

**KOREA – DEFINITIVE SAFEGUARD
MEASURE ON IMPORTS OF CERTAIN
DAIRY PRODUCTS**

Report of the Panel

The report of the Panel on Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products is being circulated to all Members, pursuant to the DSU. The report is being circulated as an unrestricted document from 21 June 1999. Pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/160/Rev.1). Members are reminded that in accordance with the DSU only parties to the dispute may appeal a panel report. An appeal shall be limited to issues of law covered in the Panel report and legal interpretations developed by the Panel. There shall be no *ex parte* communications with the Panel or Appellate Body concerning matters under consideration by the Panel or Appellate Body.

Note by the Secretariat: This Panel Report shall be adopted by the Dispute Settlement Body (DSB) within 60 days after the date of its circulation unless a party to the dispute decides to appeal or the DSB decides by consensus not to adopt the report. If the Panel Report is appealed to the Appellate Body, it shall not be considered for adoption by the DSB until after the completion of the appeal. Information on the current status of the Panel Report is available from the WTO Secretariat.

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I. INTRODUCTION

A. BACKGROUND

1.1 On 12 August 1997, the European Communities requested consultations with Korea regarding a definitive safeguard measure on imports of certain dairy products (WT/DS98/1). The European Communities made their request pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), Article XXIII:1 of the General Agreement.

1.2 On 25 August 1997 Australia, requested to be joined in the consultations (WT/DS98/2). The request was accepted by Korea on 28 August 1997 (WT/DS98/3).

1.3 Pursuant to this request, the European Communities consulted with Korea in Geneva on 10 September 1997 and 16 October 1997. Australia participated in these consultations as a third party. No mutually satisfactory solution was reached.

1.4 On 9 January 1998, the European Communities requested the establishment of a panel with the standard terms of reference provided by Article 7 of the DSU (WT/DS98/4). The European Communities made this request pursuant to Article XXIII:2 of the General Agreement on Tariffs and Trade ("GATT"), Articles 4 and 6.1 of the DSU, and Article 14 of the Agreement on Safeguards. At the Dispute Settlement Body ("DSB") meeting of 22 January 1998, the European Communities informed the DSB that they were for the time being not pursuing its Panel request.

1.5 On 10 June 1998, the European Communities reiterated its request for the establishment of a Panel.

B. ESTABLISHMENT AND COMPOSITION OF THE PANEL

1.6 At its meeting on 22 July 1998, the Dispute Settlement Body ("DSB") established a panel pursuant to the EC's request (WT/DS98/5). The Panel's terms of reference are:

To examine, in the light of the relevant provisions of the covered agreements cited by European Community in document WT/DS98/4 the matter referred to the DSB by the European Community in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.

1.7 The United States reserved its rights as to participate in the Panel proceedings as third party.

1.8 On 20 August 1998, the Panel was constituted with the following composition:

Chairman: Mr. Ole Lundby

Members: Ms. Leora Blumberg

Ms. Luz Elena Reyes

C. PANEL PROCEEDINGS

1.9 The Panel met with the Parties on 10/11 November 1998 and on 16/17 December 1998.

1.10 The Panel submitted its interim report to the parties on 3 March 1999. On 17 March 1999, both parties submitted written requests for the Panel to review precise aspects of the interim report. At the request of the European Communities, the Panel held a further meeting with the parties on

29 March 1999 on the issues identified in the written comments. The Panel submitted its final report to the parties on 8 April 1999.

II. FACTUAL ASPECTS

2.1 This dispute concerns definitive safeguard measures imposed by Korea on imports of skimmed milk powder preparations ("SMPP") classified under tariff headings HS 0404.90.0000 and 1901.90.2000. On 17 May 1998, based on a request by the National Livestock Cooperatives Federation ("NLCF") filed on 2 May 1996, the Korean Trade Commission ("KTC") decided on the initiation of the requested investigation.

2.2 On 11 June 1996, Korea notified the WTO Committee on Safeguards under Article 12.1(a) of the Agreement on Safeguards regarding the KTC's initiation of a safeguards investigation and the reasons supporting initiation.¹

2.3 On 23 October 1996, the KTC completed its Investigation Report on Industrial Injury Caused by the Increase of Certain Dairy Product Imports. A Notice of this fact was published in Korea's Official Gazette dated 11 November 1996. Non-confidential copies of the Investigation Report on Industrial Injury by the Office of Administration and Investigation ("OAI Report") were available on request prior to that date.

2.4 On 2 December 1996, Korea notified the Committee on Safeguards under Article 12.1(b) of the Agreement on Safeguards that the KTC had made a finding of serious injury to the domestic industry caused by the increased imports of dairy products.²

2.5 On 21 January 1997, Korea submitted a notification under Article 12(c) of the Agreement on Safeguards.³ The notification informed the Committee that Korea proposed to apply a safeguard measure on imports of certain dairy products.

2.6 On 31 January 1997, Korea filed a notification pursuant to Article 9, footnote 2 of the Agreement on Safeguards regarding the non-application of safeguard measures to developing countries.⁴

2.7 The final decision by Korea to apply the safeguard measure was made, and went into effect, on 7 March 1997. Notice of the application of the measure was published in Korea's Official Gazette.

2.8 On 24 March 1997, Korea submitted a supplemental notification to the Committee on Safeguards under Article 12(c) of the Agreement on Safeguards.⁵ In its notification, Korea informed the Committee that it had taken a final decision on the application of a safeguard measure on certain dairy products.

III. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

A. EUROPEAN COMMUNITY

3.1 The **European Communities** requested the Panel to find that Korea has violated Article XIX:1(a) of GATT and Articles 2.1, 4.2(a), 4.2(b), 5.1 and 12(1) to (3) of the Agreement on Safeguards.

¹ G/SG/N/6/KOR/2 (1 July 1996).

² G/SG/N/8/KOR/1 (6 December 1996).

³ G/SG/N/10/KOR/1 (27 January 1997).

⁴ G/SG/N/11/KOR/1 (21 February 1997).

⁵ G/SG/N/10/KOR/1/Suppl.1 (1 April 1997)

B. KOREA

3.2 **Korea** requested the Panel to find that the European Communities has not discharged its burden of proving that Korea failed to examine relevant facts or failed to explain adequately the basis for its determination and, therefore, conclude that the safeguard measure on SMPP was imposed by Korea in a manner fully consistent with its obligations under the Agreement on Safeguards.

IV. MAIN ARGUMENTS OF THE PARTIES⁶

A. PROCEDURAL OBJECTIONS

1. Lack of commercial interest and good faith by the European Communities

(a) Objection of Korea

4.1 **Korea** raised a procedural objection alleging a lack of commercial interest by the European Communities as well as a failure to act in good faith on their part. The following are Korea's arguments in support of its objection:

4.2 Korea argues that the EC submission admits that it has little or no commercial interest in bringing this matter before the Panel.⁷ This admission coupled with the abortive settlement procedure suggests that the current procedure lacks any issue in dispute between the parties and is merely an attempt to use the DSU to establish a precedent on safeguards. Korea is also concerned that the European Communities interest in receiving an advisory opinion is especially onerous upon Korea given the substantive weakness of the EC case.

4.3 During the course of these proceedings, Korea urged the Panel to consider that the EC objective is not to preserve its rights with respect to its exports of SMPP, but to secure an advisory opinion from the Panel. Under these circumstances, the European Communities recourse to formal dispute settlement represents an abuse of the WTO dispute settlement system.

4.4 Korea requests that the Panel consider the EC motives underlying recourse to formal WTO dispute settlement proceedings. Korea considers that the EC actions during consultations and its expression of limited interest in its first submission are inconsistent with the object and purpose of the WTO dispute settlement proceedings.

4.5 The DSU expressly provides that formal dispute settlement should be reserved for disputes where Members consider, in good faith, that their interests are being impaired.⁸ Moreover, Article 3.7 of the DSU specifically instructs Members to exercise restraint in bringing dispute settlement cases and articulates a preference for mutually agreed solutions over resort to formal dispute settlement.⁹

⁶ The Panel notes that, unless otherwise specified, the footnotes in this section are those of the parties as they appear in their different submissions.

⁷ See, in particular, EC's First Submission where the European Communities states: "The EC would stress that its complaints in this case, and notably those concerning the injury determination and procedural violations, are complaints of principle and that it considers all should be addressed by the Panel in its report."

⁸ Article 3.3 of the DSU provides that WTO dispute settlement is reserved for cases where a Member's benefits "are being impaired by measures taken by another Member." Article 3.10 states that "all Members will engage in these procedures in good faith in an effort to resolve the dispute."

⁹ Article 3.7 provides that:

"[b]efore bringing a case, a Member shall exercise its judgement as to whether actions under these procedures would be fruitful. The aim of the dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred."

4.6 It is important to note that a key strand of the EC case is that in some way Korea failed to provide the requisite information to the European Communities to enable them to enter into meaningful consultations that might lead to a settlement (which is, after all, the key objective of the DSU). While Article 12 of the Agreement on Safeguards has a specific series of requirements, Korea considers that the information provided to the Committee on Safeguards more than complied with the *pro forma* standards laid down by that Committee¹⁰, and that this enabled the European Communities to enter into meaningful but ultimately unsuccessful negotiations. Korea notes that if it had indeed abused its obligations to provide information and to permit meaningful consultations, then it is difficult to explain how the Director-General of DGI of the Commission of the European Communities could have provided the Korean delegation with a letter accepting a settlement.¹¹ The fact that the Director-General had to later withdraw his acceptance of the settlement proposed by Korea is evidence of lack of good faith on the part of European Communities, rather than on the part of Korea.

(b) Response of the European Communities

4.7 At the first meeting of the Panel with the parties the **European Communities** responded to Korea's procedural objection as follows:

4.8 As to the alleged lack of commercial interest of the European Communities in bringing this complaint, the European Communities would recall that in the *EC - Bananas* case the Appellate Body, in reply to an analogous objection by the European Communities, held that:

“a Member has broad discretion in deciding whether to bring a case against another Member under the DSU. The language of Article XXIII:1 of the GATT and of Article 3.7 of the DSU suggests, furthermore, that a Member is expected to be largely self-regulating in deciding whether any such action would be ‘fruitful’ ”.¹²

4.9 As to the alleged acceptance of a settlement offered by Korea, the European Communities assume that Korea is not seriously arguing that documents like the ones attached to its First Submission as Exhibit Korea-11 could be considered as a proposal and acceptance of a settlement for purposes of WTO provisions, nor, presumably, in any other legal system. In reality, it is apparent from that Exhibit that Korea cannot even demonstrate that it ever sent the European Communities a formal proposal in due form, let alone that the European Communities received and accepted it.

2. Inadequacy of the EC request for establishment of a panel

(a) Objection of Korea

4.10 **Korea** raises a procedural objection regarding the inadequacy of the EC request for establishment of a panel and requests the Panel to entirely reject the EC complaint on this basis. The following are Korea's arguments in support of this objection:

4.11 The EC request for the establishment of the Panel does not specify the nature of its dispute with sufficient clarity to permit Korea to conduct an effective defence. A detailed statement of the matter in dispute and the legal bases of the arguments is also necessary to permit third parties (who may not be intimately familiar with the details of the dispute) to assess whether or not to intervene.

¹⁰ WT/TC/NOTIF/SG/1 (15 October 1996).

¹¹ See, Exhibit Korea-11

¹² See, the Report of the Appellate Body in *European Communities – Regime for the Importation, Sale and Distribution of Bananas* (“EC- Bananas”), WT/DS27/AB/R, 9 September 1997, paragraph 135.

4.12 In a request for establishment of a Panel under Article 6.2 of the DSU, a Complaining Party must «provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.» In its request for the establishment of a Panel, the European Communities merely listed four articles of the Agreement on Safeguards. This listing of articles cannot satisfy the specific criteria of Article 6.2, especially in a request relating to the determination of a domestic authority under the Agreement on Safeguards.¹³

4.13 Korea acknowledges that the Panel in *EC - Bananas* found that simply listing the articles and the relevant agreements in that case satisfied the «minimum requirements» of Article 6.2 of the DSU. Korea suggests that the Panel should refrain from following this interpretation, because such an approach encourages the establishment of imprecise and potentially speculative terms of reference, and, taking into account the general purpose of the DSU, undermines the object and purpose of Article 6.2. In any event, the instant case is distinguishable from the *EC - Bananas* case because, *inter alia*:

- (a) each Article under the Agreement on Safeguards does not identify «a distinct obligation,» but encompasses a multitude of distinct obligations regarding a domestic authority's investigation;¹⁴
- (b) the Panel's interpretation of Article 6.2 in *EC - Bananas* may have been influenced by its desire to prevent further delays in a dispute that had already been subject to two GATT Panel reviews and years of consultations;
- (c) the Panel in *EC - Bananas* did not explicitly consider Article 4.4 of the DSU in evaluating the appropriate context;¹⁵
- (d) the EC approach ignores the object and purpose of Article 6.2 because it does not identify the claims with sufficient precision to establish properly a Panel's jurisdiction or to give the parties and third parties sufficient notice of the claims at issue;¹⁶ and

¹³ In *Argentina - Safeguard Measures on Imports of Footwear ("Argentina - Footwear")*, for example, the EC's request, although still inadequate, included more specificity, stating that the European Communities:

"request[s] that the Panel consider and find that these measures are in breach of Argentina's obligations under the provisions of the Agreement on Safeguards, in particular, but not necessarily exclusively, of Article 2 (especially the requirement of determining in an investigation that certain conditions are present and the non-discrimination obligation), Article 4 (in particular that all relevant factors must be investigated and to demonstrate the existence of a causal link), Article 5 (especially the condition that measures must only be applied to prevent or remedy serious injury), Article 6 (in particular the requirement of evidence of "critical circumstances") and Article 12 (especially the notification obligations) of the said Agreement and in violation of Article XIX of GATT (in particular the lack of «unforeseen developments"). WT/DS121/3 (11 June 1998).

¹⁴ WT/DS27/R/USA, paragraph 7.3 (22 May 1997).

¹⁵ Article 31 of the Vienna Convention on the Law of Treaties provides that a treaty must be interpreted in accordance with the ordinary meaning to be given to its terms in their context. The Panel in *EC - Bananas* considered that the appropriate context for interpreting Article 6.2 was Articles 3.2 and 3.3 of the DSU, and that such context does not support any interpretation not resulting in a prompt settlement of the dispute. *Id.* at paragraphs 7.6 to 7.8. Korea considers that Article 4.4 of the DSU is the more relevant context, given that it is the parallel provision to Article 6.2 addressing requests for consultations. Article 4.4 of the DSU requires that a request for consultations include "an indication of the legal basis for the complaint." Assuming the mere listing of articles satisfies Article 4.4, the drafters of the DSU must have intended that the language of Article 6.2 should be interpreted to require more specificity in a request for establishment of a Panel.

¹⁶ In *Brazil - Measures Affecting Desiccated Coconut ("Brazil - Dessicated Coconut")*, the Appellate Body stated:

- (e) previous GATT practice in antidumping and countervailing duty cases provides that the mere listing of articles is insufficient in cases involving a Panel review of a domestic authority's investigation.¹⁷

4.14 Further, Korea submits that the EC failure to comply with Article 6.2 of the DSU demonstrates the European Communities lack of any fundamental economic interest in this case, its negligent consideration of Korea's (and third-party Members') rights under the DSU, and its failure to give due consideration to the object and purpose of the WTO dispute settlement system. To preserve the integrity of the WTO dispute settlement system and the specific principles established therein, the Panel should find that the European Communities violated Article 6.2 of the DSU and should reject the European Communities complaint in its entirety.¹⁸

(b) Response of the European Communities

4.15 At the first meeting of the Panel with the parties the **European Communities** responded to Korea's position as follows:

4.16 The European Communities recall that, in the *EC - Bananas* case, the Appellate Body

"accept[ed] the Panel's view that it was sufficient for the Complaining Parties to list the provisions of the specific agreements alleged to have been violated without setting out detailed arguments as to which specific aspects of the measures at issue relate to which specific provisions of those agreements".¹⁹

"A Panel's terms of reference are important for two reasons. First, terms of reference fulfil an important due process objective--they give the parties and third parties sufficient information concerning the claims at issue in the dispute in order to allow them the opportunity to respond to the complainant's case. Second, they establish the jurisdiction of the Panel by defining the precise claims at issue in the dispute." (WT/DS22/AB/R (21 February 1997) Section VI, Terms of Reference).

¹⁷ *United States - Anti-Dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway*, ADP/87, paras. 333-335 (adopted 26 April 1994); *United States - Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway*, SCM/153, paras. 208-214 (adopted 27 April 1994); *European Communities - Imposition of Anti-Dumping Duties on Imports of Cotton Yarn from Brazil*, ADP/137, paras. 438-466 (adopted 4 July 1995); *EC - Anti-Dumping Duties on Audiotapes in Cassettes Originating in Japan*, ADP/136, para. 295 (28 April 1995 (not adopted)). The Appellate Body in *Brazil - Dessicated Coconut* cited the cases under the Tokyo Round Anti-Dumping Code favourably in stating that a Complaining Party must precisely identify the claims in its request for establishment of a Panel. (WT/DS22/AB/R (21 February 1997))

¹⁸ The Panel should not now try to assess whether the rights of Korea and third-party Members have been prejudiced by the EC's failure to comply with its obligations under Article 6.2. As a previous GATT Panel stated,

"[we] could not understand the basis on which a Panel could after the fact consider whether certain claims might have been resolved in previous stages of the dispute settlement process had those claims been raised during those stages of the process. Nor would a Panel after the fact have a basis on which to consider whether the rights of third parties to protect their interests through participation in the Panel process were jeopardized by the failure of a complainant to raise a claim at the time it requested the establishment of a Panel." ADP/136, para. 301 (28 April 1995 (unadopted)).

¹⁹ See, *EC - Bananas*, WT/DS27/AB/R, 9 September 1997, paragraph 141.

3. The nature of the EC case and its request for rulings by the Panel

(a) Submission of Korea

4.17 **Korea** asserts that the European Communities cannot challenge, and has implicitly accepted, the report of the investigating authority because it has not made any claims under Article 3 and 4.2(c) of the Agreement on Safeguards. In support of its position, Korea makes the following arguments:

(i) *Article 3 of the Agreement on Safeguards*

4.18 The EC claims must be viewed in the context of the terms of reference it sought when requesting the establishment of the Panel. The terms of reference serve as the basis upon which panels decide cases and panels can only rule on those issues that have been raised by the complaining party in the terms of reference.

4.19 Korea draws the Panel's attention to the terms of reference cited by the European Communities. These only refer to Articles 2, 4, 5 and 12 of the Agreement on Safeguards.²⁰ Further, the European Communities in their First Submission and Oral Statement request that the Panel limits its request for a ruling to whether "Korea has violated Article XIX:1(a) of the GATT and Articles 2.1, 4.2(a) and (b), 5.1, and 12(1) to (3) of the Agreement on Safeguards."

4.20 It is therefore clear that the European Communities have not invoked Article 3 of the Agreement on Safeguards in its request for a ruling from the Panel. Failure to invoke Article 3 has significant implications for the EC case because Article 3.1 deals with the adequacy of the competent authorities' report. The final sentence of Article 3.1 of the Agreement on Safeguards states that:

"The competent authorities shall publish a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law."

4.21 The EC failure to invoke Article 3, whether intentionally or erroneously, leads one to conclude that the European Communities are not challenging the OAI Report. The European Communities confinement of their request for a ruling to the adequacy of notification under Article 12 becomes all the more clear in reviewing its answer to one of the Panel's questions. In Korea's view, this question sought to clarify the nature of the EC case.²¹ Korea considered that the European Communities failed to answer this question, referring back to its answer in a previous question in which they state:²²

"A safeguard proceeding must be conducted in accordance with open and transparent procedures respecting the rights of defence of parties, which are the interested economic operators. It is for this purpose that Article 3 of the Agreement on Safeguards requires publication of a report 'setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law.'

The proper forum for discussion between WTO Members concerning the compatibility of safeguard actions with the Agreement on Safeguards is however not the national investigating authority or courts, but rather consultations and dispute settlement. Accordingly, the European Communities consider that all the information should be

²⁰ WT/DS98/4 (12 January 1998).

²¹ Korea recalled that the question read: "Does the EC believe that the obligation in Article 3 and 4 of the SA are evidence in the WTO notification? Why does the EC concentrate its argumentation only on what was reflected in these notifications?"

²² Korea recalled that the previous question read: "Where should the information used and analysis performed by the national authority of Korea for its determination of a safeguard measure be found?"

found, or at least referred to, in the notifications. It notes in this respect that Article 12.2 requires a Member to include in its notification 'all pertinent information.' This can be presented in summary form, but must cover all issues and must make clear reference to the source of the more detailed information. It is only in this way that the objectives of Article 12 can be achieved.”

4.22 The EC answer refers to Article 3 which had never been at issue between the parties. In the light of the Appellate Body’s ruling in *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products*²³ and *Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*²⁴ that a claim “must be included in the request for establishment of a panel in order to come within a panel’s terms of reference in a given case”, the European Communities cannot augment the original terms of reference by invoking Article 3 at this stage of the proceedings.

4.23 The EC failure to invoke Article 3 leads to the conclusion that the European Communities references to serious injury in Article 4.2(a) and to causal link in Article 4.2(b) are used as standards of review in relation to the notification and consultation requirements of Article 12, which Korea maintains it has fully discharged.

(ii) *Absence of claims under Article 4.2(c) of the Agreement on Safeguards*

4.24 The European Communities have not made any specific claims or put forward any arguments in relation to Article 4.2(c), and neither its First Submission nor its Oral Statement makes any reference to Article 4.2(c). Further, on both occasions where the European Communities have requested the Panel to make rulings or findings, it has omitted any reference to Article 4.2(c).

4.25 It is virtually impossible to understand what is being argued by asserting that the “relevant factors” and “causal link” have not been fully or correctly considered, yet accepting that the competent authorities promptly published “a detailed analysis on the case as well as the relevance of the factors examined.” It is important for the Panel to note that the provisions of Article 4.2(c) detail a stage subsequent to the investigation of increased imports, serious injury and a causal link between the two. The conclusion that the European Communities accept the OAI Report is only strengthened by the EC failure to make any claims in relation to Article 3 which requires a competent authority to publish “a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law.”

4.26 Korea points out that Article 4.2(c) of the Agreement on Safeguards cannot be raised at, or subsequent to, the rebuttal stage as an issue between the parties. The decisions by the Appellate Body in *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*²⁵ and *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*²⁶ clearly show that the admission of new arguments at the rebuttal stage would be a substantial violation of due process, and a significant violation of the respondent’s ability to defend itself.

4.27 Strict adherence to that procedural requirement is important because the ability to understand and defend oneself against precise and comprehensible claims is vital to any system of law based on

²³ WT/DS50/AB/R (19 December 1997) AB-1997-5.

²⁴ WT/DS56/AB/R (27 March 1997) AB-1998-1.

²⁵ WT/DS50/AB/R (19 December 1997), AB-1995-5.

²⁶ WT/DS56/AB/R (27 March 1997), AB-1998-1.

due process.²⁷ The Appellate Body in *Argentina - Textiles* summarized the two-stage process under the DSU²⁸ as follows:²⁹

“Under the Working Procedures in Appendix 3, the complaining party should set out its case in chief, including a full presentation of the facts on the basis of submission of supporting evidence, during the first stage. The second stage is generally designed to permit “rebuttals” by each party of the arguments and evidence submitted by the other parties.”

4.28 Therefore, as requested by the European Communities in their First Submission and Oral Statement, Korea requests the Panel to limit its analysis of the EC claims to examining whether “Korea has violated Article XIX:1(a) of the GATT and Articles 2.1, 4.2(a) and (b), 5.1, and 12(1) to (3) of the Agreement on Safeguards.”

4.29 Korea is of the view that the EC failure to invoke Article 3 and raise any claims under Article 4.2(c) in either its First Submission or Oral Statement can only be construed as meaning that Articles 4.2(a) and (b) are used as standards of review in relation to the notifications and consultations requirements of Article 12 of the Agreement on Safeguards. Thus, the Panel should only examine whether Korea’s notification and consultations under Article 12 of the Agreement on Safeguards were timely and adequate and whether Korea imposed its safeguard measure in accordance with the requirements of Article 5.

4.30 At the second meeting of the panel with the parties, **Korea** further advanced its arguments regarding the nature of the EC case as follows:

4.31 In Korea’s view, the unclear nature of the EC arguments stems from its apparently deliberate strategy of claiming that only the Notifications provided by Korea under Article 12 of the Agreement on Safeguards should be considered to determine whether the Korean safeguard measure is consistent with Article XIX of GATT 1994 and the Agreement on Safeguards. This lack of clarity in the EC arguments is further aggravated by confining its requests to Articles 2.1, 4.2(a), 4.2(b), 5.1 and 12(1) to (3). It does not cite Article 3, and has not made any claims in relation to Article 4.2(c).

4.32 Further, the European Communities expressly disregard the OAI Report, one of the central documents by which to evaluate the compliance of Korea’s safeguard measure with the Agreement on Safeguards. Korea refers the Panel to the EC statement in its Rebuttal Submission:

²⁷ Both Panels and the Appellate Body have ruled that the DSU is such a system (see, for example, *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items (“Argentina - Textiles”)*, paragraph 94).

²⁸ More specifically, as noted by the Appellate Body in *Argentina - Textiles*, the Working Procedures of the DSU divide the Panel process into two clear sections. The first stage, in which the parties make their case and set out their arguments is set out in paragraphs 4 and 5. These state:

“Before the first substantive meeting of the panel with the parties, the parties to the dispute shall transmit to the panel written submissions in which they present the facts of the case and their arguments.

At its first substantive meeting with the parties, the panel shall ask the party which has brought the complaint to present its case. Subsequently, and still at the same meeting, the party against which the complaint has been brought shall be asked to present its point of view.”

The second stage, in which the parties rebut the claims and arguments put forward by the other parties in the first stage, is contained in paragraph 7, which states:

“Formal rebuttals shall be made at a second substantive meeting of the panel. The party complained against shall have the right to take the floor first to be followed by the complaining party. The parties shall submit, prior to that meeting, written rebuttals to the panel.”

²⁹ See, *Argentina –Textiles* at paragraph 79.

“The European Communities have already explained that the KTC report is not an appropriate source of information to evaluate Korea’s compliance with its obligations arising under Article XIX of the GATT 1994 and the Agreement on Safeguards.”

4.33 Accordingly, the Panel must consider the implications for the EC case of its failure to invoke Article 3, and its failure to make claims in relation to Article 4.2(c).

4.34 Korea is of the view that failure to invoke Article 3 implies that the European Communities have accepted that:

“The competent authorities publish[ed] a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law.”

4.35 Furthermore, failure to make claims under Article 4.2(c) implies that the European Communities have accepted that:

“The competent authorities publish[ed] promptly, in accordance with the provisions of Article 3, a detailed analysis of the case under investigation as well as a demonstration of the relevance of the factors examined.”

4.36 Combining the EC decision not to raise Articles 3 and 4.2(c) with its statement in its Rebuttal Submission noted above, Korea then concludes that the European Communities want the Panel to limit its review of the Korean investigation to its notifications under Article 12, and its obligations under Article 5. The EC failure to invoke Article 3 leads one to the conclusion that the European Communities references to serious injury in Article 4.2(a) and to causal link in Article 4.2(b) are used as standards of review in relation to the notification and consultation requirements of Article 12.

4.37 Korea cannot accept and the Panel should not accept that notifications under Article 12 have to include all documentation and analysis undertaken by the Korean competent authorities, including documents and analysis proving compliance with Articles 2, and 4.2(a) and (b). Clearly, Articles 2 and 4 have to be fulfilled by the competent authorities undertaking the investigations of increase in imports, serious injury and a causal link between the two. However, compliance with these requirements has to be judged against how the competent authorities conducted that analysis, and not against how their investigation was notified to Members.

4.38 However, the European Communities does not want to challenge the OAI Report as a relevant document, preferring to concentrate its argumentation to challenging the quality and nature of Korea’s notifications under Article 12. The European Communities appear to want to disregard the facts established and analysis undertaken in the 85-page OAI Report, and instead judge Korea’s compliance with the Agreement on Safeguards in relation to notifications that were only intended to summarise Korea’s investigation.

4.39 In Korea’s view, the purpose of Article 12 is to provide WTO Members with a summary of what happened during the investigation, including a summary of relevant facts established and analysis undertaken. The level of information provided should be at least sufficient to permit those Members to enter into meaningful consultations, but Article 12 is not the basis upon which the investigation undertaken by the national authority must be judged. Korea submits that, as with other proceedings, such as antidumping and CVD or safeguard measures in textiles, it is always the governmental measure, and not a communication to the WTO that is under review as to a Member’s conformity with the substantive provisions of the agreement in question.

4.40 By way of conclusion, Korea requests the Panel to conclude that the European Communities are only questioning Korea’s compliance with Articles 5 and 12 of the Agreement.

(b) Response by the European Communities

4.41 At the second meeting of the panel with the parties, the **European Communities** replied as follows:

4.42 The European Communities agree with Korea that they are not bringing a complaint under Article 3 of the Agreement on Safeguards, nor is relying upon Article 4.2(c) thereof. Accordingly, it will not address the arguments developed by Korea in the first part of its Second Written Submission. It will only say that the absence of a complaint under Article 3 does not mean that the European Communities have accepted the content of the Investigation Report to be correct. The European Communities are complaining that Korea's measure does not satisfy the substantive conditions for such measures set out in Article XIX GATT 1994 and Articles 2.1, and 4.2 of the Agreement on Safeguards. This should be indication enough that it does not agree with the investigation report.

B. SUBSIDIARY ISSUES

1. Burden of proof and standard of review

(a) Submission by Korea

4.43 Regarding the issues of burden of proof and standard of review **Korea** submits the following arguments:

4.44 As a preliminary matter, the Panel should properly assign the burden of proof to the parties. The burden of proof is the fundamental obligation «of each of the parties to a dispute before an international tribunal to prove its claims to the satisfaction of, and in accordance with the rules acceptable to, the tribunal».³⁰ This fundamental obligation does not shift between the parties during the dispute.³¹ To discharge its burden of proof, the party assigned such burden must present conclusive evidence substantiating its claims, *i.e.*, the party that is required to satisfy the burden of proof must present more convincing evidence than the opposing party, and if the evidence is in equipoise, the party required to satisfy the burden of proof must lose.³²

4.45 The party claiming that a Member State exercised its rights inconsistently with the Agreement on Safeguards has the obligation to prove such inconsistency. Therefore, as the Complaining Party asserting claims that Korea acted inconsistently with the Agreement on Safeguards, the European Communities have the burden of proof throughout the course of this proceeding to present conclusive evidence that their claims are true.

³⁰ Mojtaba Kazazi, *Burden of Proof and Related Issues, A Study on Evidence Before International Tribunals* 30 (Kluwer Law International 1996).

³¹ *Id.* at 36; Joost Pauwelyn, *Evidence, Proof and Persuasion in WTO Dispute Settlement, Who Bears the Burden?*, J.Int'l Econ.L. 1, 232 (1998).

³² *Id.* at 255 and 258. WTO Panels and the Appellate Body have struggled with the proper articulation of burden of proof and have often confused the burden of proof with the procedural evidentiary concepts of burden of evidence or duty of passing the judge. These latter concepts are not recognized by international tribunals. Moreover, the shifting of a burden of evidence and the creation of "presumptions" by presenting, for example, *prima facie* evidence only inject more complexity into WTO decision making by raising the questions: What level of evidence constitutes *prima facie* evidence? What level of evidence is sufficient to rebut the presumption? One commentator suggests that the presumption technique creates the risk that WTO Panels and/or the Appellate Body in exercising their discretion may use this technique, in practice, to support results-oriented findings, *i.e.*, shift the burden to the party that it deems should lose. *Id.* at 258. The articles referenced above by Pauwelyn and Kazazi provide an detailed discussion of the proper role of the burden of proof in international dispute settlement proceedings.

(i) *Standard of review*

4.46 In light of the way the European Communities have presented their arguments in their First Submission, it appears to be necessary for the Panel to confirm the standard of review applicable in this case. Korea suggests that the Panel's role is to examine the Korean safeguard measure to determine whether it was imposed in accordance with Korea's international obligations under the Agreement on Safeguards. In conducting this examination, Korea suggests that the Panel should not engage in a *de novo* review in which it assumes the role of the investigating authority and seeks to replace its analysis of the facts and law for those of Korea. Nor should the Panel engage in assessing speculative or conclusionary arguments submitted by the European Communities as to whether the measure is appropriate or not. Instead, Korea suggests that the Panel should restrict its analysis to making an objective assessment as to whether Korea reasonably considered all relevant facts and adequately explained how such facts support the determination made.

4.47 In *United States - Restrictions on Imports of Cotton and Man-Made Fibre Underwear ("Underwear")*³³, Korea recalls the argument of the United States that a panel reviewing a safeguard measure under the special safeguard provisions of the Agreement on Textiles and Clothing ("ATC") should accord considerable deference to the determination by the US authorities. After citing the *"Transformers"* case where a panel refused to accord total deference to the domestic authority, the Panel stated the following:

"7.12 We see great force in this argument. We do not, however, see our review as a substitute for the proceedings conducted by national investigating authorities or by the TMB. Rather, in our view, the Panel's function should be to assess objectively the review conducted by the national investigating authority, in this case the CITA. We draw particular attention to the fact that a series of panel reports in the anti-dumping and subsidies/countervailing duties context have made it clear that it is not the role of panels to engage in a *de novo* review. In our view, the same is true for panels operating in the context of the ATC, since they would be called upon, as in the context of cases dealing with anti-dumping and/or subsidies/countervailing duties, to review the consistency of a determination by a national investigating authority imposing a restriction under the relevant provisions of the relevant WTO legal instruments, in this case the ATC. In our view, the task of the Panel is to examine the consistency of the US action with the international obligations of the United States, and not the consistency of the US action with the US domestic statute implementing the international obligations of the United States. Consequently, the ATC constitutes, in our view, the relevant legal framework in this matter.

7.13 We have therefore decided, in accordance with Article 11 of the DSU, to make an objective assessment of the Statement issued by the US authorities on 23 March 1995 (the «March Statement») which, as the parties to the dispute agreed, constitutes the scope of the matter properly before the Panel without, however, engaging in a *de novo* review. [footnote omitted] In our view, an objective assessment would entail an examination of whether the CITA had examined all relevant facts before it (including facts which might detract from an affirmative determination in accordance with the second sentence of Article 6.2 of the ATC), whether adequate explanation had been provided of how the facts as a whole supported the determination made, and, consequently, whether the determination made was consistent with the international obligations of the United States. [footnote omitted] We note in this respect, that in response to a question by the Panel, the United States argued that the Panel had to examine whether the domestic authorities *had* based their determination on an examination of factors required by the

³³ *United States - Restrictions on Imports of Cotton and Man-made Fibre Underwear ("US – Underwear")*, WT/DS24/6, 8 November 1996.

ATC and whether the basis for the determination was adequately explained. In the US view, such an approach was compatible with the standard of review adopted in the «Fur Felt Hat» case. [footnote omitted]³⁴

4.48 The Panel in *US - Underwear*, therefore, expressly rejected that it should engage in a *de novo* review in examining the US safeguard measure under the ATC. The Panel then articulated a standard of review intended to account for the deference that should be accorded to national authorities in their conduct of a domestic investigation. In applying the standard of review in *US - Underwear*, however, the Panel interpreted the special safeguard provisions of the ATC as an «exception» to Article 2.4 of the ATC. As such, the Panel imposed on the United States the burden of proof to demonstrate it acted consistently with the ATC. Unlike Article 2.4 of the ATC, the Agreement on Safeguards and the terms contained therein should not be considered as an exception.

