

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

L/5331

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PANEL ON VITAMINS

Report of the Panel

I. INTRODUCTION

1. The Panel was established by the Council on 11 June 1981. Its terms of reference were:

"To examine, in the light of the relevant GATT provisions, the matter referred to the CONTRACTING PARTIES by the European Communities in documents L/5157 and L/5129 and to make such findings as will assist the CONTRACTING PARTIES in making the recommendations and rulings provided for in Article XXIII:2."

2. The Chairman of the Council informed the Council of the composition of the Panel through document C/121:

Chairman: Ambassador E. Nettel (Austria)

Members: Mr. M. Pullinen (Finland)
Dr. J. Yeabsley (New Zealand)

3. The Panel met on 31 July, 10 November, 17 November, 20 November, 18 December 1981, 11 January, 12 May, 26 May and 17 June 1982.

4. In the course of its work the Panel heard statements by representatives of the European Economic Community and the United States. Background documents and relevant information submitted by both parties, their replies to questions put by the Panel as well as relevant GATT documentation served as a basis for the examination of the matter. This documentation is available in the secretariat for consultation.

II. FACTUAL ASPECTS

5. In the course of the Multilateral Trade Negotiations, the United States agreed to eliminate the American Selling Price (ASP) System of Valuation¹ upon the entry into force of the Agreement on the Implementation of Article VII of GATT (Valuation Code). Prior to the implementation of the new Valuation Code by the United States on 1 July 1980, both Vitamin B12 feedgrade and pharmaceutical qualities were subject to the ASP System of Valuation. They were classified under Tariff Line 407.85 at a nominal rate of duty of 1.7 cents per pound plus 12.5 per cent ad valorem. This rate was bound by the United States in the Kennedy Round Negotiations. The United States reserved the right in its Kennedy Round Schedule, in case the ASP system were eliminated, to convert the rates of duty on "competitive" benzenoid chemicals

¹Under the ASP system "competitive" products imported were valued for customs purposes at the wholesale price of a competitive US product rather than at the invoice price of the imported product.

as follows: "In the event that the United States makes effective measures which provide for elimination of the application of American selling price, as defined in sections 402(e) and 402a(g) of the Tariff Act of 1930 (19 U.S.C. (1964) 1401(e), 1402(g)), as a basis for determining dutiable value for any article on which a concession is provided in this schedule, it shall be free to adjust the rate of duty provided for such article in such concessions either pursuant to the agreement relating principally to chemicals, supplementary to the agreement to which this Schedule is annexed, or shall be free to adjust such rate to the extent of offsetting the difference in the amount of duty which, without such adjustment, would result from making such measure effective" (general note 4 to Schedule XX).

6. Vitamin B12 feedgrade quality and Vitamin B12 pharmaceutical quality were subject to different charges resulting from the ASP valuation: during the period 1 January 1976 - 30 June 1980 the feedgrade quality had an ASP of US\$3.45 to US\$3.50 per gram of active substance, resulting in an effective duty of approximately 21.4 per cent, whereas the pharmaceutical quality entered with an ASP of US\$11.2 per gram of active substance, resulting in an effective duty of approximately 43.6 per cent (calculated on the basis of average duties collected and average invoice values in 1976, the base year for ASP conversions).

7. In the process of conversion of the ASP rates both qualities of Vitamin B12 were taken together and the rate of duty was converted from 1.7 cents per pound plus 12.5 per cent ad valorem to 1.7 cents per pound plus 40.4 per cent ad valorem. According to US calculations, this converted rate of duty represented the weighted average of the actual charges collected for both grades. After the conversion of the rate of duty for Vitamin B12 in the Tariff Schedules of the United States (TSUS), the tariff item number for all Vitamins B12 was 412.56.

8. In connexion with the negotiations with the United States on the abolition of the ASP system of valuation, the Community agreed in a bilateral Understanding with the United States (see Annex), dated 2 March 1979, that the United States could incorporate the extra duty charged on "competitive" chemicals as a result of the ASP valuation into the base rate for the MTN tariff reductions (see paragraph 3 of the Understanding). In addition to this, the Community reserved the right to raise any problem it might have in respect of the converted rate for particular products, and the United States undertook to examine such cases "on a case-by-case basis, taking into account the characteristics of the product and of the trade with a view to finding a mutually acceptable solution".

