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1 ARTICLE 9

1.1 Text of Article 9

Article 9

Export Subsidy Commitments

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;
- (b) the sale or disposal for export by governments or their agencies of non-commercial stocks of agricultural products at a price lower than the comparable price charged for the like product to buyers in the domestic market;
- (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;
- (d) the provision of subsidies to reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services) including handling, upgrading and other processing costs, and the costs of international transport and freight;

- (e) internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments;
- (f) subsidies on agricultural products contingent on their incorporation in exported products.

2. (a) Except as provided in subparagraph (b), the export subsidy commitment levels for each year of the implementation period, as specified in a Member's Schedule, represent with respect to the export subsidies listed in paragraph 1 of this Article:

- (i) in the case of budgetary outlay reduction commitments, the maximum level of expenditure for such subsidies that may be allocated or incurred in that year in respect of the agricultural product, or group of products, concerned; and
- (ii) in the case of export quantity reduction commitments, the maximum quantity of an agricultural product, or group of products, in respect of which such export subsidies may be granted in that year.

(b) In any of the second through fifth years of the implementation period, a Member may provide export subsidies listed in paragraph 1 above in a given year in excess of the corresponding annual commitment levels in respect of the products or groups of products specified in Part IV of the Member's Schedule, provided that:

- (i) the cumulative amounts of budgetary outlays for such subsidies, from the beginning of the implementation period through the year in question, does not exceed the cumulative amounts that would have resulted from full compliance with the relevant annual outlay commitment levels specified in the Member's Schedule by more than 3 percent of the base period level of such budgetary outlays;
- (ii) the cumulative quantities exported with the benefit of such export subsidies, from the beginning of the implementation period through the year in question, does not exceed the cumulative quantities that would have resulted from full compliance with the relevant annual quantity commitment levels specified in the Member's Schedule by more than 1.75 percent of the base period quantities;
- (iii) the total cumulative amounts of budgetary outlays for such export subsidies and the quantities benefiting from such export subsidies over the entire implementation period are no greater than the totals that would have resulted from full compliance with the relevant annual commitment levels specified in the Member's Schedule; and
- (iv) the Member's budgetary outlays for export subsidies and the quantities benefiting from such subsidies, at the conclusion of the implementation period, are no greater than 64 percent and 79 percent of the 1986-1990 base period levels, respectively. For developing country Members these percentages shall be 76 and 86 percent, respectively.

3. Commitments relating to limitations on the extension of the scope of export subsidization are as specified in Schedules.

4. During the implementation period, developing country Members shall not be required to undertake commitments in respect of the export subsidies listed in subparagraphs (d) and (e) of paragraph 1 above, provided that these are not applied in a manner that would circumvent reduction commitments.

1.2 Article 9.1

1.2.1 "governments or their agencies"

1. In *Canada – Dairy*, the Appellate Body addressed the phrase "governments or their agencies" and upheld the Panel's finding that the Canadian milk marketing boards at issue were "agencies" of the government:

"According to *Black's Law Dictionary*, 'government' means, *inter alia*, '[t]he regulation, restraint, supervision, or control which is exercised upon the individual members of an organized jural society by those invested with authority'. (emphasis added) This is similar to meanings given in other dictionaries. The essence of 'government' is, therefore, that it enjoys the effective power to 'regulate', 'control' or 'supervise' individuals, or otherwise 'restrain' their conduct, through the exercise of lawful authority. This meaning is derived, in part, from the *functions* performed by a government and, in part, from the government having the *powers* and *authority* to perform those functions. A 'government agency' is, in our view, an entity which exercises powers vested in it by a 'government' for the purpose of performing functions of a 'governmental' character, that is, to 'regulate', 'restrain', 'supervise' or 'control' the conduct of private citizens. As with any agency relationship, a 'government agency' may enjoy a degree of discretion in the exercise of its functions."¹

1.3 Article 9.1(a)

1.3.1 "direct subsidies, including payments-in-kind"

2. The Panel in *Canada – Dairy* held that "'payments-in-kind' are a form of direct subsidy" and that "a determination in the instant matter that '*payments-in-kind*' exist *would also be* a determination of the existence of a *direct subsidy*."² The Appellate Body disagreed and held, *inter alia*, that "[w]here the recipient gives full consideration in return for a 'payment-in-kind' there can be no 'subsidy', for the recipient is paying market-rates for what it receives":