4.49 Therefore, consistent with the approach of the Panel in *US - Underwear*, in examining Korea's obligations in respect of the safeguard measure, Korea suggests that the Panel should restrict its analysis to making an objective assessment of the facts and law as provided under Article 11 of the DSU by examining whether Korea:

- (a) examined all relevant facts before it at the time of the investigation; and
- (b) provided an adequate explanation of how the facts before it as a whole supported the determination made.

4.50 In the view of Korea, use of the above approach would accord the proper amount of deference to Korea given that the Panel is reviewing a complex administrative investigation conducted by a Member's administering authority.

4.51 The Agreement on Safeguards requires a Member's competent authority to determine whether increased imports caused serious injury to the domestic industry. In assessing serious injury under Article 4.2(a), the competent authority is not required to give any specific weight or significance to any particular criterion. Under Article 4.2(a) of the Agreement, no criterion gives conclusive guidance as to whether serious injury occurred. The Agreement also does not require that each criterion be considered in isolation. Moreover, the Agreement on Safeguards contemplates that the competent authority may use other factors that are more relevant to a particular domestic industry in assessing serious injury.

4.52 The arguments raised by the European Communities in both the consultations under Article 12 of the Agreement on Safeguards and its submissions to the Panel imply that the European Communities are applying a very high (possibly an impossibly high) standard as to how the competent authorities of the Members should be permitted to conduct injury investigations. Korea submits that Members can set their own standards which may exceed those set out in Article 4.2.³⁵

³⁴ WT/DS24/R (8 November 1996) (Emphasis in original).

³⁵ For example, Article 10 of Regulation 3285/94, the EC's own implementation of the Agreement on Safeguards states:

1. Examination of the trend of imports, of the conditions in which they take place and of serious injury or threat of serious injury to Community producers resulting from such imports shall cover in particular the following factors:
 - (a) the volume of imports, in particular where there has been a significant increase, either in absolute terms or relative to production or consumption in the Community;
 - (b) the price of imports, in particular where there has been a significant price undercutting as compared with the price of a like product in the Community;

Each Member State of the Agreement on Safeguards is, however, only obliged to comply with the standard of that Agreement, and not the standards used by other WTO Members.

4.53 Throughout the Uruguay Round, most major trading nations, the European Communities included, recognized and accepted that the agricultural sector presented a number of unique issues requiring specific and detailed consideration, and, where appropriate, the adoption of specific rules. One of the ways in which the unique features of agriculture was recognized and dealt with was the Agreement on Agriculture, and Article 5 of the Agreement which contains a specific, detailed safeguard procedure.³⁶

4.54 Korea could not invoke the special safeguard provisions of Article 5 of the Agreement on Agriculture in this case. Therefore, to the extent that its domestic industry was being seriously injured by increased imports, Korea had to impose a safeguard measure consistent with the Agreement on Safeguards.

4.55 As the general system of rules for imposing safeguard measures, the Agreement on Safeguards will be applied to a number of different product sectors and, thus, has a degree of flexibility built into its structure and individual terms.³⁷ Certain injury criteria relevant to industrial or

(c) the consequent impact on Community producers as indicated by trends in certain economic factors such as:

- production,
- capacity utilization,
- stocks,
- sales,
- market share,
- prices (*i.e.*, depression of prices or prevention of price increases which would normally have occurred),
- profits,
- return on capital employed,
- cash flow,
- employment;

factors other than trends in imports which are causing or may have caused injury to the Community producers concerned.

The increase in the proof of injury required by the EC as compared to the Agreement on Safeguards is indeed noted by the European Commission in the Explanatory Memorandum to the proposal for a new Regulation implementing the Agreement (COM(94)414 at page 306) where the Commission notes:

"It should be pointed out, however, that Community legislation already contains precise rules that often go beyond the more general provisions of the Agreement on Safeguards. This is the case, for example, with the strict investigation deadlines and the more detailed list of factors to be considered in determining serious injury and the causal link between such injury and imports."

³⁶ The International Dairy Arrangement also made it clear that agricultural products had specific issues that needed to be addressed.

³⁷ See, for example, the following:

"The General Agreement, and in particular, Articles II and XI on the one hand, and Article XIX on the other, is a balance between the need to provide the stability necessary for decisions relating to investment and international trade and the flexibility necessary for governments to accept international obligations."

Negotiating Group on Safeguards, Drafting History of Article XIX and Its Place in GATT, MTN.GNG/NG9/W/7 (16 September 1987) at 3.

manufactured products may be irrelevant when applied to agricultural products, because those criteria are not objective and quantifiable or because they do not have a bearing on the situation of the particular agricultural industry, *i.e.*, they do not reflect the unique nature of the agricultural sector.³⁸ If particular criteria are not applicable to a specific agricultural sector, Members should be accorded the flexibility to examine other criteria that take into account the unique or specific nature of the products and industry under examination. Members should also be allowed to take into account criteria which are also relevant to the industry under examination.³⁹ Provided that relevant criteria have been considered and an adequate explanation as to whether or not they indicate serious injury has been given, the Panel should defer to the Member's determination as to whether the relevant criteria, when considered as a whole, may lead to an affirmative determination of serious injury.

4.56 In the view of Korea, the European Communities do not and cannot discharge their burden of proof simply by disputing the outcome of Korea's examination of the relevant facts or by contending that Korea has to provide an explanation of its analysis and conclusions that goes beyond the requirement to provide an adequate explanation. The European Communities must present conclusive evidence that Korea failed to examine relevant facts or failed to give an adequate explanation as to how the facts as a whole supported its determination. Korea submits that the Panel should conclude that the European Communities have failed to present evidence of this nature and that the European Communities have, therefore, failed to discharge their burden of proof regarding their claims that Korea acted inconsistently with the Agreement on Safeguards.

4.57 At the first meeting of the panel with the parties **Korea** further advanced its arguments on the issue of standard of review as follows:

4.58 Article 11 of the DSU obliges the Panel to make an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements. In the absence of particular provisions on the standard of review in the Agreement on Safeguards and the GATT, these criteria need to be construed and considered in the light of the purpose and functions of the Agreement on Safeguards, past practices and precedents, and the allocation of the burden of proof.

4.59 By its very nature, the Agreement on Safeguards, as much as Article XIX GATT and other safeguard clauses, assists Governments in entering into trade liberalizing commitments, as they may call upon safeguards should subsequent economic difficulties arise in due course. By its very nature, this Agreement applies to complex and difficult constellations in difficult times. In applying the Agreement, Governments are, of course, bound by its rules and criteria. But they all share a common

"Some [delegations] pointed out that it was unrealistic to set quantitative standards or automatic criteria for the determination of injury because not all factors were quantifiable and mathematical formulae could not be applied to all sectors of industry."

Negotiating Group on Safeguards, Meeting of 7 and 10 March 1988, MTN.GNG/NG9/5 (22 April 1988) at 5.

"This safeguard authority, or escape clause, serves as a buffer between the more open trading environment required by the trade-liberalizing obligations of the GATT, and the dislocations of domestic workers and firms which sometimes result from increased competition with a wider variety of sources."

Janet A. Nuzum, *"The Agreement on Safeguards: U.S. Law Leads Revitalization of the Escape Clause"*, in *The World Trade Organization, The Multilateral Trade Framework For the 21st Century and U.S. Implementing Legislation* 407, 408 (Terence P. Stewart ed., 1996).

³⁸ Article 4(2)(a) requires an evaluation of "all relevant factors of an objective and quantifiable nature having a bearing on the situation of *that* industry" (emphasis added). This appears to permit an investigation which takes into account the specific nature of the industry.

³⁹ In light of the fact that Article 4(2)(b) of the Agreement on Safeguards uses the term «in particular», factors other than those set forth in Article 4(2)(b) may be used to determine injury to a particular sector, such as agriculture.

interest that these rules allow for adequate flexibility in responding to the difficult constellations and difficult times. In other words, the very function of safeguard clauses implies a considerable degree of discretionary powers to Governments in assessing the situation and in determining injury.

4.60 In reviewing safeguard measures imposed by Governments, panels therefore need to focus on whether the Government has exceeded its scope of discretionary powers. Within the bounds of discretionary powers, the matter therefore has to be assessed with considerable deference.

4.61 Such discretion and deference has been accorded to the operation of safeguard clauses in the past. The 150 measures notified under Article XIX GATT 1947⁴⁰ and the fact that they have not been challenged in dispute settlement but for two cases⁴¹ proves the point in state practice.

4.62 This tradition is equally reflected in the new Agreement on Safeguards. While there was a need to strengthen disciplines and to prevent an abuse of the instrument, it still provides for adequate flexibility. Thus, Article 4.2 does not set forth a closed list of relevant factors, but allows Governments, in assessing injury, to take into account additional criteria of particular relevance for the sector concerned. In the present case, it therefore was possible to look into factors of particular relevance for agriculture, consider specific problems and factors relating to the dairy industry. All of this implies certain choices and therefore discretionary powers in construing and applying the injury test.

4.63 In assessing a safeguard measure, the Panel therefore must merely engage in reviewing the measure and its justification within the discretionary bounds of the Agreement. It clearly must not engage in assessing the situation anew. It must not make an independent ex post determination based upon arguments set forth by the complaining party. Its task is a more limited one.

4.64 This is confirmed by recent panel practice relating to the application of safeguard clauses. In *US - Underwear*⁴², the Panel was equally faced with the issue of assessing its scope and standard of review. It was a matter of finding, based upon Article 11 DSU, an appropriate way between Scylla and Charybdis: between total deference and close scrutiny. The Panel found that total deference to national injury determination could not live up to the standard of Article 11 DSU, while equally rejecting the idea of full review set forth in the *Transformers* case.⁴³ Instead, it set forth the task to "assess objectively the review conducted by the national investigating authority", to mean "to review the consistency of a determination by a national investigating authority imposing under the relevant provisions of the relevant WTO legal instruments" (para. 7.12).

4.65 Korea submits that the same standard of examining consistency should also apply to the Agreement on Safeguards. As the role and functions of safeguards are alike in different agreements, the standard of review defined and set forth by this panel should be of guidance in this first case on the Safeguard Agreement alike. It is therefore a matter to examine whether Korea remained within its bounds of discretion and had consistently examined all relevant facts before it at the time of the investigation, and provided an adequate explanation of how the facts before it as a whole supported the determination made.

4.66 Finally, the task of the Panel is further shaped and limited by the burden of proof in this case. While, in *US - Underwear*, it was for the United States to demonstrate compliance with the safeguard

⁴⁰ GATT, Analytical Index: Guide to GATT Law and Practice at 539-559 (6th ed 1995).

⁴¹ Working Party on *Withdrawal by the United States of a Tariff Concession under Article XIX of the General Agreement ("Fur Felt Hat")*, GATT/CP.6/SR 19 (adopted 22.10.51); Norway - Restrictions on Imports of Certain Textile Products, BISD 27S/119 (adopted 18 June 1980).

⁴² WT/DS24/R, 8 November 1996.

⁴³ *New Zealand - Imports of Electrical Transformers from Finland ("Transformers")*, BISD 32S/55 (adopted 28 July 1985).

clauses of the Textile Agreement due to the fact that it had been invoked as an exception, the situation is different under the Agreement on Safeguards. Here, it is up to the complaining Party, the European Communities, to demonstrate that the review conducted by the national investigating authority does not live up to the legal requirements set forth by the Agreement and exceeds the bounds of discretion. It is up to it to demonstrate that Korea has acted inconsistently with and therefore in violation of the Safeguard Agreement.

4.67 The objective assessment by the Panel therefore needs to rely upon the facts and arguments put forth by Korea and those submitted by the European Communities. It is only to the extent the Panel concludes that facts, figures and arguments submitted by the European Communities demonstrate that Korea had failed to provide an adequate justification of the measure imposed, *i.e.*, an adequate explanation as to how the facts invoked supported the determination, that a violation could be established. In other words, it will not be appropriate for the Panel to replace with its own figures and arguments the determination made by Korea.

4.68 The arguments put forward by Korea in this case are shaped in accordance with this standard of review and allocation of the burden of proof. It is not a matter of justifying anew the measure imposed. Instead, Korea's arguments demonstrate that the EUROPEAN COMMUNITIES fails to provide evidence and arguments which would allow the Panel to conclude that Korea has acted beyond its discretionary powers under the Agreement on Safeguards, and thus inconsistently with its obligations under international law.

4.69 Korea also notes that most jurisdictions provide a significant degree of latitude to investigating authorities to make injury determinations after considering complicated economic facts. For example, the European Communities' courts give a very wide degree of discretion to the European Commission in arriving at similar general economic and trade policy judgements. These courts will only review the Commission's assessment of complex factual issues where:

“the Commission has exceeded the scope of its discretion by a distortion or manifest error of assessment of the facts or by misuse of powers or an abuse of process”.⁴⁴

4.70 However, if the EC arguments are limited to the quality, depth and breadth of Korea's notification and consultations and are not requiring the Panel to conduct a *de novo* review of the Korean competent authorities investigation, then Korea is of the view that it has far exceeded the requirements of the Agreement on Safeguards.

(b) Response of the European Communities

4.71 The **European Communities** respond to Korea's submission as follows:

4.72 Both the European Communities and Korea agree that the appropriate standard is that in Article 11 of the DSU, *i.e.*,

“an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements”

4.73 However opposite conclusions are drawn as to what this means in the present case.

4.74 In its First Written Submission, Korea concluded that this requires examining whether Korea:

⁴⁴ See, for example Case C-225/91 *Matra v. Commission* [1993] ECR I-3203.

- (a) examined all relevant facts before it at the time of the investigation; and
- (b) provided an adequate explanation of how the facts before it as a whole supported the determination made.

4.75 Korea takes this formulation to mean that it need not seek out all the facts but may content itself with the “facts before it” and that even as regards the facts that it does have before it, it need only provide an “adequate” explanation of how these facts “as a whole” (that is viewed globally, rather than in detail) support its determination. The United States apparently does not draw the same conclusions as Korea from the same test because it comes to the conclusion that it was normally necessary to examine the whole of the defined domestic industry and that if Korea failed to evaluate relevant evidence, its determination would violate Article 4.2(a) of the Agreement on Safeguards.

4.76 The above formulation must be rejected since it results from Article 4.2(a) of the Agreement on Safeguards and the precedents set by the panel reports in *US - Shirts and Blouses* and *US - Underwear*⁴⁵ that

- the investigating authority has to seek out and consider “all relevant facts” (and not rely on what is “before it”); and
- it is necessary, at a minimum, for a serious injury determination under the Agreement on Safeguards to demonstrate that the relevance or otherwise of each of the injury factors listed in Article 4.2(a) of the Agreement on Safeguards was properly analysed unless it is explained for what reason the injury factor may be disregarded. It is true that no injury factor “in isolation” can establish serious injury but that does not excuse a failure to examine them all.

4.77 Korea then argued that “the very function of safeguard clauses implies a considerable degree of discretionary powers to governments in assessing the situation and in determining injury” and that “the matter ... has to be addressed with considerable deference”.

4.78 It also claimed that most domestic jurisdictions “provide a significant degree of latitude to investigating authorities to make injury determinations after considering complicated facts” and even quoted a State aid case of the European Court of Justice in support.

4.79 On the first argument brought forward by Korea, the European Communities responded that the discretionary nature of safeguard measures which may have been accepted under GATT 1947 and is evidenced in the low number of disputes, is no longer compatible with the WTO. The Agreement on Safeguards has introduced an obligation to conduct a thorough investigation as a pre-condition for imposing measures and has removed the possibility of compensation during the first three years where the measure is held to be in conformity with the Agreement on Safeguards. In addition the WTO system, characterized by binding dispute settlement, is more based on the principle of legality and less on the principle of diplomacy than the former GATT.

4.80 The European Communities do not agree with the view that the intention of the Agreement on Safeguards was to increase the discretion allowed to Members. The preamble to the Agreement on Safeguards clearly contradicts this view since it recalls the intention of Members to reinforce the disciplines of Article XIX of GATT and to re-establish multilateral control over safeguards.

4.81 The European Communities also reject the attempt to import domestic standards of review of certain jurisdictions into the WTO dispute settlement.

⁴⁵ See, Panel Report in *United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India* (“*US - Shirts and Blouses*”), 6 January 1997, WT/DS33/R; *US - Underwear*, WT/DS24/6, 8 November 1996.

4.82 First, the WTO dispute settlement system serves very different purposes to national administrative law systems. It is not designed to establish whether an investigating authority conducted itself in accordance with its duties but rather to adjudicate on the rights and obligations of Members of the WTO under the WTO Agreements.

4.83 Second, even if any of the principles applied by Member jurisdictions were relevant, the standards of all jurisdictions would have to be treated as equally valid and these standards are far too diverse to allow useful rules to be deduced. Terms such as “*de novo*” and “manifest error” have specific and often differing meanings in different legal systems and so are probably best avoided as they are susceptible of creating conflicting interpretations between Members.

4.84 Thirdly, the guiding text is Article 11 of the DSU, which requires a standard of objective assessment of the facts. This is the standard and the terminology to be applied by Panels.

4.85 In the present case, the European Communities are not contesting the basic economic data produced by Korea but only its completeness and the conclusions drawn from it. The European Communities submit that the “objective assessment of the facts” referred to in Article 11. DSU cannot be satisfied by verifying *what conclusions* the investigating authority came to but must include *how* it came to those conclusions, that is to say *its reasoning*.

4.86 The European Communities recall that Panel Report *Brazil – Milk Powder*, also established that it is not sufficient for an authority to refer to the evidence it considered and state its conclusion. In the words of that panel: “It was incumbent upon the investigating authorities to provide a reasoned opinion explaining how such facts and arguments had led to their finding.”⁴⁶

(c) Rebuttal response of Korea:

4.87 **Korea** makes the following rebuttal arguments:

4.88 First, as the complainant challenging a safeguard measure under the Agreement on Safeguards, it is for the European Communities to show that the claims it makes against Korea are proven.

4.89 Second, Korea reiterated its previously articulated standard of review in this case, as set in Paragraph 4.74 above and noted that the United States “agrees with Korea’s assertions concerning the standard of review in safeguards cases.”

4.90 At the second meeting of the panel with the parties **Korea** further advanced its arguments on the issue of standard of review as follows:

4.91 Based on the EC arguments on the standard of review in its Second Submission Korea believes that the European Communities is either:

- (a) seeking to challenge the quality of the investigation undertaken by the Korean competent authorities; or
- (b) whether intentionally or inadvertently, confusing the standard of review to be applied by the Panel in reviewing the Korea’s investigation, with the standard of investigation applicable to the Korean investigating authority.

⁴⁶ See, Panel Report on *Brazil – Imposition of Provisional and Definitive Countervailing Duties on Milk Powder and Certain Types of Milk from the European Economic Community* (“Brazilian Milk Powder”), adopted by the Committee on Subsidies and Countervailing Measures on 28 April 1994, SCM/179, and Corr. 1, at para 286.

4.92 Korea requests the Panel to conclude that the European Communities cannot challenge the quality of the Korean competent authorities' investigation after the closing of the first round of Oral Statements. This results from Korea's belief that the lack of claims under Articles 3 and 4.2(c) of the Agreement on Safeguards implies that the European Communities have not at any time during these proceedings challenged the quality of the investigation performed by Korea's competent authorities.

4.93 Korea submits that the European Communities are confusing the standard of review to be applied to the Panel's deliberations with the standard to be applied to the investigating authority. Korea notes that these are different concepts and require different analysis.

4.94 The EC arguments seek to obscure Korea's simple formulation of Standard of Review.

4.95 First, the European Communities argue that:

"Korea takes this formulation to mean that it need not seek out all the facts but may content itself with the "facts before it" and that even as regards the facts that it does have before it, it need only provide an "adequate" explanation of how these facts "as a whole" (that is viewed globally, rather than in detail) support its determination."

4.96 This attempt to misconstrue Korea's argument must be corrected for the record. Clearly the standard of review articulated by Korea does not excuse the Korean investigating authority from conducting a thorough investigation of the facts. Korea's formulation of the standard of review requires the investigating authority to examine all relevant facts which have been uncovered by the investigation based on the requirements of the Agreement on Safeguards. The OAI Report is an 85 page document setting out numerous factual findings made by the OAI, and its analysis as to whether serious injury had been caused to the domestic industry, and whether this serious injury was caused by increased imports. It should be clear from this document alone that the Korean competent authorities undertook a thorough investigation of the case.

4.97 Second, the European Communities suggest that Korea has implied that the imposition of a safeguard measure is "discretionary". This is a complete misinterpretation of Korea's view of the nature of safeguards. Safeguard measures can only be imposed on the basis of the Agreement on Safeguards and not at the discretion of any national authority. The fundamental point is that the underlying purpose of safeguards imposed on the basis of the Agreement on Safeguards is to provide Members with recourse to emergency short-term measures. This specific purpose necessitates a reviewing body to accord a significant degree of deference to the investigating authority in relation to the factual, legal and economic analysis undertaken.

4.98 Third, the European Communities refer to the panel proceedings in *Brazilian Milk Powder*, both to challenge Korea's statement on standard of review, and its compliance with Article 4.2(a). Korea agrees with the earlier Panel's statements in relation to the nature and quality of examination that needs to be undertaken by an investigating authority, and is of the view that the Korean competent authorities met that standard in this case.

4.99 In fact, the *Brazilian Milk Powder* case demonstrates that the Panel should determine Korea's compliance with the Agreement on Safeguards based on the documents of the competent authorities. For the sake of completeness, the European Communities might also have referred the Panel to its own arguments on standard of review in paragraph 32 of that Panel report where it approved of:

"paragraph 335 of the report of the panel on *United States - Softwood Lumber*" [which] had stated that "[t]he Panel considered that in reviewing the action of the United States authorities in respect of determining the existence of sufficient evidence to initiate, the Panel was not to conduct a *de novo* review of the evidence relied upon by the United States authorities or otherwise to substitute its judgement as to the sufficiency of

the particular evidence considered by the United States authorities. Rather ... [it] required consideration of whether a reasonable, unprejudiced person could have found, based upon the evidence relied upon by the United States at the time of initiation, that sufficient evidence existed of subsidy, injury and causal link to justify initiation of the investigation".⁴⁷

4.100 However, the European Communities clear implication by referring to that Panel is that the quality and nature of the Korean authorities' analysis was similar to that of the Brazilian authorities. The European Communities comparison between three paragraphs of analysis in a two page document⁴⁸ does a disservice to the 85 pages of findings and closely reasoned analysis found in the OAI Report and the 17 page April 1 Notification.

4.101 Moreover, the European Communities reference to the *Brazilian Milk Powder* panel report is misleading. For brevity, Korea noted only two material differences between the Brazilian case and the case under investigation, as these clearly show that there can be no meaningful comparison between the two:

- (a) the Panel found that Brazil had not undertaken any investigation whatsoever prior to the imposition of a provisional countervailing duty, therefore it could not have established that the relevant elements necessary for imposition of a duty were present;
- (b) the Panel found that although Brazil was required to examine certain injury criteria in establishing material injury, it only referred to one such factor in its published documents.

4.102 Fourth, the European Communities examine Korea's arguments concerning the level of deference shown in national review procedures. However, it misses or overlooks Korea's fundamental point. Korea was not asking the Panel to apply any specific definitions or legal terms when it suggested that a number of judicial systems, including those in the EU and United States, afford national authorities carrying out detailed economic analysis a great deal of discretion. Korea's point is not the precise level of deference provided, but the fact that it is provided at all by courts when reviewing complicated, factual, legal and economic analysis.⁴⁹

⁴⁷ See, *Brazil Imposition of provisional and definitive countervailing duties on milk powder and certain types of milk from the EEC*, 28 April 1994 (SCM/179).

⁴⁸ See, Korea Exhibit 17.

⁴⁹ Again, Korea notes the extremely wide discretion provided to the Commission and Council of Ministers by the European Courts of Justice, and refers the Panel to, for example, the *SAM Schiffahrt* judgment ([1997] ECR I-4475), where the ECJ notes:

"23. As the case-law has firmly established, in giving the Council the task of adopting this policy a common transport policy, the Treaty has conferred wide legislative powers upon it as regards the adoption of appropriate common rules (judgment in Case 97/78 Schumalla [1978] ECR 2311, paragraph 4).

24. In reviewing the exercise of such powers, the Court cannot substitute its own assessment for that of the Community legislature, but must confine itself to examining whether that latter assessment contains a manifest error or constitutes a misuse of powers, or whether the authority in question did not clearly exceed the bounds of its discretion (judgments in Case C-122/94 Commission v Council [1996] ECR I-881, paragraph 18; C-84/94 United Kingdom v Council [1996] ECR I-5755, paragraph 58; Case C-169/95 Spain v Commission [1997] ECR I-0000, paragraph 34).

25. The Court's case-law also shows that where, as in this case, implementation by the Council of a common policy requires it to assess a complex economic situation, its discretion is exercisable not only in relation to the nature and scope of the provisions which are to be adopted but also, to a

(d) Rebuttal response of the European Communities

4.103 At the second meeting of the Panel with the parties the **European Communities** made the following arguments:

4.104 The European Communities are not asking the Panel to redo the investigation, merely to examine the completeness and correctness of what was investigated and to verify the soundness and compatibility with the Agreement on Safeguards of the reasoning of Korea in imposing the measure. In applying this standard of review, the European Communities argue that Korea failed to investigate all the injury factors specifically mentioned in Article 4.2 and has drawn wrong conclusions from the facts which it did establish. In particular Korea failed to investigate profitability and employment of the major part of the domestic industry, the dairy farms and its causality analysis is fatally flawed by the fact that Korea ignored the protection offered the dairy farms and deliberately closed its eyes to the impact of the "milk quality scandal" on white milk consumption, by applying circular reasoning.

4.105 Korea's defence has generally been that it could not investigate certain injury factors because it did not have the data. The European Communities would make two comments: first, it should have obtained the data. The Safeguards Agreement requires an investigation (at a minimum) of all the injury factors listed in Article 4.2 of the Agreement on Safeguards; second, Korea cannot invoke its own failure to investigate in its defence.

4.106 A second line of defence used by Korea is to say that it could not collect the data since there was too much of it or it was too difficult. For example, it states that there are 20 000 dairy farms and it would have been impossible to investigate transaction prices for all of them. The European Communities would reply that the fact that it is difficult to obtain precise information does not mean that no attempt should be made to make an estimate. For example it is difficult to know how much damage is suffered by a person following a personal injury but this does not lead to judges dismissing claims for damage

2. What are the appropriate documents to be considered by the Panel in evaluating the analysis performed during the investigation?

4.107 The European Communities in their first submission based their arguments concerning the lack of compliance by Korea with its obligations under Articles 2 and 4⁵⁰ of the Agreement on Safeguards on the notifications Korea had made to the Committee on Safeguards. This situation led to an inquiry by the Panel to the parties as to what document or documents should be considered by the Panel as evidence of the information used and the analysis performed by Korea's competent authorities in determining the imposition of a safeguard measure.⁵¹

(a) Response of the European Communities

4.108 In response to the panel's question the **European Communities** argued:

certain extent, to the findings as to the basic facts, especially in the sense that it is free to base its assessment, if necessary, on findings of a general nature (judgments in Case 166/78 Italy v Council [1979] ECR 2575, paragraph 14; Case 138/79 Roquette Frères v Council [1980] ECR 3333, paragraph 25)."

⁵⁰ The Panel notes that these two articles refer respectively to the conditions for the imposition of a safeguard measure and to the determination of serious injury or threat thereof necessary to impose such a measure.

⁵¹ The Panel recalls that the question was: "Where should the information used and analysis performed by the national authority of Korea in its determination of its safeguard measure be found?"

4.109 A safeguard proceeding must be conducted in accordance with open and transparent procedures respecting the rights of defence of the parties, which are the interested economic operators. It is for this purpose that Article 3 of the Agreement on Safeguards requires publication of a report “setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law”.

4.110 The proper forum for discussions between WTO Members concerning the compatibility of safeguard action with the Agreement on Safeguards is however not the national investigating authority or courts, but rather consultations and dispute settlement under the WTO. Accordingly, the European Communities consider that all the information should be found, or at least referred to, in the notifications. It notes in this respect that Article 12.2 requires a Member to include in its notification “all pertinent information.” This can be presented in summary form but must cover all issues and must make clear reference to the source of the more detailed information. It is only in this way that the objectives of Article 12 can be achieved.

(b) Response of Korea

4.111 In the response to the Panel's question, **Korea** argued:

4.112 The Korean administrative process by which a safeguard measure is imposed has a number of stages.⁵²

4.113 First, an interested party or parties files a petition with the KTC. The KTC reviews the petition to establish whether the petitioner has proper standing under Articles 32, 33 and 40 of the Foreign Trade Act and Articles 64, 65, 66 and 76 of the Enforcement Decree implementing the Act.

4.114 Second, the KTC deliberates the *prima facie* case to decide whether to initiate an investigation on industrial injury. With the Determination to Initiate an Investigation, the KTC publishes a Public Notice of Investigation in the Korean Official Gazette, *Kwanbo*, which provides a summary of the determination to proceed. The Notice also contains details of the investigation to be undertaken; the timetable for the various stages, and contact details for the KTC. The initiation also triggers a notification to the WTO Committee on Safeguards, in the form of a notice conforming to G/SG/N/6.

4.115 In this case, the KTC made the Determination to Initiate an Investigation on 17 May 1996 (see Exhibit Korea-3).⁵³ The Public Notice of Initiation, which actually is a summary of the Determination (Exhibit Korea-3), was published in *Kwanbo* on 28 May 1996 (see Exhibit Korea-4), and this was the basis for the notification to the WTO Committee on Safeguards, G/SG/N/6/KOR/2 of 1 July 1996.

4.116 Third, the KTC forms an investigation team, normally led by an official from the Office of Administration and Investigation (“OAI”). This team undertakes the investigation and is responsible for the formulation of questionnaires, on-the-spot investigations, and the drafting of the interim report.

4.117 Fourth, prior to the finalization of the investigation report, the OAI holds a public hearing at which the findings in the investigation report are discussed with all relevant parties present at the hearing. Copies of the OAI's interim report are available to the interested parties prior to the hearing so that the OAI can take into account observations and comments made by interested parties at the public hearing before finalizing the investigation report. The date of the oral hearing is announced in *Kwanbo* to maximize transparency of this procedure.

⁵² See, Exhibit Korea-12

⁵³ Korea noted that “Public Notice of” should be deleted from the headline of Exhibit Korea-3. The Determination itself was not published in Korea's Official Gazette.

4.118 In this case, the Notice of Public Hearing was published in *Kwanbo* on 25 July 1996 (see Exhibit Korea-13). The interim report was available from the KTC upon request as from 12 August 1996. The Public Hearing was held on 20 August 1996.

4.119 Fifth, taking into account the above interim stage, the OAI completes its report for final approval by the KTC commissioners. The report includes a detailed analysis of:

- (a) the product under investigation;
- (b) the domestic industry;
- (c) like or directly competing products;
- (d) increases in the level of imports;
- (e) threat of or actual serious injury to the domestic industry; and
- (f) the causal relationship between increased imports and serious injury.

4.120 The KTC deliberates the case for a determination on injury (including causal link) on the basis of the investigation report presented to it from the OAI. The KTC's determination of injury, whether affirmative or negative, is published in *Kwanbo* with a summary of the investigation result, the decision of injury, further schedules and other administrative information. The KTC's determination on injury also triggers a notification to the WTO Committee on Safeguards, in the form of notice conforming to G/SG/N/8. It is important to note that if the KTC makes a negative determination on injury on the basis of the consideration on increased imports, serious injury, or causation, the case is rejected and no further action is possible.

4.121 In this case, the OAI Report was completed on 23 October 1996, and a Notice published in *Kwanbo* on 11 November 1996 (see Exhibit Korea-7).⁵⁴ The OAI Report was the basis for the notification to the WTO Committee on Safeguards of 2 December 1996, published by the WTO on 6 December 1996 (G/SG/N/8/KOR/1).⁵⁵ This Notification stated:

“The Korean Trade Commission has not made a decision to apply a safeguard measure yet. Therefore, there is no information on such a measure at this time. The KTC will recommend to the relevant Minister an appropriate remedial measure within 45 days of the injury determination.”

4.122 Sixth, in accordance with Article 34(1) of the Foreign Trade Act and Articles 71, 72 and 76 of the Enforcement Decree of the Foreign Trade Act, the KTC Commissioners then consider the OAI Report and decide on appropriate relief measures for recommendation to the relevant Minister.⁵⁶

4.123 In this case, the KTC Commissioners decided on the relief measure, namely the quota, on 2 December 1996, and recommended it on 6 December 1996 to the Minister for Agriculture and Forestry for his deliberation.

4.124 Seventh, taking into account the outcome of “prior consultations” under Article 12.3 of the Agreement on Safeguards, the relevant Minister takes a decision concerning the relevant relief

⁵⁴ It generally takes 2-3 weeks to prepare a notice in cooperation with the Ministry of Administration, which is in charge of the operation of *Kwanbo*.

⁵⁵ It took nearly one month for the Notification to arrive at the WTO through diplomatic channels from the KTC.

⁵⁶ The KTC's recommendation on relief measures is not made public because it is only a recommendation that has no legal effect and that is subject to change by the relevant Minister.

measure. If the Minister uses any additional reasoning not found in the OAI Report, this is provided in the relevant Notice. However, if no additional reasoning is used, then the Minister's determination adopts all relevant elements of the OAI Report.

4.125 In this case, Korea issued another notification to the Committee on Safeguards on 21 January 1997, by G/SG/N/10/KOR/1, published on 27 January 1997. The notification stated:

Pursuant to Article 12.3 of the Agreement on Safeguards, the Republic of Korea will consult with Members having substantial interest in the products covered by the safeguard measure, for the purpose of providing further information. A delegation from Korea will stay in Geneva during the week beginning 3 February 1997 to meet with those Members, before it makes a final decision on the measure by the week beginning 24 February 1997."

4.126 In addition, the letter enclosing the Notification reserved the right of Korea to make further submissions to the Committee concerning the imposition of any relief measures.

4.127 Further, on 31 January 1997, Korea filed a notification with the Committee on Safeguards concerning the application of the proposed safeguard measure to developing countries. This was done in accordance with footnote 2 of Article 9 of the Agreement on Safeguards (see G/SG/N/11/KOR/1 of 21 February 1997, and Exhibit EC-8).

4.128 The Minister of Agriculture and Forestry took his decision on 1 March 1997, and a Notice of the decision was published in *Kwanbo* on 7 March 1997 (see Exhibit Korea-9).

4.129 On 24 March 1997, Korea notified the Committee on Safeguards of an addendum to G/SG/N/10/KOR/1 (G/SG/N/10/KOR/1/Suppl.1), which was circulated on 1 April 1997.

4.130 Therefore, Korea concludes that the information used and analysis performed is found in the seven stages set out above, including, where relevant, any additional information contained in any of the Notifications made to the Committee on Safeguards. Although it may be possible to conclude that the OAI Report forms the fundamental basis of Korea's determination, it should be clear that the KTC and the relevant Minister together comprise the "competent authorities" and that any decision to impose a safeguard measure must take into account prior consultations. Accordingly, in response to the Panel's question as to where to find "the information used and analysis performed by the national authority of Korea in its determination of its safeguard measure," Korea considers that any "information used or analysis undertaken" at any time subsequent to the issuance of the OAI Report and prior to the Minister's final decision to implement relief measures is also relevant and needs to be considered as part of that decision.

