Memorandum

June 27, 2005

TO: Sen. Kent Conrad
Attention: Tom Mahr

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SUBJECT: CAFTA Related Questions

Pursuant to your request on June 26, 2005, this memorandum responds to your specific questions regarding a proposal by Secretary of Agriculture Johanns on trying to hold the U.S. sugar industry harmless from sugar imports under NAFTA and CAFTA. Due to time constraints, the answers are general and may not provide much of the detail necessary to address all aspects of the questions posed. The questions are presented in **bold** and are followed by a response.

Questions

1. It is my understanding that there is no provision in the DR-CAFTA implementing legislation introduced last Thursday that specifically addresses compensating the DR-CAFTA countries for not shipping sugar to the United States or purchasing DR-CAFTA sugar for the purpose of holding it off the U.S. market. Is that correct?

The Administration's bill to implement the DR-CAFTA was introduced by request in the Senate on June 23rd by Senator Grassley (S. 1307). An identical bill (H.R. 3045) was introduced in the House the same day by Congressman DeLay.

As of this moment [2 pm, Mon], only a pre-publication edition of H.R. 3045 is available, with the warning that "content [is] subject to change." A review of the available bill text indicates no provision exists to detail how the agreement's sugar compensation provision might operate.

The statement of administrative action [SAA] has not yet been released by either the Senate Finance Committee or the House Ways and Means Committee. This document prepared by the Executive Branch, which accompanies each trade agreement submitted to Congress, may contain some elaboration of how the compensation provision might work. The submittal of the SAA by the Administration and its availability may depend on whether this document might be used as the vehicle to elaborate on the USDA proposal, which is still being discussed with Members of Congress. Another meeting between the Secretary of Agriculture and key Members on a possible sugar deal is reportedly planned for this evening (June 27).

2. Absent some explicit authorization from Congress, the U.S. cannot make cash payments to foreign governments. Does the CCC Charter Act give the Secretary of Agriculture the authority to provide cash payments to foreign governments (or private companies in foreign countries) in return for commitments from those countries to not ship a commodity or commodities to the United States? Is there any other existing law that gives the Secretary of Agriculture (or any other U.S. government official) such authority?

There does not appear to be specific authority in the CCC Charter Act (7 U.S.C. §§ 714 *et seq.*) that authorizes the Secretary of Agriculture to provide cash payments to foreign governments in return for commitments from those countries to not ship a commodity to the United States. There appear to be some provisions (see below), nonetheless, that might be argued by some to be broad enough to support such a conclusion. These provisions, however, should be read in light of the explicit statutory provision that authorizes the CCC to procure agricultural commodities for "sale" to foreign governments (i.e., Congress explicitly provided an avenue for the involvement of foreign governments and other methods might arguably not be available or intended) and the general purpose of the Charter Act to support domestic agriculture. Due to time constraints, we only examine the CCC Charter Act.

- **15 U.S.C. §714c(a).** This provision authorizes the CCC to support the prices of agricultural commodities through "payments" and "other options." This authority is not limited to domestic purchases and does state what type of commitment is allowed or prohibited between parties. Moreover, the term "other options" is not defined and might be interpreted in a broad manner that allows payments to foreign governments. Provided it can be shown that cash payments to foreign governments (with the required commitment you described) are supporting the prices of agricultural commodities, it appears that the Secretary could plausibly be argued to have the authority under this provision to provide payments to foreign governments under the conditions presented.

- **15 U.S.C. §714c(d).** This provision authorizes the CCC to remove and dispose of or aid in the removal or disposition of surplus agricultural commodities. This provision appears quite broad and does not describe or proscribe any particular method to fulfill its purpose. Accordingly, some might argue that the Secretary of Agriculture could use this authority, if it can be shown that providing payments to foreign governments in return for their commitment not to ship an otherwise covered commodity to the United States "removes and disposes of or aids in the removal or disposition of surplus agricultural commodities."

- **15 U.S.C. §714c(f).** This provision authorizes the Secretary of Agriculture to "aid in the development of foreign markets for agricultural products." Again, provided some type of connection can be shown between providing cash payments (with the required commitment) and aiding the development of a foreign market, it appears this authority might arguably be broad enough to support the proposition in the question posed.

3. I have been given an outside legal analysis that concludes that the CCC does not have the authority to purchase domestic commodities for the purpose of donating (as opposed to selling) them to foreign countries in return for a commitment not to ship sugar to the United States (as opposed to other purposes). Do you concur with this analysis?

