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European Union Grain Export Practices: Do They Constitute a State Trading Enterprise?

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One of the disciplines for State Trading Enterprises (STEs), with respect to the WTO, is the requirement to notify the WTO of all endeavors that fit the definition of an STE. This study argues that the European Union's system of grain interventions and export refunds fits the WTO's definition of an STE. First, a system of agencies that work together for a common purpose can be considered to be an enterprise. Second, the constituents of Europe's grain intervention enterprise receive exclusive and special rights to export grain. Third, the grain intervention system has decisive voice over the timing, quantity and destination of exports. For these reasons the system should be notified to the WTO as an STE.

Keywords: State Trading Enterprises, European Union, WTO.

European Union Grain Export Practices: A System of Intervention

Introduction

During the current round of World Trade Organization (WTO) negotiations on agricultural trade, significant attention has been focused on state trading enterprises (STEs). Concern has been expressed, especially by the United States, but also by the European Union that these enterprises may engage in practices that are not disciplined by the Uruguay Round Agreement on Agriculture. State trading in grain is a particularly contentious issue. The attention has been focused to date on the Canadian Wheat Board and the Australian Wheat Board, but these are not the only instances where the state is extensively involved in the grain trade. The U.S. Commodity Credit Corporation was initially notified to the WTO as a state trading enterprise in 1995, but when the United States stopped using the Export Enhancement Program it withdrew the notification.¹ Although the grains trade in the EU involves a great deal of government intervention, the EU has not provided notification to the WTO of any of its agencies involved in the process of exporting cereals.

The issue of state trading is nonetheless central to the European position in agricultural trade negotiations. The EU's proposal on export competition advocates a comprehensive approach that addresses both direct export subsidies and such potential indirect subsidies as subsidized export credits, abuse of food aid, and state trading enterprises. They argue "exclusive rights and privileges" confer to STEs considerable market power, which can result in unfair competition against other world market traders.² Although the EU is silent about state involvement in European export practices, students of state trading, for example Veron Sorenson, argue that "the trading undertaken by the export tender system of the European Community constitutes a state trading enterprise".³

The definition of an STE is a hotly debated subject. The definition is important because it determines which agencies must be notified to the WTO as STEs and be subject to WTO disciplines. The existing WTO definition is imprecise and depends to a large extent upon self-identification, by members, of their institutions/measures that they consider to be state controlled. As a result, many enterprises with state-sanctioned powers are excluded from the WTO's STE disciplines. Peter Lloyd provides an economic definition where "state trading occurs when there exists a trading organization for which the prices and/or quantities of international transactions in commodities are determined as an instrument in the pursuit of government

policies".⁴ Given that this definition focuses on government control for public policy objectives, the system of European intervention purchases and export tendering is a strong candidate for STE notification. Although it is arguable that the entire system of EU cereals intervention fits an *economic* definition of state trading, does the system fit the *legal* definition?

This paper argues that the EU cereals intervention system, taken as a whole, fits the legal definition of an STE, even though individual elements of the system, taken on their own, may not qualify as STEs.

Three fundamental elements are identified in the WTO's working definition of a state trading enterprise: a government or non-government entity; the granting of exclusive or special rights or privileges; and the resulting influence on the level or direction of imports or exports.⁵ The objectives of this paper are to establish: that an entire intervention system can be considered as a single entity; that the type of relationship between the EU grains intervention system and the government includes the grant of an exclusive right; and that this system influences the level or direction of trade.

The structure of the paper is as follows. The second section examines alternative definitions of a state trading enterprise. The third section details the argument why the European system of cereals intervention and export tendering should be notified to the WTO as a state trading enterprise. The final section provides conclusions. A technical annex examines the operations of EU cereals intervention agencies and the system of export tendering, and describes the role of the major agents.

Definition of a State Trading Enterprise

The WTO rules on state trading contained within the General Agreement on Tariffs and Trade (1994) are primarily contained in Article XVII. The Article provides:

1. (a) Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges, such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

(b) The provisions of sub-paragraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to the

other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

(c) No contracting party shall prevent any enterprise (whether or not an enterprise described in sub-paragraph (a) of this paragraph) under its jurisdiction from acting in accordance with the principles of subparagraphs (a) and (b) of this paragraph.

One of the major deficiencies of Article XVII is the absence of a clear definition of the term “state trading enterprise”. There is no formal definition of an STE in the GATT or any other WTO agreement, hence, the meaning of the term must be determined from the language and context of Article XVII.

The general reference in Article XVII: 1(a) distinguishes between two different types of enterprise:

(a) a “state enterprise” or

(b) “any enterprise” that has been granted “formally or in effect, exclusive or special privileges”.