(c) Submission of the European Communities

4.131 In its second submission the **European Communities** further argued as follows:

4.132 The European Communities have based its attempts to show that Korea's measure was inconsistent with Article XIX of GATT and several provisions of the Agreement on Safeguards. In order to arrive at this conclusion the European Communities based themselves on Korea's 1 April 1997 Notification to the Committee on Safeguards, because it wanted to take into account all the facts and arguments on which the final position of its authorities was based. The European Communities assumed that all those facts and arguments would be reflected in the 1 April Notification in view of Korea's multilateral obligations, at least in summary and with appropriate reference to the relevant parts of other determinations of its competent authorities. Although the European Communities were prepared to accept the 1 April 1997 Notification as the ultimate source of the basis for Korea's determination, even that latest document could not sustain a close scrutiny.

4.133 The European Communities submit that, in any event, no other result is reached by looking at the documents which Korea refers to as its “final determination” or at the KTC’s determination of injury. Indeed, in the course of its consultations with Korea the European Communities already challenged the WTO-legality of its intended measures before the 1 April Notification was published.

4.134 This was done on the basis of information available at that stage, which did not include the 1 April Notification but rather the information provided in Korea’s documents and the explanations provided by Korea.

4.135 The European Communities further consider that its position as to the appropriate source of the information used and analysis performed by Korea’s authorities is confirmed by Korea’s replies to the questions of the Panel.

4.136 In its reply to the pertinent question of the Panel, Korea has described the various procedural steps leading to the imposition of the safeguard measure at issue in this dispute. In doing so, it has referred to, *inter alia*, several documents which were prepared by its competent authorities. It has also pointed out that according to its procedure these documents can be commented upon and revised accordingly, up to and including the draft final determination.

4.137 Furthermore, Korea itself admits that the final document in its procedure was the “Notice” of 7 March 1997 (produced as Exhibit Korea-9).

4.138 That document certainly fails to be “detailed” as required by Article 4.2(c) of the Agreement on Safeguards, be it directly, that is by the information included therein, or by reference, *i.e.*, by the documents which it may refer to.

4.139 In particular, the 7 March Notice, issued after the bilateral consultations with the European Communities had taken place, does not refer to any of the information and aspects raised in those consultations. Thus, if the 7 March Notice and possibly prior documents are the relevant sources, Korea disregarded, *inter alia*, the information provided in the consultations and without any reason being provided. By contrast, the 1 April Notification does take account of some of the objections made by the European Communities at the consultations.

4.140 Accordingly, the European Communities consider that its reliance on the 1 April Notification was more favourable to Korea.

4.141 Korea is itself admitting that its 1 April Notification was made to inform WTO Members of the details of the relief measures and it intended to be a summary of the “OAI Report” and of the “additional findings” based on prior consultations. Thus, the April Notification is the one (and only) document accounting for those “additional findings”.

C. CLAIM UNDER ARTICLE XIX:1(a) OF GATT

(a) **Claim by the European Communities**

4.142 The **European Communities** claim that Korea violated Article XIX:1(a) of GATT by failing to examine whether the import trends of the products under investigation were the result of unforeseen developments. The European Communities made the following arguments in support of its claim:

4.143 Article XIX:1(a) of GATT stipulates:

“If, as a result of *unforeseen developments* and of the effect of the *obligations incurred by a contracting party under this Agreement, including tariff concessions*, any product is being imported into the territory of that contracting party in such increased quantities *and*

under such conditions as to cause or threaten to cause serious injury to domestic producers in that territory of like or directly competitive products, the contracting party shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession.” (emphasis added)

4.144 It clearly results from the wording of Article XIX:1(a) that in order to allow the imposition of a safeguard measure not any increase in imports is relevant, but only those which result from both “unforeseen developments” and compliance with GATT obligations, including tariff liberalization according to a party’s schedules of concessions.

4.145 Tariff concessions and other obligations are listed in Article XIX of GATT as an additional element to “unforeseen developments”, so it necessarily follows that liberalization cannot constitute by itself such unforeseen developments.⁵⁷ If it were otherwise, a WTO Member would be allowed to withdraw the very benefits which it had undertaken to afford *e.g.*, by entering into tariff commitments as soon as those benefits materialize. This would neither be consistent with good faith interpretation of that provision nor with the liberalization aims pursued by GATT and the WTO Agreement overall. In any event, increased imports of the magnitude at issue in this case as a result of the tariff concessions agreed for SMPP cannot be considered “unforeseen” within the meaning of Article XIX:1(a).

4.146 The European Communities submit that, by failing to address how the increase in imports of milk powder blends and foodstuff preparations was the result of “unforeseen developments”, Korea violated the obligations which it assumed under Article XIX:1(a) of GATT.

(b) Response by Korea

4.147 **Korea** responds to the EC arguments as follows:

4.148 Following unsuccessful negotiations during the Tokyo Round and after years of negotiations during the Uruguay Round, WTO Members finally concluded the Agreement on Safeguards. It was intended to establish a final, complete and balanced system of rules for the imposition of safeguards, which achieved a delicate balance among the different interests of the various groups concerned. Article 1 of the Agreement on Safeguards expressly states that the Agreement on Safeguards «establishes the rules for the application of safeguard measures.» Article 1 does not provide that any different or additional rules provided under Article XIX of GATT must also apply to the application of safeguard measures.⁵⁸ Thus, in the view of Korea, the text of the Agreements supports the interpretation that the rules established in the Agreement on Safeguards are now the sole articulation of the rules that must be followed in the application of a safeguard measure⁵⁹. Without prejudice to Korea’s position that it complied with all of its international obligations in applying the safeguard measure at issue, Korea respectfully requests that the Panel examine this case in accordance with the interpretation of Korea.

⁵⁷ This also reflects a generally accepted tenet of economic theory, *i.e.*, that tariff protection can be measured in advance according to specific formulas: see B. Hoekman, M. Kostecki, *The Political Economy of the World Trading System*, Oxford, 1995, pp. 88, 93.

⁵⁸ Contrary to Article 1 of the Agreement on Safeguards, Article 10 of the Agreement on Subsidies and Countervailing Measures states that «Members shall take all necessary steps to ensure that the imposition of a countervailing duty . . . is in accordance with the provisions of Article VI of GATT and the terms of this Agreement.»

⁵⁹ In terms of the General Interpretative Note to Annex 1A of the WTO Agreement, the rules on the Agreement on Safeguards must prevail over the conflicting rules in Article XIX of the GATT.

(c) Additional arguments by the European Communities made at the first meeting of the Panel with the parties

4.149 The **European Communities** responded to Korea's Argument by asserting that:

4.150 Korea relied on a very selective - and interpolated - quotation of Article 1. Thus, the original Article 1, reading "This Agreement establishes rules for the application of safeguard measures which shall be understood to mean those measures provided for in Article XIX of GATT" becomes "This Agreement establishes the rules for the application of safeguard measures", with the rest of the provision eloquently omitted. (emphasis added)

4.151 By doing so Korea simply refuses to face the fact that GATT was incorporated in the WTO system in its entirety. From the very inception of the new WTO system panels have recognized that the fragmentation of the multilateral trading system resulting from the independent co-existence of GATT 1947 and the so-called "side-agreements" is definitively over.⁶⁰ Most recently, in *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*,⁶¹ the Appellate Body made clear in respect of dispute settlement provisions that

"[a] special or additional provision should only be found to prevail over a provision of the DSU in a situation where adherence to the one provision will lead to a violation of the other provision, that is, in the case of a *conflict* between them". "[i]t is only where the provisions of the DSU and the special or additional rules and procedures of the covered agreement *cannot* be read as *complementing* each other that the special or additional provisions are to *prevail*" (emphasis in original)

4.152 It is precisely in those very same terms that the interpretative note to Annex IA to the WTO Agreement provides that: "In the event of a *conflict* between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex IA ... , the provision of the other Agreement *shall prevail* to the extent of the *conflict*." (emphasis added).

4.153 The European Communities failed to see how Article XIX:1(a), to the extent that it requires that the increase in imports must result from "unforeseen developments", could be said to be in conflict with the provisions of the Agreement on Safeguards. Clearly, the drafters of Article XIX had difficulties too, since they cumulated these requirements.

4.154 Furthermore, derogating from Article XIX is certainly not one of the aims of the Agreement on Safeguards. That agreement rather aims to "clarify and reinforce the disciplines of GATT and specifically those of Article XIX ... to re-establish control over safeguards and eliminate measures that escape such control" and recognizes that "for these purposes a comprehensive agreement, applicable to all Members and based on the basic principles of GATT, is called for". (emphasis in original)

4.155 In response to a question by the Panel⁶², the **European Communities** further clarified their arguments:

⁶⁰ See, the Panel Report in *Brazil - Dessicated Coconut*, WT/DS22/R, 17 October 1996. e.g., paras 227, 242.

⁶¹ WT/DS60/AB/R, 2 November 1998.

⁶² The Panel recalls that the question was: "Please comment and discuss the legal relationship between the provisions of the Agreement on Safeguards and those of Article XIX of GATT, in particular with reference to 'unforeseen developments'."

4.156 The European Communities consider that the requirement in Article XIX that safeguard measures only be taken in the event of “unforeseen developments” remains applicable even if not repeated in the Agreement on Safeguards.

4.157 Article 1 of that Agreement provides that “This Agreement establishes rules for the application of safeguard measures which shall be understood to mean those measures provided for in Article XIX of GATT”.

4.158 It is clear from the omission of the definite Article before the word “rules” in this provision that the Agreement on Safeguards is *not* intended to be the exclusive source of safeguard rules.

4.159 It is true that Article 2 of the Agreement on Safeguards does not repeat the requirement of unforeseen developments but this can be explained by the intention of the Agreement on Safeguards to provide procedures for investigations. Unlike increased imports, other conditions, injury and causation, the existence of unforeseen circumstances is something within the knowledge of governments and does not require investigation involving economic operators. It is of interest to note that the requirement that the increased imports result from trade liberalization is also not mentioned in the Agreement on Safeguards (liberalization is also of course a matter within the knowledge of governments). Both these factors either exist or do not and do not need an investigation to be established. As is clearly stated in the preamble, the purpose of the Agreement on Safeguards was to clarify and reinforce the disciplines of Article XIX of GATT. The requirements of unforeseen developments and indeed the consequences of trade liberalization were not requirements which the contracting parties considered needed to be clarified and reinforced.

4.160 Article 11.1(a) of the Agreement on Safeguards expressly requires that safeguard action conform *both* to Article XIX GATT *and* to the Agreement on Safeguards. This is especially so in view of the fact that GATT and the Agreement on Safeguards are both contained in Annex 1A of the WTO Agreement and the General Interpretative Note to the WTO Agreement provides that the provisions of an agreement such as the Agreement on Safeguards should prevail over the GATT in the event of *conflict* and to the extent of the conflict. The European Communities see no conflict between Article XIX GATT and the Agreement on Safeguards.

4.161 In response to a request from the Panel that it clarify its interpretation of the *Brazil - Dessicated Coconut* case referred to in paragraph 4.151 above, the **European Communities** responded as follows:

4.162 The European Communities have referred to the *Brazil - Dessicated Coconut* case in reply to the position taken by Korea on the issue of the “applicable law”. Korea has argued that “the rules established in the Agreement on Safeguards are now the sole articulation of the rules that must be followed in the application of a safeguard measure”, to the exclusion of Article XIX of GATT, because Article 1 of the Agreement on Safeguards does not provide that any different or additional rule under Article XIX of GATT must also apply.

4.163 The European Communities disagree with Korea and consider that the *Brazil - Dessicated Coconut* Panel Report, upheld by the Appellate Body, supports its view that such an express provision is not required, but rather that GATT and the Agreement on Safeguards:

“represent an inseparable package of rights and disciplines that must be considered in conjunction”.⁶³

4.164 The *Brazil - Dessicated Coconut* Panel also stated:

⁶³ Panel Report, para 227, recalled in Appellate Body Report, p. 14 (emphasis added). The Panel concluded for the non-separability of Article VI of GATT and the SCM Agreement in para 257 of its Report.

“Article VI of GATT and the SCM Agreement represent a new and different package of rights and obligations, as among WTO Members, regarding the use of countervailing duties. ... The SCM Agreements do not merely impose additional substantive and procedural obligations on a potential user of countervailing measures. Rather, the SCM Agreements and Article VI together define, clarify and in some cases modify the whole package of rights and obligations of a potential user of countervailing measures.”⁶⁴

4.165 The European Communities concur with the conclusion, drawn by the United States from this passage, that the “new package” made up by the Agreement on Safeguards and Article XIX of GATT is different from Article XIX of GATT 1947.

4.166 The European Communities however disagree with the additional conclusion drawn by the United States as a third party in this dispute that after the entry into force of the Agreement on Safeguards “those provisions of Article XIX *that remain in force* are incorporated into the Agreement on Safeguards” and that the requirement that “unforeseen developments” must have caused an increase in imports is no longer applicable. With this statement the United States seem to be attempting to reduce the “package” to the provisions of only one part, the Agreement on Safeguards. This is the opposite of what the Appellate Body meant when it agreed that the GATT provision and the specific agreement needed to be treated as an “inseparable package”.

4.167 The European Communities added that, on the status of GATT in the WTO system, the *Brazil - Desiccated Coconut* Panel considered:

“It is evident that both Article VI of GATT and the SCM Agreement have force, effect and purpose within the WTO Agreement. That GATT has not been superseded by other Multilateral Agreements on Trade in Goods (“MTN Agreements”) is demonstrated by a general interpretative note to Annex 1A of the WTO Agreement. (footnote omitted) The fact that certain important provisions of Article VI of GATT are neither replicated nor elaborated in the SCM Agreement further demonstrates this point.”⁶⁵

4.168 On the other hand, the European Communities recall that in that case the Panel did not have to decide on the precise content of the “new package”, that is, on whether and to what extent the GATT provision at issue (Article VI) had been modified as a result of the relevant Agreement in Annex 1 A (the Agreement on Subsidies and Countervailing Measures). In fact, the Panel concluded for the inapplicability of the whole relevant “package” to the case before it.⁶⁶

(d) Additional arguments by Korea made at the first meeting of the Panel with the parties

4.169 In response to a question by the Panel⁶⁷, **Korea** further clarified its arguments as follows:

4.170 Article XIX:1(a) of GATT 1947 provided that Contracting Parties could apply safeguard measures in response to “unforeseen developments” resulting in increased imports that threatened or caused serious injury to domestic producers of like or directly competitive products. GATT includes

⁶⁴ Panel Report, para 246; Appellate Body Report, p. 16 (emphasis in original).

⁶⁵ “For example, the SCM Agreement does not replicate or elaborate on Article VI:5 of GATT, which proscribes the imposition of both an anti-dumping and a countervailing duty to compensate for the same situation of dumping and export subsidization, nor does it address the issue of countervailing action on behalf of a third country as provided for in Article VI:6(b) and (c) of GATT. If the SCM Agreement were considered to supersede Article VI of GATT altogether with respect to countervailing measures, these provisions would lose all force and effect. Such a result could not have been intended.” (Panel Report, para 227).

⁶⁶ Panel Report, paras 231, 257.

⁶⁷ The Panel recalls that the question was: “Please comment and discuss the legal relationship between the provisions of the Agreement on Safeguards and those of Article XIX of GATT, in particular with reference to ‘unforeseen developments’.”

the text of GATT 1947, including Article XIX. The Agreement on Safeguards, however, does not include the condition of “unforeseen developments.”

4.171 WTO dispute settlement panels and the Appellate Body have established that the language of GATT and the WTO Agreements should be interpreted in accordance with the rules of interpretation set forth in the Vienna Convention on the Law of Treaties⁶⁸ (“Vienna Convention”). These rules require an examination of the ordinary meaning of the words of a treaty, read in their context and in the light of the object and purpose of the treaty involved.⁶⁹

4.172 Accordingly, in its interpretation of the Agreement on Safeguards and Article XIX, Korea first addresses the respective texts. After having established the meaning of the texts in their context, Korea discusses the object and purpose of the provisions at issue. In light of the disagreement between the parties to this dispute, Korea also analyses supplemental sources of interpretation in accordance with the Vienna Convention in order to clarify the meaning of the texts and the object and purpose of the provisions at issue.⁷⁰

4.173 Korea submits that the legal relationship between the Agreement on Safeguards and Article XIX is based on the text of Articles 1 and 11.1(a) of the Agreement on Safeguards. Article 1 states that:

“[t]his Agreement establishes rules for the application of safeguard measures which shall be understood to mean those measures provided for in Article XIX of GATT.”
(Emphasis added).

4.174 Article 11.1(a) of the Agreement on Safeguards states that

“[a] Member shall not take or seek any emergency action on imports of particular products set forth in Article XIX of GATT unless such action conforms with the provisions of that Article applied in accordance with this Agreement.” (Emphasis added).

4.175 Thus, Articles 1 and 11.1(a) of the Agreement on Safeguards clearly and conclusively establish that safeguard measures originally provided for in Article XIX may only be applied in accordance with the rules established under the Agreement on Safeguards.

4.176 Pursuant to the express terms of Article 11.1(a), the Agreement on Safeguards and Article XIX must be read together, and applied in accordance with the provisions of the Agreement on

⁶⁸ Done at Vienna, 23 May 1969, 1155 U.N.T.S. 33; 8 International Legal Materials 679.

⁶⁹ See, the Appellate Body Report in the *United States - Import Prohibition of Certain Shrimp and Shrimp Products* (“*United States - Shrimp-Turtle*”), WT/DS58/AB/R, footnote 82 and accompanying text, citing *United States - Standard for Conventional and Reformulated Gasoline*, (“*United States - Gasoline*”) adopted 20 May 1996, WT/DS2/AB/R, p. 17; *Japan - Taxes on Alcoholic Beverages*, (“*Japan - Alcoholic Beverages*”) adopted 1 November 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, pp. 10-12; *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products*, adopted 16 January 1998, WT/DS50/AB/R, paragraphs. 45-46; *Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, adopted 13 February 1998, WT/DS56/AB/R, paragraph. 47; and *European Communities - Customs Classification of Certain Computer Equipment*, adopted 22 June 1998, WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, paragraph. 85.

⁷⁰ See, *United States - Shrimp*, Appellate Body Report, Section VI.A, stating that “[w]here the meaning imparted by the text itself is equivocal or inconclusive, or where confirmation of the correctness of the reading of the text itself is desired, light from the object and purpose of the treaty as a whole may usefully be sought.” I. Sinclair, *The Vienna Convention on the Law of Treaties*, 2nd ed. (Manchester University Press, 1984), pp. 130-131.

Safeguards.⁷¹ The Appellate Body has established that, taken together, provisions of the GATT and the *WTO Agreements* create a new “package of rights.”⁷² Accordingly, Korea submits that the provisions of Article XIX have been defined, clarified, and modified according to the new “package of rights” applicable under the Agreement on Safeguards.

4.177 Korea submits that conflicts between the provisions of Article XIX and the Agreement on Safeguards must be resolved according to the *General Interpretative note to Annex 1A* to the *WTO Agreements* (the “Interpretative Note”), which provides:

“In the event of conflict between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A to the Agreement Establishing the World Trade Organization..., the provision of the other agreement shall prevail to the extent of the conflict.”

4.178 The provisions of the Agreement on Safeguards, therefore, prevail to the extent of conflict with Article XIX.

4.179 Pursuant to Article 11.1(a), safeguard measures must be applied in accordance with the Agreement on Safeguards. The “unforeseen developments” condition cannot be applied in accordance with the Agreement on Safeguards, because such condition is not specified in the Agreement. Article XIX, on the other hand, does require “unforeseen developments.” This conflict⁷³ must be resolved according to the Interpretative Note, which requires that the Agreement on Safeguards must prevail to the extent of conflict with Article XIX.

4.180 Because the “unforeseen developments” condition of Article XIX does not conform with the provisions of the Agreement on Safeguards, Members are not required to consider such condition when taking or seeking the emergency actions on imports of particular products set forth in Article XIX of GATT.

4.181 In addition to the rule set forth in Article 11.1(a), Article 2 of the Agreement on Safeguards provides that “[a] Member may apply a safeguard measure to a product only if that Member has determined, pursuant to the provisions set forth below...” that the applicable criteria have been established (emphasis added). The “provisions below” of the Agreement on Safeguards do not include the “unforeseen developments” condition. Moreover, Article 2 continues to reiterate every provision of Article XIX:1(a) except those regarding “unforeseen developments” and “obligations incurred by a contracting party under [GATT], including tariff concessions.” Thus, the language of

⁷¹ Although it may consider that the application of Article 11.1(a) may be inconvenient for its purposes, the EC cannot simply ignore its legal effect. As the Appellate Body has noted on two occasions “one of the corollaries of the ‘general rule of interpretation’ in the Vienna Convention is that interpretation must give meaning and effect to all terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.” Appellate Body Report, *Japan - Alcoholic Beverages*, pp. 11-12, citing Appellate Body Report, *United States - Gasoline*, p.23.

⁷² See, *Brazil - Measures Affecting Desiccated Coconut*, WT/DS22/AB/R, adopted 21 February 1997, p.16, where the Appellate Body stated that “[t]he SCM Agreements do not merely impose additional substantive and procedural obligations on a potential user of countervailing measures. Rather, the SCM Agreements and Article VI together define, clarify and in some cases modify the whole package of rights and obligations of a potential user of countervailing measures.” (Emphasis added.)

⁷³ In Korea's view the EC attempts to avoid “conflict” between the provisions of the agreements by comparing Article XIX:1(a) to Article 2 of the Agreement on Safeguards, which can, on their face, be read complementary to each other. The conflict that brings the Interpretative Note into application, however, is between Article XIX:1(a) and Article 11:1(a) of the Agreement on Safeguards, which requires that safeguard measures be applied according to the Agreement on Safeguards (that does not include the “unforeseen developments” condition).

Article 2 of the Agreement on Safeguards mandates the interpretation that the condition of “unforeseen developments” is not included in the new “package of rights” in effect under WTO law.

4.182 Korea considers that its interpretation of the WTO safeguards regime reflects the object and purpose of the Agreement on Safeguards together with Article XIX. The preamble to the Agreement on Safeguards includes the following as its object and purpose:

- to improve and strengthen the international trading system based on GATT; and
- to clarify and reinforce the disciplines of GATT, and specifically those of its Article XIX..., to re-establish multilateral control over safeguards and eliminate measures that escape such control.

4.183 Korea considers that its interpretation of the Agreement on Safeguards and Article XIX is also consistent with the object and purpose of the *WTO Agreements* as a whole. The Appellate Body has noted that “[t]he authors of the new WTO regime intended to put an end to the fragmentation that had characterized the previous system.” This intent is evident in the preamble to the *WTO Agreement*, which states, in pertinent part:

“Resolved, therefore, to develop an integrated, more viable and durable multilateral trading system encompassing the General Agreement on Tariffs and Trade, the results of past trade liberalization efforts, and all of the results of the Uruguay Round of Multilateral Trade Negotiations.”

4.184 Thus, the object and purpose of the provisions at issue, and of the *WTO Agreements* generally, is to introduce changes to the GATT regime that improve and strengthen the multilateral trading system.

4.185 The object and purpose of the provisions at issue is further illustrated by practice of the parties under Article XIX and the Agreement on Safeguards.⁷⁴ Practice under Article XIX confirms that the GATT Contracting Parties did not consider that the condition of “unforeseen developments” was required. For example, as early as 1951, the United States did not apply the “unforeseen developments” condition in determining whether to impose safeguard measures.⁷⁵

4.186 Significantly, the lack of subsequent practice under Article XIX reflects the view held by many Contracting Parties that Article XIX’s provisions were unrealistic and unusable. The proliferation of “grey area” measures since the inception of GATT 1947 is widely attributed to Contracting Parties’ perception that the political and economic reality attendant to safeguard measures could not be accommodated under Article XIX.

4.187 Even if it is considered that “unforeseen developments” were required under GATT 1947, but were simply not complied with, practice by the parties confirms that “unforeseen developments” are not required under the Agreement on Safeguards. Safeguards practice subsequent to the *WTO Agreements*’ entry into force is generally limited to Members’ implementation of laws and regulations consistent with the Agreement on Safeguards, especially since the instant case is the first dispute to be brought under the Agreement on Safeguards. According to the notifications of legislation submitted to the Committee on Safeguards pursuant to Article 12.6 of the Agreement on Safeguards, the laws

⁷⁴ Article 31, Paragraph 3 of the Vienna Convention provides that in interpreting a treaty, “[t]here shall be taken into account, together with the context:... (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation[.]”

⁷⁵ In 1951, the US Congress passed the Trade Agreements Extension Act, which eliminated the “unforeseen conditions” requirement from US safeguards law.

and regulations of the parties and third party to this dispute do not include the condition of “unforeseen developments”⁷⁶,

4.188 Under the presumption that these WTO Members have implemented the measures required under the Agreement on Safeguards in good faith, Korea submits that the absence of the “unforeseen developments” condition indicates that such condition in their domestic legislation is not considered to exist under the Agreement on Safeguards.

4.189 The object and purpose of the Agreement on Safeguards, as illustrated by the parties’ practice, is to improve and strengthen the multilateral trading system by introducing effective means for applying safeguard measures. This object and purpose would be completely undermined by the inclusion of the “unforeseen developments” condition.

4.190 Korea considers that the relevant texts clearly do not require the condition of “unforeseen developments.” To the extent that the texts are deemed ambiguous or unreasonable, however, Korea notes that preparatory work to the Agreement on Safeguards reinforces the negotiators’ intent that the condition of “unforeseen developments” does not apply under the Agreement on Safeguards.⁷⁷

4.191 The preparatory work to the Agreement on Safeguards provides additional guidance on the meaning of the texts and the object and purpose of the relevant agreements. In addition, Korea considers that the EC imposition of the “unforeseen developments” condition on Korea, but not on itself, would lead to a manifestly absurd and unreasonable result.⁷⁸ which is not tolerated under the Vienna Convention rules, and should be rejected by the Panel.

4.192 In reviewing the preparatory work to the Agreement on Safeguards, Korea first looks to the language of the disputed provision. As indicated above, the Agreement on Safeguards reiterates every provision of Article XIX:1(a) except those regarding “unforeseen developments” and “obligations incurred by a contracting party under [GATT], including tariff concessions.” The Agreement on Safeguards’ negotiating drafts also reflect that the negotiators considered, and rejected, the “unforeseen developments” requirement.⁷⁹

⁷⁶ The European Communities - G/SG/N/1/EEC/1; the Republic of Korea - G/SG/N/1/KOR/1; the United States of America - G/SG/N/1/USA/1. Since the entry into force of the Agreement on Safeguards, the United States has conducted the following safeguards investigations, in which “unforeseen developments” were not considered: *Broom Corn Brooms*, Inv. Nos. TA-201-65 and NAFTA 302-1, USITC Pub. 2984 (Aug. 1996); *Fresh Tomatoes and Bell Peppers*, Inv. No. TA-201-66, USITC Pub. 2985 (Aug. 1996); and *Wheat Gluten*, Inv. No. TA-201-67, USITC Pub. 3088 (March 1998).

⁷⁷ For an example of the Appellate Body’s recourse to treaty preparatory materials, see *United States - Shrimp-Turtle* Appellate Body Report, footnote 152, and accompanying text.

⁷⁸ Similarly, the Oral Statement of the United States notes that requiring the “unforeseen developments” condition would lead to yet another unreasonable result. In particular, the United States opines that

“[i]t is simply not credible to suggest that a trade Minister would negotiate a particular concession if it could be foreseen that such a concession would result in increased imports that, in turn, would seriously injure an industry in the country granting the concession. A Minister who engaged in such conduct would, quite properly, be relieved of his or her post.”

In this regard, Korea takes note of the United States’ comment that the modification of Article XIX to delete the condition of “unforeseen developments” was “necessary in order to reflect actual practice.” Oral Statement of the United States, p. 6, n8. (See, also discussion of safeguards practice under GATT at note [7], *supra*.)

⁷⁹ See, MTN.GNG/NG9/W/25, 27 June 1989; MTN.GNG/NG9/W/25/Rev.1, 15 January 1990; MTN.GNG/NG9/W/25/Rev.2, 13 July 1990; MTN.GNG/NG9/W/25/Rev.3, 31 October 1990; MTN.GNG/NG9/19, paragraph A.3.

4.193 Several authors provide insight on the relationship of the Agreement on Safeguards and Article XIX under the new WTO safeguards regime. Professor Thiébaud Flory has opined that Article XIX “functioned for many years in a defective manner - moreover the Community has only triggered the safeguard clause under Article XIX twenty times since the beginning of the 1980's. This very low number of inquiries displays the defective nature of the functioning of the safeguard clause under Article XIX of the General Agreement of 1947....”⁸⁰ In the context of safeguard negotiations during the Uruguay Round, Pierre Didier has observed with respect to the “unexpected, sudden, and large” conditions contemplated by the negotiating group on safeguards, that “both the US and EU rejected this terminology as being too difficult to apply.”⁸¹

4.194 Regarding the outcome of the Uruguay Round negotiations, Marco Bronckers notes that “exporting interests have also lost on a couple of points in the agreement, for example: - the triggering condition of injury no longer needs to be attributable to ‘unforeseen developments’ or to ‘GATT obligations....’”⁸² In addition, Janet A. Nuzum, former Commissioner of the US International Trade Commission, has noted the change from Article XIX’s requirements that the Agreement on Safeguards does not require “unforeseeable developments and of the effect of obligations incurred by a contracting party under [GATT] including tariff concessions....”⁸³ Finally, Edmond McGovern has expressed the view that “[t]he requirements in Article XIX:1 that the injury should occur “as a result of unforeseen developments and of the effect of obligations incurred... under this Agreement” were not repeated in the 1994 Agreement because they were no longer of practical significance.”⁸⁴ Thus, learned commentary on the matter in dispute also leads to the conclusion that the “unforeseen developments” condition required under the “defective” Article XIX does not apply under the Agreement on Safeguards.

4.195 Korea submits that the new “package of rights” in effect under the Agreement on Safeguards and Article XIX of GATT does not include the condition of “unforeseen developments.”

(e) Rebuttal arguments made by the European Communities

4.196 The **European Communities** made the following arguments in rebuttal:

4.197 In its reply to the Panel's question on Article XIX, Korea correctly refers to the interpretative criteria set out in Article 31 of the Vienna Convention.⁸⁵ Their application, to the extent that it is correct, does not however improve Korea's case.

⁸⁰ *The Agreement on Safeguards in The Uruguay Round Results, A European Lawyers' Perspective* (European Interuniversity Press 1996), pp. 265-66. In support of his opinion, Prof. Flory cites to an extensive list of GATT/WTO publicists, including: T. Flory, *Le GATT, droit international et commerce mondial* (LGDJ, 1968); J. Jackson, *World Trade and the Law of GATT* (The Bobbs-Merrill Company, 1969); J. Jackson, *The World Trading System* (MIT, 1989); M.C.E.J. Bronckers, *Selective Safeguard Measures in Multilateral Trade Relations* (Kluwer Law and Taxation, 1985); Edmond McGovern, *International Trade Regulation* (Globefield Press, 1985), pp. 291-310.

⁸¹ Pierre Didier, *Les principaux accords de l'OMC et leur transposition dans la Communauté Européenne* (Bruylant, 1997) pp.271-272.

⁸² Marco C.E.J. Bronckers, *Voluntary Export Restraints and the GATT Agreement on Safeguards, in The Uruguay Round Results, A European Lawyers' Perspective* (European Interuniversity Press 1996).

⁸³ *The Agreement on Safeguards, U.S. Law Leads Revitalization of the Escape Clause, in World Trade Organization, the Multilateral Framework for the 21st Century and U.S. Implementing Legislation* (American Bar Association, 1996) p. 413.

⁸⁴ *International Trade Regulation* (Globefield Press, 1998 update) p. 10.21-2.

⁸⁵ Article 33 of the Vienna Convention on the Law of Treaties (1155 U.N.T.S 332) reads: “1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”

4.198 When examining the text of the provisions to be interpreted, Korea, which seems to focus exclusively on that of the Agreement on Safeguards, reiterates the same basic position: because the “unforeseen developments” requirement was not repeated in the Agreement on Safeguards, it cannot be applied “in accordance with” that Agreement and therefore has been modified (hence repealed) by the “new package” of rules resulting from the Uruguay Round negotiations.

4.199 The European Communities submit that lack of repetition does not amount to modification or abrogation, certainly not in the current WTO system. The Appellate Body has reconstructed the relationship between GATT and the other Annex 1A Agreements and has set the threshold below which a Member cannot arbitrarily diminish its obligations under the WTO, notably under GATT.

4.200 The European Communities consider that lack of repetition rather means that the Agreement on Safeguards has not elaborated on this particular requirement, which did not need special “clarification and reinforcement” in accordance with the agreement’s avowed objectives. The Agreement on Safeguards does not, by its terms, represent the exclusive source of the WTO safeguards regime and the “unforeseen developments” requirement remains in force elsewhere in the WTO system.

4.201 With respect to the provisions of the Agreement on Safeguards upon which Korea specifically relies the European Communities asserted that the full text of Article 2.1, which is referred to by Korea, can clarify its real meaning:

“1. A Member may apply a safeguard measure to a product only if that Member has determined, pursuant to the provisions set out below, that such product is being imported into its territory in such increased quantities, absolute or relative to domestic production, and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces the like or directly competitive products.” (emphasis added)

If some of the requirements of Article XIX of GATT are not even referred to it is hardly surprising that they are not elaborated upon in the provisions of the Agreement on Safeguards “set out below”. Article 2.1 therefore adds nothing to Korea’s case and by quoting it Korea falls in a rather circular argument.

4.202 With respect to the object and purpose of the provisions in question, Korea, again focusing on the Agreement on Safeguards, equally fails to support its case.

4.203 Korea rightly recalls that the objectives of that Agreement are to “improve and strengthen the safeguard regime”, and effectively summarizes them as “to introduce changes to the GATT regime that improve and strengthen the multilateral trading system”. The European Communities argue that, Korea has not yet demonstrated, how elimination of a requirement for the imposition of safeguard measures would weaken, rather than strengthen, the multilateral safeguards regime and would “completely undermine” the abovementioned objectives.⁸⁶

4.204 As to the “practice” of some WTO Members the European Communities first observes that in order to reconstruct the “object and purpose” of a treaty in terms of the Vienna Convention that practice is irrelevant. The “practice in the application of the treaty” is relevant under Article 31.3(b) of the Vienna Convention as an autonomous interpretative tool, not to identify object and purpose.

4.205 Furthermore the practice which is relevant under the Vienna Convention is the one “which establishes the agreement of the parties” on the interpretation or the application of a given treaty

⁸⁶ Eliminating the “unforeseen developments” requirement would rather frustrate the other Agreement on Safeguards’ objective to “re-establish multilateral control over safeguards and eliminate measures that escape such control.” (see the Agreement on Safeguards, Preamble, para 2).

provision. Korea has instead only quoted implementing legislation of a few WTO Members.⁸⁷ Moreover, that unilateral practice does not establish the agreement of all WTO Members on the alleged repeal or “disappearance” of the “unforeseen developments” requirement. Domestic implementing legislations of other Members expressly refer to that requirement.⁸⁸

4.206 Last, the European Communities recalled that they are not challenging Korea’s legislation *per se*, but rather the application of a safeguard measure in a specific case, and inasmuch as it understands that Korea’s legislation does not require Korean authorities to violate Article XIX requirements the European Communities took no position on their conformity with that Article.