9. In letters to the United States delegation dated 6 April, 6 June and 12 June 1979, after the conclusion of the above-mentioned Understanding on 2 March 1979, the Community raised specifically the case of the converted rate of 1.7 cents per pound plus 40.4 per cent for Vitamin B12 feedgrade quality in the US offer and requested the United States to consider splitting TSUS 412.56 into two items, for feedgrade and pharmaceutical quality, in order to provide for a converted base rate of duty of not more than 21.4 per cent for feedgrade quality, subject to an MTN reduction to 16.2 per cent ad valorem applicable to the whole of the TSUS 412.56. On 19 June 1979, the United States delegation orally informed the Community that it was not possible to accede to the Community's request with respect to vitamin B12 on the grounds of possible diversion. The Community did not consider this as a final United States position and it was never formally confirmed in writing. The United States considered this position final and that no further written bilateral confirmation was necessary, since that position had been in the United States tariff offer and was incorporated formally in the United States GATT schedule.

10. Schedule XX - United States which was annexed to the Geneva (1979) Protocol on 30 June 1979 established for the whole of item 412.56 a base rate of 1.7 cents per pound plus 40.4 per cent ad valorem; this compound rate would be reduced to 16.2 per cent ad valorem by 1 January 1987. The Community made no reservation in its Schedule LXXII with respect to the conversion of Vitamin B12.

III. MAIN ARGUMENTS

11. The Community representatives pointed out that, as a result of the Kennedy Round negotiations, the United States had granted a concession on Vitamin B12 which, because of the ASP valuation system, meant that feedgrade quality vitamins were subject to a lower duty (21.4 per cent) than pharmaceutical quality vitamins (43.6 per cent), although the nominal rate was the same. The Community had a reasonable expectation that this differentiated treatment would be maintained after the abolition of the ASP valuation system unless the contrary was specifically agreed.

12. Up to 1 July 1980, exports of feedgrade quality of Vitamin B12 to the United States had been constantly increasing; in fact they had tripled from 1979 to July 1980. As from 1 July 1980, because of the doubled duty, the European producers had stopped their exports. In 1981, because of a considerable effort to quote competitive prices and the rise of the dollar, they had been able to resume modest exports to the United States in order to keep their market position, whilst awaiting a favorable decision in the matter.

13. The increase in the actually applied rate for feedgrade vitamins from 21.4 per cent to 1.7¢ plus 40.4 per cent was contrary to the provisions of Article II paragraph 1 (a) and (b) and paragraph 3 of the GATT and constituted, unless renegotiations had been carried out under Article XXVIII, a nullification or impairment of the concession given by the United States in the Kennedy Round negotiations. Given the relatively short time for negotiations in a complex area, which imposed on both sides the need for a pragmatic approach, the Community had accepted an approach in this sector on the basis of a bilateral agreement and in doing so the Community had also agreed that the United States would not follow the formal procedures of GATT Article XXVIII for ASP conversions, which however did not mean that it had abandoned its normal GATT rights in case of disagreement.

14. The Community emphasized that, in the bilateral Understanding concluded between the Community and the United States on 2 March 1979, the United States had undertaken to examine, at the request of the Community, specific cases of ASP conversion "on a case-by-case basis, taking into account the characteristics of the product and of the trade with a view to finding a mutually acceptable solution". The Community negotiators had repeatedly stressed these points in the negotiations that had taken place between the Community and the United States in the MTN in 1979. At the time the United States MTN schedule had been incorporated in the Geneva (1979) Protocol, 30 June 1979, the United States negotiators had not yet taken a final position to the Community claim that the Vitamin B12 rate should be split up in two. Therefore, the Community had not had any reason to make a reservation to the United States schedule, as intimated by the United States. The question of the split up of Vitamin B12 together with certain other issues relating to "non-competitive" and "future" chemical products (see paragraphs 4, 5 and 6 of the Understanding) had been further discussed during the second half of 1979. Only a short time before the entry into force of the

new rate on item 412.56 on 1 July 1980 had it become clear that the United States was not going to meet the Community request.

15. The United States had argued that its statutory powers under Section 225 of the Trade Agreement Act (TAA) of 1979 clearly excluded any modifications of duty rates included in Schedule XX for "competitive" chemicals and that the Community should have been aware of this. But it should be noted, the Community stressed:

- first, that the TAA had been enacted on 26 July 1979, subsequent to the presentation in Geneva of Schedule XX. Consequently, the Community could not have known of the final provisions of the law at that time and in any event had believed that subsequent action to modify duty rates would still have been possible, and indeed this had occurred in a number of cases;
- second, that at no time in the bilateral discussions in the latter part of 1979 on chemical products had the United States delegation informed the Community that modification of the duty rate of Vitamin B12 was statutorily impossible.

16. The United States representatives stressed that the United States tariff treatment of Vitamin B12, including feedgrade quality thereof, did conform with the US GATT Schedule XX.

17. The base rate fixed for vitamin B12 after the abolition of the ASP valuation system was the weighted average of the duties paid under the ASP system as a percentage of the invoice values for all grades of Vitamin B12. The rate applied to Vitamin B12 after conversion from the ASP system was thus calculated in conformity with the GATT obligations of the United States.