First, a “state enterprise” appears to mean any government-owned or government-controlled enterprise regardless of whether it has been granted exclusive or special rights and privileges.⁶ Second, “any enterprise” that has been granted “formally or in effect, exclusive or special privileges” refers to enterprises having some special relationship with government. This second type of enterprise will also be an STE even if it is not owned by government. The interpretive note to Article XVII specifically details that marketing boards that are established by governments and are engaged in purchasing or selling goods are subject to the provisions on state trading enterprises.⁷

Although several dispute panel reports⁸ under GATT 1947 have contained references to the meaning of state trading enterprise, the definitional issue of what is an STE has not yet been specifically ruled on by any dispute settlement panel.⁹ These panel reports make it clear that it is not only an “instrumentality of government” which is caught by Article XVII. State trading enterprises also include non-governmental bodies that have been granted exclusive or special privileges. None of the panel reports, however, have dealt with state trading exporters, for they deal only with importers. As a result, there is no GATT jurisprudence specifically directed to the issue of the definition of a state trading exporter.¹⁰

The 1960 GATT panel on *Subsidies and State Trading* narrowed the definition of an STE in two ways. First it established that not all functions of government, such as trade policy, can be considered to be state trading activities:

[T]he Panel did not use the word “enterprise” [in connection with the scope of the notification requirements] to mean any instrumentality of government. There would be nothing gained in extending the scope of the notification provisions of Article XVII to cover governmental measures that are covered by other articles of the General Agreement. The term “enterprise” was used to refer either to an instrumentality of government which has the power to buy or sell or to a non-governmental body with such power and to which the government has granted exclusive or special privileges.¹¹

Second it narrowed the government instrumentality to buying or selling and influencing trade:

The term “enterprise” was used to refer either to an instrumentality of government which has the power to buy or sell, or to a non-governmental body with such power and which the government has granted exclusive or special privileges. The activities of a marketing board or any enterprise defined in paragraph 1(a) of Article XVII should be notified where that body has the ability to influence the level or direction of imports or exports by its buying or selling.¹²

The evolution of STE definitions culminated in paragraph 1 of the WTO Understanding on the Interpretation of Article XVII of GATT 1994, which provides the following working definition for state trading enterprises:

Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence, through their purchases or sales, the level or direction of imports or exports.

Ernst-Ulrich Petersmann argues that this definition is narrower than the definition in Article XVII: 1. The definition is narrower because state-owned enterprises are excluded unless they satisfy two conditions: (1) they have a special right or privilege and (2) they influence the level or direction of trade through sales or purchases.¹³ This is a higher standard than the plain language of Article XVII, which does not require a trade influence. The working definition also switches the focus from an institutional definition to a functional definition because it focuses on the causal effect that special rights or privileges have on trade flows. The emphasis on function raises the question:

what are the boundaries of an enterprise? The more basic question remains – what is an enterprise?

This latter question can be addressed using an interpretive approach used by recent dispute settlement panels. The Dispute Settlement Body of the WTO has now shed some light on how it will approach the interpretation of the language in GATT 1994. The dispute settlement panels and the Appellate Body have taken a consistent interpretive approach to applying the language of the WTO agreements. The approach starts with an examination of the plain meaning of the words of the agreement.¹⁴ The Dispute Settlement Body has used this approach by examining dictionary definitions of the words at issue.¹⁵

Black's Law Dictionary defines “enterprise” to mean:

“an organization or venture, especially for business purposes” or “one or more persons or organizations that have related activities, unified operation or common control, and a common business purpose”.¹⁶

The New Shorter Oxford English Dictionary describes an enterprise as:

“a piece of work taken in hand, an undertaking”.¹⁷

Merriam-Webster's Collegiate Dictionary defines “enterprise” as:

“a project or undertaking that is especially difficult, complicated, or risky” or “a unit of economic organization or activity; especially: a business organization”.¹⁸

It is clear from these definitions that the word “enterprise” extends beyond a legal entity such as a corporation. Rather, an enterprise can extend to an entire project made up of one or more organizations that have related activities and a common business purpose. An enterprise can therefore be a single entity or a group of organizations, including both government and non-governmental organizations.