(i) *The relationship between GATT and the other Annex 1A Agreements in the WTO system*

4.207 The European Communities argue that the relationship between GATT and the other Annex 1A Agreements provisions has, on the one hand, been regulated in the WTO system itself, and, on the other hand, all the forms of this relationship have already been addressed in dispute settlement. Both WTO provisions and Panel and Appellate Body Reports make clear that as a rule GATT and the other Annex 1A Agreements apply cumulatively. It has also been made clear that to this effect it is not necessary that an Agreement in Annex 1A either repeat or specifically provide that a given provision of GATT is applicable although not repeated in its text. Thus, the rule is rather the opposite of that put forward by Korea in its First Written Submission.

4.208 The European Communities consider that already the *Brazil - Dessicated Coconut* Panel Report, upheld by the Appellate Body, supports their view that an express provision is not required, but rather that GATT and the Agreement on Safeguards

“represent an inseparable package of rights and disciplines that must be considered in conjunction”.⁸⁹

On the status of GATT in the WTO system, the same Panel considered:

“It is evident that both Article VI of GATT and the SCM Agreement have force, effect and purpose within the WTO Agreement. That GATT has not been superseded by other Multilateral Agreements on Trade in Goods (“MTN Agreements”) is demonstrated by a general interpretative note to Annex 1A of the WTO Agreement. (footnote omitted) The fact that certain important provisions of Article VI of GATT are neither replicated nor elaborated in the SCM Agreement further demonstrates this point.”⁶⁹

⁸⁷ The EC would note in respect of its domestic legislation, quoted by Korea as an example of derogation from Article XIX of GATT, that Article XIX is repeatedly recalled in the preamble of Council Regulation (EC) No 3285/94 of 22 December 1994, inter alia in the following terms: “Whereas the Agreement on Safeguards meets the need to clarify and reinforce the disciplines of GATT, and specifically those of Article XIX” (para 4 of the statement of reasons).

⁸⁸ See, e.g., Japan (WTO Doc. G/SG/N/1/JPN/2, 17 July 1995); Costa Rica (WTO Doc. G/SG/N/1/CRI/1, 30 March 1995); Norway (WTO Doc. G/SG/N/1/NOR/3, 2 February 1996); and also a more recent Member, Panama (WTO Doc. G/SG/N/1/PAN/1, 9 April 1998). That not all WTO Members accept that the “unforeseen developments” clause is no longer in force is clear when some of those Members ask other Members about the reasons for not including the requirement in their legislations and the implications thereof (See, e.g., WTO Doc. G/SG/Q1/IND/8, *Follow-up Questions Posed by JAPAN regarding the Notification of INDIA*, 25 September 1998).

⁸⁹ Panel Report, para 227, recalled in Appellate Body Report, p. 14 (emphasis added). The Panel concluded for the non-separability of Article VI of GATT and the SCM Agreement in para 257 of its Report.

⁶⁹ For example, the SCM Agreement does not replicate or elaborate on Article VI:5 of GATT, which proscribes the imposition of both an anti-dumping and a countervailing duty to compensate for the same situation of dumping and export subsidization, nor does it address the issue of countervailing action on behalf of a third country as provided for in Article VI:6(b) and (c) of GATT. If the SCM Agreement were considered to supersede Article VI of GATT altogether with respect to countervailing measures, these provisions would lose all force and effect. Such a result could not have been intended.”⁹⁰

The European Communities submit that with the interpretation of the Agreement on Safeguards which they proposes Korea is unduly restricting the scope of its obligations under the whole of the WTO “package”.

4.209 As the Appellate Body observed still in the *Brazil - Dessicated Coconut* case:

“The General Interpretative Note to Annex 1A was added to reflect that the other goods agreement in Annex 1A, in many ways, represent a substantial elaboration of the provisions of the GATT, and to the extent that the provisions of the other goods agreements conflict with the provisions of the GATT 1944, the provisions of the other goods agreements prevail. This does not mean, however, that the other goods agreements in Annex 1A, such as the *SCM Agreement*, supersede the GATT”.⁹¹

4.210 Thus, the Appellate Body recognized that in the relationship between GATT and the other goods agreements in Annex 1A, the prevalence of the latter is only to the extent of the conflict and that otherwise this entails no “supersession”. This is otherwise consistent with the principle of effective interpretation of treaties, which was also recognized by the Appellate Body, according to which every provision should be given its meaning and effect.

4.211 In *Brazil - Dessicated Coconut* the Panel had already stated that failure to repeat a provision is not dispositive and does not allow a departure from cumulative application of GATT and other Annex 1A Agreements.⁹² The Appellate Body in *EC - Bananas* made this point further clear when it had to decide whether both Article X:3(a) of GATT and Article 1.3 of the Agreement on Import Licensing Procedures applied to the European Communities import licensing procedures.⁹³ Notwithstanding the fact that the Appellate Body found that “there are distinctions between [the] two articles” (that is, that the two provisions read differently), and at the same time that they have “identical coverage”⁹⁴ (that is, regulate the same aspect of the same case in point), the Appellate Body did not consider that they conflicted and thus that the Interpretative Note to Annex 1A applied. As a consequence, it found that both Article X of GATT and Article 1.3 of the Agreement on Import Licensing Procedures were applicable.⁹⁵

4.212 The European Communities submit that the hypothesis considered in the Appellate Body Report in *EC - Bananas* is different from the one at issue in the present dispute. In fact the Agreement on Safeguards and Article XIX of GATT do not overlap, in the sense that the “unforeseen developments” requirement is additional and therefore complementary to the matter regulated in the Agreement on Safeguards. In any event, even if these provisions overlapped, the *EC - Bananas* case law makes clear that the GATT provision is not eliminated by the system, but rather remains in force and is applicable cumulatively with the Agreement on Safeguards.

⁹⁰ Panel Report, para 227.

⁹¹ See, *Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/AB/R, 21 February 1997, p. 14 (italics in original, emphasis added).

⁹² *Id.*, para 227.

⁹³ See, Appellate Body Report on *EC - Bananas*, 9 September 1997, WT/DS27/AB/R, paras 199 ff.

⁹⁴ *Id.*, para 203.

⁹⁵ *Id.*

4.213 The Appellate Body in *EC - Bananas* also addressed the relationship between Article XIII of GATT and the Agreement on Agriculture,⁹⁶ notably to decide “whether the provisions of the Agreement on Agriculture allow market access concessions on agricultural products to deviate from Article XIII of GATT”.⁹⁷ The European Communities had argued in this respect that concessions made pursuant to the Agreement on Agriculture prevailed over Article XIII of GATT, based on Articles 4.1 and 21.1 of the former agreement.⁹⁸ The Appellate Body however upheld the Panel’s conclusion that the Agreement on Agriculture

“does not permit the European Communities to act inconsistently with the requirements of Article XIII of GATT.”⁹⁹

4.214 The European Communities submit that, likewise, the Agreement on Safeguards does not authorize Korea to act inconsistently with the requirements of Article XIX of GATT. Indeed the contrary is the case since Article 11.1(a) requires Members to apply measures “in accordance with this Agreement.”

4.215 The reasoning of the Appellate Body sheds light as to what is required for finding a derogation from GATT in another Annex 1A Agreement. When reviewing Article 4.1 of the Agreement on Agriculture, the Appellate Body observed:

“we do not see anything in Article 4.1 to suggest that market access concessions and commitments made as a result of the Uruguay Round negotiations on agriculture can be inconsistent with the provisions of Article XIII of the GATT. (...) If the negotiators had intended to permit Members to act inconsistently with Article XIII of the GATT, they would have said so explicitly. The *Agreement on Agriculture* contains several specific provisions dealing with the relationship between articles of the *Agreement on Agriculture* and the GATT. For example, Article 5 of the *Agreement on Agriculture* allows Members to impose special safeguards measures that would otherwise be inconsistent with Article XIX of the GATT and with the Agreement on Safeguards. In addition, Article 13 of the *Agreement on Agriculture* provides that, during the implementation period for that agreement, Members may not bring dispute settlement actions under either Article XVI of the GATT or Part III of the *Agreement on Subsidies and Countervailing Measures.* With these examples in mind, we believe it is significant that Article 13 of the *Agreement on Agriculture* does not, by its terms, prevent dispute settlement actions relating to the consistency of market access concessions for agricultural products with Article XIII of the GATT. As we have noted, the negotiators of the Agreement on Agriculture did not hesitate to specify such limitations elsewhere in that agreement; had they intended to do so with respect to Article XIII of the GATT, they could, and presumably would, have done so. We note further that the *Agreement on Agriculture* makes no reference to ... any ‘common understanding’ among the negotiators of the Agreement on Agriculture that the market access commitments for agricultural products would not be subject to Article XIII of the GATT.”¹⁰⁰

4.216 By this reasoning the Appellate Body set the standard which is required to find a derogation from GATT: unless express derogating terms are found in an Annex 1A Agreement, no action inconsistent with GATT is allowed, even if “pursuant to” an Annex 1A Agreement. This is exactly the opposite of what Korea proposes when arguing that failure to repeat the “unforeseen developments” requirement in the Agreement on Safeguards authorizes to disregard such requirement.

⁹⁶ *Id.*, paras 153 ff.

⁹⁷ *Id.*, para 155.

⁹⁸ *Id.*, para 153.

⁹⁹ *Id.*, para 158.

¹⁰⁰ *Id.*, para 157 (italics in original, underlined added).

4.217 The Appellate Body went further and also provided genuine examples of derogation from GATT found in the Agreement on Agriculture, all of which are drafted in explicit terms, very different from those of the Agreement on Safeguards. The European Communities note that the Appellate Body considered that measures authorized under one of these derogations, the special safeguard clause, would otherwise have been inconsistent with both Article XIX and the Agreement on Safeguards.

4.218 In the light of the foregoing, the European Communities consider that the language of the Agreement on Safeguards is not explicitly derogating from GATT, and therefore the standard set out by the Appellate Body is not met in the present case. Accordingly, Korea is not allowed to “act inconsistently with the requirements of” Article XIX of GATT, even if its measure had been adopted “pursuant to”, or “in accordance with”, the Agreement on Safeguards.

4.219 The Appellate Body further considered¹⁰¹ Article 21.1 of the Agreement on Agriculture, which expressly regulates the relationship with GATT in the following terms:

“The provisions of GATT and of other Multilateral Trade Agreements in Annex 1A to the WTO agreement shall apply subject to the provisions of this Agreement.” (emphasis added)

In spite of the explicit and strong language of that provision, the Appellate Body could still reach the conclusion that the Agreement on Agriculture does not permit a WTO Member to act inconsistently with the requirements Article XIII of GATT.

4.220 The European Communities submit that a different conclusion cannot be warranted in the present case. The provisions of the Agreement on Safeguards referred to by Korea do not even include language as strong as the one emphasized above¹⁰², and aim more at restricting Members’ conduct (Article 2.1, Article 11.1) or at setting out the general scope of the Agreement (Article 1) than at regulating the relationship with GATT.

4.221 In the light of the foregoing the European Communities reiterate that the Agreement on Safeguards does not include an express derogation from GATT. Therefore, it does not authorize WTO Members, including Korea, to act inconsistently with the requirements of Article XIX, and notably with the “unforeseen developments” requirement.

4.222 The fourth form of relationship between the provisions of GATT and those of other Annex 1A Agreements is one of conflict, not solved a priori by the system itself by a derogation rule. The *General Interpretative Note to Annex 1A* governs all cases not expressly regulated in the following terms:

“In the event of a *conflict* between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A ... , the provision of the other Agreement *shall prevail* to the extent of the *conflict*.” (emphasis added).

4.223 The Appellate Body had most recently an opportunity to clarify the meaning of this criterion of relationship – conflict – in *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*. The Appellate Body made clear, in respect of dispute settlement provisions, that

¹⁰¹ *Id.*, para 155.

¹⁰² In the *EC - Bananas* case the United States argued that the language of the Agreement on Agriculture could not authorize a Member to act inconsistently the requirements of GATT, and is now arguing that mere failure to repeat the “unforeseen development” clause in the Agreement on Safeguards or the requirement to adopt measures “in accordance with” such agreement is sufficient to entail “subsumption” of Article XIX of GATT. The EC considered it difficult to see how these positions can be reconciled.

“[a] special or additional provision [laid down in a “covered agreement”] should only be found to prevail over a provision of the DSU in a situation where adherence to the one provision will lead to a violation of the other provision, that is, in the case of a conflict between them”. “[i]t is only where the provisions of the DSU and the special or additional rules and procedures of the covered agreement cannot be read as complementing each other that the special or additional provisions are to prevail.”¹⁰³

4.224 In the EC view, it is precisely in terms of “prevalence” and “conflict” that the *General Interpretative Note to Annex 1A* to the WTO Agreement is drafted.

4.225 The European Communities maintain that Korea has not shown how Article XIX:1(a), to the extent that it requires that the increase in imports and the conditions thereof must result from “unforeseen developments”, could be said to be in conflict with the provisions of the Agreement on Safeguards. Clearly, the drafters of Article XIX thought that it was possible to meet all these requirements, since they cumulated them in the same provision.

4.226 In a case where a conflict cannot be shown, the Appellate Body confirmed that special and additional provisions apply together with the basic GATT provisions and complement each other.¹⁰⁴ Accordingly, it reversed the Panel’s finding that Article 17 of the *Anti-Dumping Agreement* “provides for a coherent set of rules for dispute settlement specific to dumping cases ... that replaces the more general approach of the DSU.”¹⁰⁵

4.227 In summary, in the EC view, the relationship between GATT and other Annex 1A Agreements is exhaustively regulated in WTO rules, as interpreted in Panel and Appellate Body decisions. That relationship can be expressed in terms of cumulation (the normal situation); differences (speciality); express derogation (conflict solved *a priori* by the Drafters of the WTO Agreement); conflict. Only in the latter two hypotheses listed do the provisions of other Annex 1A Agreements prevail over those of GATT. The use of the term “subsumption” merely confuses the issue. If this term means derogation or conflict, then the Agreement on Safeguards prevails. If not, it does not. In the case of the Agreement on Safeguards and Article XIX of GATT no case of derogation or conflict has been identified and therefore Article XIX and the Agreement on Safeguards apply cumulatively. Korea has not demonstrated that a conflict exists, and therefore that it was justified in not examining whether the increase in imports of SMPP was the result of “unforeseen developments”. Accordingly, the Panel should find that it violated Article XIX:1(a) of GATT as it did not proceed to that examination before imposing the safeguard measure on SMPP at issue in this dispute.

(f) Rebuttal arguments made by Korea

4.228 **Korea** makes the following rebuttal arguments:

4.229 Korea considers that the applicable law in this dispute is the Agreement on Safeguards. Korea considers that the provisions in Article XIX of GATT regarding “unforeseen developments” and “of the effect of the obligations incurred” are no longer part of the package of rights and

¹⁰³ See, Appellate Body Report on *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, 2 November 1998, para 65 (italics in original, underlined added).

¹⁰⁴ The Appellate Body addressed another specific derogation clause embodied in the WTO system – namely Article 2.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (“the DSU”), regulating conflicts between the DSU and specific dispute settlement rules procedures in the “covered agreements”. As it found that the criterion laid down therein (the existence of a “difference” between general and special rules) was not met, it confirmed that general and special rules and procedures had to “apply together” (para 65 of the Report).

¹⁰⁵ See, the Appellate Body Report, para 68 (underlined added).

obligations applicable to the imposition of safeguard measures. For the reasons set out in Paragraphs 4.170-4.195.

4.230 Korea expressed puzzlement with the EC statement that:

“Unlike increased imports, other conditions, injury and causation, the existence of unforeseen circumstances is something within the knowledge of governments and does not require investigation involving economic operators. It is of interest to note that the requirement that the increased imports result from trade liberalization is also not mentioned in the Agreement on Safeguards (liberalization is also of course a matter within the knowledge of governments). Both these factors either exist or do not and do not need an investigation to be established.”

4.231 Korea noted that, under the EC logic, “unforeseen developments” or “of the effect of the obligations incurred” either exist or do not exist, are strictly within the “knowledge” of each Member, and do not need an investigation to be established. Under this articulation, presumably, the only basis for the Panel to find that Korea violated Article XIX of GATT is if the factors “do not exist.” As an alternative argument, Korea respectfully submits that such factors exist:

- (a) the increased imports resulted from “unforeseen developments” because Korea did not foresee that the European Communities would take the unprecedented step of emptying its inventories of SMPP on the Korean market in order to take advantage of the lower Korean tariff on SMPP versus milk powder negotiated pursuant to the Uruguay Round; and
- (b) the increased imports resulted from “the effect of the obligations incurred” because they resulted from the tariff concessions negotiated under the Uruguay Round and GATT balance-of-payments (“BOP”) process.

(g) Additional arguments by the European Communities made at the second meeting of the Panel with the parties

4.232 At the second meeting of the panel with the parties, the **European Communities** observed that:

4.233 Korea both dismissed the “unforeseen development” requirement as repealed by the Agreement on Safeguards, and tried to justify its measure under that clause. As the European Communities have constantly said, and Korea has not challenged, it is hard to see how a deep imbalance in the tariff bindings of two competing products like SMPP and milk powder would not lead to a relative change in imports. The European Communities would also recall in this connection that in cases where a WTO Member miscalculated its concessions and is facing difficulties as a result of its tariff commitments it is entitled to negotiate and modify its schedule under Article XXVIII of GATT. It may not however use safeguard measures to achieve this result where the conditions for their application are not met.

4.234 As to the negotiating history of the Agreement on Safeguards, the European Communities observed the following.

4.235 Korea's view is that the requirement of unforeseen developments in Article XIX was in conflict with the Safeguards Agreement and therefore not applicable was supported by Mr Didier in a book published in 1997 where he reported that an early draft contained a provision “that there has been an unexpected, sudden and large increase in the quantity of such product being imported” but that this was later dropped.

4.236 Mr Didier considered that this provision related to the requirement of unforeseen developments in Article XIX. Korea argues from this that there was an intention to delete the requirement of unforeseen developments. It is interesting to note that later in the same contribution Mr Didier develops his thesis further. He considers that there is a need for a requirement of unforeseen developments since it cannot be any increase of imports which can be argued to cause injury which should be allowed to justify safeguard measures, but only increases which result from abnormal or unexpected situations.¹⁰⁶

4.237 In fact, a closer look at the deleted draft text demonstrates that it had nothing to do with the requirement of unforeseen developments. Mr Didier was mistaken and could have saved himself the trouble of trying to invent a replacement for “unforeseen developments”. The draft in fact referred to an *unexpected increase of imports* not of unforeseen developments *leading to* an increase in imports.

4.238 One way of understanding the requirement of unforeseen developments is to consider the continuum of causality starting with trade liberalisation, running into unforeseen developments which result in increased imports which occur under conditions which are such that serious injury results. This starts with loss of sales, continues with loss of sales and production, falling capacity utilisation, losses and finally unemployment.

4.239 In fact one might say that unforeseen developments is a defining feature of safeguard measures since it defines the circumstances in which they may become justified. As Korea said, Article 1 of the Safeguard Agreement expressly refers Article XIX as defining what a safeguard measure is.

4.240 In other words, Article XIX tells you what a safeguard measure is and the Safeguard Agreement tells you how to apply it. The consequence of this was however not mentioned by Korea. It is that the Safeguard Agreement is not exhaustive.

(h) Additional arguments by Korea made at the second meeting of the Panel with the parties

4.241 At the second meeting of the panel with the parties, **Korea** further advanced its arguments under Article XIX:1(a) as follows:

4.242 Korea has pointed out that this requirement was omitted from the Agreement on Safeguards, and maintains that it no longer applies. The European Communities refer to Article XIX GATT, and claims that the obligation to show “unforeseen developments” still exists.

4.243 First, if one looks at the Agreement on Safeguards, it is clear that it was meant to strike a new balance and move beyond Article XIX GATT, which had proved to be difficult to apply in practice. In its first Article, the Agreement states that it:

“establishes rules for the application of safeguard measures which shall be understood to mean those measures provided for in Article XIX of GATT.”¹⁰⁷

In other words, Article XIX GATT tells one what a safeguard measure is, and this new Agreement tells one how ('the rules for the application') to take those measures.

¹⁰⁶ Pierre Didier, *Les principaux accords de l'OMC et leur transposition dans la Communauté Européenne* (Bruylant, 1997) p. 272, where reference is made to the need to “limiter la prise de mesures aux cas sinon anormaux, du moins imprévus”.

¹⁰⁷ See, Article 1 of the Agreement on Safeguards.

4.244 Second, in furtherance of the above purpose, Article 2 of the Agreement then goes on to lay out the 'conditions' for taking safeguard measures. Interestingly, it repeats almost verbatim what was said in Article XIX:1(a) GATT, except that:

- (a) it removes some language, specifically the “unforeseen developments” language and the requirement to show that the difficulties were the “result of . . . the effect of the obligations incurred by the contracting party under this Agreement, including tariff concessions”; and
- (b) adds some other language: that the increase in quantities of imports can be either “absolute or relative to domestic production”; and
- (c) makes explicit that the measures must be non-discriminatory, *i.e.*, the safeguard should apply to imports from all sources.

4.245 Where a text is adopted almost word-for-word, but makes certain omissions and additions to it, it stands to reason that those omissions and additions were deliberate. The preparatory work to the Agreement on Safeguards further supports this conclusion. According to the respected academic Pierre Didier, “a 1990 draft of an agreement included [*unforeseen developments*] and amplified it by imposing the obligation to establish an *unforeseen, sudden and significant increase*’. Both the United States and the EU rejected this terminology as being too difficult or restrictive to apply.”¹⁰⁸ The entire reference to “unforeseen developments” was then dropped. However, now the European Communities want to characterize omission of the “unforeseen developments” criteria as a mere “failure to repeat” that language. Why would this deletion have happened, and why would the European Communities argue that it was too difficult and restrictive to apply if the obligation to consider “unforeseen developments” remained via Article XIX?

4.246 Third, contrary to the EC assertions, Korea considers that the removal of the obligation regarding “unforeseen developments” was intended to strengthen the multilateral safeguard regime. The European Communities contend that Korea has not demonstrated why this would be the case. As stated above, both the United States and the EU considered that the “unforeseen developments” requirement was too difficult and restrictive to apply, and Korea seriously doubts whether it still served in state practice. The inability of Members to determine the scope of their rights under Article XIX led to the proliferation of “grey area” measures. By improving the safeguard regime and eliminating unworkable obligations, the drafters intended to strengthen the safeguard regime by ensuring that Members resorted to emergency action under the Agreement on Safeguards, rather than use trade-disruptive and non-transparent “grey area” measures.

4.247 Fourth, the European Communities assert that if the drafters had wanted to deviate from Article XIX, they had to do so expressly, and cites the *EC - Bananas*¹⁰⁹ Appellate Body report as support for this contention. Korea notes that *EC - Bananas* case dealt with a different agreement, the Agreement on Agriculture, in which the drafters made express derogations. An example is Article 5 of the Agreement on Agriculture, although, Korea noted that Article 5 only makes an express derogation from Article II:1(b) GATT, not from Article XIX and the Agreement on Safeguards.

4.248 However, nowhere in the Agreement on Safeguards is there an express derogation. While the Agreement is full of fundamental changes (see, for example, the requirement to wait three years before retaliating against certain safeguard measures¹¹⁰ (which is contrary to Article XIX:3(a)), or the requirement not to reduce the quantity of imports below that of a representative past period (which is

¹⁰⁸ *Les principaux accords de L'OMC et leur transposition dans la Communauté Européenne* (Bruylant, 1997) pp.271-272

¹⁰⁹ Appellate Body Report on *EC - Bananas*, WT/DS27/AB/R, 9 September 1997, at para. 155.

¹¹⁰ Article 8(3) of the Agreement on Safeguards.

contrary to Article XIX:1(a))¹¹¹, the Agreement did not need to expressly signal every derogation. Any doubt as to the precedence of those provisions over the provisions of Article XIX GATT is resolved by the *General Interpretative Note to Annex 1A* of the WTO. Indeed, if express derogations were required, one would wonder why this Interpretative Note was included.

4.249 Furthermore, the European Communities fail to mention that the Appellate Body in *EC - Bananas* only addresses the situation where the relevant WTO Agreement does not specifically deal with the subject matter of the relevant Article under GATT. In its Second Submission, the European Communities quoted a lengthy paragraph from the Appellate Body's report in *EC - Bananas*. The European Communities, however, tellingly omitted the second sentence of the paragraph that states that '[t]here is nothing in Articles 4.1 or 4.2, or in any other Article of the Agreement on Agriculture, that deals specifically with the allocation of tariff quotas on agricultural products.' In other words, no Article of the Agreement on Agriculture addressed the subject matter of Article XIII of GATT. The Appellate Body went on to conclude '*Therefore, the provisions of the GATT, including Article XIII, apply to market access commitments concerning agricultural products, except to the extent that the Agreement on Agriculture contains specific provisions dealing specifically with the same matter.*'¹¹² (emphasis added).

4.250 Here, the Agreement on Safeguards does explicitly deal with the conditions for adopting safeguard measures, under the very heading "conditions". The Agreement on Safeguards specifically lays out the conditions for adopting a safeguard. "Unforeseen developments" is not one of them.

4.251 Furthermore, if one reads the relevant texts according to the European Communities position, there would be a conflict between Article XIX and the Agreement on Safeguards. If one adheres to Article 2 of the Agreement on Safeguards and adopts a safeguard measure without meeting the "unforeseen developments" requirement, one would be in conformity with the Agreement on Safeguards but in violation of Article XIX. The General Interpretative Note to Annex 1A of the WTO clearly provides that in case of conflict between the GATT and an Agreement (like the Agreement on Safeguards), it is the Agreement, not the GATT, that takes precedence.

4.252 In that regard, this case is not the same as *Guatemala - Anti-dumping Investigation Regarding Portland Cement from Mexico*¹¹³, to which the European Communities refer. That case involved the overall rules applying to dispute settlement in the WTO and the specific rules applying to anti-dumping, and the Appellate Body found that both sets of rules fit together to form a 'comprehensive, integrated dispute settlement system for the *WTO Agreement*.'¹¹⁴ Even there, the Appellate Body said that if there were a conflict between the two sets of rules, the special anti-dumping rules would prevail in case of conflict. The Appellate Body clarified that a conflict would exist where "*adherence to one provision will lead to a violation of the other provision*".¹¹⁵ Korea believes that here, such a conflict exists.

4.253 Finally, Korea questioned whether the European Communities even really believed in its own argument, noting that it did not include the "unforeseen developments" requirement in its own rules for the application of safeguard measures.¹¹⁶ Its officials proceed with a set of rules that tell them everything they need to show in order to adopt a safeguard measure, yet that regulation does not mention or even refer to a couple of extra important requirements.

¹¹¹ Article 5(1) of the Agreement on Safeguards.

¹¹² Appellate Body Report on *EC - Bananas*, WT/DS27/AB/R, 9 September 1997, at para. 155.

¹¹³ Appellate Body Report on *Guatemala - Anti-dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, 2 November 1998.

¹¹⁴ Appellate Body Report on *Guatemala - Anti-dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, 2 November 1998, para. 66.

¹¹⁵ Appellate Body Report on *Guatemala - Anti-dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, 2 November 1998, para. 65.

¹¹⁶ EC Regulation 3285/94 on the common rules for imports, OJEC 1994 L349/53.

4.254 To shift attention from the discrepancy between its argument now and its own implementation of the Agreement on Safeguards, the European Communities refer to the legislation of a few other countries in which the “unforeseen developments” requirement was included. However, it is not disputed that WTO Members are permitted to adopt rules that are more restrictive of their use of safeguard measures than required by the WTO rules. What is at issue is what those WTO rules require. Korea maintains that those rules do not condition adoption of a safeguard measure on a showing of “unforeseen developments.”¹¹⁷

D. CLAIM UNDER ARTICLE XIX:1(a) OF GATT AND ARTICLE 2.1 OF THE AGREEMENT ON SAFEGUARDS

(a) Claim by the European Communities

4.255 The **European Communities** claim that by failing to analyse the conditions under which the imported products enter the import market Korea has violated its obligations under Article XIX:1(A) of GATT and Article 2.1 of the Agreement on Safeguards. The following are the EC arguments in support of this claim:

4.256 Recalling and developing Article XIX:1(a) of GATT, Article 2.1 of the Agreement on Safeguards provides that

“A Member may apply a safeguard measure to a product only if that Member has determined, pursuant to the provisions set out below, that such product is being imported into its territory in such increased quantities, absolute or relative to domestic production, and *under such conditions* as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products.” (emphasis added).

4.257 In this respect the European Communities observe that, as they did with the “unforeseen developments” clause, by including a reference to the conditions of importation in the text of Article XIX:1(a) and of Article 2 of the Agreement on Safeguards, the drafters of both agreements have excluded that the volume and rate of increase of the imports be in itself sufficient to justify safeguard action.

4.258 However, Korea limited its consideration to the increase in imports and failed to examine under which conditions these occurred and in particular the prices at which the product was imported. The European Communities therefore submit that Korea failed to comply with its obligations under Article XIX:1(a) and Article 2 of the Agreement on Safeguards, to address whether the conditions under which importation of the products being investigated occurred were of such nature as to cause serious injury to the domestic industry producing like or directly competitive products.

4.259 At the first meeting of the panel with the parties, the **European Communities** further advanced their arguments under Article XIX:1(a) of GATT and Article 2.1 of the Agreement on Safeguards as follows:

4.260 By requiring that serious injury result both from an increase in imports and from the conditions under which this increase takes place, Article 2 of the Agreement on Safeguards clearly indicates that those “conditions” also need to be assessed. Among them, the European Communities asserted that import prices and their impact on domestic prices are clearly in the forefront.

¹¹⁷ However, “unforeseen” factors were present in this case, as the Korean Government did not foresee that the EC would dramatically shift the balance of exports from milk powder to SMPP in order to take advantage of the Korean tariff structure. According the EC’s formulation of “unforeseen circumstances”, the existence of such factors is simply a question of fact, and will justify the imposition of a safeguard measure provided all other required conditions are present.

4.261 In its April Notification to the Committee on Safeguards Korea attempts to dispose of this requirement in two lines reading "Although the sales price of imported products rose by 381 Won/kg during the period under investigation, the sales price of domestic milk powder dropped by 360 Won/kg." When reviewing the price conditions in its First Submission the European Communities, meant that in the EC view this was insufficient and Korea had failed to indicate whether and how import prices depressed or otherwise adversely affected those of domestic products.

4.262 In response to a question by the Panel¹¹⁸, the **European Communities** further clarified that they believe that among the conditions to be considered under Article 2.1 price is paramount but other conditions such as superior quality or advertising can also be imagined in certain cases.

(b) Response by Korea

4.263 In response to a question by the Panel¹¹⁹ **Korea** argued that the "under such conditions" language contained in Article 2.1 of the Agreement is merely part and parcel to the causality requirement that must be demonstrated under Article 4 of the Agreement on Safeguards. This language does not impose any separate or distinct obligation.

4.264 The special safeguard provision of the Agreement on Textiles and Clothing (ATC) supports this interpretation. Article 6 of the ATC states that a Member must demonstrate that "a particular product is being imported into its territory in such increased quantities as to cause serious damage, or actual threat thereof, to the domestic industry." The drafters did not consider it necessary to add the term "under such conditions," although a finding of causation is presumably still required. In addition, the superfluous nature of the language "under such conditions" is also supported by the fact that the Guide to GATT Law and Practice prepared by the GATT/WTO Secretariat refers to all other language except "under such conditions" in analyzing identical language under Article XIX of GATT 1947.

4.265 The object and purpose of the Agreement on Safeguards is to accord Members the right to impose a safeguard measure as a last resort when increased imports are causing injury or threat of injury to a particular domestic industry. The Agreement does not specify that causation must be based solely on price undercutting or on any other factor. Increased imports may displace competing domestic products, and cause injury to a particular domestic industry, for a wide range of reasons, including image, quality, style, structure of the industry, technical assistance, etc. A Member could also find causation when the prices of imports are increasing, because the prices of domestic products may still be selling at a loss or at a level that gives insufficient return on investment. Provided a Member demonstrates that increased imports are causing serious injury or threat thereof to the domestic industry and provided it discounted injury potentially caused by other factors, the panel should find that such Member satisfied its obligations under Articles 2 and 4 of the Agreement on Safeguards.

(c) Rebuttal arguments made by the European Communities

4.266 The **European Communities** made the following arguments in rebuttal:

4.267 Korea has not rebutted EC claim that it did not analyse the impact of import prices on the domestic prices of raw milk and milk powder and, to the extent that it gathered information in this

¹¹⁸ The Panel recalls that the question was: "What factors, other than price, can be considered under the proposition 'under such conditions as to cause or threaten to cause injury . . .', mentioned in paragraph 2.1 of the Agreement on Safeguards?"

¹¹⁹ The Panel recalls that the question was: "What factors, other than price, can be considered under the proposition 'under such conditions as to cause or threaten to cause injury . . .', mentioned in paragraph 2.1 of the Agreement on Safeguards?"

respect, this information could not support a finding that the conditions under which imports increased were such as to cause serious injury. Furthermore, Korea did not indicate any other prevailing "conditions" that it considered relevant under Article 2.1 of the Agreement on Safeguards, but simply omitted to review whether that provision was fulfilled. In its reply to the Panel's questions, the European Communities has indicated what those factors, in addition to prices, can be, for instance, the quality of the imports or their promotion on the importing market could also be relevant, as could *e.g.*, the rapidity of market penetration (as opposed to market share).

4.268 Although there is a table in Korea's Notification of 24 March giving prices of domestic milk powder and imported SMPP, Korea has failed to conduct any analysis of these prices. The European Communities consider that it is not sufficient simply to compare these prices. The products involved in this case, raw milk, milk powder and SMPP are substitutable and competing to some extent but still have different characteristics and different uses. Indeed, Korea asserts that, "most Korean users of milk powders state ... that the domestic products are of higher quality than the imported SMPP." Furthermore, the KTC investigation report highlights the differences between these products in relation to their end uses. It is stated in the report that the Food Industry Handbook allows different end uses for them. No analysis is given of the proportion of the market held by the products for which SMPP can be used, in comparison with the products for which milk powder can be used or with those produced from raw milk. The conclusion is that a direct comparison cannot be made between milk powder and SMPP, firstly because of the different characteristics of the products and secondly because of the different opportunities for their end use. Korea is wrong to assume price undercutting on the part of SMPP imports simply because they were available at a lower price than domestic milk powder. No mention is made in Korea's Notification or the KTC Report of how the differences in the two products, both in terms of inherent characteristics and end use, were taken into account in the price comparison. Indeed, comparing the price differences between domestic milk powder and imported SMPP is analogous to comparing prices between butter and margarine. In many markets the price of these competing and substitutable products will be very different.

4.269 In the response to questions by the Panel¹²⁰ posed at the second meeting, the **European Communities** further clarified their arguments as follows:

4.270 The "under such conditions" requirement must primarily be related to the imported products and not to the domestic market. Semantically, the term "under such conditions" in Article 2.1 relates to the imported product and not to the state of the domestic market or the industry which are susceptible to be affected by the increased imports. One of the conditions of imports which is always present and always relevant is price.