"In our view, the term 'payments-in-kind' describes one of the *forms* in which 'direct subsidies' may be granted. Thus, Article 9.1(a) applies to 'direct subsidies', *including* 'direct subsidies' granted in the form of 'payments-in-kind'. We believe that, in its ordinary meaning, the word 'payments', in the term 'payments-in-kind', denotes a transfer of economic resources, in a form other than money, from the grantor of the payment to the recipient. However, the fact that a 'payment-in-kind' has been made provides no indication as to the economic *value* of the transfer effected, either from the perspective of the grantor of the payment or from that of the recipient. A 'payment-in-kind' may be made in exchange for full or partial consideration or it may be made gratuitously. Correspondingly, a 'subsidy' involves a transfer of economic resources from the grantor to the recipient for less than full consideration. As we said in our Report in *Canada – Aircraft*, a 'subsidy', within the meaning of Article 1.1 of the *SCM Agreement*, arises where the grantor makes a 'financial contribution' which confers a 'benefit' on the recipient, as compared with what would have been otherwise available to the recipient in the marketplace. Where the recipient gives full consideration in return for a 'payment-in-kind' there can be no 'subsidy', for the recipient is paying market-rates for what it receives. It follows, in our view, that the mere fact that a 'payment-in-kind' has been made does not, *by itself*, imply that a 'subsidy', 'direct' or otherwise, has been granted.

¹ Appellate Body Report, *Canada – Dairy*, para. 97.

² Panel Report, *Canada – Dairy*, para. 7.43.

... The Panel should have considered whether the particular 'payment-in-kind' that it found existed was a 'direct subsidy'. Instead, because the Panel assumed that a 'payment-in-kind' is necessarily a 'direct subsidy', it did not address specifically either the meaning of the term 'direct subsidies' or the question whether the provision of milk to processors for export under Special Classes 5(d) and 5(e) constitutes 'direct subsidies'.³

1.3.2 "contingent on export performance"

3. In *US – Upland Cotton*, the Appellate Body analysed "Step 2" payments to exporters of US upland cotton, which were payable based on proof of export of eligible cotton by the exporter, and agreed with the Panel that these payments were "contingent on export performance".⁴ Consequently, the Appellate Body found that these payments were also export-contingent for purposes of Article 3.1(a) of the SCM Agreement.⁵

1.4 Article 9.1(c)

1.4.1 "payments"

1.4.1.1 A payment includes a payment-in-kind

4. In *Canada – Dairy*, the Appellate Body interpreted the term "payments" to include a transfer of resources other than money, including a "payment in kind":

"We have found that the word 'payments', in the term 'payments-in-kind' in Article 9.1(a), denotes a transfer of economic resources. We believe that the same holds true for the word 'payments' in Article 9.1(c). The question which we now address is whether, under Article 9.1(c), the economic resources that are transferred by way of a 'payment' must be in the form of money, or whether the resources transferred may take other forms. As the Panel observed, the dictionary meaning of the word 'payment' is not limited to payments made in monetary form. In support of this, the Panel cited the *Oxford English Dictionary*, which defines 'payment' as 'the remuneration of a person with money or its equivalent'. (emphasis added) Similarly, the *Shorter Oxford English Dictionary* describes a 'payment' as a 'sum of money (or other thing) paid'. (emphasis added) Thus, according to these meanings, a 'payment' could be made in a form, other than money, that confers value, such as by way of goods or services. A 'payment' which does not take the form of money is commonly referred to as a 'payment in kind'.

We agree with the Panel that the ordinary meaning of the word 'payments' in Article 9.1(c) is consistent with the dictionary meaning of the word. Under Article 9.1(c), 'payments' are 'financed by virtue of governmental action' and they may or may not involve 'a charge on the public account'. Neither the word 'financed' nor the term 'a charge' suggests that the word 'payments' should be interpreted to apply solely to money payments. A payment made in the form of goods or services is also 'financed' in the same way as a money payment, and, likewise, 'a charge on the public account' may arise as a result of a payment, or a legally binding commitment to make payment by way of goods or services, or as a result of revenue foregone."⁶

5. The Appellate Body in *Canada – Dairy* considered that the context of Article 9.1(c) also supported a reading of the word "payments" that covered "payments-in-kind":

"The context of Article 9.1(c) also supports a reading of the word 'payments' that embraces 'payments-in-kind'. That context includes the other sub-paragraphs of Article 9.1. As the Panel explained, *none* of the export subsidies listed in Article 9.1 is restricted to grants made solely in money form and several expressly involve subsidies granted in a form other than money. Under Article 9.1(a), 'payments-in-

³ Appellate Body Report, *Canada – Dairy*, paras. 87-88.