18. Furthermore, the conversion adjustment made was, in accordance with United States commitment in the Understanding with the Community of 2 March 1979, neutral and did not "involve any arbitrary increase in customs duties". The Community had conceded that by entering into the Understanding of 2 March 1979, it had accepted to negotiate further tariff reductions in the MTN on the basis of converted ASP rates without a need for separate renegotiations under Article XXVIII. The agreement by the Community that the United States would not follow the renegotiation procedures of Article XXVIII also obviously meant that the Community could not make any further claims for compensation under that Article or claim other rights on the basis that the United States had not followed the procedures of Article XXVIII.

19. The United States, in the Understanding, had undertaken to examine conversion cases raised by the Community with a view to finding a mutually acceptable solution. It had, on the other hand, not made a commitment to meet the Community requests in each single case. Prior to 30 June 1979, the United States had agreed to continue the splitting out of the so-called "non-competitive" and "future" products, in accordance with paragraphs 4 through 6 of the Understanding of 2 March 1979, beyond the date of the opening for acceptance of the Geneva (1979) Protocol, because of technical difficulties on both sides with respect to those categories. However, the United States had made no such offer for so-called "competitive" products such as Vitamin B12. The United States had, before 30 June 1979, made it clear to the Community that it had not been in a position to split up the Vitamin B12 heading, because of the potential for circumvention if separate rates of duty had been established for convertible grade. The Community had also been aware, well before 30 June 1979, that the United States Trade Agreement Act (TAA) would include authority to modify tariff treatment of

"non-competitive" and "future" products, but that "competitive" products would be specifically excluded from such authority. Though the TAA had not been enacted until 26 July 1979, the Community had been given drafts prior to 30 June, and the legislation had been publicly introduced in a form that could not be amended in any way on 19 June 1979. The Community should have made a reservation, when accepting the United States schedule on 30 June 1979, if it could not agree with the United States' position in respect of Vitamin B12; no such reservation had, however, been made. Thus the Community had in effect waived whatever rights that might have been attached to Vitamin B12.

20. The United States further observed that the practical consequences of the conversion on trade in feedgrade quality on Vitamin B12 appeared to be slight, and of short duration. According to United States statistics, annual imports of Vitamin B12 in the 1978-1981 period had been quite stable from the Community, though there had been a shift within the Community in the relative importance of different member states as suppliers to the United States market. In 1980, it was true that there had been a considerable surge of imports in the first six months as importers had appeared to stockpile feedgrade Vitamin B12. Since imports during the first six months of 1980 had exceeded normal levels for a year, it was not surprising that trade had virtually stopped in the latter half of 1980. However, United States imports in 1981 had been at levels nearly equal to 1979. The relatively slight reduction in United States imports could possibly be explained by declining overall United States sales of Vitamin B12 and other farm inputs in 1981. In any case, any effects of the duty conversion on feedgrade Vitamin B12 would be short lived, as staged reductions pursuant to the MTN would reduce this duty (currently 31.4 percent) to 22.3 percent on 1 January, 1985 and to a final rate of 16.2 percent in 1987. The United States also noted that the converted rate on pharmaceutical quality would have been higher at all stages since 1980, but for the trade-weighted averaging used in this and other ASP conversions.

21. In response to United States arguments the Community representatives made the following points:

- the United States had argued that they could not meet all requests on competitive products. In fact, the Community had raised only one single case: Vitamin B12 feedgrade quality;
- the United States had not, formally and in writing, informed the Community that the request to split the Vitamin B12 heading had been refused, whether prior to 30 June 1979 or during later bilateral discussions including consultations under GATT Articles XXII and XXIII. The only statement to this effect had been made in the letter of 22 April 1981.
- as regards the argument that the Community should have made a formal reserve to Schedule XX, the Community considered that as long as negotiations on unresolved issues were continuing, formal reserves were not necessary.

IV. CONCLUSIONS

22. The Panel reached the following conclusions:

- (a) On the basis of the information supplied by the parties to the dispute, the Panel has not been able to determine with certainty whether the United States had made it clear to the Community negotiators, prior to 30 June 1979, that United States was not

prepared to continue the negotiations on Vitamin B12 after that date. The United States thought that it had made it clear that it was not prepared to continue the negotiations. The Community, on the other hand, reverted to the question of the conversion of the duty on Vitamin B12 at several occasions between June 1979 and April 1981 without receiving a final negative reply in written form from the United States until 22 April 1981. In these circumstances the Panel believes that the Community could not reasonably have been expected to make a reservation concerning Vitamin B12 with respect to the United States Tokyo Round Schedule. The existence of such a reservation would in any event, in the opinion of the Panel, not have been relevant for its further consideration of the dispute.