4.271 It is clear from the presence of the word "and" in Article 2.1 that "under such conditions" constitutes a separate requirement from imports being "in such increased quantities".

4.272 The conditions under which the imports occur, together with increased imports, are at the beginning of the causality continuum which terminates in the injury. In fact they are not quite at the beginning, they come after trade liberalization and unforeseen developments. The important point is that the increased imports and the "such conditions" causally precede the injury. Accordingly, the criteria which are relevant for establishing the conditions under which imports take place are not the same as the ones determining the causal link. In other words, the criteria examined under this concept of "under such conditions" relate to the objective existence of certain conditions whereas causality requires a reasoned analysis of cause and effect between increased imports and those conditions on

¹²⁰ The Panel recalls that the questions were: "Article 2 of the Safeguard Agreement refers to 'under such conditions'. Does 'under such conditions' refer to criteria related to the imports? the domestic market? or both?" "Does 'under such conditions' constitute a separate requirement from the increased imports causing injury?" "What is the difference between the criteria examined under the concept 'under such conditions' and those to be examined under the causal link?"

one side and injury on the other side. Concretely, the examination of the concept of “under such conditions” will require an examination of prices whereas an examination of the causal link will require an examination of the way in which those prices cause injury to the domestic industry. The existence of low-priced imports by itself is not injury, it is only a circumstance susceptible to lead to injury.

(d) Rebuttal arguments made by Korea

4.273 **Korea** makes the following rebuttal arguments:

4.274 Article 2 of the Agreement on Safeguards (*Conditions*) provides that a Member may apply a safeguard measure to a product if:

“that Member determine[s], pursuant to the provisions set out below, that such product is being imported into its territory in such increased quantities, absolute or relative to domestic production, and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products.”
(Emphasis added)

4.275 Korea complied with the conditions established under Article 2 because it complied with Articles 4.2(a) and (b) in making its determination of serious injury and causal link, with Article 5 in applying the safeguard measure, and with Article 12 in properly notifying and consulting with the Committee on Safeguards and interested Members.

4.276 In response to questions by the Panel¹²¹ posed at the second meeting, **Korea** further clarified its arguments as follows:

4.277 In Korea’s view the language “under such conditions” can only be interpreted as relating to imports.

4.278 Korea considers that “under such conditions” is part and parcel of the causality analysis. This language does not impose any separate or distinct obligation on the investigating authorities.

4.279 Korea is of the view the criteria examined by the investigating authorities under the concept “under such conditions” are not different from those examined under causal link. In other words, it is the conditions under which imports enter a market that link such imports to the serious injury to the domestic industry.

E. KOREA'S APPLICATION OF SAFEGUARD MEASURES TO AGRICULTURAL PRODUCTS

(a) Submission by Korea

4.280 **Korea** makes the following submission concerning the nature of the Korean dairy industry, and the application of a safeguard measure to an agricultural product:

4.281 The Agreement on Safeguards is the general safeguard mechanism under the WTO system, and its provisions are applicable to most products covered by the WTO system. Other safeguard measures are applicable to sectors that raise specific or unique issues, most notably, textiles and agricultural products. These other safeguard measures are designed to provide the appropriate degree

¹²¹ The Panel recalls that the questions were: "Article 2 of the Safeguard Agreement refers to 'under such conditions'. Does 'under such conditions' refer to criteria related to the imports? the domestic market? or both?" "Does 'under such conditions' constitute a separate requirement from the increased imports causing injury?" "What is the difference between the criteria examined under the concept 'under such conditions' and those to be examined under the causal link?"

of sensitivity required by those sectors or products. The Agreement on Safeguards inevitably does not afford the same sensitivity to the agricultural sector as the Agreement on Agriculture.

4.282 Article 5 of the Agreement on Agriculture recognizes the unique nature of agricultural markets and how even short term and relatively minor increases in imports can produce dramatic dislocations in the relevant industry. As a consequence, Article 5 has a much lower threshold for action than the Agreement on Safeguards. However, Korea was unable to invoke Article 5 of the Agreement on Agriculture to remedy serious injury to its dairy markets caused by increased imports. Instead, Korea followed the procedures under the Agreement on Safeguards and still concluded that serious injury had been caused to its domestic industry, even though the standards for the imposition of safeguard measures under the Agreement on Safeguards are higher than those under the Agreement on Agriculture.

(b) Response of the European Communities

4.283 The **European Communities** respond to Korea's submission as follows:

4.284 The European Communities consider that evaluating whether Korea's measure would have been consistent with the Agreement on Agriculture, and notably its Article 5, falls outside the terms of reference of this Panel. In any event, Korea cannot compensate the fact that it could not invoke the safeguard provision of the Agreement on Agriculture by arbitrarily lowering the standard of Article XIX of GATT and of the Agreement on Safeguards. Furthermore, quantitative measures, and for four years, are clearly not contemplated in Article 5 of the Agreement on Agriculture.

(c) Rebuttal response of Korea:

4.285 **Korea** makes the following rebuttal arguments:

4.286 As the general system of rules for imposing safeguard measures, the Agreement on Safeguards will be applied to a number of different product sectors and, thus, has a degree of flexibility built into its structure and individual terms.

4.287 Certain injury criteria relevant to industrial or manufactured products may not be relevant when applied to agricultural products because those criteria are not of an objective and quantifiable nature having a bearing on the situation of the particular agricultural industry, *i.e.*, they do not reflect the unique nature of the agricultural sector.¹²²

4.288 If particular criteria listed in Article 4.2(a) of the Agreement on Safeguards are not relevant to a specific agricultural sector, Members should be accorded the flexibility to examine other listed criteria that more fully take into account the unique or specific nature of the products and industry under examination. Members should also be allowed to take into account unlisted criteria that are relevant to the industry under examination.¹²³

4.289 At the second meeting of the panel with the parties, Korea further advanced its arguments regarding the Agreement on Agriculture as follows:

¹²² Article 4.2(a) requires an evaluation of "all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry". This appears to permit an investigation that takes into account the specific nature of the industry.

¹²³ In light of the fact that Article 4.2(a) of the Agreement on Safeguards uses the term "in particular", factors other than those set forth in Article 4.2(a) may be used to determine injury to a particular sector, such as agriculture.

4.290 Korea's purpose in referring to the Agreement on Agriculture, and Article 5 in particular, was to show that:

- (a) in any investigation of any industry under the Agreement on Safeguards, the products and industry in question need to be carefully considered and any specific aspects identified need to be factored into the relevant determinations of serious injury and causation. Certain injury criterion may be relevant in one case but not in others. This view is shared by the Government of the United States
- (b) due to circumstances beyond its control, Korea was required to investigate the dairy industry under the Agreement on Safeguards, as opposed to the Agreement on Agriculture. The Government of Korea undertook a full and proper investigation of its dairy industry under the Agreement on Safeguards, but would under normal circumstances have been able to use the specific provisions of the Agreement on Agriculture. Korea does not claim that it could replace the higher investigation standards of the Agreement on Safeguards with the lower standards of the Agreement on Agriculture, and the Panel must be clear that the Korean competent authorities complied fully with the requirements of the Agreement on Safeguards, and in no way referred to the standards applicable under the Agreement on Agriculture.

F. CLAIM UNDER ARTICLE 4.2(a) OF THE AGREEMENT ON SAFEGUARDS

(a) **Claim by the European Communities**

4.291 The **European Communities** claim that Korea violated Article 4.2(a) of the Agreement on Safeguards by failing to show that serious injury occurred to the domestic industry. The following are the EC arguments in support of that claim:

(i) *The definition of the "domestic industry"*

4.292 Article 4.1.(c) of the Agreement on Safeguards provides that:

"in determining injury or threat thereof, a "domestic industry" shall be understood to mean the producers as a whole of the like or directly competitive products operating within the territory of a Member, or those whose collective output of the like or directly competitive products constitutes a major proportion of the total domestic production of those products."

4.293 For the purposes of its safeguard investigation, Korea defined¹²⁴ the "domestic industry" as :

"the industry that produces raw milk and milk powder. These products are directly competitive with the imported products under investigation. Raw milk producers consist of dairy farming households and milk processing companies which directly operate their own dairy farms; milk powder producers are livestock co-operatives and milk processing companies, including producers, who commission processing to third parties because of the absence of facilities for manufacturing milk powder."

4.294 The European Communities agree with Korea that this is an appropriate definition of the domestic industry. Production of raw milk and milk powder are interconnected and complementary activities. Not only does each depend on the other to be able to conduct its own business, but many

¹²⁴ See, Paragraph III.2 of the Notification of 1 April 1998, G/SG/N/10/KOR/1/Suppl.1 (Exhibit EC-10).

raw milk producers are also milk powder producers or own milk powder producers (the livestock cooperatives are owned by dairy farmers).

4.295 The European Communities however take issue with the fact that Korea did not apply this domestic industry definition consistently for its determination of serious injury. Some injury factors were either examined only for the raw milk industry and others only for the milk powder industry. In many cases there is not even any explanation as to why only part of the domestic industry was examined and the only apparent explanation is that examination of the other part would not have supported a finding of serious injury. In other cases, the evaluation of the injury factors is flawed for other reasons. The incomplete examination of the injury factors arising out of the inconsistent application of the domestic industry definition and the other errors committed by Korea in the evaluation of injury factors renders the determination contrary to Article 4.2(a) of the Agreement on Safeguards.

(ii) *Failure to examine correctly all relevant factors of an objective and quantifiable nature having a bearing on the situation of the domestic industry*

4.296 Article 4.2.(a) of the Agreement on Safeguards requires that the serious injury investigation evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of the domestic industry, in particular the rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment.

4.297 This provision lays down the principle that an injury investigation must be *complete* (“all relevant factors”). Only factors that are not relevant, or not objective or quantifiable, or do not have a bearing on the situation, may be excluded. Clearly, it is necessary to examine a factor before it can be considered that it is not relevant, or not objective or quantifiable, or does not have a bearing on the situation. The European Communities note that this position has been supported in two recent Panel reports¹²⁵ which dealt with the standard of “serious damage” set forth in Article 6.3 of the ATC.¹²⁶ Both Panel reports stressed the obligation to examine each of the enumerated injury factors. In the *US - Underwear* case, the Panel criticized the United States for providing inconsistent and inadequate information. The Panel in the *US - Shirts and Blouses* case stated that “at a minimum, the importing Member must be able to demonstrate that it has considered the relevance or otherwise of each of the factors listed [...]”.¹²⁷ Since the United States did not examine eight of these factors in the context of the particular industry without giving any explanation for not doing so, the requirements of Article 6 of the Agreement on Textiles and Clothing were not respected.¹²⁸

4.298 Even though the wording of Article 6.3 of the Agreement on Textiles and Clothing is slightly different from Article 4.2 (a) of the Agreement on Safeguards, both provisions nevertheless contain a list of injury factors which shall be evaluated by the investigating authority. Therefore, in accordance with the rationale stated in the above Panel reports, the European Communities submit that, at a minimum, a serious injury determination under the Agreement on Safeguards must demonstrate that the relevance or otherwise of each of the factors listed in Article 4.2(a) of the Agreement on

¹²⁵ See, Panel report in *US - Shirts and Blouses*, 6 January 1997, WT/DS33/R; *US - Underwear*, WT/DS24/6, 8 November 1996. Both Panel reports were subject to review by the Appellate Body which did, however, not rule on the standard of serious damage.

¹²⁶ “In making a determination of serious damage, [...] the Member *shall examine* the effect of those imports on the state of the particular industry, as reflected in *changes in such relevant economic variables as* output, productivity, utilization of capacity, inventories, market share, exports, wages, employment, domestic prices, profits and investments; none of which, either alone or combined with other factors, can necessarily give decisive guidance.” (emphasis added)

¹²⁷ See, *US - Shirts and Blouses*, para. 7.26.

¹²⁸ See, *id.* at para. 7.52.

Safeguards was considered. The European Communities would further submit that that provision requires each injury factor to be properly analysed unless it is explained for what reason the injury factor may be disregarded.

4.299 With respect to each of the factors set out in Article 4.2(a), the European Communities made the following arguments:

(a) Rate and amount of the increase in imports in absolute and relative terms

4.300 This factor was not fully examined by Korea with regard to the products which were finally covered by the measures. Paragraph IV.2 of the Notification of 1 April 1997, merely explains that there was an increase in absolute and relative terms for products within the headings of the Harmonized Tariff Schedule of Korea 0404.90.0000 and 1901.90.2000. However, Korea excluded certain products from the scope of the measure such as milk mineral (calcium) concentrated product, Chilean special products and raw material for production of Cerelac of Nestlé. No allowance is made for these excluded products in assessing the increase of imports. Indeed, during the dispute settlement consultations, Korea stated that it was not even in a position to give a reasonable estimate of the volume of the excluded products during the investigation period. Furthermore Korea did not consider the increase in imports in relation to the decline in imports of milk powder, which is a like product.

(b) Share of the domestic market taken by increased imports

4.301 This requirement was examined by Korea in Paragraph IV.3.4. of the Notification of 1 April 1997 where it is explained that the total market share of domestic raw milk and milk powder declined some 5.7 percentage points from 91.1 per cent to 85.4 per cent during the investigation period. Although this is one of the factors on which Korea subsequently relies to conclude that there was serious injury in its conclusion (Paragraph IV.4 of the Notification of 1 April 1997), there is no explanation of why such a small decrease in market share should be a cause for concern, let alone supportive of a serious injury finding. The only comment made in the Notification of 1 April 1997 is designed to excuse the small increase in market share from 1995 to 1996 as being “a temporary phenomenon triggered by sales of milk powder below manufacturing cost in order to reduce inventories which was incurring storage costs and expenses”.

(c) Changes in the level of sales

4.302 This factor was to some extent examined in Paragraph IV.3.3 of the Notification of 1 April 1997 in the form of an examination of “consumption of domestic raw milk (including milk powder)”. Again this was remarkably stable at 1,844,463 tons in 1993, 1,947,128 tons in 1994, 1,947,965 tons in 1995, and 984,934 tons during the first half of 1996 (presumably equivalent to 2 times 984,934, that is 1969,868, tons for a full year). Korea states that there was a decrease in 1996, but this seems to be an error on its part.

(d) Production

4.303 This factor was examined by Korea. As explained in Paragraph IV.3.1 of the Notification of 1 April 1997, production of raw milk and milk powder increased 3.2 per cent in 1994, 4.2 per cent in 1995 and 4.4 per cent during the first half of 1996. Korea does not attempt to present this as “serious injury” but merely to explain it away by stating that

“the production of raw milk cannot be temporarily reduced without resorting to the slaughter of dairy cows. Rather than reducing the size of their herds - the average size of which is quite small - Korean dairy farmers continue normal levels of raw milk production even during periods of weak demand, since excess raw milk is supplied to the livestock co-operatives for conversion into milk powder.”

4.304 In the EC view Korea's explanation is not credible. Korea is not describing a "temporary" increase in production but a continuous increase over a period of three years. Not only can production be adjusted by varying the use of feed and additives and other technology, dairy cows have in any case a useful life of eight to ten years which means that 10 to 12 per cent are inevitably retired or slaughtered every year. Production can be reduced when necessary even in dairy farms and the fact that it nonetheless continues to increase in Korea demonstrates that there can be no serious injury.

(e) *Productivity*

4.305 This factor was examined only concerning the raw milk industry. According to Paragraph IV.3.2 of the Notification of 1 April 1997, productivity of dairy farmers has "slightly increased". In fact, productivity in Korean dairy farms has been quite significant. Again, Korea attempts to explain this away with some remarkable reasoning, stating that :

"This indirect indication of increased productivity is found to be the result of advances in technology, not of changes in the market condition. The fact that the domestic industry stagnated in spite of increased productivity, indicates that the injury to the domestic industry was caused not by its internal factors but by external factors, *i.e.*, increased imports."

In effect, Korea assumes the conclusion to which it wishes to arrive at (injury or "stagnation") in order to explain away a positive factor and attribute the assumed stagnation to imports.

4.306 A further defect in this Paragraph of the Notification of 1 April 1997 is that productivity was not evaluated at all regarding the milk powder industry but an "explanation" is given for its absence since it is stated that

"Because the production of milk powder is greatly affected by the supply and demand of raw milk, and as production facilities cannot accommodate drastic changes in the short term, a review [of] productivity can be replaced by a review of the production level."

This explanation is, however, in the EC view insufficient, because, contrary to this explanation, productivity is a distinct factor listed in Article 4.2.(a) of the Agreement on Safeguards. The examination of this factor cannot be replaced by the examination of another factor.

4.307 In reality, the productivity of the milk powder industry can be expected to have increased since its total production has increased and there is no indication that the installed production capacity has been increased.

4.308 In the EC opinion examination of the injury factor of productivity does not support a serious injury finding, but rather the reverse.

(f) *Capacity utilization*

4.309 This factor was also addressed only concerning the raw milk industry. According to Paragraph IV.3.2 of the Notification of 1 April 1997, "capacity utilization was always 100 per cent in the raw milk industry since raw milk is produced by dairy cows, which cannot be left idle like some other form of production."

4.310 The European Communities maintain that this is not a serious examination of the injury factor. A farm which can support 100 cows can choose to only have 80, if economic conditions require this. Capacity utilization in the milk powder industry is not even mentioned. In reality, Korea has simply not examined capacity utilization for the domestic industry at all.

(g) *Profits and losses*

4.311 Profitability of the raw milk industry was examined by Korea in terms of the profit or loss per unit of production in Paragraph IV.3.9 of the Notification of 1 April 1997 and in the form of a “financial analysis” in Paragraph IV.3.10 of the Notification of 1 April 1997, but in both cases only in respect of the milk powder industry.

4.312 Korea considered exclusively the financial condition of the co-operatives and the milk powder operations of the milk processing companies and neglected to consider the profitability of dairy farmers. This gives a misleading picture because one of the most significant factors governing the profitability of the dairy cooperatives and milk processing companies is the price which they must pay for their raw material, and this price is inversely related to the profitability of the dairy farmers. For example, a 20 per cent increase in the guaranteed milk price would give a considerable increase in profitability to the dairy farmers but would severely squeeze the operating margins of the dairy cooperatives milk and processing companies.

4.313 The “financial analysis” in Paragraph IV.3.10 of Korea’s Notification of 1 April 1997 reviews the turnover and operating profit/loss of two large co-operatives and four milk processing companies.

4.314 The profitability of these companies varies enormously. Of the two co-operatives referred to by Korea in its Notification of 1 April 1997, Seoul Dairy was making large and increasing profits, whereas Pusan-Kyungnam Dairy Co-operative was making large and increasing losses. If the figures for Seoul dairy were combined with those of any co-operative other than Pusan-Kyungnam Dairy Co-operative the picture would have been of large and increasing profits.

4.315 Similarly, in the case of the milk processing companies, Korea has omitted from its sample the second and third largest amongst them in terms of milk powder production, Maeil and Namyang, which coincidentally are extremely profitable.

4.316 The European Communities therefore conclude that Korea’s examination of the profitability of the domestic industry is not in conformity with Article 4.2(a) of the Agreement on Safeguards since it does not examine the whole of an interconnected industry.

(h) *Employment*

4.317 This factor was only examined by Korea with regard to raw milk producers in Paragraph IV.3.6 of the Notification of 1 April 1997, where it is shown that the number of dairy farmers is slowly decreasing. The European Communities would observe however that within the context of increasing production of dairy farms, this is indicative of a healthy consolidating industry and certainly not of serious injury.

4.318 There is no evaluation of the employment injury factor with regard to the milk powder industry. Korea merely states that employment of milk powder industry is difficult to evaluate. However, this statement is clearly insufficient since at least a reasonable estimate would have to be provided in an acceptable serious injury investigation; the investigating authority is obliged to collect such data or explain why reliable collection is impossible.

(i) *Other factors*

4.319 Korea examined and referred to other factors in its conclusion that are not contained in the list in Article 4.2(a) of the Agreement on Safeguards.

4.320 The first of these is sales prices, which is examined by Korea in Paragraph IV.3.7 of the Notification of 1 April 1997, but only with regard to milk powder, it being stated that the price of raw milk is kept stable by the government (in fact it is regularly increased). Korea states that:

“The sales price of milk powder by the livestock cooperatives (periodic average price) fell from 5,354 Won/kg in 1993 to 5,294 Won/kg in 1994, increased slightly to 5,388 Won/kg in 1995, and decreased sharply to 4,994 Won/kg during the first four months of 1996. There was no correlation between such change and seasonal factors.”

4.321 Objective examination of these figures shows remarkable stability in the price obtained, there being an *increase* over the three years 1993 to 1995. Only in 1996 is there a decrease. Korea forgets to mention in this regard the special factor which it stressed when explaining away the increased market share of the domestic industry in 1996 – that this was “a temporary phenomenon triggered by sales of milk powder below manufacturing cost in order to reduce inventories which was incurring storage costs and expenses”.¹²⁹ Thus the European Communities conclude that it is apparent that sales prices of raw milk are increasing and the sales price of milk powder is stable, except for “a temporary phenomenon” in 1996. This does not support a serious injury finding.

4.322 The second additional injury factor considered by Korea in its conclusion is the level of inventory of domestic milk powder.

4.323 The evolution of inventory is described in Paragraph IV.3.5 of the Notification of 1 April 1997. It is explained that:

“Inventories of domestic milk powder totalled 4,509 tons at the end of 1993, 1,517 tons in 1994, 6,565 tons in 1995 and 14,994 tons at the end of June of 1996, reflecting inventory ratios of 2.4 per cent in 1993, 0.8 per cent in 1994, 3.3 per cent in 1995, and 13.0 per cent during the first half of 1996 vis-à-vis the total demand. The total value of inventories of milk powder at the end of June 1996 was estimated at 92,633 million Won (about US\$122 million).”

Thus inventories increased from a low level from the end of 1995, the total in 1996 being still only 13 per cent. Korea does not say on what basis these figures are calculated but assumes they all relate to an annual figure for total demand for milk powder (not just milk). This is still only about one and a half month's milk powder supply and the European Communities consider this not to be a high level and certainly not indicative of serious injury. No explanation is given by Korea as to why this level of inventory should be considered undesirable. In fact at their peak level in May 1996 milk powder stocks were equivalent to less than one month's domestic milk production.

4.324 According to Article 4.1(a) of the Agreement on Safeguards, serious injury shall be understood to mean a significant overall impairment in the position of the domestic industry.

4.325 In the EC view Korea's determination of the existence of serious injury cannot be justified by the injury factors which it cites in this regard, even if they could be considered complete and to the extent that they may be considered correct.

4.326 Korea's conclusion on serious injury is set out in Paragraph IV.4 of the Notification of 1 April 1997 as follows:

“It was determined that the domestic industry was suffering serious injury based on, *inter alia*, the following facts: the market share of domestic raw milk decreased between 1993 and June 1996: inventory of domestic milk powders grew from 4,509 tons

¹²⁹ Para. IV.3.4. of the Notification of 1 April 1997.

in 1993 to 14,994 tons in June 1996; sales price witnessed a drop while manufacturing costs increased; livestock cooperatives' ordinary income steadily decreased and registered a huge loss in the first half of 1996; seven livestock cooperatives had a debt to equity ratio exceeding 1,000 per cent while six cooperatives depleted their paid-in-capital; and employment decreased."

4.327 With respect to the factors cited by Korea the European Communities make the following arguments:

- Market share - The European Communities submit that a decline of 5.7 percentage points from 91.1 per cent to 85.4 per cent during the investigation period cannot be considered supportive of a finding of serious injury.
- Increase in inventory - The European Communities do not consider, and find no explanation by Korea why, an inventory level equivalent to one and a half months total demand can be considered supportive of a finding of serious injury. The increase of inventory occurred at the end of 1995.
- Sales price drop while manufacturing costs increased - The European Communities assume that Korea is not suggesting that the increase in manufacturing costs can be blamed on imports, according to Korea's own data, sales prices of raw milk are increasing and the sales price of milk powder is stable, except for what it has termed a "temporary phenomenon" in 1996. This is therefore also not supportive of a finding of serious injury. In this connection the European Communities would stress that the price of imported SMPP or a price difference between it and domestic milk powder are not identified as an element of alleged serious injury. Indeed, it could not have been since Korea, for its own reasons, did not investigate prices or price differences or indeed the price relationship between SMPP and the different categories of milk powder (skimmed and whole). The prices which are given in the table on page 11 of the Notification of 1 April must represent some kind of average of various categories of product and are in any event not comparable between imports and domestic products.
- The financial situation of certain livestock co-operatives. The European Communities note that the situation of these livestock co-operatives cannot be considered to support a finding of serious injury for the domestic industry as a whole which consists not only of the livestock co-operatives but also of milk processing companies and dairy farmers.
- Decrease in employment. The European Communities note that this finding relates exclusively to the dairy farmers and, since their production has increased, is indicative of a healthy consolidating industry and certainly not of serious injury.

4.328 Korea does preface its list of injury factors on which it based its determination with the words "in particular". However, none of the other factors support the determination. Indeed, the limited data supplied by Korea does not show an industry in distress. Several injury indicators in fact pointed at a positive development and were disregarded by Korea.

4.329 The domestic industry in this case is characterized by increasing production and productivity. The only information available on employment is the gradual decrease in the number of dairy farmers, which is a positive indicator in the light of increasing production and is also an objective of Korean government policy. Furthermore, since production and prices of raw milk increased, domestic sales must have increased in 1995 and the first half of 1996. Market share of raw milk and milk powder fell by only 5.7 percentage points from 1993 until 1995 but increased again in 1996. Korea itself stated that this was only a temporary phenomenon, but, in any event, such a small decrease cannot be accepted as an indicator of a significant overall impairment of the industry.

4.330 The only clearly negative factor is the difficult financial situation of some of the dairy cooperatives. However, the financial position of these companies appears to be very variable and in any case is of lesser importance than the raw milk industry, even according to the incomplete and inconsistent investigation conducted by Korea.

4.331 The European Communities consider that on the basis of the limited data provided by Korea, the picture that emerges is that even if the domestic industry is consolidating (a feature which it shares with many other OECD countries), it is nonetheless healthy. There is no evidence of a “significant overall impairment of the domestic industry” which would be required to support a finding of serious injury.

4.332 Therefore the European Communities conclude that Korea violated Article 4.2(a) of the Agreement on Safeguards by making a determination of serious injury which is unsupported by the facts.

(b) Response by Korea

4.333 **Korea** responds to the EC arguments as follows:

4.334 In order to impose a safeguard under Article 2 of the Agreement on Safeguards, Korea must show that:

- (i) a product is being imported into its territory in such increased quantities;
- (ii) as to cause or threaten to cause serious injury;
- (iii) to a domestic industry;
- (iv) producing a like or directly competitive product.

4.335 In its attempts to depict the Korean dairy industry as being healthy, the European Communities provide the Panel with incorrect or misleading facts and unsubstantiated allegations. The European Communities even engage in the selective use of evidence and also discards the relevant parts of the evidence when they do not suit its purpose.

4.336 When it cannot produce evidence in support of its contention, the European Communities conveniently claim that Korea did not consider various serious injury criteria. In the view of Korea, the EC claim that Korea did not take into account certain injury criteria may stem from its failure to examine the investigation report¹³⁰ and related documents¹³¹ which were made publicly available at the time of the public hearing. However, it is clear that during the course of the Article 12 and Article XXII negotiations, all the issues considered by Korea in its investigation, and reported to the Committee of Safeguards and the Members, were exhaustively discussed with the European Communities.

4.337 A review of the investigation report and the interim report shows that Korea considered all relevant factors «of an objective and quantifiable nature having a bearing on the situation of that industry.» As the industry in question was an agricultural one and given the unique nature of

¹³⁰ Korea made the results of the injury investigation publicly available and the EC obtained a copy thereof. The Korean version was translated into English by the EC and was referred to many times during the consultations. Korea even took the step to point out numerous translation errors for the benefit of the EC during the prior consultations.

¹³¹ Korea made public the interim investigation report which was used and distributed at the public hearing to determine whether a safeguard measure should be applied, at which the Netherlands Embassy official, Agriculture Counsellor A C van Arnhem was present.

agriculture recognized by the WTO Members, Korea examined the following criteria during its investigation. These elements taken together as a whole, pointed to an industry suffering serious injury.

(i) *Domestic industry and like or directly competing products*

4.338 Korea determined that the "domestic industry" under investigation was the industry that produces raw milk and milk powder. These products are directly competitive with the products under investigation¹³². As established by the relevant Korean law, and consistent with the Agreement on Safeguards, the investigation discounted the import activities of the "domestic industry". Korea notes that the European Communities agree with this definition of "domestic industry" and does not appear to dispute its definition of "directly competitive products".

(ii) *Increase in imports*

4.339 During the investigation period (January 1993 - June 1996), imports of SMPP increased as follows:¹³³

IMPORTS OF SMPP		
<i>Year</i>	<i>Amount (tonnes)</i>	<i>Per cent Increase</i>
1993	3,217	
1994	15,561	384%
1995	28,007	80%
1996 (1-6)	16,320	16.9%

Based on the above data, Korea found that imports increased in absolute terms during the period of investigation.

4.340 There was also a significant increase in imports of SMPP relative to domestic production of raw milk, as evidenced by the following:¹³⁴

IMPORTS OF SMPP RELATIVE TO DOMESTIC PRODUCTION		
<i>Year</i>	<i>Annual Growth Rate of Raw Milk Production</i>	<i>Annual Growth Rate of Imports of SMPP</i>
1994	3.2%	384%
1995	4.2%	80%
1996 (1-6)	4.4%	16.9%

(iii) *Serious Injury*

(a) *Profit and loss of the domestic industry, declining prices, and sales below production costs*

4.341 During the period of investigation, the livestock cooperatives incurred an operating loss of 755 million Won in 1993, 622 million Won in 1994, 1,244 million Won in 1995, and 681 million Won in the first four months of 1996 from their milk powder operations, representing an annual loss rate (defined as operating loss over net revenue) of -6.3 per cent, -6.5 per cent, -10.7 per cent, and -

¹³² See, Notification, paragraph III.2.

¹³³ See, Notification IV.2.

¹³⁴ See, Notification, paragraphs IV.2 and IV.3.1.

29.5 per cent, respectively. Given that dairy farmers owned and capitalized the livestock cooperatives, these losses reflect injury to the dairy households.

4.342 Similarly, the processing companies experienced losses from their milk powder operations.¹³⁵ The difference between sales price and production cost *per* kilogramme (periodic average price) was as follows:¹³⁶

PROFIT\LOSS FROM MILK POWDER BUSINESS

<i>Year</i>	<i>Profit\Loss per kg (Won)</i>
1993	196
1994	-130
1995	-472
1-6/1996	-1,184

4.343 In the raw milk sector, Korea suggests a reference price for raw milk to promote fair transactions between individual dairy farmers and large users, such as the processing companies. Using the suggested reference price as a surrogate, however, the dairy farms experienced a declining profit margin during the investigation period.

PRICE AND PRODUCTION COST OF RAW MILK

	<i>1993</i>	<i>1994</i>	<i>1995</i>	<i>1996</i>
<i>Reference Price (Won/100kg)</i>	41,400	41,400	41,400	45,600
<i>Prod. Cost (Won/100kg)</i> ¹³⁷	40,084	38,861	41,255	46,499
<i>Difference</i>	1,316	2,539	145	-899

The above figures show that the difference between the suggested reference price and production cost had declined until 1996 when this price did not even cover production costs. The combination of this declining profit margin and the compensatory practice of providing 70-80 per cent in cash and the rest in kind for purchases of raw milk by the cooperatives during difficult periods aggravated the weak financial condition of the dairy farms.

4.344 In the milk powder sector, the price is set by market forces. During the period of investigation, with the exception of 1993, domestic milk powder prices were less than production costs. This loss grew larger each year.

PRICE AND PRODUCTION COST OF KOREAN MILK POWDER

	<i>1993</i>	<i>1994</i>	<i>1995</i>	<i>1996</i>
<i>Sales Price (Won/kg)</i>	5,354	5,296	5,388	4,994
<i>Prod. Cost (Won/kg)</i>	5,158	5,426	5,860	6,178
<i>Profit\Loss</i>	196	-130	-472	-1,184

Korea is not suggesting that the increase of manufacturing cost can be blamed on imports. However, the low price of imports had a suppressing effect on the price of domestic raw milk and milk powder, suppressing the price of raw milk to levels that in 1996 did not even cover the production costs.

¹³⁵ See, Notification IV.3.10.b.ii.

¹³⁶ See, Notification IV.3.7, and the table on page 11 thereof.

¹³⁷ Source: NLCF. These production costs were obtained by surveying 150 dairy farms.

4.345 Korea determined that these sales below costs indicated serious injury to the domestic industry, especially given that both milk powder producers and dairy farmers (by virtue of their ownership of the cooperatives) share in the losses from such sales.

(b) *Increase in inventory*

4.346 Korea determined that inventories of milk powder increased and remained at high levels during the period of investigation.¹³⁸

INCREASE IN INVENTORY

<i>Year</i>	<i>Inventory (tonnes)</i>	<i>Per cent Increase</i>	<i>Inventory Ratio in Months</i> ¹³⁹
1993	4,509		4.4
1994	1,517	-66.4%	1.5
1995	6,565	332.8%	7.4
1996 (1-6)	14,994	342.7%	8.1

The total value of inventories as of June 1996 was estimated at 92,633 million Won (about US\$122 million).¹⁴⁰

4.347 Given the unique nature of dairy industries generally and the Korean dairy industry specifically, as discussed in detail above, Korea considered that the accumulation of inventories indicated serious injury to the domestic industry.

(c) *The rise in unemployment*

4.348 During the period of investigation, the number of dairy farms declined by approximately 20 per cent, from 28,219 in 1993 to 22,725 in 1996. This decline occurred even though Korea sought to assist the domestic industry by providing long-term loans of up to 300 million Won¹⁴¹ per farm to improve the industry's competitiveness. Unemployment rose despite the fact that virtually all 28,219 dairy farms obtained long-term loans.¹⁴²

(d) *Debt-to-equity ratio and capital depletion*

4.349 Prior to the increased imports of SMPP in 1993, the domestic industry derived profit from selling raw milk, and producing milk powder. As a result of the circumvention of the 220 per cent agreed tariff rate on milk powders, and the import into Korea of SMPP at a 40 per cent tariff rate, loss began to accumulate rapidly in the Korean livestock cooperatives. The table below shows the losses accruing to livestock cooperatives from production of milk powder, and its overall contribution to their annual debt.

¹³⁸ See, Notification, IV.3.5.

¹³⁹ Inventory ratio is defined as the inventory amount divided by the production of milk powder.

¹⁴⁰ See, Notification, IV.3.5.

¹⁴¹ Approximately US\$220,000 based on October 1998 exchange rates.

¹⁴² Source: MAF. The objective of the loan programme was not to «consolidate» or «rationalize» the industry, since Korea provided financial assistance to keep dairy farms in the business. The long-term loans were not provided, for example, to encourage the dairy farmers to relocate and find other livelihood, given that the loans were earmarked solely for dairy business purposes and that the farmers had to repay the loans even if they ceased to operate in the dairy business.