⁴ Appellate Body Report, *US – Upland Cotton*, paras. 567-583.

⁵ Appellate Body Report, *US – Upland Cotton*, para. 584.

⁶ Appellate Body Report, *Canada – Dairy*, paras. 107-108.

kind' are specifically included as a form of 'direct subsidies'. Similarly, under Articles 9.1(b), the export subsidy identified may involve the disposal of agricultural goods *at less than domestic price*. Under Article 9.1(e), the provision of transport services for export shipments *at prices lower than the price charged for domestic shipments* is also an export subsidy. Thus, each of these three sub-paragraphs of Article 9.1 specifically contemplates that the export subsidy may be granted in a form other than a money payment.

The context, in our view, also includes Article 1(c) of the *Agreement on Agriculture*. In terms of that provision, 'revenue foregone' is to be taken into account in determining whether 'budgetary outlay' commitments, made with respect to export subsidies as listed in Article 9.1, have been exceeded. In our view, the foregoing of revenue usually does not involve a monetary payment. Thus, if a restrictive reading of the words 'payments' were adopted, such that 'payments' under Article 9.1(c) had to be monetary, no account could be taken, under Article 9.1(c), of 'revenue foregone'. This would, we believe, prevent a proper assessment of the commitments made by WTO Members under Article 9.2, as envisaged by Article 1(c) of the *Agreement on Agriculture*. We, therefore, prefer a reading of Article 9.1(c) that allows full account to be taken of 'revenue foregone'. The contrary view would, in our opinion, elevate form over substance and permit Members to circumvent the subsidy disciplines set forth in Article 9 of the *Agreement on Agriculture*.⁷

6. The Appellate Body in *Canada – Dairy* acknowledged that Article 9.1(c) did not refer explicitly to 'payments-in-kind', unlike other provisions of the Agreement on Agriculture, but held that the purpose of its express inclusion was "to counter any suggestion that the ordinary meaning of the terms 'direct subsidies' and 'direct payments' does *not* include 'payments-in-kind':

"It is true, as Canada argues, that Article 9.1(c) does not expressly include 'payments-in-kind' within its scope, whereas Article 9.1(a) and paragraph 5 of Annex 2 to the *Agreement on Agriculture* do. However, we do not regard the express inclusion of 'payments-in-kind' in these two provisions as necessarily implying the exclusion of 'payments-in-kind' under Article 9.1(c). In Article 9.1(a) and in paragraph 5 of Annex 2, the term 'payments-in-kind' is used in conjunction with the words 'direct subsidies' and 'direct payments', respectively. We believe that reference is made to 'payments-in-kind' in these two provisions to counter any suggestion that the ordinary meaning of the terms 'direct subsidies' and 'direct payments' does *not* include 'payments-in-kind'. By contrast, since the ordinary meaning of the word 'payments' in Article 9.1(c) includes 'payments-in-kind', there was no need for 'payments-in-kind' to be expressly provided for. Moreover, if 'payments-in-kind' are *included* in the qualified concept of 'direct payments' under Annex 2, paragraph 5, it would be incongruous to *exclude* them from the broader concept of 'payments' in Article 9.1(c)."⁸

7. The Appellate Body in *Canada – Dairy* consequently agreed with the Panel that the ordinary meaning of the word "payments" in Article 9.1(c) encompassed "payments" in forms other than money, including revenue foregone⁹:

"In our view, the provision of milk at discounted prices to processors for export under Special Classes 5(d) and 5(e) constitutes 'payments', in a form other than money, within the meaning of Article 9.1(c). If goods or services are supplied to an enterprise, or a group of enterprises, at reduced rates (that is, at below market-rates), 'payments' are, in effect, made to the recipient of the portion of the price that is not charged. Instead of receiving a monetary payment equal to the revenue foregone,

⁷ Appellate Body Report, *Canada – Dairy*, paras. 109-110.