There does not appear to be a specific provision in the CCC Charter Act that provides the Secretary of Agriculture with the authority to purchase domestic commodities for the purpose of donating them to foreign countries in return for a commitment not to ship sugar to the United States. However, it might be argued that the CCC does have such authority under 15 U.S.C. §§ 714c(d) and (f). Section 714c(d), as mentioned above, does not describe or proscribe what methods could be used to remove and dispose of or aid in the removal or disposition of surplus agricultural commodities. Section 714c(f), again, might be applicable if some type of connection can be shown between purchasing domestic commodities for the purpose of donating them to foreign countries (with the required commitment) and aiding the development of a foreign market. It, like §714c(d), does not specify what courses of action can be taken by the Secretary to fulfill the Charter Act's intended purposes. At this time, we could not verify or refute the accuracy of the outside legal analysis you provided us.

4. If the U.S. were to purchase commodities and donate them to the CAFTA countries, would this be consistent with our WTO obligations regarding export subsidies?

Under the WTO Agreement on Agriculture, WTO Members have agreed that specific export subsidies listed in Article 9.1 of the Agreement are subject to reduction commitments. Reduction commitments for specified agricultural products or groups of products are listed in each Member's Schedules. These commitments were to have been fulfilled by the end of 2000.

Article 3.3 of the Agreement places two obligations on each WTO Member regarding Article 9.1 subsidies: (1) a Member may not provide export subsidies listed in the Article for scheduled products "in excess of the budgetary outlay and quantity commitments levels specified in" the Schedule; and (2) a Member may not provide such subsidies with respect to any agricultural product not specified in its Schedule.

In addition, Article 10 of the Agreement contains several obligations aimed at preventing the circumvention of export subsidy commitments under the Agreement. Article 10.1 provides that export subsidies not listed in Article 9.1 "shall not be applied in a manner which results in, or which threatens to lead to circumvention of export subsidy commitments." Moreover, "non-commercial transactions" may not be used "to circumvent such commitments." In addition, under Article 10.3, any Member claiming that "any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports in question." Further, the Agreement requires at Article 10.4 that

international food aid be bona fide, stating WTO food aid donors "shall ensure .. that the provision of international food aid is not tied directly or indirectly to commercial exports of agricultural products to recipient countries"; that food aid transactions be carried out in accordance with FAO principles of surplus disposal; and that aid be provided to the extent possible in fully grant form or on terms no less than concessional than those provided for in Article IV of the 1986 Food Aid Convention (Art. 10.4).[1]

Regarding Article 9.1, it would appear that the proposed transaction may qualify as an export subsidy for purposes of Article 9.1 in that it may arguably constitute, for example, the provision by a government or one of its agencies "of direct subsidies, including payments-in-kind, 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" (Art. 9.1(a)) or "the sale or disposal for export" by a government or a government agency "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" (Art. 9.1(b)). To the extent that the proposed transaction qualified as an export subsidy identified in Article 9.1, the United States would be in violation of Article 3.3 were the subsidy to exceed the U.S. scheduled reduction commitments.[2] If the product is unscheduled, however, the United States may not under Article 3.3 provide any export subsidy listed in Article 9.1 with respect to that product. In addition, were the transaction to exceed the reduction commitment level, the United States would need to show that no export subsidy was being granted with respect to the quantity of exports in question (Art. 10.3). In addition, even were the proposed transaction not to qualify as a subsidy listed in Article 9.1, the United States would be under an obligation not to apply "any export subsidy" in a manner that "results in" or "threatens to" circumvent U.S. Article 9.1 commitments (Art. 10.1).

Even assuming that the export subsidy provisions contained in the Agreement on Agriculture do not apply to a proposed agreement regarding sugar imports, there may nevertheless be potential international trade issues arising from the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement).[3] Generally speaking, for a measure or government program to be considered a subsidy there must be a financial contribution or an income or price support that confers a benefit and is determined to be specific to an enterprise, industry, or a group of enterprises or industries.[4]

The SCM Agreement sets out four specific examples of what may constitute a financial contribution. First, financial contributions are situations where the government practice involves a direct or potentially direct transfer of funds, such as a grant, loan, or loan

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[1] Because the commodities here would be provided with the *quid pro quo* that the CAFTA recipients agree not to export specified amounts of sugar to the United States, this proposal would not appear to qualify as international food aid in the sense contemplated in the Agriculture Agreement. Note also that even were it to be argued that the purchase and donation constituted a non-commercial transaction, such a transaction could not be used to circumvent the U.S. scheduled commitments (Art. 10.1).

[2] The United States has made export subsidy reduction commitments regarding wheat, coarse grains, rice, vegetable oils, butter and butter oils, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, and eggs. *See* H.Doc. 103-316, v.2, at 3845-47.

[3] *See generally*, Agreement on Subsidies and Countervailing Measures, *available at* http://www.wto.org/english/docs_e/legal_e/24-scm.pdf [hereinafter SCM Agreement].