**PERCENTAGE OF DEBT INCURRED BY COOPERATIVES FROM THEIR MILK
POWDER OPERATIONS**

(Unit: million Won)

	1991	1992	1993	1994	1995	1996
<i>Annual Debt (A)</i>	12,010	10,364	82,560	43,630	42,267	32,543
<i>Profit and Losses from Milk Powder Business (B)</i>	1,814	2,240	482	-330	-1,651	-12,502
<i>Ratio (B/A)</i>	15.1%	21.6%	0.6%	-0.8%	-3.9%	-38.4%

(e) Inability to invest in research and development

4.350 The continued loss by cooperatives caused by SMPP further exacerbated and accelerated the underinvestment in new facilities at a time when the cooperatives needed to upgrade facilities and equipment to remain competitive. Their inability to attract investment is what led Korea to provide financial assistance through the Livestock Development Fund¹⁴³ under the Dairy Cow Competitiveness Enhancement Programme.

4.351 Because the livestock cooperatives were unable to operate at a reasonable profit level, they could not make the necessary investments in research and development. Thus, the domestic industry produces only two types of milk powder (skimmed and whole) and has not been able to expand into the production of the other diverse forms of milk powders and milk powder preparations which are produced by exporting nations.

(f) Loss of market share

4.352 The share of the domestic market occupied by both domestic raw milk and milk powder producers fell during the period of investigation from 91.1 per cent to 85.4 per cent, with only a slight increase in the first half of 1996 attributable to below cost sales of domestic milk powder made as a defensive measure to alleviate the financial burden.

4.353 Given the unique nature of agricultural sectors generally and the Korean dairy industry specifically, Korea considered that the decline in market share for both raw milk and milk powder during the period of investigation indicated serious injury to the domestic industry.¹⁴⁴

4.354 When the market share figures of raw milk and milk powder are disaggregated, the proportion of the consumption of milk powder in Korea taken by SMPP increased dramatically.

MILK POWDER MARKET SHARE OF SMPP

<i>Year</i>	<i>Market Share</i>
1993	10.7%
1994	38.4%
1995	60.6%
1996 (1-6)	69.4%

4.355 It is important to note that any increase in market share of SMPP must be correlated to the rate of increase in milk powder consumption in Korea. In this regard, total consumption of milk

¹⁴³ Funds are established and operated by the government to provide assistance to specific sectors which cannot attract investments.

¹⁴⁴ For reference, see the recent US International Trade Commission report in *Wheat Gluten*, Inv. No. TA-201-67, USITC Pub. No. 3088 (Mar. 1998) at I-16 and II-25, where the US ITC found serious injury even though the overall increase in the market share of imports was 8.8 per cent.

powder increased by 34.3 per cent in 1994, 14.1 per cent in 1995, and 14.5 per cent for the first six months of 1996.¹⁴⁵ Given the low prices of imported SMPP and their functional substitutability with Korean raw milk and milk powder, an increase in Korean consumption effectively only benefits suppliers of the cheaper imported SMPP. As the increase in imports of SMPP displaces both domestically-produced raw milk and milk powder, it is to the direct detriment of the Korean cooperatives and dairy farmers.

(g) *Consumption*

4.356 The consumption of domestic raw milk (including milk powder) was 1,844,463 tonnes in 1993, 1,947,128 tonnes in 1994, 1,947,965 tonnes in 1995, and 984,934 tonnes during the first half of 1996, reflecting a distinct decreasing trend from 5.6 per cent in 1994, to 0.0 per cent in 1995, and to -2.0 per cent during the first half of 1996. Consumption of domestic milk powder decreased relative to the total milk powder consumption during the period of investigation. The domestic milk powder consumption rate was 40 per cent in 1993, 30 per cent in 1994, 23 per cent in 1995, and 28 per cent in the first six months of 1996.¹⁴⁶

4.357 The consumption of white milk (only produced from Korean raw milk), the predominant end use of raw milk fell, with the exception of 1994, during the investigation period, from 1,287,000 tonnes in 1993, to 1,374,000 tonnes in 1994, to 1,319,000 tonnes in 1995, and to 610,000 tonnes for the first six months of 1996. The fall in consumption resulted in a decline of market share of white milk by nearly 10 per cent from 63 per cent to 53.7 per cent between 1993 and the first six months of 1996.¹⁴⁷

4.358 On the other hand, the consumption of flavoured and fermented milk (which primarily use the cheaper imported SMPP) increased during the investigation period. Flavoured milk increased from 123,000 tonnes in 1993, to 176,000 tonnes in 1994, to 255,000 tonnes in 1995, and to 133,000 tonnes for the first six months of 1996, representing an increase rate of 43.5 per cent in 1994, 44.6 per cent in 1995, and 10 per cent in the first six months of 1996. The market share of flavoured milk increased from 6 per cent to 11.7 per cent during the period of investigation. The consumption of fermented milk surged from 466,000 tonnes in 1993, to 525,000 tonnes in 1994 to 539,000 tonnes in 1995 to 297,000 tonnes in the first six months of 1996. The annual increase rate was 12.7 per cent in 1994, 2.8 per cent in 1995, and 7.3 per cent in the first six months of 1996. The market share of fermented milk increased from 22.8 per cent in 1993 to 26.2 per cent in the first six months of 1996. Korea determined that the import of the cheaper SMPP was the primary reason for the processing companies to increase the production of flavoured and fermented milk and curtail the production of white milk that can only be produced from domestically-produced raw milk.¹⁴⁸

4.359 Korea considered that the data above indicated that consumption of downstream products made from Korean raw milk and milk powder were declining, resulting in an overall decline in the consumption of domestic raw milk and milk powder.

¹⁴⁵ Source: MAF.

¹⁴⁶ See, Notification IV.3.3. The consumption of domestic milk powder increased in the first half of 1996 because the price fell from a high of 5,388 Won/kg in 1995 to a low of 4,994 Won/kg in the first six months of 1996. The fall in the price is attributable to an acute rise in inventory from 6,565 tonnes in 1995 to 14,994 tonnes in the first half of 1996, an increase of 342.7 per cent, caused by the single largest increase between 1995 and 1996. The sharp increase in inventory amount compelled the cooperatives to sell milk powder at below production cost. Source: MAF.

¹⁴⁷ Source: MAF

¹⁴⁸ Source: MAF

(h) *Productivity and capacity utilization*

4.360 Korea asserted that capacity utilization is an example of an injury criterion which is relevant to industrial goods but is not necessarily useful in assessing serious injury to an industry in the agricultural sector. In the case of industrial goods such as autos, a high capacity utilization ratio of plants would be regarded as a positive indicator for the industry. This, however, is not the case in the raw milk/milk powder industry.

4.361 Korea emphasized that capacity utilization of *both* the raw milk *and* milk powder sectors was fully considered in the serious injury determination. Korea fails to understand the basis on which the European Communities claim that there is "no examination of capacity utilization" in view of the fact that the interim investigation report explicitly dealt with that issue.¹⁴⁹

4.362 After considering capacity utilization for the milk powder sector, Korea determined that this element did not accurately reflect the condition of the domestic industry because the unused portion of raw milk became larger as SMPP replaced raw milk, livestock cooperatives' and processing companies' intake of the unsold raw milk quantity for conversion into milk powder increased, thereby increasing the milk powder industry's capacity utilization; however, despite the increase in capacity utilization, the raw milk converted into milk powder became unsaleable inventory. Thus, capacity utilization was not a suitable criterion for injury determination purposes and the investigating authority placed less emphasis on this factor than other injury elements.

4.363 In connection with capacity utilization of raw milk, the investigating authority found that the rate of utilization was 100 per cent, since all cows had to be milked. Here again, however, like the milk powder sector, high capacity utilization does not signal a healthy industry. Raw milk had been substituted for by cheaper SMPP imports and the excess (*i.e.*, unsold) raw milk, due to its perishability, was turned into unsaleable milk powder inventory. Accordingly, after due consideration, Korea discounted capacity utilization in determining the existence of serious injury to the domestic industry.

(i) *Production*

4.364 Korea considered the raw milk and milk powder production data in its injury analysis and concluded that it was not an appropriate measure for determining the state of the domestic industry. It is true that raw milk production rose by 3-4 per cent during the investigation period. However, the excess raw milk was not consumed and thus became milk powder inventory.

4.365 The demand for flavoured and fermented milk products also increased, but such products were largely made from the cheaper imported SMPP which displaced the domestically-produced raw milk and milk powder.

4.366 In response to a question by the Panel¹⁵⁰, **Korea** further clarified certain aspects of the injury investigation concerning the calculation of the manufacturing costs for the domestic industry:

4.367 The figures of the production costs of raw milk were calculated by adding the costs for feed, hired labour, depreciation, family labour, interest, and for miscellaneous items such as veterinary services and medicines, and by subtracting income from by-products. The annually published and

¹⁴⁹ See, Exhibit Korea-5. A copy of the interim investigation report was publicly available to everyone and was distributed to all attendants of the public hearing, including the Agriculture Counsellor A C Van Arnhem of the Netherlands Embassy.

¹⁵⁰ The Panel recalls that the question was: "In Korea's first submission, you refer to "production costs of raw milk." Could you please provide evidence on how these calculations were performed. Could you also do the same for "production costs of Korean milk powder"."

publicly available "Annual Report of Livestock Production Cost Survey" by NLCF contains detailed figures for the production costs of raw milk. These figures are as follows:

PRODUCTION COST OF RAW MILK (WON/100KG)

	1993	1994	1995	1996
Feed	18,209	18,730	20,028	22,432
Hired labour	303	362	536	612
Depreciation	7,067	7,256	7,395	7,538
Family labour	14,382	13,264	13,975	14,816
Interest	6,188	5,116	5,935	6,472
Miscellaneous	3,012	3,322	3,604	3,934
By-products	9,077	9,189	10,218	9,305
Production costs	40,084	38,861	41,255	46,499

4.368 Data for production cost of Korean milk powder was calculated by the total manufacturing cost over amount of production of milk powder produced by the NLCF, which appear in pages 46 and 54 of the OAI Report. Total cost of manufacturing consists of raw material cost, labour cost and other expenses as is shown in the following Table, reproduced from pages 46 and 54 of the OAI Report.

TOTAL MANUFACTURING COST OF THE NLCF (UNIT: MILLION WONS, WON/KG)

	1993	1994	1995	1996.1.-4.
Total manufacturing cost (A)	16,917	13,576	20,491	18,911
- raw material cost (B)	13,996	11,428	16,992	16,209
- labour cost (C)	1,181	961	1,451	772
- other expenses (D)	1,740	1,187	2,047	1,931
Raw material cost/total manufacturing cost (% , B/A)	82.7	84.2	82.9	85.7
Amount of production (E, tonnes)	13,512	9,495	15,719	10,401
Per unit manufacturing cost (F)	5,158	5,426	5,860	6,178
Sales price (G)	5,354	5,294	5,388	4,994
Difference in prices (G-F)	197	-132	-472	-1,184

4.369 With regard to the exclusion of certain products from the final measure **Korea** in answer to a question by the Panel¹⁵¹ made the following arguments:

4.370 The precise amount of products excluded and the methodology used to exclude them are set out on page 7 of the OAI Report. The European Communities obtained a copy of the OAI Report at the KTC's Public Hearing on 20 August 1996. The European Communities provided the Government of Korea with a translation during the consultations. Thus, the European Communities has already had access to the figures at issue.

4.371 Based on the analysis of the exporters' responses, the OAI concluded that certain items falling under the same HS code number as that of the SMPP should be excluded from the application of the safeguard measure on the ground that:

¹⁵¹ The Panel recalls that the question was: "In paragraph 51 of Korea's oral statement to the first meeting of the Panel, you appear to refer to some products which would have been excluded from the application of the final safeguard measure. Is this statement accurate? Were any of these products (or any other products) excluded by Korea when it conducted its investigation, in particular, for the injury analysis? If so, please explain the methodology Korea used in doing so as well as the criteria it used to perform such assessment."

- they were not simple mixtures of whey powder or starches with milk powder prepared solely for the purpose of evading comparatively high tariffs;
- they were commonly traded products, and not exclusively targeted at countries with high negotiated tariffs such as Korea; and
- the import volume was very small.

4.372 Also in response to a question of the Panel¹⁵² **Korea** offered the following clarification on the relation between SMPP imports and milk powder imports:

4.373 Korea's notification of 24 March 1997 and the OAI Report provide the import figures for SMPP at the second paragraph of section IV.2. It also provides the equivalent figures for imports of milk powder in paragraph V.2.2 of the same Notification.

	Imports of milk powder	Imports of SMPP	Total imports	SMPP's share of total imports
1993	14,843	3,217	18,060	17.8%
1994	11,581	15,561	27,142	57.73%
1995	7,576	28,007	35,583	78.78%
1996 (1-4)	583	16,320	16,903	96.6%

4.374 The volume of total imports of milk powder and SMPP increased by approximately 90 per cent over the investigation period, and within that total increase, SMPP's share increased from 17.8 per cent to 96.6 per cent. Therefore, the conclusion that the increase in imports of SMPP far outweighs the decrease in imports of milk powder is evident.

4.375 The Panel also asked¹⁵³ **Korea** to clarify its arguments on the composition of the domestic industry and to summarize how the serious injury factors were considered for the whole domestic industry. The following constitutes Korea's response:

4.376 Article 2-1 of Korea's Regulation on Relief of Injury to Domestic Industry Caused by Imports states:

“(i) ‘Domestic industry’ shall mean all the domestic producers who produce products of the same kind as or products having directly competitive relations with imported goods concerned; or a group of the domestic producers of the above product whose collective production accounts for a major portion of the total domestic production.

(ii) If a domestic producer concurrently takes part in the import of the product concerned, only his domestic production shall be included in the domestic industry. If a domestic producer turns out more than one product, only the production of the product concerned shall be considered as domestic industry under consideration.”

4.377 The OAI Report in delineating the domestic industry states:

¹⁵² The Panel recalls that the question was: "Please provide supporting evidence that the increased SMPP "far outweighed" the drop in imports of milk powder paying the agreed tariff rate."

¹⁵³ The Panel recalls that the question was: "Please provide the panel with a detailed explanation of the factors you used to identify one single domestic industry (composed of raw milk and milk powder). In addition, Article 4.1(a) provides "‘serious injury’ shall be understood to mean a significant overall impairment in the position of the domestic industry". Please provide a summary and clarification as to how the factors considered led to a determination of serious injury to the whole of the domestic industry."

“Domestic industry cited in this survey means natural milk industry and powdered milk industry which produce natural milk and powdered milk having direct competitive relations with imports. Natural milk producers include dairy farms and dairy firms that directly run ranches. Powdered milk producers are the NLCF and dairy firms and include those who have no powdered milk production facilities and produce powdered milk on a piecemeal basis.”

4.378 The OAI’s position is also reflected in the Notification of 24 March 1997.¹⁵⁴ In making this conclusion, the OAI considered overlapping commercial use among raw milk, milk powder, and SMPP, and resulting commercial competition among those products. The detailed analysis is also set out in the OAI Report.

4.379 In determining whether the whole domestic industry was suffering serious injury by reason of increased imports of SMPP, the competent authorities considered the relevant factors set out in Article 4.2(a) for the whole domestic industry. In instances where a factor was not relevant to a particular sector of the domestic industry (because it was not of an objective and quantifiable nature having a bearing on the state of that industry), the competent authorities explained the basis for disregarding this factor or the reason why this factor still provided an indication of injury to the whole domestic industry.

4.380 Korea evaluated the following factors as summarized in its first submission and explained in, *inter alia*, the OAI Report and the 24 March Notification:

- (a) the rate and amount of the increase in imports of the product concerned in absolute and relative terms;¹⁵⁵
- (b) the share of the domestic market taken by increased imports¹⁵⁶;
- (c) changes in the level of sales;¹⁵⁷
- (d) production;¹⁵⁸
- (e) productivity;¹⁵⁹
- (f) capacity utilization;¹⁶⁰
- (g) profits and losses;¹⁶¹ and
- (h) employment.¹⁶²

¹⁵⁴ G\SG\N\10\KOR\1\Suppl.1, page 7.

¹⁵⁵ OAI Report at Section V, Notification at Section IV.2.

¹⁵⁶ OAI Report at Sections VI.2 (a) and (b), Notification at Section IV.3.4.

¹⁵⁷ OAI Report at Sections VI.2 (a) and (b) (sales were compared for the livestock cooperatives given the non-availability of sales for individual dairy farmers), Notification at Section IV.3.9 and 10.

¹⁵⁸ OAI Report at Sections VI.2 (a) and (b), Notification at Section IV.3.1.

¹⁵⁹ OAI Report at Section VI.2 (a), Notification at Section IV.3.2.

¹⁶⁰ See, Exhibit Korea-5 for the discussion of this in the OAI’s Interim Report circulated at the public hearing. Further, the Notification of 1 April 1997 made it plain that capacity utilization was unhelpful in analyzing the serious injury to both the raw milk and milk powder sectors, and so was discounted.

¹⁶¹ OAI Report at Section VI.2 (a) and (b) (the profits and losses were compared for the livestock cooperatives given the non-availability of profits and losses for individual dairy farmers), Notification at Section IV.3.10.

¹⁶² OAI Report at Sections VI.2(a)(2) and (b)(5), Notification at Section IV.3.6.

The competent authorities also considered additional relevant factors indicating serious injury including:

- (i) inventory;¹⁶³
- (ii) investment;¹⁶⁴
- (iii) price;¹⁶⁵ and
- (iv) other financial indicators including debt-to-equity ratios and capital depletion.¹⁶⁶

4.381 Based on their evaluation of the above factors, the competent authorities considered that the whole domestic industry was suffering serious injury.

(c) Additional arguments by the European Communities made at the first meeting of the Panel with the parties

4.382 At the first meeting of the panel with the parties, the **European Communities** further advanced their arguments under Article 4.2(a) as follows:

(i) Industry definition

4.383 Korean dairy farmers are characterized by having small farms (average 25 cattle per farm), high costs and low productivity and being subject to a high level of government intervention. In recent years there has been a decline in the number of dairy farms, but an increase in the number of cattle and in milk production, both absolutely and per head. This shows that the Korean dairy farmers are undergoing a process of consolidation, similar to that of many other dairy producers in the most advanced economies, whereby the smallest, least efficient farms are being absorbed and investment for improvements is being targeted on the remaining larger, more efficient farms.

4.384 This process of rationalization and consolidation is encouraged by the Korean Government. Financial stimulus is given by the Dairy Cow Competitiveness Enhancement Programme introduced in 1994, under which the Korean Government gives loans to dairy farmers to improve their facilities. Korea has declined to give details of the level of expenditure committed to this programme. However, the success of governmental intervention can be seen by the facts: between 1993 and 1996 the number of dairy farms decreased by 22 per cent, but the number of dairy cattle increased by 1.6 per cent and milk production by 9.5 per cent.

4.385 Despite the fact that the Korean dairy farmers are still rather inefficient by international standards, Korean milk production has increased almost continuously for the past 20 years and rose by 17 per cent in the most recent five-year period for which figures are available (1991-96). Production is continuing to rise and it is anticipated that it will increase by a further 2-3 per cent in 1998.

4.386 These production increases are rendered possible by the system operated by the Korean Government, under which producers are guaranteed a very high price for their raw milk, for unlimited quantities and irrespective of domestic demand. Like the production, this guaranteed price has also regularly increased over the course of the last 20 years, so that Korean milk producer prices at the

¹⁶³ OAI Report at Section VI.2 (a) and (b), Notification at Section IV.3.5 (inventory in the raw milk sector was estimated by examining inventory in the milk powder sector).

¹⁶⁴ OAI Report at Sections VI.2(a)(3) and (b)(4).

¹⁶⁵ OAI Report at Sections VI.2(b)(3), Notification at Section IV.3.7 (given the non-availability of sales transaction price for raw milk, sales transactions of milk powder were used as a surrogate).

¹⁶⁶ OAI Report at Section VI.2, Notification at Section IV.3.10.

time of the safeguard investigation were among the highest in the world, second only to Japan during the period of investigation. Korea has admitted that the price of raw milk “is maintained at a stable level fixed by the government” and that the price of raw milk was also increased twice during the investigation reference period.¹⁶⁷ Although Korea terms these prices as “suggested”, they are identical to the ones that it submitted to the OECD as domestic prices within the framework of OECD Members’ reporting obligations.

(ii) *Failure to examine correctly all relevant factors of an objective and quantifiable nature having a bearing on the situation of the domestic industry*

4.387 The European Communities consider that the evaluation of injury factors conducted by Korea is incomplete in the following respects:

- for the raw milk industry, Korea failed to evaluate the profits and losses of the raw milk industry
- with regard to the milk powder industry, Korea did not examine productivity, and employment
- there is in reality no examination at all of capacity utilization.

4.388 In addition, the evaluation of many other factors is seriously flawed. These are:

- the rate and amount of the increase in imports of the product concerned in absolute and relative terms (inclusion of excluded products),
- changes in the level of sales (incorrect calculation),
- profits and losses (failure to exclude effects of other activities of the co-operatives)
- sales prices (failure to take account of the fact that 1996 below cost sales were a “temporary phenomenon”)
- inventory (no reason why inventory levels indicated should be a cause for concern). This is a matter which the European Communities will clarify below.

4.389 Therefore the European Communities conclude that Korea violated Article 4.2(a) of the Agreement on Safeguards by making an incomplete and flawed evaluation of the injury factors.

(a) *Profitability*

4.390 The European Communities noted that Korea supplied for the first time some data on profitability of dairy farmers in its First Written Submission. The European Communities considered that: first, Korea’s late submission of information demonstrates that those data could indeed have been gathered and supplied, contrary to what Korea had claimed when the European Communities made their objections during the consultations, and second, the information which is now supplied confirms the EC case.

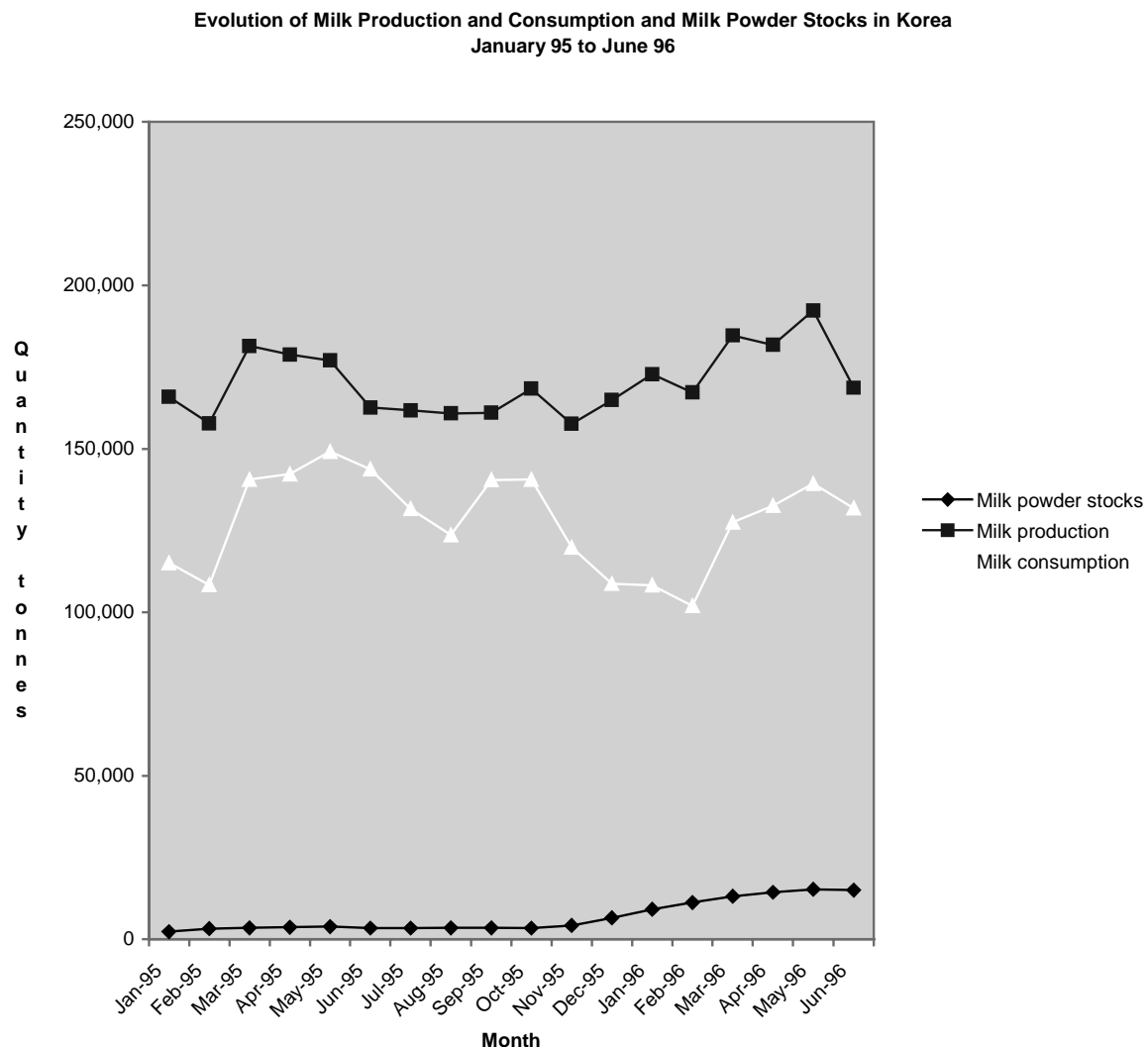
4.391 The European Communities asserted, based on Korea’s data, that in 1994, which witnessed the imports’ sharpest increase, farmers’ profitability was also at its peak. The absence of correlation between increase in imports and profitability further demonstrates the absence of causal link between profitability and the increase in imports. In reality the profitability of Korean dairy farmers is determined by government decisions on the “reference price”. Korea’s table on price and production

¹⁶⁷ See, WTO Doc. G/SG/N/10/KOR/1/Suppl.1, 1 April 1997, p. 10, paragraph IV.3.7 (Exhibit EC-10).

cost of raw milk shows that the decrease in profitability is due to an increase in production costs which of course has nothing to do with imports of SMPP.

(b) *Inventory*

4.392 Apart from the size of the stocks, the other important point is the timing of the increase. The European Communities presented the following graph:



4.393 The European Communities argued this graph shows very clearly that the increase in stocks occurred in November 1995 immediately following the serious decrease in consumption caused by the “pus milk” scandal. Moreover, the graph shows clearly that the increase in stocks coincided with steadily increasing milk production. In the light of the above, the European Communities reiterate their conclusion that the inventory level reported by Korea could not be considered “excessive”, and that its origin is to be found in a cause which is very different from imports of SMPP.

(c) *Employment*

4.394 The figures given by Korea in connection with employment in fact only relate to the numbers of dairy farm households - which the European Communities take to mean farms. This of course is

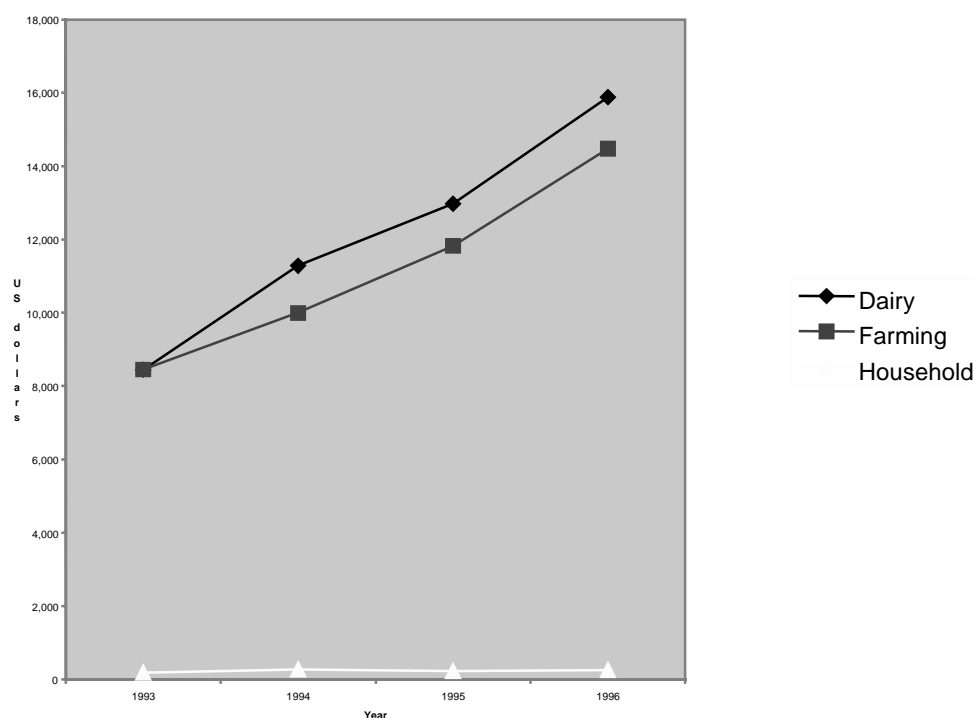
not a measure of employment, especially in a period where farms are consolidating and increasing in size (a development encouraged by Korean government policy).

4.395 The European Communities reiterated that employment is an injury factor expressly listed in Article 4.2 Agreement on Safeguards and Korea has completely failed to investigate it.

(d) *Debt*

4.396 The European Communities note with equal interest that in order to emphasize the problems of one part of its industry - farmers - which it omitted to consider in its determination, Korea is now able to supply data on their debt, and even comparing the household debt increase rate of dairy farmers with that of other farmers. The comparability of the debt level of dairy farmers and the other farmers is expressed in the graph below submitted by the European Communities:

Average Indebtedness



This graph, drawn from Korea's own data, shows that although there was an increase of indebtedness in 1994 (a year of high profits for the Korean dairy industry as we have just seen), the indebtedness of the dairy industry is following exactly the same trend as Korean farming generally.

4.397 The European Communities too recalled that an incentive to accumulate debt can also stem from the favourable credit conditions that Korea admits its dairy industry can enjoy as a result of the Dairy Cow Competitiveness Enhancement Programme.

4.398 In the EC view the figures in the table on the percentage of debt incurred by cooperatives from their milk powder operations submitted show a declining trend in indebtedness throughout the investigation period of 1993 to 1996 which is a healthy trend. Also, the evolution of profits and

losses shows no correlation to indebtedness. The figures do not correspond for example, the high profits in 1992 were followed by an increase of debt in 1993. But more fundamentally, Korea is comparing apples and pears by calculating a ratio of profits and losses from milk powder business by annual (that is presumably accumulated) debt corresponding to all business sectors of the co-operatives. The information is simply misleading and in no measure supports Korea's findings.

(e) Research and Development

4.399 In the EC view Korea's First Written Submission contains a new and remarkable argument – that the ability of the domestic industry to invest in research and development was being impaired. There is no basis for this in the Notification and indeed no figures for such investment are given. The European Communities submit that this new attempt of justification of the finding of serious injury must be disregarded.

(f) Loss of Market Share

4.400 It is always possible to make figures appear more impressive by reducing the denominator and this is what in the EC view what Korea does in its First Written Submission by expressing imports of SMPP as a percentage of the milk powder market. The domestic industry definition covered all milk production and therefore the appropriate figures are for this market. The total market share of domestic raw milk and milk powder declined some 5.7 percentage points from 91.1 per cent to 85.4 per cent during the investigation period. The European Communities do not see how this can be considered indicative of serious injury.

(g) Consumption

4.401 In the EC view, Korea makes an admission in its First Written Submission when it stresses the importance of the switch in Korea from the consumption of "white milk" to the consumption of flavoured and fermented milk and that the latter is directly at the expense of the former. Korea suggests that since flavoured and fermented milk can be more easily manufactured using imported SMPP, this demonstrates serious injury. This is not the case. The trend identified by Korea demonstrates that the decrease in domestic milk production was at least partially caused by a change in consumer preferences in Korea. This is an additional factor contributing to the situation of the domestic industry which Korea failed to take into consideration under the second sentence of Article 4.2(b). This is an additional violation.

(h) Capacity utilization

4.402 Korea asserts that evidence of its investigation into this factor can be found in the KTC's Interim Report. This might be true, but it simply overlooks the point that the factors leading to the imposition of a safeguard measure should be at the basis of the final decision, which is at issue in this procedure on "Definitive Safeguard Measures on Imports of Certain Dairy Products". In the absence of even a reference to the interim report on this aspect in the final measure, the European Communities fail to see how it could have been understood that the preliminary determination would not be, precisely a preliminary one but a definitive one

(d) Additional arguments by Korea made at the first meeting of the Panel with the parties

4.403 At the first meeting of the panel with the parties, **Korea** further advanced its arguments under Article 4.2(a) as follows:

4.404 As to the more general substantive points raised by an examination of serious injury and causation, Korea maintains:

- (a) the Agreement on Safeguards does not require application of all the specific injury criteria set out in Article 4, but refers Members to criteria that should be considered if relevant, and of an “objective and quantifiable nature”
- (b) the Agreement on Safeguards does not provide any indication as to how these criteria of injury are to be assessed. In the view of Korea, it is not possible to challenge a safeguard measure by examining individual injury criteria, since individual criteria need to be correlated to general trends and to other relevant criteria. For example, could an examination of changes in domestic production indicate anything about serious injury unless correlated to data concerning changes in imports and consumption?; and
- (c) the Agreement on Safeguards does not require that a Member show causation in specific manner.

4.405 WTO Members should be allowed to set more onerous standards than the Agreement on Safeguards for the imposition of safeguard measures (as indeed the European Communities do). Korea only has to comply with Agreement on Safeguards. In its view, the consideration of this case, and the notification and consultation procedures were in full conformity with that Agreement.

4.406 Looking at the injury criteria it considered as relevant, objective and quantifiable, the Korean investigation concluded that the imports of cheap SMPP had increased, that serious injury had been suffered by the domestic industry, and that the serious injury was caused by the increased imports. The Korean investigation took into account a number of factors demonstrating a causal link between the increased imports and serious injury, and discounted factors that had an insignificant or limited effect.

4.407 More specifically, there was an increase in imports both in absolute and relative terms. In 1993, the amount of SMPP imported was 3,217 tonnes. The amount increased to 15,561 tonnes in 1994, 28,007 tonnes in 1995 and 16,320 during the first half of 1996. Based on the above data, Korea found that imports had increased during the period of investigation.

4.408 There was also a significant increase in imports of SMPP relative to domestic production of raw milk. While the annual growth rate of raw milk production was 3.2 per cent in 1993, 4.2 per cent in 1995, and 4.4 per cent in the first half of 1996, the annual growth rate of SMPP was 384 per cent in 1994, 80 per cent in 1995, and 16.9 per cent in the first half of 1996.

4.409 Korea also undertook a profit and loss analysis of the Korean industry, which also showed serious injury. Both the raw milk and milk powder sectors of the Korean industry incurred heavy losses during the investigation period. As to the raw milk sector, the European Communities claimed in its First Submission that the dairy farmers of Korea are guaranteed a “very high price” by the Government. However, the reference price was only suggested and not guaranteed, and did not even cover the cost of production. For example, in 1996, the production price *per* 100 kg was 899 Won above the suggested reference price. The milk powder sector also showed a great loss. The slight profit of 196 Won *per* kg in 1993 turned into a heavy loss of 1,184 in 1996. There was also a significant rise in unemployment in the domestic industry due to the imports of cheap SMPP.