⁸ Appellate Body Report, *Canada – Dairy*, para. 111.

⁹ This finding had been reaffirmed in the first *Canada – Dairy* compliance case; see Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 6.12 and Appellate Body (Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 71 and 76. The point had not been re-argued by the parties before the Panel on the second *Canada – Dairy* compliance case: Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 5.26.

the recipient is paid in the form of goods or services. But, as far as the recipient is concerned, the economic value of the transfer is precisely the same.

We, therefore, uphold the Panel's finding, in paragraph 7.101 of the Panel Report, that the provision of discounted milk to processors or exporters under Special Classes 5(d) and 5(e) involves 'payments' within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.¹⁰

1.4.1.2 Cross-subsidization as a payment

8. In *EC – Export Subsidies on Sugar*, the Appellate Body examined the EC sugar regime, in which all "C sugar" could not be disposed of in the EC internal market and could only be exported without further processing. The Appellate Body agreed with the Panel that because C sugar "must be exported", then "advantages, payments or subsidies to C sugar, that must be exported, are subsidies 'on the export' of that product."¹¹ The Appellate Body found that because C sugar "must be exported", "[i]t follows that payments in the form of 'cross-subsidization' are, by definition, 'payments' 'on the export'".¹²

1.4.1.3 Benchmark to be applied when assessing payments

9. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US)* explained the importance of a benchmark when assessing if the measure at issue involves "payments" under Article 9.1(c):

"Thus, the determination of whether 'payments' are involved requires a comparison between the price actually charged by the provider of the goods or services – the prices of CEM in this case – and some objective standard or benchmark which reflects the proper value of the goods or services to their provider – the milk producer in this case. We do not accept Canada's argument that as the producer negotiates freely the price with the processor, and CEM prices are, therefore, market-determined, it is not necessary to compare these prices with an objective standard.

Article 9.1(c) of the *Agreement on Agriculture* does not expressly identify any standard for determining when a measure involves 'payments' in the form of payments-in-kind. The absence of an express standard in Article 9.1(c) may be contrasted with several other provisions involving export subsidies which do provide an express standard. Thus, for instance, even within Article 9.1 itself, sub-paragraphs (b) and (e) expressly provide that the domestic market constitutes the appropriate basis for comparison.¹³

We believe that it is significant that Article 9.1(c) of the *Agreement on Agriculture* does not expressly identify a standard or benchmark for determining whether a measure involves 'payments'. It is clear that the notion of 'payments' encompasses a diverse range of practices involving a transfer of resources, either monetary or in-kind. Moreover, the 'payments' may take place in many different factual and regulatory settings. Accordingly, we believe that it is necessary to scrutinize carefully the facts and circumstances of a disputed measure, including the regulatory framework surrounding that measure, to determine the appropriate basis for comparison in assessing whether the measure involves 'payments' under Article 9.1(c).¹⁴

¹⁰ Appellate Body Report, *Canada – Dairy*, paras. 113-114.

¹¹ Appellate Body Report, *EC – Export Subsidies on Sugar*, para. 274 (referring to Panel Reports, *EC – Export Subsidies on Sugar*, para. 7.321).

¹² Appellate Body Report, *EC – Export Subsidies on Sugar*, para. 275.

¹³ (footnote original) See also, items (c), (d), (f), (g), (h), (j) and (k) of the Illustrative List of the *SCM Agreement*, each of which expressly identifies one or more benchmarks to be used as a basis for comparison in determining whether a measure involves export subsidies. See further, paragraphs 8 and 13 of Annex 3, and paragraph 2 of Annex 4, of the *Agreement on Agriculture*, which expressly identify one or more benchmarks for calculating the amount of domestic support.

¹⁴ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 74-76.

10. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US)* rejected the Panel's suggestion that the domestic market provided the "right benchmark" for the dispute:

"The domestic price in this case is an administered price fixed by the Canadian government as part of the regulatory framework established by it for managing the supply of milk destined for consumption in the domestic market. As with administered prices in general, this price expresses a government policy choice based, not only on economic considerations, but also on other social objectives. The Canadian regulatory framework for managing domestic milk supply, including the establishment of the administered price, is not in dispute in this case. There can be little doubt, however, that the administered price is a price that is favourable to the domestic producers. Consequently, sale of CEM by the producer at less than the administered domestic price does not, necessarily, imply that the producer has foregone a portion of the proper value of the milk to it. In the situation where the producer, rather than the government, chooses to produce and sell CEM in the marketplace at a price it freely negotiates, we do not believe it is appropriate to use, as a basis for comparison, a domestic price that is fixed by the government."¹⁵

11. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US)* also rejected an alternative "benchmark" which relied on world market prices:

"The alternative 'benchmark' which the Panel relied upon to determine whether CEM prices involve 'payments' was the terms and conditions on which alternative supplies are available to processors on world markets, through IREP. In reviewing this benchmark, we recall that, in these proceedings, the standard used to determine whether there are 'payments' under Article 9.1(c) must be based on the proper value of the milk to the producer, in order to determine whether the producer foregoes a portion of this value. If a producer wishes to sell milk for export processing, it is obvious that the price of the milk to the processor must be competitive with world market prices. If it is not, the processor will not buy the milk, as it will not be able to produce a final product that is competitive in export markets. Accordingly, the range of world market prices determines the price which the producer can charge for milk destined for export markets. World market prices do, therefore, provide one possible measure of the value of the milk to the producer.

However, world market prices do not provide a valid basis for determining whether there are 'payments', under Article 9.1(c) of the *Agreement on Agriculture*, for, it remains possible that the reason CEM can be sold at prices competitive with world market prices is precisely because sales of CEM involve subsidies that make it competitive. Thus, a comparison between CEM prices and world market prices gives no indication on the crucial question, namely, whether Canadian export production has been given an advantage. Furthermore, if the basis for comparison were world market prices, it would be possible for WTO Members to subsidize domestic inputs for export processing, while taking care to maintain the price of these inputs to the processors at a level which equalled or marginally exceeded world market prices. There would then be no 'payments' under Article 9.1(c) of the *Agreement on Agriculture* and WTO Members could easily defeat the export subsidy commitments that they have undertaken in Article 3 of the *Agreement on Agriculture*.

We do not, therefore, accept that world market prices are an appropriate basis for determining whether sales of CEM by producers involve 'payments' under Article 9.1(c) of the *Agreement on Agriculture*.¹⁶

12. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US)* indicated that a number of possible measures for assessing the value of milk existed:

"We turn now to determine the appropriate standard for assessing whether sales of CEM by producers involve 'payments' under Article 9.1(c) of the *Agreement on*

¹⁵ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 81.

¹⁶ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 83-85.

Agriculture. We reiterate that the standard must be objective and based on the value of the milk to the producer.

Although the proceeds from sales at domestic or world market prices represent two possible measures of the value of milk to the producer, we do not see these as the only possible measures of this value. For any economic operator, the production of goods or services involves an investment of economic resources. In the case of a milk producer, production requires an investment in fixed assets, such as land, cattle and milking facilities, and an outlay to meet variable costs, such as labour, animal feed and health-care, power and administration. These fixed and variable costs are the total amount which the producer must spend in order to produce the milk and the total amount it must recoup, in the long-term, to avoid making losses. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, possibly 'by virtue of governmental action'.¹⁷

13. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US II)* considered that the average total cost of production benchmark should be an industry-wide average:

"We believe that the standard for determining the existence of 'payments', under Article 9.1(c), should reflect the fact that the obligation at issue is an international obligation imposed on Canada. The question is not whether one or more individual milk producers, efficient or not, are selling CEM at a price above or below their individual costs of production. The issue is whether Canada, on a national basis, has respected its WTO obligations and, in particular, its commitment levels. It, therefore, seems to us that the benchmark should be a single, industry-wide cost of production figure, rather than an indefinite number of cost of production figures for each individual producer. The industry-wide figure enables cost of production data for producers, as a whole, to be aggregated into a single, national standard that can be used to assess Canada's compliance with its international obligations.

By contrast, if the benchmark were to operate at the level of each individual producer, there would be a proliferation of standards, requiring individual-level inquiry and application of Article 9.1(c), as if the obligations under the *Agreement on Agriculture* involved rights and obligations of individual producers, rather than WTO Members."¹⁸

14. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US II)* agreed with the Panel that certain imputed costs and selling costs should be included in the cost of production benchmark:

"We, therefore, find that the COP standard for determining whether 'payments' exist, under Article 9.1(c) of the *Agreement on Agriculture*, includes all monetary and non-monetary economic costs of production, such as the costs of family labour and management, and of owner's equity.

