article XVI of GATT 1994, which contains references, in paragraphs 3 and 4, to the concept of indirect subsidisation. Those provisions also denounce the notion that any subsidy should result in a WTO Member having more than an equitable share in the world export trade in the subsidised product.

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[4] Agriculture Agreement - Article 9.1(a) and (c)

"*1. The following export subsidies are subject to reduction commitments under this Agreement:*

(a) the provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance;

(c) payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived;"

Most of the relevant obligations in Article XVI of GATT 1994 have been elaborated upon in the SCM Agreement, but WTO dispute settlement panels are still obliged to apply them along with the Uruguay Round agreements, including the SCM Agreement, whenever such application is possible and does not raise a conflict.

3.1.3 Conclusion

The success of the claim, that export subsidies have been applied in excess of commitments of the EC, will depend on a persuasive argument that the overall effect of domestic price support, exports of surplus quota sugar with refunds, and exports of C sugar should be considered together and that the cumulative effect is a form of indirect subsidisation that is not in keeping with the spirit of the Agreement. To support this claim, the concept of export subsidies subject to reduction in the Agriculture Agreement will have to be construed much more broadly than the express provisions appear to dictate. Notably, the other factors in play in the system, the special safeguard measures keeping out non-preferential sugar imports and preferential arrangements with the ACP countries have not been directly challenged by Brazil and Australia in these requests.

3.2 Intervention Price Constitutes a National Treatment Violation

The second main argument put forward by the Complainants is that the guarantee of a fixed Intervention Price for in-quota sugar sold in the EC is a violation of Article III of the GATT, because it is only available to EC producers, thus affording imported products less favourable treatment. Article III of the GATT has been considered at length in the history of the GATT and the WTO and extensive analysis would be necessary to thoroughly assess whether there is legal foundation to this claim. Whatever its technical merits, however, the claim is of little practical importance, given that almost all non-preferential sugar imports are excluded from the EC market by 140% tariffs. The only significant imports are those imported on a preferential basis, which enter free of tariffs and receive what is in effect the guaranteed intervention price. In the absence of a challenge against tariffs, non-tariff barriers and MFN, Brazil and Australia will benefit little from a national treatment claim.

4 POLICY ARGUMENTS IN SUPPORT OF COMPLAINTS

The policy arguments in favour of the complaints by Australia and Brazil are persuasive from both a trade and a development perspective. From a trade policy perspective, principles embodied in the WTO and other trade agreements disfavour the use of subsidies as an instrument of trade policy, particularly where they are directly related to exports. The basis for this relates to the distortions that such subsidies cause in otherwise competitive markets. In this case, EU export-contingent subsidies for sugar are alleged to be the cause of substantial declines in the world market price for sugar to levels below the cost of production for the most efficient producers. Such distortions and the inefficiencies that they cause are the basis for the prohibitions on export subsidies in trade agreements.

In addition to basic trade policy objections to the EU's sugar regime, substantial development-based objections have been raised, both by WTO Members and by non-governmental organisations ("NGOs"). For example, Oxfam prepared a briefing paper on "The Great EU Sugar Scam", in which it set forth its unequivocal views on the cover:

> "European consumers and taxpayers are paying to destroy livelihoods in developing countries. Under the Common Agricultural Policy (CAP), the EU has emerged as the world's largest exporter of white sugar. Subsidies and tariffs generate vast profits for big sugar processors and large farmers - and vast surpluses that are dumped on world markets. Smallholder farmers and agricultural labourers in poor countries suffer the consequences. Oxfam is calling for an immediate end to EU sugar exports and improved market access for the poorest countries."

As discussed below, however, certain ACP countries rely heavily on the EU regime to support their economy. Oxfam considers that those benefits accruing to certain ACP countries are unjustified, however, because "almost 80 per cent of the benefits accrue to just five of them - Mauritius, Fiji

Islands, Guyana, Swaziland and Jamaica - none of which are least developed countries." It also argues that the preferential access accorded to these ACP countries has:

- "limited the opportunity for these ACP countries to add value to their commodity exports and create their own white sugar brands" and
- "led several countries to have a high degree of dependence on exports of raw sugar cane."

Essentially, other WTO Members and certain NGOs consider that sacrificing the interests of certain developing ACP countries, at least in the short term, is acceptable in order to improve the situation for a larger group of developing and least developed countries that are not benefiting under the current EU regime. It is obvious that Australia and Brazil support their WTO complaints because it is in the interests of their sugar producers and exporters, but they have not paired this self-interest with any proposals about how to address the adverse consequences, whether intended or unintended, on a number of ACP countries. Certain NGOs similarly ignore or otherwise marginalize the interests of these ACP countries by failing to understand the magnitude of the irreversible damage that would be caused.

It would appear warranted for the Complainants and interested NGOs to evaluate how to address the specific consequences of succeeding in a WTO challenge prior to moving forward and to present proposals now for addressing the potentially catastrophic effects of a successful WTO case on a number of ACP countries.

5 IMPACT ON ACP COUNTRIES

For certain ACP countries, the consequences of a successful case that results in the removal or substantial lowering of the guaranteed price for the purchase of ACP raw cane sugar could be catastrophic in the short term.