(e) Rebuttal arguments made by the European Communities

4.410 The **European Communities** made the following arguments in rebuttal:

(i) *The Requirements of Article 4.2(a) Agreement on Safeguards*

4.411 In essence, the **European Communities** complain that Korea should have investigated all the relevant facts, and not, as put forward by Korea, “the facts before it”. The investigating authority must gather all the facts which are available in order to conduct an assessment of the facts as a whole. This is necessary to meet the requirements of Article 4.2 of the Agreement on Safeguards, notably that the authority must conduct an evaluation (“detailed analysis of the case under investigation”) and that, in addition to it, it must engage in a “demonstration of the relevance of the factors examined”.¹⁶⁸

4.412 Korea omitted consideration of certain of the injury factors listed in Article 4.2(a). Also, certain conclusions drawn by Korea could not be supported by the facts listed, or could not logically follow from them. As a previous Panel once had the opportunity to note, it is not sufficient for an authority to refer to the evidence it considered and state its conclusion:

“It was incumbent upon the investigating authorities to provide a reasoned opinion explaining how such facts and arguments had led to their finding.”¹⁶⁹

4.413 In addition, Article 4.2(a) of the Agreement on Safeguards and the precedents quoted in the EC First Written Submission¹⁷⁰ confirm that the standard of review is for the Panel to verify whether the investigating authority considered “all relevant facts”, not “the facts before the investigating authorities”.

4.414 Korea cannot excuse its failure to consider all the relevant facts and all the injury factors mentioned in Article 4.2(a) Agreement on Safeguards by claiming that it need only provide an adequate explanation of how the facts before it as a whole supported its determination. The European Communities submit that it is necessary, at a minimum, for a serious injury determination under the Agreement on Safeguards to demonstrate that the relevance or otherwise of each of the factors listed in Article 4.2(a) of the Agreement on Safeguards was considered. The European Communities would further submit that that provision requires each injury factor to be properly analysed unless it is explained for what reason the injury factor may be disregarded. It is true that no injury factor “in isolation” can establish serious injury but that does not excuse a failure to examine them all.

(ii) *Failure to examine correctly all relevant factors of an objective and quantifiable nature having a bearing on the situation of the domestic industry*

(a) *Profitability and prices*

4.415 The 24 March 1997 Notification of Korea provided no information as to the profitability of its dairy farmers. It was only in its First Written Submission that Korea, for the first time, supplied data in this respect, and subsequently stated, in answer to a question by the European Communities, that surveys on production cost are implemented every year, including during the period of the KTC investigation. This, in the first place, shows that contrary to what Korea has said, it was possible to gather those data and meet the obligation to consider them in the investigation.

¹⁶⁸ See, Article 4.2(c) of the Agreement on Safeguards, summarizing this.

¹⁶⁹ See, Panel Report on *Brazil – Imposition of Provisional and Definitive Countervailing Duties on Milk Powder and Certain Types of Milk from the European Economic Community*, adopted by the Committee on Subsidies and Countervailing Measures on 28 April 1994, SCM/179, and Corr.1, para 286.

¹⁷⁰ See, Panel Report in *US - Shirts and Blouses*, 6 January 1997, WT/DS33/R; *US - Underwear*, WT/DS24/6, 8 November 1996.

(1) Raw milk prices

4.416 The European Communities have explained their view that the “suggested price” for milk in Korea, although arguably not formally binding, has considerable practical force. The European Communities based its assumption on Korea’s statement, in its 24 March Notification, that

“The price of milk powder is subject to change according to market forces of supply and demand, although that of raw milk is maintained at a stable level fixed by the government”.¹⁷¹

4.417 Additionally, the Dairy Industry Promotion Act states:

"Article 3 (the Dairy Committee)

- a) The Dairy Committee, which belongs to the Minister of Agriculture and Forestry, shall be established to deliberate on important matters for dairy industry promotion.
- b) The organisation, tasks and operations of the Dairy Committee shall be determined by Presidential Ordinance."

"Article 13 (maintenance of prices)

(1) The Minister of Agriculture and Forestry is able to decide specifications and appropriate prices of raw milk in consultation with the Dairy Committee."

"Article 14 (mediation of disputes)

(1) In case there is a dispute concerning raw milk transactions, both parties or one party of the dispute are able to apply for mediation to the Minister of Agriculture and Forestry.

(2) In case there is an application for mediation in accordance with the previous provision, the Minister of Agriculture and Forestry shall make a mediation and decision in consultation with the Dairy Committee.

The details such as methods and procedures of the mediation stipulated in the previous provision shall be determined by Ordinance of the Ministry of Agriculture and Forestry."

4.418 Furthermore, if a particular milk processor is paying to dairy farmers less than the prices decided by MAF, dairy farmers have the legal right to take the milk processor to court on the basis of the Dairy Industry Act. In fact, a group of dairy farmers are presently carrying out legal action against Haitai Dairy on the grounds that they did not receive the guaranteed raw milk price decided by MAF under the Dairy Industry Act.¹⁷²

¹⁷¹ See G/SG/N/10/KOR/1/Suppl.1, 1 April 1997, Section IV.3.7, p. 10 (emphasis added).

¹⁷² For example, the following article appeared in the Agriculture, Fisheries and Livestock News of October 19, 1998 (Exhibit EC-23).

"Subject : The Ministry of Agriculture and Forestry (MAF) urged Haitai Dairy Co., Ltd. to pay unpaid prices of raw milk, 12.3 billion won (approx. US\$ 9.8 million) as soon as possible.

MAF has urged Haitai Dairy, which applied for the court mediation for rescheduling of debt repayment to the Suwon District Court, to pay raw milk prices, which are generally recognised as

4.419 The European Communities argue that Korea admits that the "suggested prices" are sufficiently reliable to justify a conclusion on the profitability of the raw milk producers, that is, dairy farms. Further strong supporting evidence that the price set by Ministry of Agriculture and Forestry ("MAF") is a guaranteed minimum price is found in the statistics for the production cost of milk powder supplied by Korea in answer to a question by the Panel. These were not previously made available.

4.420 Taking the 1993 figures in Korea's table as an example:

The manufacturing cost for milk powder (F in the table) is stated as 5,158 Won/kg.
The proportion of this cost which is accounted for by the raw material is stated as 82.7 per cent, giving a price of $5,158 \times 82.7 \text{ per cent} = 4,266 \text{ Won/kg}$.
Korea has stated that the ratio between milk powder and raw milk is 1:10 (*i.e.*, 10 units of raw milk are needed to produce 1 unit of milk powder).
The price at which the raw milk producers sold to the milk powder companies can therefore be shown to be $4,266 \div 10 = 427 \text{ Won/kg}$.
The MAF price for raw milk in 1993 was 394 Won/kg, so the milk powder companies were paying on average 8 per cent above the MAF price.

4.421 Performing this calculation for all of the relevant years gives the following results:

SELLING PRICE OF RAW MILK FOR MILK POWDER PRODUCTION, 1993-96				
	1993	1994	1995	1996 (1-4)
Manufacturing cost (W/kg)	5,158	5,426	5,860	6,178
Raw material as % of total	82.7%	84.2%	82.9%	85.7%
Raw milk selling price	427	457	486	529
MAF price (W/kg)	394	394	414	431
Premium for raw milk sold for milk powder over the MAF price	+ 8.3%	+ 16.0%	+ 17.4%	+ 22.7%

4.422 based on this information, the European Communities observed:

- Firstly, actual raw milk sales prices, do respect the MAF prices and on average are higher.¹⁷³ Since the sale prices of raw milk for milk powder production would be expected to be at the lower end of the market, (Korea has stated that it is surplus raw milk production which goes for milk powder) prices for other purposes can be expected to be higher.

wages, as soon as possible. On October 15, 1998 Mr. Nam-Chul Kim, Director of the Livestock Administration Division of MAF stated 'Raw milk prices have to be generally recognised as wages' and 'when the payment of raw milk prices is continuously deferred, dairy farmers will have difficulties in keep a normal level of living, and will have difficulties in paying for animal feed, and will be eventually bankrupt.

If Haitai Dairy does not pay for the prices of raw milk appropriately, the Government will be forced to take appropriate measures. In relation to this matter MAF asked the Suwon District Court to give cooperation so that the prices of raw milk for which payment is deferred will be paid regardless of the application for the court mediation for rescheduling of debt repayment."

¹⁷³ See, WTO Doc. G/SG/N/10/KOR/1/Suppl.1, 1 April 1997, Section V.2.4, p. 17, where Korea describes the price set by the government as a "base price".

- Secondly, the Korean Government did in fact have available to it information on raw milk transaction prices, at least on an overall basis, which would have enabled it to include an examination of this in the safeguards investigation.

(2) Dairy farm profitability

4.423 Regarding the profitability of dairy farms, Korea indicated in the bilateral consultations with European Communities that this could not be examined by the KTC investigation because this information was not available. In its First Written Submission Korea contradicts this by seeking to demonstrate the poor level of profitability of its dairy farms by using on the one hand the government “suggested” prices as a “surrogate” for actual transaction prices, and on the other hand production costs, which it now admits are “annually published and publicly available” in the ‘Annual Report of Livestock Production Cost Survey’.

4.424 The EC assertion that “producers are guaranteed a very high price for their raw milk” is borne out, and even extended, by the additional information supplied by Korea. It is stated that “the MAF suggests the raw milk price reflecting changes in the production cost”. This implies that MAF has knowledge of the production costs each year and uses them to set a “suggested price” which will guarantee a profit to dairy farmers.

4.425 Korea uses profitability figures to show the supposed injury caused to dairy farmers. However, these profitability figures are based only on MAF reference prices which, as has been shown above, are a minimum rather than a norm to be followed.

4.426 The European Communities maintain that the figures provided in Korea's table on price and production costs of raw milk may be misleading. The cost of raw milk production is compared there only with the MAF reference price. However, if the cost of production is compared with the price received for milk powder production, a very different picture emerges:

PROFIT MARGIN OF DAIRY FARMERS SELLING RAW MILK FOR MILK POWDER, 1993-96

	1993	1994	1995	1996
Reference price (W/kg) ¹⁷⁴	394	394	414	431
Production cost (Won/kg)	401	389	413	465
Sale price for milk powder	427	457	486	529
Difference: profit (W/kg)	+ 26	+ 68	+ 73	+ 64
Profit as % of production price	6.5%	17.5%	17.7%	13.7%

4.427 Based on this table, the European Communities assert that, at least as far as sales of raw milk for milk powder are concerned, these remained very profitable for the dairy farms throughout the KTC investigation period. In fact, at the very time when imports of SMPP increased significantly, in 1994 and 1995, the profitability of dairy farms in this area increased significantly too.

4.428 Therefore, not only was the profitability of dairy farmers significantly greater than Korea has indicated, but also there is no evidence of injury at the time when SMPP imports were increasing. Not only did Korea not properly investigate this issue when this was perfectly feasible, but it is also clear that the result of this investigation would have been that no injury was being caused to dairy farms.

¹⁷⁴ The reference prices shown in Korea's First Submission do not coincide with those submitted by Korea to the OECD. In this table the latter figures have been used.

4.429 Korea's reply to a question by the European Communities indicate the magnitude of government loans for each dairy farm – this also is newly supplied information.

KOREAN GOVERNMENT LOANS TO DAIRY FARMS, 1993-96

	No of dairy farms receiving loans	% of total dairy farms receiving loans	Total value of loans (million Won)	Average loan per household (Won)
1993	19,306	68.4%	3,911	202,000
1994	19,549	76.2%	69,402	3,550,000
1995	20,052	85.3%	72,936	3,637,000
1996	13,353	60.4%	91,959	6,887,000

This table shows that the vast majority of Korean dairy farmers¹⁷⁵ are in receipt of very generous loans, at a time when their operations were rather profitable. Also, there seems to have been a clear shift in government policy in 1996, lending substantially more money, but to only two-thirds of the number of farmers compared with the previous year.

(3) Milk powder prices and profitability

4.430 As regards milk powder prices, which are provided in the 24 March Notification¹⁷⁶, the European Communities recall that they show a remarkable stability and that the decrease in the first four months of 1996 is explained by Korea itself as a "temporary phenomenon", which therefore cannot, explain the reduction in profitability.

4.431 The table on the selling price of raw milk for milk powder production 1993-96, in the EC view clearly demonstrates that the problems facing the milk powder companies during the period of the KTC investigation stem principally from the increasingly high prices which they were having to pay for their raw material, prices which were increasing even faster than the guaranteed MAF price. This shows that any decline in profitability of the milk powder companies can be directly related to a corresponding increase in the profits of the dairy farmers, since the cost of the raw material accounted for between 82.7 per cent and 85.9 per cent of manufacturing costs in the period 1993-96.

4.432 Referring to the basic economic laws of supply and demand, one would conclude that this increase in the price of raw milk for milk powder production must be due to a shortage of supply of the raw material. This entirely reasonable hypothesis would serve to explain why Korean dairy companies increased their imports of SMPP during the KTC investigation period.

4.433 In fact, Korea states that "the shortage of milk began to be eliminated from the end of 1994". This begs the question as to when the shortage actually ended (when was the end rather than the beginning of the end?) It also fails to explain why raw material prices for milk powder continued to rise so much after the end of 1994 and why over 7,500 tonnes of milk powder was imported in 1995, in addition to the increased imports of SMPP.

4.434 In conclusion, it is obvious to the European Communities that neither the imports of a given product nor their trends have any relation whatsoever with the production costs of the competing domestic products and therefore with any decrease in profitability resulting from an increase in such costs. Korea milk powder companies' profits are crucially dependent on the cost of the raw material. In the period 1993-96 they were paying a price significantly higher than the MAF price for their raw

¹⁷⁵ It should also be noted that the above figures contradict the assertion by Korea that it sought to assist the domestic industry by providing virtually all 28,219 farms with loans to improve their competitiveness. At no time in the four years indicated above did the government provide loans to more than 20,052 farms, only 69.6 per cent of the total 28,219 farms quoted – this is, in the EC's view hardly "virtually all".

¹⁷⁶ See, WTO Doc. G/SG/N/10/KOR/1/Suppl.1, 1 April 1997, Section IV.3.7, p. 10.

material. Profitability could have been very easily restored by reducing their raw milk purchase price, and it is not clear why this step was not taken.

(b) *Employment*

4.435 The European Communities observed that, in relation to dairy farms the only evidence brought forward is the decline in the number of farms. In its view, the European Communities have put forward to demonstrate that this is largely due to a consolidation and rationalization in the industry. None the less the questions remain. In Korea's reply to a question by the European Communities it is stated that "there is no difference between the terms 'dairy farms' and 'dairy households'". A number of points remain unclear, due to Korea's asserted failure to investigate basic data on this point, in particular:

- the number of people in the households who are actually employed on the farms;
- the number of people outside of the households who are employed on the farms;
- the number of people in the 'households' who can be considered as full-time farmers;
- the number of people in the households who are not full-time but generate the majority of their income from the farms;
- the age structure of the dairy farmers

4.436 Without an investigation of such data it is impossible to reach an appropriate conclusion on employment patterns in the dairy farms.

(c) *Cheese imports*

4.437 Another possible causal factor which was not examined in any way by Korea is the level of cheese imports. This is rather surprising in view of the statement in the OAI Report notes that cheese imports have "direct influence on consumption of domestic raw milk."¹⁷⁷ This is followed by the equally puzzling assertion that "considering the characteristics of the analysis, data on cheese imports was excluded", without giving any justification for such an exclusion.

(f) **Rebuttal arguments made by Korea**

4.438 **Korea** makes the following rebuttal arguments:

4.439 As an initial matter, Korea notes that in conducting its analysis, the Korean authorities explained that:

"[b]ecause the raw milk and milk powder are inextricably linked, it is useful to analyse both industries as a whole, and then examine the milk powder separately. Towards this end, the investigation team will first analyse the raw milk industry which includes milk powder industry and then conduct a separate analysis of the milk powder industry for the sake of clarity."¹⁷⁸

¹⁷⁷ See, OAI Report, p. 16, footnote.

¹⁷⁸ OAI Report at 37. The competent authorities determined that milk powder and SMPP are not like products due to the differences in physical characteristics as SMPP contains on average 80 per cent milk powder. However, they are directly competitive products. The Government of Korea respectfully suggests that the Panel should compare SMPP with milk powder on a 1 to 1 basis, not just in relation to 80 per cent of SMPP as the EC contends in its First Submission. SMPP cannot be divided, whether commercially or actually, into milk powder and other ingredients.

(i) *Imports of SMPP in absolute and relative terms.*

4.440 Under Article 4.2(a) of the Agreement on Safeguards, the competent authorities must examine the rate and amount of the increase in imports of the product concerned in absolute and relative terms. The competent authorities stated that “[i]t is essential to examine whether the import of SMPP subject to investigation increased absolutely or whether they increased relatively compared to domestic production.”¹⁷⁹ The Korean authorities examined imports of SMPP in absolute terms:

IMPORT OF SMPP SUBJECT TO INVESTIGATION¹⁸⁰

(unit: tonnes, thousand dollars, %)

	1993	1994		1995		Jan.-Aug. 1996	
			Increase rate(%)		Increase rate(%)		Increase rate(%)
Quantity	3,217	15,561	384	28,007	80	22,140	16.9
Value	7,037	32,851	366	59,837	82	55,021	40.7

Source : Korea International Trade Association (KITA)

4.441 The Korean authorities noted an absolute increase from 3,217 tonnes in 1993 to 15,561 tonnes in 1994, 28,007 tonnes in 1995 and 22,140 tonnes in 1996 (Jan.-Aug.), reflecting an increased rate of 384 per cent in 1994 from the previous year, 80 per cent in 1995 and 16.9 per cent in the first six months of 1996.

4.442 The Korean authorities then examined imports of SMPP in relative terms:

RELATIVE CHANGE OF IMPORT SHARE IN DOMESTIC DEMAND¹⁸¹

(unit : tonnes)

	1993	1994		1995		Jan.-Jun. 1996	
			Increase rate(%)		Increase rate(%)		Increase rate(%)
Total Demand (A)	2,025,063	2,218,738	9.6	2,303,795	3.8	1,153,964	-2.3
Production of raw milk	1,857,873	1,917,398	3.2	1,998,445	4.2	1,069,224	4.4
Import of SMPP (B)	3,217	15,561	384	28,007	80	16,320	16.9
Market Share of SMPP (B/A, %)	1.6	7.0	-	12.2	-	14.1	-

Source : MAF and KITA

Notes : Market share is computerized by using the figures calculated in terms of imported raw milk.

The table above indicates the relative increase in imports of SMPP was 384 per cent as compared to 3.2 per cent increase in the production of raw milk in 1994, 80 per cent as compared to 4.2 per cent in 1995, and 16.9 per cent as compared to 4.4 per cent in the first half of 1996.

¹⁷⁹ OAI Report at 32.

¹⁸⁰ OAI Report at 32. *See*, also Notification IV.2. Contrary to the EC’s claim that Korea failed to remove the volume of “excluded” products before doing its calculations, Korea refers the Panel to the OAI Report at 7.

¹⁸¹ OAI Report at 35. *See*, also Notification at IV.2 and IV.3.1.

(ii) *Profits and losses*

4.443 The Korean authorities determined that it was not feasible to accurately calculate the income of all 23,000 Korean dairy households, which are, for the most part, small and unsystematic.¹⁸² Because profits and losses of the dairy households were not available¹⁸³, the competent authorities used profit and loss information from the cooperatives' milk processing activities as a surrogate for the profits and losses of the domestic industry covering dairy households and livestock cooperatives. The aggregate ordinary profit of all 14 livestock cooperatives in milk processing activities decreased from 6,720 million Won in 1993, 4,721 million Won in 1994, 209 million Won in 1995 to -17,546 million Won during the first half of 1996, while the ratio of ordinary income (loss) to sales (expenditure) decreased from 1.4 per cent, 0.8 per cent, 0.0 per cent to -5.3 per cent, respectively.¹⁸⁴ As explained by the Korean authorities in the OAI Report:

“[s]ince the livestock cooperatives, which are comprised of dairy households producing raw milk, distribute their profits to their members, the livestock cooperatives' profits and losses are directly linked to the raw milk producers' income.”¹⁸⁵

4.444 The Korean authorities examined whether the livestock cooperatives made sales below manufacturing costs and determined that the sales price of milk powder was higher than the manufacturing costs by 196 Won/kg in 1993. However, the cooperatives incurred losses of 132 Won/kg in 1994 and the negative margin grew larger to 472 Won/kg in 1995 and further to 1,184 Won/kg in the January-to-April period of 1996.¹⁸⁶

PRICE AND PRODUCTION COST OF KOREAN MILK POWDER

(unit: Won/kg)

	1993	1994	1995	1996(1-4)
Sales Price ¹⁸⁷	5,354	5,294	5,388	4,994
Production Cost ¹⁸⁸	5,158	5,426	5,860	6,178
Profit/Loss ¹⁸⁹	196	-132	-472	-1,184

4.445 To complete the analysis of profit and loss of the entire domestic industry, the Korean authorities also examined the profit and loss statements for milk processing companies that produce a majority of milk powder within this sector. Additionally, they reviewed profit and loss data for two livestock cooperatives which also account for a majority of milk powder production within this sector.¹⁹⁰

¹⁸² Notification at IV.3.10.a.

¹⁸³ Using the suggested reference price as a surrogate for the raw milk price, it should also be noted that dairy households experienced declining profit margins during the investigation period.

¹⁸⁴ Notification at IV.3.10.a.

¹⁸⁵ OAI Report at 41. *See*, also Notification at IV.3.10.a. In its response to a question by Korea, the EC states that the price paid by the cooperatives for milk powder is inversely related to the profitability of dairy farmers. Korea submits that where, as in this case, the cooperatives are required to purchase raw milk from dairy farmers at a price that is unprofitable for the farmers (either because the price is below cost or because the payment is in part in the form of milk powder) and convert the raw milk into unsaleable inventory, no such inverse relationship exists.

¹⁸⁶ OAI Report at 54. *See*, also Notification at IV.3.8-9.

¹⁸⁷ OAI Report at 47.

¹⁸⁸ OAI Report at 53

¹⁸⁹ *Id.*

¹⁹⁰ OAI Report at 50. *See*, also Notification at IV.3.10.b. Contrary to the EC's erroneous observations in its First Submission where it states that 'Korea's examination of the profitability of the domestic industry is not in conformity with Article 4.2(a) of the Agreement on Safeguards since it does not examine the whole of an

4.446 The authorities examined sales and gross profit(loss), operating loss, and ordinary loss.¹⁹¹ Non-confidential information regarding this examination included (a) a decreasing trend in the two cooperatives' net turnover from milk powder operations from 11,937 million Won in 1993, 9,533 million Won in 1994, 11,589 million Won in 1995, and to 2,310 million Won during the first four months of 1996¹⁹², (b) a decrease in the turnover from milk powder operations of the milk processing companies from 21,010 million Won in 1994 to 19,750 million Won in 1995¹⁹³, (c) an increase in operating losses from the milk powder operations of the livestock cooperatives from 755 million Won in 1993, 622 million Won in 1994, 1,244 million Won in 1995, and 681 million Won in the first four months of 1996,¹⁹⁴ and (d) an increase in corresponding operating losses sustained by milk processing companies from 680 million Won in 1994 to 1,330 million Won in 1995.¹⁹⁵

4.447 In conclusion, the competent authorities considered the profit and loss of the dairy households by looking at the profit and loss of the livestock cooperatives to which they belong and of which they are shareholders. Because livestock cooperatives are owned by dairy farmers who contribute to the paid-in capital, the health of the dairy households may be considered through the financial position of the livestock cooperatives. Facts set out in the OAI Report indicated that the livestock cooperatives incurred serious losses during the investigation period. Therefore, the OAI found that the depression in domestic prices caused by the imports of cheap SMPP prevented the livestock cooperatives from increasing their sales prices.¹⁹⁶ By the same token, milk processing companies incurred losses because their milk powder was more expensive than SMPP¹⁹⁷.

(iii) *Sales and sales price*

4.448 As the European Communities correctly indicated in their first submission, the competent authorities examined changes in the level of sales based on an examination of consumption information for domestic raw milk. The consumption of domestic raw milk was:

“1,844,463 tons in 1993, 1,947,128 tons in 1994, 1,947,965 tons in 1995, and 984,934 tons in the January-June period of 1996. The consumption increase rate was 5.6 per cent for 1994, 0.0 per cent for 1995, and -2.0 per cent for the January-June period of 1996.”¹⁹⁸

4.449 The Korean authorities also examined prices for the entire domestic industry. Because Korea recommends a reference price for raw milk, while the price for milk powder varies in accordance with changes in supply and demand in the market,¹⁹⁹ the Korean authorities reviewed the price of milk powder. However, it should be noted that any impact of declining domestic milk powder prices adversely affected the entire domestic industry, since raw milk producers own the livestock cooperatives.²⁰⁰ The authorities identified the following trend in nominal prices:²⁰¹

interconnected industry', the Korean authorities carried out a profit and loss analysis covering the entire domestic industry.

¹⁹¹ OAI Report at 50.

¹⁹² Notification at IV.3.10.b.i.

¹⁹³ *Id.*

¹⁹⁴ Notification at IV.3.10.b.ii.

¹⁹⁵ *Id.*

¹⁹⁶ OAI Report at 62.

¹⁹⁷ *Id.*

¹⁹⁸ OAI Report at 38. *See*, also Notification at IV.3.3.

¹⁹⁹ OAI Report at 48. *See*, also Notification at IV.3.7.

²⁰⁰ Korea refers the Panel to the more detailed discussion of prices in the context of causal link below.

²⁰¹ In its Response to a question by Korea, the EC states that “it does not entirely understand what is meant by Korea with the term ‘real price’. The real price of a product is its price adjusted by the rate of inflation which reflects, for example, increases in production costs. In developing countries like Korea, which

CHANGES IN SELLING PRICES OF DOMESTIC MILK POWDER²⁰²
(unit: Won/kg.)

	1993	1994	1995	1996. 1-4
Prices	5,354	5,294	5,388	4,994

Data: Provided by NLCF to the KTC.

Note: According to the Dairy Handbook, whole milk powder price, which stood at 5,100 Won/kg. in 1993 declined to 4,700 Won/kg. in 1994.

4.450 The Korean authorities also examined price data from May to August 1996 and determined based on confidential data that the most recent prices for domestic whole milk powder ranged from 2,900 to 4,500 Won/kg and skimmed milk powder from 3,800 to 4,200 Won/kg.²⁰³ The OAI Report considered and evaluated the decline in prices, but given the confidentiality attached to actual sales prices could only publish the following table:

TREND OF DOMESTIC MILK POWDER PRICES²⁰⁴

	Date	Seller (Cooperative)	Buyer (Firm)	Price (Won/kg.)	Volume (kg.)
Whole Milk Powder	96-8-24	Seoul Milk Producers	Urimil Co.	x,xxx	Xx
	96-7-29	Chongju Milk Producers	Haptong Co.	x,xxx	x,xxx
	96-4-27	Kwangju/Chonnam	Puch'on Co.	x,xxx	x,xxx
	96-7-4	Kwangju/Chonnam	Ugwang Co.	x,xxx	xx,xxx
	96-5-31	Kyongnam Dairy	Sobu Co.	x,xxx	x,xxx
Skimmed Milk Powder	96-7-29	Kyongnam Dairy	Sobu Co.	x,xxx	x,xxx
	96-5-29	Taebaek	Sejin Co.	x,xxx	xx,xxx
	96-8-26	Umsong	Namyang co.	x,xxx	xx,xxx

Data: Provided by NLCF to the KTC.

4.451 In conclusion, the Korean authorities determined that the decline in sales of domestic products would have been much higher and more rapid had the Korean milk powder producers not sold milk powder at below production cost.

4.452 Regarding the suggested reference prices for raw milk Korea stated that the NLCF recognizes the suggested reference price for raw milk established by the Government of Korea. This scheme in no way guarantees the Korean dairy farmer a profit²⁰⁵. Indeed, in certain years, the price suggested by the Government of Korea was lower than the average production cost of the Korean dairy farmer²⁰⁶.

have annual inflation rates of several percent, what really matters is the trend of the real price, rather than its nominal price. Real price of domestic milk powder declined substantially during the investigation period.

²⁰² OAI Report at 48. See, also Notification at IV.3.7 (including the price comparison table).

²⁰³ OAI Report at 48.

²⁰⁴ *Id.*

²⁰⁵ See Notification Pursuant to Article 12.1.(C) of the Agreement on Safeguards, G/SG/N/10/KOR/1/Suppl. 1, (1 April 1997), Paragraph V.2.4. See also EC's First Submission, Exhibit EC-10.

²⁰⁶ It is important to note that the prices suggested by the Government of Korea, while slowly increasing, do not fully reflect the increase in the prices within Korea. Therefore, the real price equivalent has in

Further, in times of difficulty, it is normal for the livestock cooperatives to pay dairy farmers partially in kind. This usually takes the form of 70-80 per cent cash and up to 20-30 per cent milk powder²⁰⁷.

4.453 Korea considers that the EC's statement that "producers are guaranteed a very high price for their raw milk" is misleading. The price suggested by the Government of Korea, particularly when compared to the production cost, is not very high. Furthermore, the Korean government does not impose a guaranteed price, but only provides a suggested reference price to facilitate a fair transaction between individual dairy farmers and large users of raw milk, such as processing companies. This price is forecasted by the government taking into account inflation and production costs. It does not necessarily result in a price that covers production costs, which was the case in 1996.

4.454 The Korean government does not set a guaranteed price, but only provides a suggested reference price. In addition, dairy farmers may sell a virtually unlimited quantity of their production, but when the market for milk powder declines and inventories rise, as was the case during the investigation period, cooperatives often pay for raw milk in a combination of cash and milk powder²⁰⁸.

(iv) *Employment*

4.455 The Korean authorities found that the number of dairy households declined during the investigation period as seen in the following table:

fact declined. For the period 1982-1996, farmers, including dairy households saw an increase of 81.1 per cent in the cost of their inputs (as a result of inflation), while the government suggested price for raw milk only increased by 37.7 per cent. See Korean National Statistical Office, *Major Statistics of the Korean Economy*, 1998.3, p.151.

²⁰⁷ See, for example, the *Livestock Farming Newspaper* dated 30 April 1996 (see Exhibit Korea-1) noted that:

"Financial difficulties facing small-scale dairy cooperatives have been aggravated due to the increased milk stockpile, so that most of them are paying partly in milk powder for purchases of raw milk", said an official of the NLCF.

He added 'For example, recently Kyungnam Dairy Cooperative and Pusan-Kyungnam Milk Cooperative are making payments in kind for up to 20 per cent of their purchases of raw milk. If the milk powder stockpile continues to increase, dairy cooperatives will have to pay in milk powder and not in cash.'

In addition, he urged the Government to establish policy measures for reducing the current huge milk powder stocks."

²⁰⁸ The percentage increase in the membership of the NLCF increased during the investigation period. This increase was a direct result of the increase in imports of SMPP, since as these replaced Korean raw milk, farmers that had sold raw milk directly to processing companies were now faced with stiff competition from SMPP. In order to get rid of the raw milk, they had to sell to cooperatives, and in order to sell to cooperatives, they had to be members of those cooperatives.

CHANGES IN THE NUMBER OF DAIRY HOUSEHOLDS²⁰⁹

	1993	1994		1995		1996. 1-6	
			Increase Rate (%)		Increase Rate (%)		Increase Rate (%)
Number of Dairy Households	28,219	25,667	-9.4	23,519	-8.4	22,725	-3.9

4.456 Contrary to the EC claims, the reduction in the number of dairy households is not a result of any Korean Government programmes. Indeed, the dairy households were provided with loans from the Livestock Development Fund to maintain their competitiveness.²¹⁰

4.457 With respect to domestic milk powder production, the Korean authorities stated:

“As the milk powder production became automated, the number of workers employed in milk powder production decreased over the years. Currently, very few people are fully employed for the exclusive purpose of engaging in milk powder production. Workers producing other dairy products are used temporarily, when needs arise, to engage in milk powder production. Accordingly, employment and wage are insignificant factors in operating milk powder business.”²¹¹

4.458 Therefore, because unemployment increased in the raw milk sector and was an insignificant factor in the milk powder sector, the Korean authorities considered that employment declined during the period of investigation for the whole domestic industry.²¹²

(v) *Inventory*

4.459 For the domestic industry as a whole, the Korean authorities examined changes in the level of inventory. The authorities stated:

“The amount of domestic milk powder in inventory was 4,509 tons at the end of 1993, 1,517 tons at the end of 1994, 6,565 tons at the end of 1995, and 14,994 tons at the end of June 1996. As such, the inventory rate of raw milk which slightly decreased from 2.4 per cent in 1993 to 0.8 per cent in 1994 increased to 3.3 per cent in 1995 and further to 13.0 per cent in the January-June period of 1996. The total value of raw milk inventory as of June 1996 is 92,633,000,000 Won.”²¹³

²⁰⁹ OAI Report at 40. See, also Notification at IV.3.6.

²¹⁰ Loans were not provided to consolidate or rationalize the industry since these loans were not provided to encourage dairy farmers to relocate and find other means of livelihood. The loans were paid exclusively for dairy business purposes and the farmers had to repay the outstanding loans amounts once they left the dairy industry. The EC's reference to the Dairy Industry Plan which sought to reduce the size of the Korean dairy industry by 5.9 per cent is irrelevant since the Plan only took effect in August 1997 and the investigation of the dairy industry in this case ended in October 1996.

²¹¹ OAI Report at 49. See, also Notification at IV.3.6.

²¹² Contrary to the EC's contentions, the Korean authorities did investigate employment for the whole domestic industry and considered that declining dairy farming households properly represented declining employment in the Korean dairy industry. In response to a question by Korea, the EC tells Korea how to interpret its data on dairy households and essentially refers to any examination of a factor that differs from how the EC would have examined such factor as the failure to examine the factor at all. Korea considers that the Panel should not evaluate this case based on the EC's view of how the EC itself would have conducted the investigation.

²¹³ OAI Report at 38. See, also Notification at IV.3.5.

4.460 Increase of milk powder inventory is clear evidence of serious injury in this case not only to the milk powder industry, but also to the entire domestic industry. As explained above, raw milk that is not consumed has to be converted into, *inter alia*, milk powder. Conversion only increases supply and inventory of milk powder. Therefore, increased milk powder inventory not only indicates oversupply of milk powder but also demonstrates displacement of domestic raw milk by cheap imported SMPP, thus signifying serious injury to the entire domestic industry.

4.461 The Korean authorities then presented the supply and demand for raw milk (including milk powder) as follows:

SUPPLY AND DEMAND OF RAW MILK (INCLUDING MILK POWDER)²¹⁴

	1993	1994		1995		1996. 1-6	
			Increase Rate (%)		Increase Rate (%)		Increase Rate(%)
Total Demand (A)	2,025,063	2,218,738	9.6	2,303,795	3.8	1,153,964	-2.3
Domestic Raw Milk Consumed (B)	1,844,463	1,947,128	5.6	1,947,965	0.0	984,934	-2.0
Production (D)	1,857,873	1,917,398	3.2	1,998,445	4.2	1,069,224	4.4
Inventory (E) (in terms of Raw Milk)	4,509 (45,090)	1,517 (15,170)	-65.4	6,565 (65,650)	332.8	14,994 (149,940)	342.7
Inventory Rate (E/A, %)	2.4	0.8	-	3.3	-	13.0	-
Domestic Raw Milk's Market Share (B/A, %)	91.1	87.8	-	84.6	-	85.4	-

Data : MAF

Notes : 1) Total demand reflects demand for raw milk, imported milk powder, SMPP, and milk powder in stock.
2) Inventory, inventory rate and the consumption amount are calculated based on the amount of milk powder calculated in terms of the conversion ratio when converting milk powder to raw milk.

