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SPAIN - MEASURES CONCERNING DOMESTIC
SALE OF SOYABEAN OIL

United States: Comments to the Report of the Panel

The following communication dated 19 June 1981, has been received from the United States Trade Representative, with the request that it be circulated to contracting parties.

COMMENTS ON THE SOYBEAN PANEL REPORT

The Delegation of the United States wishes to bring to the attention of the CONTRACTING PARTIES certain fundamental issues of GATT interpretation contained in the Report of the Panel concerning the U.S. complaint against Spanish restrictions on the domestic sale of soyabean oil (L/5142). The United States appreciates the action of the Council in establishing the panel to examine the matter and the efforts of the panel to promote a mutually satisfactory bilateral resolution of the dispute. It is regrettable that such a settlement was not achieved.

However, the United States believes that the GATT Council should not adopt the Report of the Panel in this case. That Report interprets important GATT provisions in a manner which the United States believes, for the reasons discussed below, are inconsistent with the language, intent and practices of the GATT.

The United States considers that the issues of principle involved are far more important than the immediate trade consequences of the Spanish measures that were in dispute. We therefore ask the Contracting Parties to focus on these issues, and we will not ask the CONTRACTING PARTIES to make recommendations to Spain with respect to this proceeding.

The United States would not consider it sufficient merely to note U.S. disagreement with interpretations in the report. We believe Contracting Parties should carefully examine the issues and avoid establishing precedents for the interpretation of GATT that are harmful to the GATT system.

I. SUMMARY OF ISSUES

The United States disagrees with each of the following interpretations of GATT provisions contained in the Panel Report:

1. The Panel found that internal regulations that protect domestic production could not be considered contrary to Article III:1 unless it were demonstrated the regulations had adverse effects on imports of directly competitive products. The United States believes that proof of damage is not required to demonstrate that a measure is inconsistent with Article III:1. In accordance with GATT practice, the question of trade damage

is not relevant in determining whether a measure is contrary to Article III of the GATT, but is relevant in determining the extent of compensation owed.

2. The panel found that the prohibition against internal quantitative limitations in the second sentence of Article III:5 does not apply if the limitations are imposed on an imported product after it has been through a stage of domestic processing, even in cases where such processing is essential to the commercial use and value of the imported product, where there is no substantial domestic production of the product, and where the processing involves the addition of no other ingredient. The United States believes that such quantitative limitations are subject to the obligations of Article III:5 and are not exempted under the interpretative note ad Article III:5.

3. The panel found that the term "like product" as used in Article III:4 means "more or less the same product." The United States believes such a definition is too narrow. Moreover, in past cases under the dispute settlement process, the CONTRACTING PARTIES have followed a pragmatic approach, examining the specific factors of each particular case, and have avoided a general definition of "like products."

II. BACKGROUND

The following summary of factual aspects of the dispute may be helpful in examining the GATT interpretations at issue.

The dispute between the United States and Spain arises from Spain's internal quota on the quantity of soybean oil which may be sold on the domestic market. The quota was established for the purpose of protecting the Spanish olive sector. That quota has been set at progressively lower levels over the last five years. No quantitative limitations are imposed on the domestic sale of any other vegetable oil. While Spanish imports of soybean oil are small, large quantities of soybeans are imported and then processed into meal and oil. Less than one percent of Spain's soybean supplies are produced domestically. Because domestic sales of soybean oil are restricted, most of the soybean oil derived from imported beans must be exported. As a result, soybean oil has been reduced from 35 percent of Spanish vegetable oil consumption in 1967-68 to 12 percent in 1980-81. Spanish exports of soybean oil rose from 4000 metric tons to 375,000 tons over the same period.

The quota on soybean oil is expressly intended to protect Spanish production of olives and olive oil, though another practical effect has been a considerable growth in Spanish sunflower seed production and sunflower oil consumption. We noted that soybeans have no commercial use or value other than for processing into two products, oil and meal.