For example, as reported by the EC's Court of Auditors, Mauritius benefits the most out of all ACP countries in the preferential structure of the EC regime. Approximately 95 percent of all 1998 sales were conducted under the EC's Sugar Protocol. A substantial decline in the prices guaranteed to raw sugar cane originating in Mauritius, in favour of cheaper exports from Australia and Brazil, would have disastrous effects on the local economy and societal welfare generally.

More generally, the benefits of the EU's preferential sugar regime are estimated at Euro 500 million per year compared to the earnings available on the world market. Most of the benefits of the sugar regime accrue to only a few developing countries, including Fiji, Guyana, Jamaica, Mauritius, and Swaziland. Thus, the impact on these countries of a successful challenge by Australia and Brazil would be to destroy their primary source of income.

Although it may be the case that these five economies, as well as several other developing and least developed ACP countries, focus too narrowly on a single crop, the type of systemic changes necessary to transform their economies will take decades. The effects of the reforms in the EU market, however, are likely to be immediate and catastrophic.

6 THIRD PARTY PARTICIPATION IN WTO PROCEEDINGS

Based on the significant adverse effects described above, those ACP countries that are also WTO Members may determine that it is in their interests to participate directly in the WTO case. Because the countries would essentially be supporting the EC's defence of the case, their role would be limited to joining in consultations, if permitted, and participating as a third party in any dispute panel and/or Appellate Body proceedings.

6.1 Joining Consultations

Article 4.11 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") provides for the participation of third party countries in consultations. In general, for a WTO Member to participate in consultations in the dispute involving the EU sugar regime, it must:

(1) consider that it has a substantial trade interest in the consultations between the EU and the Complainants;

(2) notify the EU, the Complainants, and the WTO's Dispute Settlement Body ("DSB") by Friday, 11 October 2002; and

(3) ensure that the EU agrees that the third country's claim of substantial interest is "well-founded" and informs the DSB accordingly.

The previous section on the impact of a successful case appears to provide ample support for certain ACP countries to satisfy the above conditions for consultations. As a legal matter, the only condition effectively outside the control of these countries is the final condition of obtaining the EU's consent for the countries to join consultations.

In the past, WTO Members have refused to grant this consent, although only in unusual and highly controversial cases and/or where the countries denied consent were supporting the complainants. For example, as part of the lengthy dispute settlement proceedings challenging the EU's banana regime, the EU requested WTO consultations regarding the U.S. approach to retaliation following an adverse panel and Appellate Body decision, the so-called "carousel".[5] The United States refused to allow Australia, the Dominican Republic, Jamaica, Japan, and Saint Lucia to join consultations, relying on the discretion accorded to the defending Member under DSU Article 4.11 and on its view that such countries did not have a substantial trade interest in the dispute. The EU was especially critical of the U.S. action and thus is unlikely to refuse requests from the ACP countries, especially as they are supportive of its defence.

Therefore, the first step for ACP countries that would be adversely affected by a successful challenge to the EU sugar regime or that would otherwise be affected by any reform to such regime is to request immediately to join consultations under DSU Article 4.11.

6.2 Third-Party Participation Before a Panel and/or the Appellate Body

Assuming consultations fail to resolve the dispute and the Complainants decide to request the establishment of a WTO dispute settlement panel, ACP countries may decide to participate in the panel proceeding as a third party. DSU Article 10.2 enables third-party WTO Members to notify the DSB and participate in the proceedings where they have a substantial interest in the matter before the panel. Unlike in consultations, DSU Article 10.2 does not accord any discretion to the defending Member(s) or the Complainants to prevent other WTO Members from participating in the proceedings as third parties. Thus, ACP countries that may be adversely affected by a successful challenge to the EU sugar regime have the right, as WTO Members, to participate in the panel proceedings. A similar right exists if a panel's findings are appealed to the Appellate Body.

7 CONCLUSION

Australia and Brazil have initiated the first formal step in WTO dispute settlement proceedings by requesting consultations with the EC regarding its sugar regime. The precise nature of the Complainants' claims remains unclear, although they clearly target the EC's mechanisms for ensuring relatively higher prices for EU-origin sugar beets and for preferential imports of raw cane sugar. If the Complainants are successful, the EC may decide to reform its sugar regime in a manner that reduces or eliminates the price supports for the purchase of preferential imports of raw cane sugar. Such a result would be catastrophic for certain ACP countries that rely almost exclusively on the EC market for sales of their raw cane sugar.

Although the Complainants and certain NGOs have voiced strong opposition to the EU sugar regime on trade and development grounds, they have not shown sufficient concern about the effects of reforms on

[5] See, e.g., United States - Section 306 of the Trade Act of 1974 and Amendments Thereto, WT/DS200.

those developing and least developed ACP countries that rely on the regime almost exclusively to support their countries. Certainly, the benefits to reforming the EU sugar regime for the Complainants and other producing countries should be balanced against the significant and irreversible harm that may be caused to certain ACP countries. The focus moving forward should be on achieving such a balance through comprehensive negotiations in the context of the Doha Development Agenda among all interested parties rather than on a resource-intensive WTO dispute on the technical details of the EU regime.

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Produced by the Economic Affairs Division of the Commonwealth Secretariat.
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