...

Accordingly, we find that any transport, marketing, and administrative costs are to be included in the COP standard applied under Article 9.1(c), as are any costs of acquiring and retaining quota."¹⁹

1.4.2 "financed by virtue of governmental action"

15. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US)* considered the meaning of the term "governmental action" under Article 9.1(c):

¹⁷ Appellate Body Report, *Canada – Dairy, (Article 21.5 – New Zealand and US)*, paras. 86-87.

¹⁸ Appellate Body Report, *Canada – Dairy, (Article 21.5 – New Zealand and US II)*, paras. 95-96.

¹⁹ Appellate Body Report, *Canada – Dairy, (Article 21.5 – New Zealand and US II)*, paras. 110 and 116.

"We recall that, in the original proceedings, the role of the government in managing the supply of milk for export was manifest. We stated that:

'[G]overnmental action' is not simply involved; it is, in fact, indispensable to enable the supply of milk to processors for export, and hence the transfer of resources, to take place. In the regulatory framework, 'government agencies' stand so completely between the producers of the milk and the processors or the exporters that we have no doubt that the transfer of resources takes place 'by virtue of governmental action'. (emphasis added)

Although the phrase 'financed by virtue of governmental action' must be understood as a whole, it is useful to consider separately the meaning of the different parts of this phrase. Taking the words 'governmental action' first, we observe that the text of Article 9.1(c) does not place any qualifications on the types of 'governmental action' which may be relevant under Article 9.1(c). 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."²⁰

16. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US)* considered the meaning of the term "financed" under Article 9.1(c):

"[I]t will not be sufficient simply to demonstrate that a payment occurs as a consequence of governmental action because the word 'financed', in Article 9.1(c), must also be given meaning.

The word 'financed' might be given a rather specific meaning such that it would be confined to the financing of 'payments' in monetary form or to the funding of 'payments' from government resources. However, we have already recalled that 'payments', under Article 9.1(c), include payments-in-kind, so the word 'financed' needs to cover both the financing of monetary payments and payments-in-kind. In addition, Article 9.1(c) explicitly excludes a reading of the word 'financed' whereby payments must be funded from government resources, as the provision states that payments can be financed by virtue of governmental action 'whether or not a charge on the public account is involved'. Thus, under Article 9.1(c), it is not necessary that the economic resources constituting the 'payment' actually be paid by the government or even that they be paid from government resources. Accordingly, although the words 'by virtue of' render governmental action essential, Article 9.1(c) contemplates that payments may be financed by virtue of governmental action even though significant aspects of the financing might not involve government."²¹

1.4.2.1 Link between governmental action and the financing of payments

17. When examining the link required between governmental action and the financing of payments under Article 9.1(c), the Panel in *Canada – Dairy (Article 21.5 – New Zealand and US)* considered that governmental action should be "indispensable" to the financing of payments, and "establish[es] the conditions which ensure that the payment ... takes place."²² Further, the Panel indicated that for the "by virtue of" test of Article 9.1(c) to be met "it must be established that a payment would not be financed ... but for governmental action."²³ This "but for" standard would be met if the following two requirements were established:

²⁰ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 111-112. See also Appellate Body Report, *EC – Export Subsidies on Sugar*, para. 235.

²¹ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 114. See also Appellate Body Report, *EC – Export Subsidies on Sugar*, para. 237.

²² Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 6.38, 6.40 and 6.44.

²³ Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 6.39.

"[T]hat governmental action, *de jure* or *de facto*: (i) prevents Canadian milk producers from selling more milk on the regulated domestic market, at a higher price, than to the extent of the quota allocated to them; and (ii) obliges Canadian milk processors to export all milk contracted as lower priced commercial export milk, and, accordingly, penalizes the diversion by processors of milk contracted as commercial export milk to the domestic market. As explained below, only if both those requirements were to be met, governmental action could be said to be indispensable for the transfer of resources to take place: the lower priced commercial export milk would not have been available to Canadian processors for export *but for* these governmental actions, taken together."²⁴

18. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US)* confirmed that mere governmental action would not be sufficient for a finding that an export subsidy existed under Article 9.1(c) and expanded on the meaning of the words "by virtue of":

"The words 'by virtue of' indicate that there must be a demonstrable link between the *governmental action* at issue and the *financing* of the payments, whereby the payments are, in some way, financed as a result of, or as a consequence of, the governmental action."²⁵

19. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US)* indicated that establishing such a link would be more difficult in cases involving payments-in-kind.