At the request of the United States, the GATT Council established a Panel to examine the complaint (L/4859). Before the panel the United States argued that Spanish consumption quotas on soybean oil violate GATT Article III because they discriminate against the imports of beans from which the oil is derived. In addition, the quotas impair the trade concession the U.S. obtained from Spain on soybeans, because the duty was bound to the United States at a five percent ad valorem on the reasonable expectation that there would be no interference by Spain with then existing competitive conditions for the processing and sale of soybean products. In fact, however, restrictions on domestic consumption of soybean oil resulted in Spain becoming the world's third largest exporter of soybean oil. Spain conceded it was protecting its domestic olive sector, but argued that the obligations of Article III did not apply to Spanish restrictions on soybean oil because soybean oil obtained from imported beans crushed in Spain is a domestic product.

The Panel concluded that the Spanish measures were not inconsistent with the provisions of GATT invoked by the United States but did not exclude the possibility (paragraph 4.14 of the Report) that the measures would displace United States exports of soybean oil in traditional markets and thus be nullifying or impairing United States benefits under the GATT.

III. ELABORATION OF U.S. VIEWS

A. The United States believes that with respect to Article III:1 it is not necessary to show adverse or restrictive effects on imports of directly competitive or substitutable products to establish that a measure conceded to protect domestic production is inconsistent with the provisions and principles of Article III:1.

Article III sets forth important GATT rules pertaining to discriminatory internal taxes and regulations. Paragraph one of that Article establishes the general rule:

The contracting parties recognize that internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specific amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

The Panel concluded that the Spanish measures were not inconsistent with Article III:1 because the panel considered that the measures had not restricted imports of U.S. soybeans. Paragraph 4.2 of the Panel Report states the Panel's interpretation that "regulations or requirements applied to imported or domestic products and which afforded protection to domestic production had to have adverse effects on directly competitive or substitutable imported products in order to be contrary to the provisions of Article III, paragraph 1."

After finding that the measures protected domestic production of olive oil, the Panel then examined whether Spanish imports of U.S. soybeans had been "restricted or limited" as a result of the Spanish measures (paragraph 4.3). Finding that such imports had in fact increased, the panel concluded the Spanish measures "had not had restrictive effects" on such imports, and "consequently" concluded that the consumption quota was not inconsistent with paragraph III:1.

The United States believes that it is clear from the language and history of Article III:1 that it is not necessary to demonstrate a decline in imports of a directly competitive or substitutable product to establish that a measure that is found to protect domestic production is inconsistent with the provisions of Article III:1.

The language of Article III:1 contains no reference to adverse or restrictive effects on imports, let alone to measuring such effects by import volume. The proscription is against measures applied "so as to afford protection to domestic production." By their own terms, the Spanish measures were intended to afford protection to the Spanish olive sector (paragraph 2.9 of the Report), and the Panel further found the measures protected domestic production of olive oil. There is no additional requirement in Article III:1 that such protection be evidenced by declining imports of a competing imported product.

To require, in effect, a showing of injury to imports as a condition of demonstrating an inconsistency with Article III:1 is contrary to long-standing interpretation of most GATT obligations. The standard rule of interpretation, most recently restated in the framework agreement (the Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance), is that the question of trade damage arises only after a determination whether a measure is inconsistent with a rule of GATT. If a measure is inconsistent with a specific provision of GATT, then the presumption is that it will have an

adverse impact on other contracting parties, and it is up to the party maintaining the measure to rebut the presumption. Degree of trade damage can also be relevant in determining what compensatory action will be authorized if a party declines to comply with its obligations.

The drafters of the GATT were explicit in those unusual instances in which injury or adverse effects were intended to be an element of a GATT provision. For example, the GATT specifically requires a finding of "material injury" for antidumping and countervailing duty actions under Article VI, and authorizes safeguard actions under Article XIX only in cases of "serious injury." Since it is evident that the drafters of GATT were able to provide a damage test explicitly where one was intended, by inference the lack of such language must be taken as evidence that no such test was intended for Article III:1.

The precedent for Article XXIII cases under GATT supports the view that proof of damage to imports is not necessary to establish a violation of Article III. For example, in an early GATT working party reviewing Brazilian taxes under Article III:2 (II BISD, page 181), the majority considered that neither demonstration of damage to other parties nor the level of imports from contracting parties was relevant in determining whether a measure conformed with Article III:2.