The Dispute Settlement Body has also applied an accepted set of legal interpretive principles to the interpretation of treaty language. The Dispute Settlement Body considers the text in which the word is found, the context for the term in the treaty or agreement, and the objects and purpose of the agreement. With regard to the text of Article XV11: 1(a), it should be noted that the term “enterprise” is used in both “state enterprise” and “any enterprise”. This supports the suggestion that “enterprise” should be broadly construed to include any combination of state-owned or state-controlled organizations and other types of organizations. The context of this term in Article XVII also supports a broad interpretation, in that the article is intended to place STEs

under the same rules as member states regarding GATT obligations (e.g., subsidies). A broad interpretation of “enterprise” to include a variety of complex organizations, schemes or projects would be supported by this context.

Further, the objective of GATT is to liberalize trade and reduce trade distortions. This supports a broad definition of “enterprise”. It would be inconsistent with the purpose of GATT to allow member states to circumvent their trade obligations by creating enterprises that fall outside the definition.

The application of these interpretive principles results in a meaning for the word “enterprise” as “one or more persons or organisations” that have “an organisation or venture, especially for business purposes” or “one or more persons or organisations that have related activities, unified operation or common control, and a common business purpose”. This definition of “enterprise” will be used in this paper in conjunction with the working definition of state trading enterprise provided by the WTO.

The objective of this paper is to establish that the European cereals export system should be notified as an STE to the WTO. The definition that is used to establish this claim is the working definition of the WTO Understanding on the Interpretation of Article XVII. Although this is the narrowest definition of an STE, it is employed because it requires a higher standard than the plain wording of Article XVII, in that it requires an influence on trade flows. It also provides a functional definition. The boundaries of an “enterprise” are extended along functional lines by this working definition to include the system that controls the flow of cereal exports from the EU. The focus now shifts to the case for providing the WTO with notification of the EU cereals intervention and export tendering system as a State Trading Enterprise.

Why the EU should provide notification:

Three fundamental elements are identified in the working definition of a state trading enterprise: (1) a governmental or non-governmental entity, (2) exclusive or special rights or privileges and (3) influence on the level or direction of trade. The premise of this paper is that the entire EU system of intervention purchases and export tenders constitutes a state trading enterprise; so the question is, does this system include these three elements? Specifically, can the intervention/export tender system be considered one enterprise in the context of Article XVII? Has the system been granted exclusive or special privileges and rights? Does the system influence the level or direction of trade? These questions are considered in turn.

Can a system be an enterprise?

The dictionary definitions detailed above indicate that a group of organizations with related activities and a common purpose can constitute an enterprise. The workings of the EU cereals intervention system, how the parts of the system fit together, and the roles of the major players are described in the technical annex. The European Commission manages a significant undertaking in the control of all aspects of EU cereals markets. The various management committees are essential components of the Community machinery that contribute to the process of adopting and implementing the European Union's Common Agricultural Policy. The member state intervention agencies are the instruments that control the day to day functioning of cereals market intervention and help to implement the commercial export policy of the EU Commission. These organisations are all part of a single grain export enterprise ultimately answering to the political body of the Union's Council of Ministers.

The case for providing notification to the WTO of the EU system of cereals intervention and export tenders was made by the European Court of Auditors, which argues that through its "subsidised export of agricultural products, the Commission is in effect responsible for a commercial operation on an international scale."¹⁹

Do the constituents of Europe's grain export enterprise have exclusive or special rights or privileges?

Numerous rights and privileges are shared among the three constituents of the intervention/ export tendering system. Since 1962, the Council of Ministers has entrusted the Commission with a growing volume of executive duties with respect to the Common Agricultural Policy and with ensuring that these duties are carried out in close collaboration with the member states. This collaboration is achieved by working with management committees on which member states are represented.

The Council of Ministers has the exclusive right to determine the purchase and sale prices for domestic cereals. The Cereals Management Committee (CMC) has the right to provide opinions on market management measures. The member state intervention agencies have the exclusive right to undertake intervention purchases and sales. The intervention purchases are mandatory for cereals that meet certain quality standards. The money that member state intervention agencies receive for the purchase of grain ultimately comes from the European Guarantee and Guidance Fund (EAGGF). In addition, the intervention agencies have the right of payment from the EAGGF for entrance and exit storage fees, cost of transportation, and financing costs. Responsibility for storage of grain held in intervention is the sole responsibility of the

member state intervention agencies. The EU Commission has legal title to the product in intervention and bears the market risk of the product while it is in storage.

The Cereals Management Committee is consulted on sales from intervention and on calls for tenders for the dispersal from intervention stocks; it also accepts the submitted bids for the tendering of stocks. The tendering process allows the Commission, and the system's other constituents, to control the volume of trade. The open market tendering process has been described as a system where the Commission "buys the export services of traders".²⁰ The Cereals Management Committee is the sole issuer of export licences. The member state intervention agencies are the chief administrators of these licences.