[4] *Id.* at Art. 1-3.

guarantee.[5] Second, financial contributions may be found where "government revenue is either forgone or not collected."[6] Third, a financial contribution may involve the government providing "goods or services other than general infrastructure or purchases of goods."[7] Finally, financial contributions can arise where the government "makes payments to a funding mechanism" or directs a private body to do so.[8]

In addition to a "financial contribution," Article 1 of the SCM Agreement also requires that "a benefit is thereby conferred."[9] While the Agreement's language is silent regarding what precisely is meant by the term "benefit," the WTO Appellate Body (AB), in a case involving Canadian exports of civilian aircraft, has written that the term "'benefit,' as used in Article 1.1(b), implies some kind of comparison."[10] The AB continued by explaining how a benefit should be determined in cases of a governmental financial contribution. According to the AB:

> there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favorable than those available to the recipient in the market.[11]

In other words, the AB concluded that the way to measure whether a benefit has been conferred as a result of a governmental financial contribution is to compare the party's position after receiving the contribution with the position of the party in the free market without the contribution. Thus, a benefit is received if the party is better off as a result of the government's financial contribution.

Finally, Article 2 of the SCM Agreement establishes a set of principles for determining whether a subsidy is specific to an enterprise, industry, or a group of enterprises or industries. The first of these principles requires a finding that "the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises ...."[12] Another method is to demonstrate that the subsidy is limited "to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority ...."[13] It is not, however, sufficient merely to show that the legislation

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[5] *Id.* at Art. 1.1(a)(1)(i).

[6] *Id* at Art. 1.1(a)(1)(ii).

[7] *Id.* at Art. 1.1(a)(1)(iii).

[8] *Id.* at Art. 1.1(a)(1)(iv).

[9] SCM Agreement, *supra* note 3 at Art.1.1(b).

[10] Canada - Measures Affecting the Export of Civilian Aircraft; Report of the Appellate Body, WT/DS70/AB/R, para. 157 (1999)[hereinafter *Canada Aircraft – AB Report*].

[11] *Id.*

[12] SCM Agreement, *supra* note 3 at Art. 2.1(a).

[13] *Id.* at Art. 2.2.

or granting authority establishes "objective criteria or conditions ...."[14] In the event that specificity is unclear, Article 2 also supplies a set of additional factors that may be considered in making a determination. These factors include the "use of a subsidy program by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy."[15] Moreover, Article 2 provides that certain subsidies, including those contained in Article 3, are automatically deemed to have met the specificity requirement.[16] For example, Article 3 states, in relevant part, that "subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I,"[17] are automatically considered to be specific and, therefore, are prohibited.

Given both the limited time frame and the scarcity of public information regarding the proposals made by Secretary of Agriculture Johanns, it appears that even if the Agreement on Agriculture provisions are found not to apply, it may still be possible to argue that such an agreement would be a prohibited export subsidy and, therefore, a violation of the SCM Agreement. Our research has produced no WTO Panel or Appellate Body decision that appears to be on point. That being said, based on what information is available, it would appear that any program involving the transfer of funds or commodities to DR-CAFTA countries in exchange for a reduction in the amount of sugar exported to the United States could arguably be considered a financial contribution – either as a direct transfer of funds, a provision by the government of goods or services, or as a payment to a funding mechanism – by the U.S. government that confers a benefit to the U.S. sugar industry. Therefore, it may be argued that such a proposal may be a violation of the SCM Agreement that could potentially trigger international litigation before the WTO Dispute Settlement Body.

5. Is there any provision in U.S. law that gives the CCC the authority to purchase foreign sugar?

To our knowledge, there is no precedent for the CCC purchasing any foreign commodity to accomplish a policy objective. Again, however, the CCC Charter Act is silent in its specific grants of powers as to the purchase of foreign commodities but its basic thrust is to support domestic agriculture.

6. Is there any provision in NAFTA that would permit the United States to unilaterally require Mexico to not ship sugar to the United States and instead accept some form of compensation?

A review of NAFTA's Chapter 7 (Agriculture and Sanitary and Phytosanitary Measures) does not reveal any provision that would explicitly allow the United States to unilaterally compensate Mexico for sugar [or any other commodity] not shipped to the U.S. market under

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[14] *Id.* at Art. 2.1(b).

[15] *Id.* at Art. 2.1(c).

[16] *Id.* at Art. 2.3 (stating that "[a]ny subsidy falling under the provisions of Article 3 shall be deemed to be specific").

[17] *Id.* at Art. 3.1(a).

NAFTA's terms. This chapter contains NAFTA's sugar provisions (Annex 703.2, section A, paragraphs 13-22, but not the side letter).