A case more directly in point involved EEC measures on animal feed proteins (BISD, 25th supp., 49, L/4599 (1978)), in which the Panel examined, inter alia, "the consistency of the EEC regulation as an 'internal quantitative regulation' with the provisions of Article III:1, particularly as to whether the regulation afforded protection to domestic production." The EEC measures in effect required the purchase of domestically produced skimmed milk powder for use in feedingstuffs as a condition of importation or domestic production of vegetable proteins. The objective of the measures was to allow for increased utilization of denatured skim milk powder as a protein source for use in feedingstuffs for certain animals with the stated purpose of reducing the surplus stock of such domestically produced powder held by governmental intervention agencies.

The EEC argued that the measures had not had the effect of restricting imports. On the contrary, the EEC asserted that imports of protein-based products had increased during the period the measures were in effect (BISD, 25th supp., p. 56). Despite the EEC arguments regarding lack of trade damage and lack of protective intent, the Panel concluded that regulations to ensure the sale of a given quantity of domestically produced skimmed milk powder protected this product contrary to the principles of Article III:1 and 5.

In short, the Panel in the animal feed proteins case rejected precisely the argument that the Panel in this case considered dispositive, i.e., that restrictive effects on imports had to be demonstrated and that increases in imports showed there was no protection of domestic production.

B. With respect to Article III:5, the United States believes internal quantitative limitations are not exempt from the obligations of Article III:5 merely because limitations are imposed on an imported product only after domestic processing, at least in those cases where the imported product has no commercial use in an unprocessed state and requires the addition of no other ingredient for processing and where there is no substantial domestic production of the imported product.

The second sentence of Article III:5 provides that "no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1." This sentence of Article III:5 thus establishes, by reference to Article III:1, a binding obligation not to apply quantitative regulations to imported or domestic products so as to afford protection to domestic production. The only exception to this rule is that provided by interpretative ad Article III:5 which states:

Regulations consistent with the provisions of the first sentence of paragraph 5 shall not be considered to be contrary to the provisions of the second sentence in any case in which all of the products subject to the regulations are produced domestically in substantial quantities.

The Panel found that the Spanish measures fell within the exception in ad Article III:5 because "all of the products subject to the Spanish measures and in particular soybean oil were produced domestically in substantial quantities" (paragraph 4.5). This finding presumably constituted an independent basis for the Panel's conclusion that the Spanish measures were not inconsistent with Article III:5.

Such an interpretation exempts from the obligations of Article III:5 quantitative limitations imposed on domestic consumption of a commodity after it has been through domestic processing essential to its use and commercial value, even in cases where there is no substantial domestic production of that commodity and where the processing requires the addition of no other ingredients. Clearly, this interpretation of ad Article would permit similar consumption restrictions to be placed on oils derived from such oilseeds as cottonseeds, flaxseeds, rapeseeds, sunflowerseeds, and peanuts, regardless of the protective effect on domestic production.

The potential ability of a country to circumvent the principle of non-discrimination embodied in Article III through use of this interpretation is evident if one considers the following hypothetical situation. Country A processes domestically both oranges and apples into juice. Country A produces apples, but no oranges and has granted a concession on orange imports to country B. Country A then imposes a quantitative restriction on the sale of orange juice while imposing no restriction on apple juice. Clearly the effect of this measure is to protect domestic production of apples vis-a-vis imported oranges. Under the Panel's interpretation of article III:5, a restriction of this type would be permissible regardless of its protective effect. Similar examples could be provided with respect to a host of other raw materials whose processing is essential to their commercial value as traded commodities.

The United States does not believe that such an interpretation was ever intended with respect to Article III:5 and the interpretative note ad Article III:5. Article III:5 bans the use of internal quantitative regulations to afford protection to domestic production. The acknowledged intent of the Spanish internal quantitative regulation is to protect domestic production of olives and olive oil.