These rights and privileges are exclusive to constituents of the EU system of cereals intervention and export tendering in that no other enterprise in the grain export trade has the same rights. These rights are special in the sense that they are granted by government and are different in nature from the rights or privileges otherwise enjoyed by private traders where there is no government intervention involved.

Is the level or direction of exports influenced?

Level

This part of the definition requires that the quantity of product exported is increased or reduced by the STE from what would be the case without the involvement of the special right or privilege. A strict test of the "influence" on trade requires a factual comparison of trade with and without the intervention agency in place. Since this comparison is not possible, the influence on trade must be determined conceptually on the basis of the special rights and privileges offered.

The European system of cereals intervention clearly can influence the level of trade. First, intervention prices that exceed those that would occur in an unfettered market will induce production and reduce consumption. Furthermore, compensatory payments can potentially induce higher levels of production and affect the allocation of area among crops. These instruments increase the size of the exportable surplus.

In the absence of export subsidies, this exportable surplus could not be sold on international markets.²¹ So the system of export tenders and refunds determines whether or not the EU will export grain. The level of trade is influenced by the size of the refunds that are determined by the tendering process. The procedure for setting the maximum refund in the open market tender is unclear (see the technical annex for details). Despite the existing "cross-check", there is no definitive method by which the

refunds are determined. There appears to be significant leeway for the Commission to manipulate where the maximum refund should be set according to the tenders received, without any required justification. Similarly, for intervention tenders, the procedure for setting the minimum price is ambiguous. Despite the ambiguity in the method, the tender and refund system clearly influences the level of trade.

Direction

This part of the test examines whether the STE has an influence on the destination of exports. In other words, do the state trader rights influence where exports will go? While the private trader (tenderer for the restitution) decides where the product is to be exported, the Commission/Cereals Management Committee can affect the trader's decision on the destination. It influences the direction of trade by adjusting the timing of the tendering process, stipulating that certain third countries are ineligible for restitution, directing trade through standing refunds, and influencing the direction of trade through the system of correctives (see the technical annex).

The Commission/Cereals Management Committee is afforded even greater power in controlling the quantity and recipient of exported cereals by not being obligated to accept the minimum bid for the cereals in intervention. There are recorded instances when the Commission has chosen to pay a premium for some exports when they deemed the customer worthy or important or when they were trying to counteract the initiative of the U.S. Export Enhancement Program.²²

The introduction of a "special one-day refund" in the standing refund procedure is questionable (see the technical annex). Set criteria that explain the circumstances allowing this type of procedure do not exist. The decision to use the procedure is a unilateral one taken by the Commission, demonstrating yet again its considerable control over both the quantity and destination of the traded product.

Is the influence on the level or direction of exports a result of the rights or privileges?

STEs that engage in commercial activity will be affected by many factors, including price, quality, demand considerations, market structure and other commercial considerations. The level and direction of exports are determined by these commercial factors. If the special rights or privileges, such as refunds from government, also influence the level or direction of exports, then the enterprise having the rights or privileges will fall within the definition of an STE.

In the circumstances of the European Commission and the CMC, the rights or privileges involved in the implementation of the intervention schemes allow the intervention system to influence the level or direction of exports.

Is the influence exerted through sales by the enterprise?

The functional definition set out above appears to require that sales be performed by the enterprise. The purchase of grain stocks by the member state intervention agencies at a fixed intervention price has an influence on eventual export of the grain. These purchases make a supply of grain available, through intervention stocks, to private traders to sell into the export market. The sales of this grain by the intervention agencies, as part of the enterprise established by the EU, directly influence the level and direction of exports. The sales by the intervention agencies result in sales of specific grain into specific markets at prices determined by the EU. This is precisely the type of behaviour that Article XVII is attempting to regulate.

Conclusions

The European system of cereals intervention purchases and export restitution fits the definition of an STE exactly, when the definition of an enterprise is broadened to include all constituents of the system. At the heart of this system is the EU Commission, which determines the level of exports by setting intervention prices and refund rates. This system effectively gives the Commission a flexible means of managing the export market. The Commission has a decisive voice over such key parameters as the timing, quantity and destination of subsidised exports. The member state intervention agencies are the instruments that help implement the commercial export policy of the EU Commission. A wide array of special privileges, which result in influence over the level and direction of trade, are shared among the members of this system. The tendering process allows the Commission to control the volume and direction of trade. The treasuries of member countries deal with the financing of intervention purchases and export sales. The member state intervention agencies hold title to the product for part of its journey to the export market.