"[T]he link between governmental action and the financing of payments will be more difficult to establish, as an evidentiary matter, when the payment is in the form of a payment-in-kind rather than in monetary form, and all the more so when the payment-in-kind is made, not by the government, but by an independent economic operator."²⁶

20. Further, the Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US)* indicated that it disagreed with the Panel's findings that governmental action had "oblige[d]" or "drive[n]" producers to sell commercial export milk ("CEM").²⁷ However, the Appellate Body did not make any further findings on the meaning of "financed by governmental action" at that stage of the proceedings.

21. In *Canada – Dairy (Article 21.5 – New Zealand and US II)* the Appellate Body considered the meaning of "financed by government action" in light of the ordinary meaning of the word "financing" but, on the other hand, the fact that Article 9.1(c) expressly states that "payments" need not involve "a charge on the public account". It found as follows:

"Accordingly, even if government does not fund the payments itself, it must play a sufficiently important part in the process by which a private party funds 'payments', such that the requisite nexus exists between 'governmental action' and 'financing'."²⁸

22. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US II)* considered the fact of the dispute and agreed with the Panel that a significant percentage of producers were likely to finance sales of commercial export milk ("CEM") at below the costs of production as a result of participation in the domestic market and, further, that payments made through the supply of CEM at below the costs of production were financed by virtue of "governmental action" within the meaning of Article 9.1(c) of the Agreement on Agriculture:

"It falls now to consider the role of the Canadian government in financing payments made on the sale of CEM. We have agreed with the Panel that a significant percentage of producers are likely to finance sales of CEM at below the costs of

²⁴ Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 6.42. The Panel found that these requirements were satisfied – a finding which led Canada to appeal.

²⁵ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 113. See also Appellate Body Report, *EC – Export Subsidies on Sugar*, para. 237.

²⁶ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 113.

²⁷ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 116-117.

²⁸ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 133.

production as a result of participation in the domestic market. Canadian 'governmental action' controls virtually every aspect of domestic milk supply and management. In particular, government agencies fix the price of domestic milk that renders it highly remunerative to producers. Government action also controls the supply of domestic milk through quota, thereby protecting the administered price. The imposition by government of financial penalties on processors that divert CEM into the domestic market is another element of governmental control over the supply of milk. Further, the degree of government control over the domestic market is emphasized by the fact that government pools, allocates, and distributes revenues to producers from all domestic sales. Finally, governmental action also protects the domestic market from import competition through tariffs.

In our view, the effect of these different governmental actions is to secure a highly remunerative price for sales of domestic milk by producers. In turn, it is due to this 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 costs of production."²⁹

23. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US II)* dismissed an objection that this reasoning brings "cross-subsidization" under Article 9.1(c) of the Agreement on Agriculture:

"We have explained that the text of Article 9.1(c) applies to any 'governmental action' which 'finances' export 'payments'. The text does not exclude from the scope of the provision any particular governmental action, such as regulation of domestic markets, to the extent that this action may become an instrument for granting export subsidies. Nor does the text exclude any particular form of financing, such as 'cross-subsidization'. Moreover, the text focuses on the consequences of governmental action ('by virtue of which') and not the intent of government. Thus, the provision applies to governmental action that finances export payments, even if this result is not intended. As stated in our Report in the first Article 21.5 proceedings, this reading of Article 9.1(c) serves to preserve the legal 'distinction between the domestic support and export subsidies disciplines of the *Agreement on Agriculture*'. Subsidies may be granted in both the domestic and export markets, provided that the disciplines imposed by the Agreement on the levels of subsidization are respected. If governmental action in support of the domestic market could be applied to subsidize export sales, without respecting the commitments Members made to limit the level of export subsidies, the value of these commitments would be undermined. Article 9.1(c) addresses this possibility by bringing, in some circumstances, governmental action in the domestic market within the scope of the 'export subsidies' disciplines of Article 3.3."³⁰

24. The Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US II)* considered that the "payments" at issue were not financed "by virtue of" another form of governmental action in the dispute, which was an exemption for processors from paying the higher domestic price for milk when they purchased commercial export milk:

"We do not believe that this action influences the 'financing' of payments by the producer. Certainly, this action explains why the *processor* of CEM is not *required* to pay the higher domestic price for CEM. However, the mere fact that the processor is not obliged to buy CEM at the domestic price does not demonstrate a link between this exemption and the financing of payments by the *producer* on the sale of CEM. The exemption is, in short, not linked to the mechanism by which the producer funds the payments."³¹

²⁹ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, paras. 144-145.