The purpose of the exception stated in the ad Article is to exempt cases in which the regulation, because its effects are felt upon domestically produced, as well as imported products, is deemed to be non-protectionist and non-discriminatory. However, where the regulation applies to one product derived through simple processing from an imported raw material which is not produced domestically in substantial quantities, but does not apply to another product which is derived from domestically produced raw materials, the effect of regulation is to discriminate against imports in a manner which affords protection to domestic production. Thus, the exception set forth in the ad Article should not apply.

In view of the foregoing and in terms of Article III:1 and 5, the United States believes that soybeans must be considered subject to the Spanish internal quantitative regulations which restrict their full and normal use. The Spanish regulations constitute internal quantitative limitations on the commercially necessary use of soybeans so as to afford protection to Spanish domestic production of olives and sunflower seeds.

Indeed, the Spanish regulations by their own terms are intended to provide "basic protection to the olive sector..." (Paragraph 2.9 of the Panel Report). It is essential to the realization of the commercial value of soybeans that they be processed into their basic components - oil and meal. Regulation of soybean oil is, therefore, tantamount to regulation of soybeans, of which Spain has no substantial domestic production. Therefore, such quantitative regulations are clearly proscribed by Article III:5.

In summary, the United States believes that the contracting parties should not adopt an interpretation of Article III:5 that represents a fundamental departure from the language and spirit of Article III:5 by allowing internal quantitative limitations to protect domestic production from external competition whenever the limitations are imposed only after a stage of domestic processing essential to the commercial use of the imported product.

C. The United States believes that for purposes of Article III:4, the definition of "like product" is not "more or less the same product."

Article III:4, which requires that imported products be treated no less favorably under certain internal regulations than "like products" of national origin, provides:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

Paragraph 4.6 of the Panel Report states that "in past GATT practice" the term "like products" has been given a "narrow definition" meaning "more or less the same product." The United States believes that no such definition in fact has been established, either by the preparatory committees to the GATT or by past working parties and Panels that have examined the issue.

Where a determination whether products are "like" has been essential to resolution of a dispute, the GATT practice has been to proceed on a case-by-case basis, examining all relevant factors, including the nature of the product and the purpose of the GATT provision in question. For example, in the animal feed protein case the Panel considered "such factors as the number of products and tariff items carrying different duty rates, tariff findings, the varying protein contents and the different vegetable, animal and synthetic origins of the protein products..." (BISD, 25th supp., p. 64). Similarly, in the recent case of Spanish tariff treatment of unroasted coffee (L/5135), the Panel, before making its decision, examined the tariff treatment Spain and other GATT members accorded to unroasted coffee and the arguments for that treatment, the manner in which unroasted coffee is sold, and its end use.

The United States believes that, given the difficulties inherent in defining "like product," the practice of case-by-case examination has been wise. Regardless of the appropriate result of such an examination in this case under Article III:4, and without any attempt to formulate an alternative definition, we believe that the contracting parties should continue to construe the term "like product" on a case-by-case basis and that they should not adopt an interpretation that "like product" is defined as "more or less the same product."

IV. CONCLUSIONS

For the reasons discussed above, the United States believes that the CONTRACTING PARTIES should not adopt the Panel Report. In the view of the United States, each of the interpretations discussed above constitutes an independent basis for not adopting the Report. It would be contrary to GATT practice and understandings to adopt the Panel's interpretation that restrictive effects on imports must be demonstrated to establish that a measure is contrary to Article III:1. With respect to Article III:5, the Panel's findings would create a significant loophole for internal restrictions to be imposed on imported products that must be processed in order to have commercial value. With respect to Article III:4, the United States believes it is not correct that in past GATT practice the term "like product" has been narrowly defined to mean "more or less the same product," and we believe that the CONTRACTING PARTIES should not adopt such a definition now.

Each of these three interpretations would create an undesirable new precedent for the GATT system, undermining the important objective of providing that imported products, after entering the customs territory of a contracting party, will have equal competitive opportunities vis-a-vis domestic products. The United States would hope that other CONTRACTING PARTIES will agree that the Report should therefore not be adopted.