The significance of the conclusion that the European cereals intervention system is a state trading enterprise is twofold. First, the EU should be providing a state trading notification to the WTO regarding its cereals intervention system. Such a notification would be consistent with its obligations under Article XVII of GATT 1994. The EU should provide this notification if it expects to have any legitimacy in its arguments about the state trading activities of other WTO members.

Second, the fact that the European cereals intervention system is a state trading enterprise will have a significant influence on the next round of WTO negotiations. The acceptance by the EU of the working definition of state trading enterprise, and acceptance that the cereals intervention system fits this definition, would provide momentum for meaningful negotiations on export subsidies, state trading enterprises, and agricultural trade in general.

Endnotes

1. The United States last provided notification regarding this organization in 1995. See State Trading Notification of the United States G/STR/N/1/USA (29 Sept 1995).
2. See European Community's proposal to the WTO Committee on Agriculture Special Committee "Export Competition" G/AG/NG/W/34 (18 Sept. 2000).
3. V. Sorenson, "The Economic and Institutional Dimensions of State Trading" in *State Trading in International Agricultural Markets: Institutional Dimensions and Select Cases*. (Washington: International Policy Council on Agriculture and Trade, 1991) p. 5.
4. P. Lloyd, "State Trading and the Theory of International Trade" in *State Trading in International Markets*, ed. M.M. Kostecki. (New York: St. Martins Press, 1981).
5. World Trade Organization, "Illustrative List of Relationships between Governments and State Trading Enterprises and the Kinds of Activities Engaged by these Enterprises," Working Party on State Trading Enterprise, G/STR/4 (30 July 1999).
6. See E.-U. Petersmann, "GATT Law on State Trading Enterprises: Critical Evaluation of Article XVII and Proposals for Reform" in *State Trading in the Twenty-First Century*, ed. T. Cottier and P.C. Mavroidis (Ann Arbor: The University of Michigan Press, 1998) for an elaboration of this position. He also argues (p.88) that a state enterprise includes inter alia a branch of a government ministry or agency that is "(1) financed by government budget allocations; or (2) has another public law statute different from private law companies; or (3) the capital and management of private law company are exclusively or predominantly controlled by the government."
7. See M. Annand and D. Buckingham, "State Trading Exporters and the World Trade Organization: What are the Rules" in *World Agricultural Trade*, ed. T Yildirim, A. Schmitz, and W.H. Furtan. (Boulder: Westview Press, 1998).
8. Canada – Administration of the Foreign Investment Review Act, BISD 30S/140 (1984); Japan – Restrictions on Imports of Certain Agricultural Products, BISD 35S/163, (1988); Korea – Restrictions on Imports of Beef Complaint by the United States, BISD 36S/268.
9. See W. Davey, "Article XVII GATT: An Overview" in *State Trading in the Twenty-First Century*, ed. T. Cottier and P.C. Mavroidis. (Ann Arbor: The University of Michigan Press, 1998) p. 26.
10. M. Annand, "The WTO Regulation of State Trading Exporters", Master of Laws Thesis, University of Saskatchewan, Saskatoon, Saskatchewan, Canada, 1998.

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11. Adopted on 24 May 1960, BISD 9S/179, paras. 21-23.
 12. See BISD 9S/179-184.
 13. See E.-U. Petersmann, *op. cit.*, p 86.
 14. This is consistent with Article 31 of the Vienna Treaty, which requires that the words in treaties be given their plain meaning.
 15. Panel Report, Canada Measures Affecting the Importation of Milk and the Exportation of Dairy Products (CanadaMilk), WT/DS103/R, WT/DS113/R adopted 27 October 1999.
 16. Black's Law Dictionary. (St. Paul: West Group, 1999).
 17. The New Shorter Oxford English Dictionary. (Oxford: Clarendon Press, 1993).
 18. Merriam-Webster's Collegiate Dictionary. (Springfield, Mass: Merriam-Webster Incorporated, 1993).
 19. See Court of Auditors of the European Communities (1990), "Special report No. 2/90 on the management and control of export refunds accompanied by the replies of the Commission", Official Journal of the European Communities 90/C 133/01. 31/05.90.
 20. J.-M. Bourgeon and Y. Le Roux, "Tenders for European Cereal Export Refunds: A Structural Approach", *European Review of Agricultural Economics* 23, (1996) pp. 5-26.
 21. Agenda 2000 lowered intervention prices sufficiently that the EU was able to export wheat and barley without restitution, given the low Euro, for periods in 2001 and 2002. However, more recently refunds have begun to be used again.
 22. See Special Report No. 2/90 of European Court of Auditors, *op. cit.* para. 2.69.

The technical annex to this paper, pages 190-202, is available as a separate document.

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