³⁰ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 148.

³¹ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 149.

1.5 Article 9.1(d)

1.5.1 "costs of marketing exports"

25. In *US – FSC*, the measure at issue provided an income tax credit (directly reducing income tax liability for certain US corporations). It provided, *inter alia*, that those corporations incurred a certain portion of their marketing expenses abroad. The Panel found that the United States' measure constituted a subsidy to "reduce the costs of marketing exports", within the meaning of paragraph 1(d).³² The Appellate Body disagreed and held:

"We turn, first, to the word 'marketing' in Article 9.1(d), which is at the heart of the phrase 'to reduce the costs of *marketing* exports' in Article 9.1(d). Taken alone, that word can have, as the Panel indicated, a range of meanings. The Panel noted the *Webster's Dictionary* meaning, according to which 'marketing' is the 'aggregate of functions involved in transferring title and in moving goods from producer to consumer including among others buying, selling, storing, transporting, standardizing, financing, risk bearing and supplying market information'. ... *The New Shorter Oxford Dictionary* provides a similar meaning: 'The action, business, or process of promoting and selling a product...'. However, we must look beyond dictionary meanings, because, as we have said before, 'dictionary meanings leave many interpretive questions open.'

The text of Article 9.1(d) lists 'handling, upgrading and other processing costs, and the costs of international transport and freight' as examples of 'costs of marketing'. The text also states that 'export promotion and advisory services' are covered by Article 9.1(d), provided that they are not 'widely available'. These are not examples of just *any* 'cost of doing business' that 'effectively reduce[s] the cost of marketing' products. Rather, they are specific types of costs that are incurred *as part of* and *during* the process of selling a product. They differ from general business costs, such as administrative overhead and debt financing costs, which are not specific to the process of putting a product on the market, and which are, therefore, related to the marketing of exports only in the broadest sense.

... Income tax liability under the FSC measure arises only when goods are actually sold for export, that is, *when they have been the subject of successful marketing*. Such liability arises *because* goods have, in fact, been sold, and not as *part of the process* of marketing them. Furthermore, at the time goods are sold, the costs associated with putting them on the market – costs such as handling, promotion and distribution costs – have already been incurred and the amount of these costs is not altered by the income tax, the amount of which is calculated by reference to the sale price of the goods. In our view, if income tax liability arising from export sales can be viewed as among the 'costs of marketing exports', then so too can virtually any other cost incurred by a business engaged in exporting."³³

1.6 Article 9.2

26. The Appellate Body in *EC – Export Subsidies on Sugar* found that "the use of the conjunctive 'and', and the corresponding use of the word 'levels' in the plural, suggest that the drafters of the Agreement intended that both types of commitments [(budgetary outlays and quantity commitment levels)] must be specified in a Member's Schedule in respect of any export subsidy listed in Article 9.1."³⁴ The Appellate Body further found "contextual support for [this] interpretation in Article 9.2(b)(iv)":

"This provision prescribes the export subsidy commitment levels to be reached at the conclusion of the implementation period (and to be maintained thereafter), and those commitment levels are expressed in terms of both budgetary outlays and quantities. We do not see how a Member could comply with Article 9.2(b)(iv), or for that matter Article 9.2(a), without having specified its export subsidy commitments in terms of

³² Panel Report, *US – FSC*, para. 7.155.

³³ Appellate Body Report, *US – FSC*, paras. 129-131.

³⁴ Appellate Body Report, *EC – Export Subsidies on Sugar*, para. 193.

both budgetary outlays and quantities. We also consider it significant that both Article 9.2(b)(iii) and Article 9.2(b)(iv) use the expression 'budgetary outlays for export subsidies and the quantities *benefiting from such subsidies*'. (emphasis added) This shows the drafters' recognition of the need to address the budgetary outlays and quantities together."³⁵

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³⁵ Appellate Body Report, *EC – Export Subsidies on Sugar*, para. 194.