- (b) By entering into the bilateral Understanding with the United States on 2 March 1979 concerning ASP Chemical Products, the Community - for which, the Panel holds, the abolition of the ASP valuation system represented one of the aims of the negotiations - accepted that the base rates for the tariff cuts to be negotiated in the Tokyo Round for Vitamin B12, as for other "competitive" ASP products, would be the converted rates offered by the United States without a need for renegotiations under Article XXVIII in respect of such products.
- (c) In the ASP Chemical Products Understanding the United States undertook to examine, on a case by case basis, with a view to finding a mutually acceptable solution any specific cases raised by the Community on the ground that the Community in such case contested the method of conversion. The Panel noted that the only case concerning a "competitive" product raised by the Community related to Vitamin B12.
- (d) It is clear in the opinion of the Panel that the ASP Chemical Products Understanding, while requiring the United States delegation to examine cases raised by the Community with a view to finding a mutually acceptable solution, did not create an obligation for the United States to meet the requests of the Community in each case it could raise.
- (e) The Panel considers that the United States did not have an obligation to maintain the de facto tariff rate differentiation between feedgrade and pharmaceutical quality vitamins, provided that the method used for the conversion of the previous common bound rate was neutral and did not involve any arbitrary increase. The Panel believes the method used by the United States for the calculation of the level of the base rate - the weighted average of actual duties collected for feedgrade and pharmaceutical quality vitamins - to be in conformity with that proviso.
- (f) The Panel notes that Community exports of feedgrade Vitamin B12 to the United States virtually ceased in the second half of 1980, after the abolition of the ASP valuation system on 1 July 1980, but that they recommenced in 1981, although at a lower level than in 1978 and 1979.
- (g) Although the Panel, as indicated above, considers that the method used by the United States for the calculation of the base rate for Vitamin B12 was in principle fair and equitable, it felt that in this particular case, the result in respect of feedgrade quality vitamins had excessively negative effects for the suppliers of this

product. The European Economic Community could reasonably have foreseen that the abolition of the ASP valuation system in some cases would lead to a less favourable tariff treatment for certain products, but it had in the opinion of the Panel no reason to assume that the tariff treatment of feedgrade quality vitamins would be modified in such a way that imports into the United States would decrease to the extent experienced.

- (h) The Panel considers that the United States has not infringed its commitment under the General Agreement or under the ASP Chemical Products Understanding of 2 March 1979. Nevertheless, the Panel feels that in the light of the particular circumstances, the Council could invite the United States to advance the implementation of the Tokyo Round concession rate on feedgrade Vitamin B12 to such an extent that imported vitamins could again attain their traditional competitive position in the United States market.

A.S.P Chemical Products

1. Pursuant to note no 4 to the US GATT schedule of concession the US has reserved the right, in the event of abolition of ASP, to adjust the rates of duties provided for in Schedule XX to the extent of offsetting the difference in the amount of duty which, without such adjustment, could result from making such abolition effective.

Both parties agree that this adjustment must remain neutral and shall not involve any arbitrary increase in customs duties.

2. The US Delegation has communicated in June 1978 an offer including both the conversion of customs on chemical products subject to ASP as well as MTN reductions.

3. The Commission Delegation does not contest the principle of conversion in so far it applies to "competitive" products. It nevertheless reserves the right to raise specific cases, which the US Delegation will examine on a case by case basis, taking into account the characteristics of the product and of the trade with a view to finding mutually acceptable solution.

4. Th US offer contains a number of groupings. In some of them, the Commission believes that some "noncompetitive" products have been grouped with "competitive" products. The Commission Delegation will promptly notify such products which it considers to be "noncompetitive". The US Delegation agrees to exclude from the groupings all products that have been imported in commercial quantities and have not been valued on an ASP basis, and to itemise them in its offer without any conversion.

5. In the items "other" (basket) a distinction will be established, between "future products" and other items in the basket.

This solution will be applicable to all the "basket" positions which in the present US offer are subject to a conversion involving a converted rate higher than the nominal rate.

Except for dyestuffs, the US will fully implement its offer on "future products", as opposed to other items in the basket, on the date at which the United States will implement the Customs Valuation Code. On dyestuffs (items 406.10 B, 406.50 B, D, F, H, K, M, O, P and 406.70 B), the offers on "future products" will be fully implemented in 5 annual steps from the date of implementation of the Customs Valuation Code.

6. Future products are defined as products which have not been imported into the USA before January 1, 1978 nor produced in the United States before May 1, 1978. A list of products which are not to be considered as future products will be agreed between the two delegations; only these products which have been produced or imported in commercial quantities, will be taken into consideration. For purposes of this paragraph, the basis of the identification of imported products will be the U.S. International Trade Commission publications, "Imports of Benzenoid Chemical and products." Both delegations may propose the addition or deletion of chemical that may have been omitted or included erroneously in these publications.

2 March 1979