4.462 The increased inventory incurred a significant amount of costs.²¹⁵ Even if depreciation is disregarded, the cost of inventory amounted to 17.3 billion Won (approximately US\$21.6 million) during the investigation period. The inventory costs during the first six months of 1996 alone were 5.8 billion Won (approximately US\$7.3 million), and the domestic producers were compelled to incur the full inventory cost because, unlike the European Communities, Korea does not subsidize the inventory costs of milk powder.

(vi) *Investment*

4.463 The Korean authorities evaluated investment in the raw milk and milk powder sectors of the domestic industry. The only investment information for the raw milk sector was based on the amount allocated to dairy farmers by the Dairy Cow Competitiveness Enhancement Programme.²¹⁶ This project was necessary because of the inability of the raw milk sector to attract investment.²¹⁷ The

²¹⁴ OAI Report at 39.

²¹⁵ Notification at IV.3.4

²¹⁶ OAI Report at 40.

²¹⁷ *Id.*

authorities also evaluated investment in the livestock cooperatives as an indicator of injury to the whole industry, given the ownership of the cooperatives by the raw milk producers.²¹⁸ The authorities' evaluation showed, *inter alia*, that total investment, which includes research and development, declined significantly over the investigation period and that there was virtually no investment made in the milk powder industry for purposes of expanding production facilities.²¹⁹

(vii) *Share of the domestic market taken by SMPP*

4.464 The Korean authorities examined the share of the total domestic market (consisting of domestic raw milk, domestic milk powder, imported milk powder, and imported SMPP), and found that the share of the domestic market taken by SMPP increased by 12.5 per cent during the investigation period.²²⁰

4.465 Korea would like to clarify one point that may have caused confusion in interpreting the actual market share of SMPP in the Korean domestic market. According to the figures set out on page 58 of the OAI Report, the market share of SMPP increased from 1.6 per cent in 1993 to 7 per cent in 1994, 12.2 per cent in 1995 and 14.1 per cent in the first six months of 1996. This represents a net increase in the market share of 12.5 per cent during the investigation period. Because the product under investigation is only SMPP, the table at page 58 of the OAI Report represents an accurate measure of SMPP's share of the total market. While the market share of SMPP increased from 1.6 per cent to 14.1 per cent during the investigation period, the market share of imported milk powder and SMPP increased by 5.7 per cent²²¹ (although the market share of SMPP increased by 12.5 per cent the market share of imported milk powder decreased by 6.8 per cent). This is reflected in the Table on page 17 of the OAI Report. However, as the product under investigation is SMPP, only the market share of SMPP must be emphasized, not the combined market share of imported milk powder and SMPP.

(viii) *Capacity utilization*

4.466 The Korean authorities examined capacity utilization for both the raw milk and milk powder sectors of the domestic industry in the interim injury investigation report. In both sectors, capacity utilization was discounted in determining serious injury because it was considered of limited relevance, *i.e.*, it was not "of an objective and quantifiable nature having a bearing on the state of that industry", and was therefore omitted from the final OAI Report. For the raw milk sector, "[c]apacity utilization was always 100 per cent since raw milk is produced by dairy cows, which cannot be left idle like some other forms of production."²²²

²¹⁸ OAI Report at 49.

²¹⁹ *Id.* Contrary to the EC's Oral Statement, page 49 of the OAI Report shows that consideration of investment was not "new and remarkable".

²²⁰ OAI Report at 58. Korea agrees with the United States comment in its third party oral submission that "Article 4.2(a) contains no numerical test or threshold requirement for market penetration, explicit or implied. Instead, Article 4.2(a) requires that the competent authority evaluate 'all relevant factors,' of which the percentage share of the domestic market is only one.". Korea cited the *United States Wheat Gluten* case in its first submission to highlight the fact that a low market penetration rate does not preclude competent authorities from making an affirmative serious injury finding based on all relevant factors and such a low rate may even be significant based on "the nature of the product and the nature of competition in the market.

²²¹ The EC simply alleges, whether erroneously or intentionally, that a decline of 5.7 per cent points (in market share) cannot be considered supportive of a finding of serious injury. The allegation is totally wrong in that the number of 5.7 per cent refers to the imported milk powder and SMPP combined, not the product subject to injury investigation, namely the SMPP.

²²² Notification at IV.3.2. See, also OAI Report at 36 ("The collection of raw milk from dairy farmers does not change simply because there is a change in demand."). The EC states that the Korean authorities' examination of capacity utilization was, in its view, not "serious" because a Korean dairy farmer with 100 cows

4.467 For the milk powder sector, the authorities examined capacity utilization in their interim report²²³ but determined that this factor had limited relevance because:

“Raw milk, milk powder and SMPP can be used as raw materials to produce fermented milk, flavoured milk, ice cream and other marketable milk products. An increase in SMPP affects the amount of domestic milk powder consumed and also impacts the milk powder inventories and prices. An increase in the import of SMPP also affects the amount of raw milk consumed which in turn affects the milk powder inventories and prices.”²²⁴

4.468 In other words, “the absolute increase of [SMPP] led to a drastic increase in the surplus of raw milk, all of which was then converted into milk powder.”²²⁵ The necessity of converting excess raw milk to milk powder means that high capacity utilization rates do not necessarily indicate an absence of injury, especially when the milk powder remains as unsold inventory. Therefore, capacity utilization was considered to have only limited relevance as an injury factor.

(ix) *Production and productivity*

4.469 The Korean authorities examined production information for the whole domestic industry, stating that:

“[t]he production amount of domestic raw milk [including milk powder] was 1,857,873 tons in 1993, 1,917,398 tons in 1994, 1,998,445 tons in 1995, and 1,069,224 tons in the January-to-June period of 1996. The increase rate was 3.2 per cent for 1994, 4.2 per cent for 1995, and 4.4 per cent for the January-June period of 1996.”²²⁶

4.470 The authorities reasoned that an increase in production in the domestic industry does not necessarily indicate the existence or absence of injury. As they stated:

“The production of raw milk cannot be temporarily reduced without resorting to the slaughter of dairy cows. Rather than reducing the size of their herds - the average size of which is quite small - Korean dairy farmers continue normal levels of raw milk production even during periods of weak demand, since excess raw milk is supplied to the livestock cooperatives for conversion into milk powder.”²²⁷

4.471 Milk processing companies decreased their purchases of raw milk from dairy households, while increasing their purchase of cheaper SMPP. As milk processing companies curtailed their purchases of domestic raw milk, Korean dairy households were forced to turn to the livestock cooperatives, which were obliged to collect the unsold raw milk produced by their member dairy households. In short, the absolute increase of SMPP led to a drastic increase in the surplus of raw milk, all of which was then converted into milk powder.²²⁸

“can choose to only have 80, if economic conditions require this.” Korea does not consider that the slaughtering of 20 per cent of Korea’s dairy cows is a viable remedy to the serious injury caused by increased imports of SMPP from the EC.

²²³ See, Exhibit Korea-5.

²²⁴ OAI Report at 37.

²²⁵ Notification at IV.3.1. Contrary to the EC’s contention, the Korean authorities examined the relevance of capacity utilization during its investigation

²²⁶ OAI Report at 38. See, also Notification at IV.3.1.

²²⁷ Notification at IV.3.1.

²²⁸ Notification at IV.3.1. See, also OAI Report at 36-38. In its First Submission, the EC argues that the Korean competent authorities’ reasoning is, in its view, not credible. The EC contends that technology (feed, additives, etc.) exists to vary production and 10-12 per cent of dairy cows are retired or slaughtered every

4.472 As to productivity, given the nature of the industry, the authorities evaluated this criterion in terms of production for the whole domestic industry.²²⁹ Productivity alone was considered of limited relevance because the increase of “productivity” in the raw milk sector (*i.e.*, increased production of raw milk despite the declining number of dairy households) was attributable to advances in technology²³⁰ and because the increased “productivity” in the milk powder sector (*i.e.*, increased production compared to stable factors of production) was attributable to the fact that increased amounts of raw milk were required to be converted into milk powder, which remained as unsold inventory.²³¹ In the dairy industry, increased productivity in the milk powder sector, in fact, suggests injury to the whole domestic industry.

4.473 Contrary to the EC claims, the authorities examined productivity for the whole domestic industry. Moreover, the authorities did not “replace the examination” of one factor with another. The authorities examined productivity and determined that it was not strictly relevant (*i.e.*, not of an objective and quantifiable nature having a bearing on the situation of that industry).

4.474 Thus, the Korean authorities considered production and properly concluded that changes in productivity were not appropriate indicators of serious injury because it was not possible to curtail production of raw milk without slaughtering cows, and so any surplus had to be converted, *inter alia*, into milk powder.

(g) Additional arguments by the European Communities made at the second meeting of the Panel with the parties

4.475 At the second meeting of the panel with the parties, the **European Communities** further advanced their arguments under Article 4.2(a) as follows:

(i) Profitability

4.476 The **European Communities** reiterated their view that Korea did not investigate the profitability of dairy farmers during its investigation, only the profitability of the milk powder producers.

4.477 In reply to the EC complaints during the consultations, Korea claimed both then and subsequently in its Notification of 24 March 1997²³², that *it could not carry out* a profitability analysis for the dairy farmers because they were too numerous. However, in its first written submission it produced for the first time a comparison of prices and production costs based on a survey of 150 dairy

year. Through these means, the EC considers that dairy farms can reduce production whenever necessary. Korea considers that the EC is again simply conducting its own unsubstantiated investigation of Korea’s dairy industry. The EC ignores the fact that in Korea’s relatively underdeveloped dairy industry composed of approximately 23,000 individual dairy households, any potential technological advancement is used to increase production, and dairy cows cannot be slaughtered “when necessary” in response to increased SMPP imports. Moreover, although it is feasible to reduce the production capacity of cows through reduction of feed, the EC fails to point out that once a cow’s output has been reduced in this way, it is almost impossible to increase it again.

²²⁹ See, OAI Report at 38; Notification at IV.3.2.

²³⁰ Technological advancements include, *inter alia*, construction of open sheds equipped with fan ventilation systems to keep temperatures at an optimum level, use of milking machines to collect milk, including installation of pipelines to collect milk, and use of total mixed ration (TMR) system to provide adequate nutrition to cows. Dairy cows are very sensitive to temperature and their production varies according to their surrounding temperature. At a temperature ranging between 4 and 27 degrees Celsius, dairy cows produce an optimum amount of milk, approximately 25 kg. If the temperature increase to 30 degrees or above, output is reduced to 80 per cent. At 40 degrees or above, it falls to 40 per cent. See, *United States Feed Grains Council, Dairy Feeding Guide* at 117.

²³¹ *Id.*

²³² See, paragraph 3.10(a) at page 12.

farmers which showed high profits in 1994 declining to a small loss in 1996 because a steadily increasing reference price did not keep up with the increase in production costs. Furthermore Korea admitted that production costs are calculated and published on an annual basis (in the 'Annual Report of Livestock Production Cost Survey') and that the "suggested reference price" is set with the aim of covering the costs of production.

4.478 In the EC view this proves that Korea did have access to the information and therefore could have investigated profitability of dairy farmers.

4.479 The European Communities do not accept Korea's reasoning, that the livestock co-operatives' profits and losses are directly linked to the raw milk producers' income because the dairy farms own the cooperatives. In fact, the livestock cooperatives' profits have an *inversely proportional relationship* to the income of the dairy farmers. If the price of raw milk increases, dairy farmers make more profit and milk powder producers and livestock cooperatives make less.

4.480 Korea also provided data showing the manufacturing cost of milk powder and the percentage represented by raw milk. This allows calculation of the average price obtained for this raw milk by the dairy farmers. This calculation shows that dairy farmers were obtaining more than the suggested price and that this positive margin was increasing over the period a healthy situation for dairy farmers. Of course the figures can be adjusted to take into account other costs but, they will still show a margin over the suggested price.

4.481 Admittedly these deduced prices only relate to sales for milk powder production. But Korea itself insists that only surplus milk which cannot be disposed of in sales of fresh milk is sold for milk powder. Accordingly, the dairy farms must have been obtaining even better prices for their other milk sales.

4.482 The EC table on the profit margin of dairy farmers selling raw milk for milk powder shows the profit levels of the dairy farms for sales of raw milk for milk powder, which would tend to represent the lowest price received for raw milk. Rather than a profit situation degenerating into loss, as Korea has claimed in its own figures, this Table shows precisely the opposite, that dairy farms were becoming increasingly profitable during the investigation period.

4.483 From another perspective the tables on selling price of raw milk for milk powder, above at paragraph 4.426, production and profit margin of dairy farmers selling raw milk for milk powder, show that the steadily increasing profit levels obtained by the dairy farms were squeezing the margins of the milk powder companies and reducing their profitability.

4.484 By only looking at the profitability of the small part of the domestic industry that was losing money to the larger part which was profiting at its expense, Korea has failed to properly examine profitability and its injury finding cannot be considered in conformity with the Agreement on Safeguards.

(ii) *Employment*

4.485 In the EC view the number of dairy farms cannot be taken as a measure of employment as Korea has done. This is especially so in view of the fact that the number of cows per farm and productivity were increasing – *i.e.*, the industry was consolidating. As the European Communities pointed out this is a perfectly healthy development.

4.486 Korea has not responded to this objection and persists in confusing the number of dairy households (that is farms) with employment levels in dairy farms.

4.487 In the EC view, therefore Korea has not properly examined employment.

(iii) *Investment*

4.488 Investment was not identified as an injury factor in Korea's 24 March Notification but the EC comments on it because it features in Korea's submissions to the Panel.

4.489 There are numerous inadequacies in this attempt to justify a finding of injury *ex post facto* on the basis of investment. For example, Korea states that the losses suffered by cooperatives led to their inability to attract investment and this led Korea to provide financial assistance through the Livestock Development Fund. However, Korea later states that "the only investment information for the raw milk sector was based on the amount allocated to dairy farmers by the Dairy Cow Competitiveness Enhancement Programme. (footnote omitted) This project was necessary because of the inability of the raw milk sector to attract investment." In the EC view the economic data relied upon by Korea seems to change from one submission to the next.

(iv) *Livestock cooperatives' volume of raw milk collected*

4.490 Korea claims that dairy farms were forced to turn to the livestock cooperatives, which were obliged to collect the unsold raw milk. Membership of NLCF increased from 85 to 99 per cent over the investigation period.

4.491 In fact, analysis of the figures provided by Korea shows that the increased purchases of raw milk by the livestock cooperatives were due primarily to increases in their membership, and that the proportion of their members milk which they actually collected declined steadily between 1993 and 1996, as shown in the table below.

	1993	1994	1995	1996
Proportion of dairy farmers who are NLCF members (A)	85.5%	91.2%	93.3%	99.9%
Proportion of raw milk production collected by NLCF (B)	41.36%	42.80%	44.30%	45.30%
Proportion of NLCF members' milk collected by NLCF (= B÷A)	48.4%	46.9%	47.5%	45.3%

The percentage of milk collected by cooperatives is calculated as a percentage of total milk production and increases from 41.36 per cent to 45.3 per cent over the reference period. This is in fact a lower proportionate increase than the increase of the Membership and therefore demonstrates that the proportion of milk collected by the cooperatives was declining. Consequently there cannot have been any change in the ability of dairy farms to dispose of their milk to other purchasers at prices well above the suggested price. Again in the EC view this does not suggest injury but rather the contrary.

(v) *Production and productivity*

4.492 The European Communities refer to Korea's second written submission where Korea states that

"Productivity alone was considered of limited relevance because the increase of "productivity" in the raw milk sector (*i.e.*, increased production of raw milk despite the declining number of dairy households) was attributable to advances in technology and because the increased "productivity" in the milk powder sector (*i.e.*, increased production compared to stable factors of production) was attributable to the fact that increased

amounts of raw milk were required to be converted into milk powder, which remained as unsold inventory. In the dairy industry, increased productivity in the milk powder sector, in fact, suggests injury to the whole domestic industry.”

4.493 In the EC view this paragraph shows injury (if such it is) caused by one part of the industry (the raw milk producers who were increasing production) to another (the cooperatives who were obliged to buy milk at fixed prices).

4.494 This injury (if such it is) is not caused by imports but technological advances, according to Korea.

4.495 This technological advances increase the production and profitability of dairy farms and contributes to producing a surplus of milk at a time of declining consumption at least in 1995-96. This in turn is what has led to an increase in milk powder inventories.

4.496 The effect of increasing production of raw milk colliding with its decreasing consumption and a stable level of imports of SMPP has been graphically illustrated by the European Communities. A remarkable coincidence is evident between the decrease in consumption starting in November 1995 and the increase in stocks.

(vi) *Price relationships*

4.497 A fundamental criticism of Korea's determination is that it has not conducted an investigation into the prices of the imported products and their possible effect on the domestic industry.

4.498 Korea claims that it did examine prices and “undercutting” and refers to page 62 of the OAI Report (English version). The figures presented there show SMPP at half the price, tonne for tonne, of domestic milk powder. But, In the EC view this is like comparing the prices of butter and margarine. It is clear that the characteristics and uses of a product like the domestic one, pure milk powder, cannot be the same as that of a product like the imported one, SMPP, which is only a mixture containing milk powder. Indeed Korea asserts that “most Korean users of milk powders state ... that the domestic products are of higher quality than the imported SMPP.” Not only are the characteristics of the products different but so also are their uses. Korea admits that “SMPP was an effective substitute for domestic raw milk and milk powder in most industrial uses”, but not in all.

4.499 These differences clearly have an impact on pricing decisions for both products. However Korea made no analysis of the extent to which substitution may take place or what the proper price relationship should be.

4.500 It is accepted that the products compete but so for example do Whisky and Sochu. That does not make them of equal value.

(h) Additional arguments by Korea made at the second meeting of the Panel with the parties

4.501 At the second meeting of the panel with the parties, **Korea** further advanced its arguments under Article 4.2(a) as follows:

4.502 Korea asserted that the European Communities raised two fundamentally inconsistent arguments:

- (a) that the OAI Report is not the appropriate source of relevant information for review of Korea's obligation, yet the European Communities seek to make arguments in relation to Korea's failure to comply with Articles 2 and 4; and

- (b) that this report “has only been made recently available”.

If the OAI Report is not a relevant source of material for its review, why does the European Communities complain that they have only just received that Report (which Korea maintains is untrue), and what relevance do arguments under Articles 2 and 4 relating to establishment of the increase in imports, serious injury and causal link between the two have if the investigation undertaken by the Korean authorities is not at issue?

4.503 Regarding the EC specific arguments on Article 4.2(a) and (b), Korea notes the perils inherent in permitting a Member to substitute its own analysis and conclusions for that already undertaken by the investigating authority of another Member. Such investigations require an analysis of complicated factual, legal and economic issues, and these are simply not amenable to second-guessing by any third party, least of all a complainant.

4.504 In Korea's view the European Communities build a major part of their Rebuttal Submission around their calculation of the price of raw milk from the price of milk powder produced by the NLCF. This analysis calls for a number of comments:

- (a) First and most importantly, there is no reliable way of arriving at an accurate or appropriate transaction price for raw milk in Korea, since there are more than 20,000 vendors. As noted at page 41 of the OAI, Section IV.3.10a of the Notification, this is why the OAI did not undertake such a calculation. Korea is not seeking to arrive at a more accurate selling price for raw milk than that arrived at by the European Communities, but is simply seeking to show that it is not possible to arrive at an accurate figure, and any attempt will not be a basis for a rational analysis;
- (b) However the European Communities make their calculations, the reality is that it is not feasible to produce “actual raw milk sales prices”. Such prices are only found in the individual contracts between the dairy farmers and their purchasers, and are not disclosed to third parties. It strains credibility for the European Communities to assert that “the Korean Government did in fact have available to it information on raw milk transaction prices, at least on an overall basis”;
- (c) Even if the Panel considers that it is possible to adopt the broad methodology attempted by the European Communities, which Korea does not, then looking specifically at the EC table on the selling price of raw milk for milk powder production, see paragraph 4.420, Korea notes that the European Communities have assumed, incorrectly, that the NLCF's “raw material cost” is identical to the cost of raw milk. The NLCF's “raw material” cost includes several elements of cost which were incurred after the purchase of raw milk from the farmer, and so cannot form part of the farmers' selling price. In order to begin to work back from the NLCF's manufacturing cost to the price of raw milk paid to the farmer, these subsequent costs would need to be deducted. The two most significant costs are collection (including transportation from the farm to the NLCF's production facility), and the cost of packaging the finished milk powder. In 1993²³³, for example, the NLCF reported that its collection cost (including transportation) of raw milk from the farm to its milk powder production facilities was 40.6 Won/kg. Further, in the same year, the NLCF packaging cost was 5.9 Won/kg. In order to eliminate these two elements from the “raw material cost” of the NLCF, it is necessary to deduct approximately a further 10.9 per cent from the “raw material cost”. After such deduction, and on the basis of the EC methodology (which Korea reiterates is not an appropriate method to derive

²³³ Korea understands that this method would need to be applied to all other years.

the selling price of raw milk), the prices paid by the NLCF to farmers for their raw milk often did not exceed the MAF suggested reference price; and

- (d) Finally, farmers occasionally are paid by the NLCF in milk powder as opposed to cash. While such payments in kind reduce the farmers' feed costs, they also affect their cash flow derived from the selling price, and so this also needs to be taken into account in assessing the validity of the EC calculations.

4.505 Further, the errors in methodology noted above in relation to calculation of price are then brought forward into the discussion on profitability, where further assumptions Korea views as spurious are added into the process. As Korea has consistently pointed out, there is no reliable data available on the profitability of Korean dairy farmers. The information provided in Korea's First Submission, and seized upon by the European Communities as some form of *ex post facto* reasoning, was only provided to rebut the EC claims about "guaranteed profits" for dairy households. It cannot be construed as a basis for calculating the profitability of Korean dairy farmers. In quoting Korea's answers to the Panel's questions, and in its suggestion that either Korea engaged in *ex post facto* analysis, or failed to use all available evidence, the European Communities appear to have forgotten or omitted to refer to Korea's answers to the EC questions, which also deal with profitability where Korea clearly and unequivocally states that:

"Korea provided the information on production costs to rebut the EC characterization of the suggested reference price as a price 'under which producers are guaranteed a very high price for their raw milk, irrespective of how much they produce and irrespective of domestic demand'."

4.506 The European Communities assert that they understand the data better than the Korean authorities', arguing that "MAF has knowledge of production costs each year." This is untrue. Through the NLCF, the MAF has access to an annual survey of 150 dairy farmers' production costs. However, this is not a comprehensive data series, and certainly not one that the Korean authorities felt they could use in investigating serious injury caused by imports of SMPP. Korea wonders whether, had it used this sample of 150 dairy farms, the European Communities would now be arguing that 150 farms was unrepresentative.

4.507 Further on profitability, the European Communities assert that "this increase in price of raw milk for milk powder production must be due to a shortage of supply of the raw material." Korea notes:

- (a) that inflation, a common phenomenon in a number of countries, including in EU Member States caused increases in actual price. Even if the nominal price of raw milk increased, its real price adjusted by the overall inflation rate might have fallen, reflecting excess supply of raw milk as a result of the increase in imports of SMPP; and
- (b) milk powder inventory levels never fell below 1.5 months of supply, and were usually much higher.

Therefore, in Korea's view the EC conclusion is entirely inaccurate.

4.508 Finally, on profitability, the European Communities appear to argue that the milk powder producers could have reduced or eliminated the serious injury by reducing their raw milk purchase price. While, this sounds easy, it would have involved increasing the serious injury to Korean dairy farmers, and Korea finds it unacceptable to be offered advice on operation of free markets in dairy products from the regulator of one of the most protected dairy markets on earth.

4.509 The European Communities attempt to show that the suggested reference price for raw milk in Korea is more than a mere suggestion, and cites various examples. As Korea has consistently stated the Government price for raw milk is a suggested reference price and is not binding upon any parties. The European Communities cite Article 13 of the Dairy Industry Promotion Act. This merely establishes the framework in which the suggested reference price can be established. It does not provide any compulsion or impose any sanction on any party that fails to follow such a suggested reference price. Therefore, while the DIPA establishes that a suggested reference price can be set, dairy farmers and milk processing companies remain free at all times to establish their own prices at which they buy and sell raw milk.

4.510 In Korea's view the European Communities seek to re-investigate the issue of milk powder stocks. The European Communities graph on milk powder inventories,²³⁴ is based on three erroneous arguments:

- (a) Although the milk powder stocks increased abruptly during November 1995 to December 1995, the increase since January 1996 reflected other factors including the effects of increased imports of cheap SMPP;
- (b) actual consumption of milk returned to around the historic three year average as from early 1996;
- (c) the statistical and econometric models used by the OAI showed that the effect of the "milk quality" controversy disappeared as from January 1996. Use of the econometric causality tests showed that the import of cheap SMPP was the cause of the increase in milk powder inventory during the entire investigation period.

4.511 During the investigation, the OAI concluded that, although the "milk quality" controversy had an impact on milk powder inventory for a few months, it was the import of cheap SMPP that caused the increase in inventory during the investigation period.

4.512 In Korea's view, the European Communities purport to understand the status of loans to dairy farmers better than the Korean Government. Korea reiterates that during the course of the investigation period "virtually all" farms received the loan. Korea provided information on the loans provided to dairy farmers during the period of investigation. During this period, the Livestock Development Fund made almost 72,000 individual loans to 28,000 dairy households. The recipients of loans in one year do not necessarily need or apply for a loan in subsequent years. Therefore, while there was no year in which loans were made to all 28,000 households, during the period of investigation, loans were made to "virtually all" households. Further, loans were not given to dairy farms for the purpose of leaving the dairy industry, but to virtually all dairy households for the purpose of improving their competitiveness, thus ensuring they have an option to remain in the Korean dairy industry.

4.513 The European Communities again seek to fulfil the role of investigating authority by arguing that Korea "failed to tackle [employment] in an adequate manner." As Korea has noted repeatedly, data on changes in the employment of individuals in the Korean dairy industry is simply not available, and so the Korean authorities used changes in the number of dairy households as a surrogate. The EC suggested analytical framework is simply not applicable to the Korean dairy industry. The framework, while possibly appropriate for a large-scale dairy farm in the Netherlands or Denmark, ignores the fact that Korean dairy farms are on the whole small scale family businesses, and represent one part of the economic activity of some members of that family. It is not possible to determine how much time each person spends working on that business, and what proportion of that time is devoted

²³⁴ Exhibit EC-26

to dairy production, and therefore Korea believes that the EC arguments do nothing to prove that Korea failed to comply with its obligations under Article 4.

4.514 Korea understands the European Communities to be arguing that, in addition to the comparison of any quality differences between milk powder and SMPP in establishing “like” or “directly competitive product”, the Korean authorities were also required to take any differences in quality into account in assessing price undercutting. Korea notes that the Korean authorities took the quality differences into account in deciding that milk powder and SMPP were directly competitive, which the European Communities appear not to dispute. Had Korea found that the products were not directly competitive, no further investigation would have taken place.

4.515 During the course of the second meeting of the parties, Korea provided two rebuttals to the inferences drawn by the European Communities from the table in paragraph 4.491 relating to the volume of raw milk collected by livestock cooperatives. First, the figures provided cannot be used to provide any reliable conclusion, since the figure of 45.3 per cent provided for in the second row for 1996 is a half-year figure, whereas all other figures provided are full year figures. Second, even if the figures could provide a reliable basis for the analysis proposed by the European Communities, they do not reflect the EC conclusion. The proportion of NLCF members milk collected by the NLCF does not “decline steadily between 1993 and 1996”, since the figures for 1995 show an increase over 1994.

G. CLAIM UNDER ARTICLE 4.2(b) OF THE AGREEMENT ON SAFEGUARDS

(a) **Claim by the European Communities**

4.516 The **European Communities** claim that Korea violated Article 4.2(b) of the Agreement on Safeguards because it failed to show the existence of a causal link between the increased imports and the serious injury to the domestic industry. The following are the EC arguments in support of this claim:

(i) *The inadequacies of Korea’s analysis under the first sentence of Article 4.2(b) of the Agreement on Safeguards*

4.517 In the EC view, Korea’s attempted demonstration of causal link was as follows:

- (a) It described the rising market share of SMPP out of total domestic consumption (domestic raw milk (including milk powder), imported milk powder, and SMPP) and the even more rapidly rising market share when compared with domestic and imported milk powder and SMPP. (Paragraph V.1.1 of the 1 April 1997 Notification).
- (b) It recalled the stable level of prices for imported SMPP and the allegedly falling prices for domestic milk powder using the same figures as in Paragraph IV.3.7 of the Notification (which are discussed in Section C.3(c)(ix) above) and claimed that as the share of imported products in total consumption increased, the sales price of domestic milk powder dropped and that therefore increased imports of the products subject to investigation caused the price of domestic milk powder to drop. (Paragraph V.1.2 of the 1 April 1997 Notification).
- (c) It next described the slow increase in the share of livestock co-operatives’ raw milk collection in Korea increased (from 40.56 per cent in 1990 to 41.14 per cent in 1991, 40.19 per cent in 1992, 41.36 per cent in 1993, 42.80 per cent in 1994, 44.30 per cent in 1995, and 45.30 per cent for the first four months of 1996) and alleged that this was because milk processing companies reduced purchases of domestic raw milk and purchased more imported products. It concluded that increased imports of the products subject to investigation had an adverse effect on the “white market milk” sector.

- (d) It finally alleged that the price difference between the imported and domestic products forced domestic producers to decrease their price to the point of sales below cost, and to stockpile excess inventory of unsold milk powder. For good measure it alleges that increasing competition from imported products caused the number of dairy farmers to decrease.

(a) *The rising market share of SMPP*

4.518 It is true that the market share of SMPP as measured by Korea was rising. The figures given are however, in the EC view misleading because the total production used to calculate market share (the denominator of the fraction in the calculation) included in each case imported milk powder. Much of the increase of imports of SMPP was at the expense of imported milk powder. Including imported milk powder in the denominator means that a simple substitution of SMPP for imported milk powder with no loss of sales or market share for domestic products would give a result showing an increase of market share for SMPP. A more accurate presentation is that given by Korea in Paragraph IV.3.4 of the 1 April 1997 Notification.

(b) *The falling prices for domestic products*

4.519 The price of imported SMPP was stable during the reference period as was the price of domestic milk powder except for what Korea itself describes the temporary phenomenon at the beginning of 1996. Korea's claim that increased imports of SMPP coincided with falling price of domestic products and its deduction that the first caused the second are in the EC view demonstrably false.

4.520 The European Communities recalled Korea's precise reasoning:

"Analysis showed that as the share of imported products in total consumption increased, the sales price of domestic milk powder dropped from 5,354 Won/kg in 1993 to 4,994 Won/kg for the four months of 1996. Thus, increased imports of the products subject to investigation caused the price of domestic milk powder to drop."

Korea's case is that increased *market share* for SMPP caused a decrease in the *price* of domestic milk powder. It is not arguing that low *prices* for SMPP caused a decrease in the *price* of domestic milk powder. This is logical to the extent that it did not identify low prices for SMPP as an injury factor in its examination or its conclusion in Paragraph IV.4 of its Notification of 1 April 1997. To have established low or falling prices for imported SMPP as an injury factor, Korea would have had to carry out a price investigation which it did not for its own reasons.

4.521 It is true that the share of imported products (that is SMPP) increased. However, this increase occurred throughout the period whereas the sales price of domestic milk powder only dropped at the *end* of the period. Therefore Korea's statement that they dropped at the same time is incorrect.

4.522 According to Korea's own figures, the price in 1995 was 5,388 Won/Kg, which represents an *increase* over 1993 and 1994. The whole decrease on which Korea is relying occurred in the first four months of 1996, during what it has itself termed a "temporary phenomenon". The deduction of causality which relies purely on the supposed simultaneity of the effects described is therefore incorrect and unjustified. In fact in the EC view the correct conclusion is the opposite: that is there is no causal relation between the increase in market share of imported SMPP and the decrease in price in domestic milk powder which occurred at the beginning of 1996.

(c) *The increase in the share of livestock co-operatives' raw milk collection in Korea*

4.523 The figures given by Korea on this point show a slowly but steadily rising proportion of raw milk collection by co-operatives from 1990 to 1996. This establishes the opposite of what Korea seeks to prove because increases in imports of SMPP did not affect a trend which already existed before their liberalization.

(d) *Imports forced domestic producers to decrease their prices to below cost and reduce the number of dairy farmers*

4.524 The prices of domestic milk powder as well as imported SMPP were stable except for the temporary phenomenon at the beginning of 1996. The fact that domestic sales came to be made below cost is entirely due to the increase in the cost of production which obviously has nothing to do with imports (but was due to government imposed price increases for raw milk from dairy farmers).

4.525 There is a suggestion for the first time in Paragraph V.1.4 of the Notification that a "price difference" between imported SMPP and domestic milk powder was relevant to the analysis of the causal link. This is inconsistent with all the previous arguments of Korea and in particular with its failure to identify the prices of SMPP or even a price difference between SMPP and domestic milk powder as an injury factor.

4.526 Also, imports had no effect on the number of dairy farmers since they received guaranteed and rising prices for their milk and increased their production and productivity. The reduction in numbers was due to healthy consolidation and the increase in the size of farms in accordance with Korean government policy.

(ii) *The problems of the domestic industry were due to other factors – second sentence of Article 4.2(b) of Agreement on Safeguards*

4.527 The European Communities consider that any problems the domestic industry may have had were due to other factors than imports of SMPP and most notably the high and increasing price guaranteed to Korean dairy farmers for their milk by the Korean Government. Korea claims to examine these factors in Paragraph V.2 of its Notification of 1 April 1997. However, in the EC view, Korea's examination of other factors that could have caused or contributed to any problems of the domestic industry is incomplete, the European Communities also believes Korea should have considered the extent to which Korean domestic industry itself imported SMPP and benefited therefrom. Korea's assumption that such imports by the domestic industry could be considered to cause injury to that same domestic industry requires at the very least a justification – which Korea has nowhere provided.

(a) *Milk quality scandal*

4.528 Korea deals with this issue in Paragraph V.2.1 of its Notification of 1 April 1997 as follows:

"After examining the facts related to the controversy which occurred from October to November 1995, it was acknowledged that this incident did reduce the demand for market milk, though only temporarily. It was determined that the controversy ceased to be a cause of reduced market milk demand in January 1996. The quality dispute affected only three months of consumption out of an investigation period totalling 42 months. No evidence was submitted by any of the parties concerned which demonstrated that the injury caused by the quality dispute was as serious or persistent as that caused by increased imports."

However, in the EC view there was a much greater and more persistent effect on consumption of milk in Korea and stocks than claimed by Korea. The rise of inventory occurred at exactly the time the milk quality scandal erupted and that therefore the milk quality scandal was the major cause of the increase in milk powder stocks in Korea in early 1996.

4.529 The European Communities note that even Korea admits that there was an effect both on consumption and stocks. It rejects the analysis of these effects by other parties but fails to make any analysis itself or to make any allowance for them in its own determination and in particular to examine how it might have effected the state of stocks and sales of milk powder in the first four months of 1996 on which Korea relies so heavily throughout its Notification (a price decrease and increased sales of milk powder by domestic producers which Korea describes as a “temporary phenomenon”).

(b) Effect of reduced imports of milk powder

4.530 Korea examines this issue in Paragraph V.2.2 of its Notification of 1 April 1997. It constitutes in effect an attempt to deal with the objections to Korea’s presentation of the “increasing market share of SMPP”.

“It has been noted that the increase in imports of the products under investigation contributed to a reduction in imports of milk powder from 14,843 tons in 1993, 11,581 tons in 1994, 7,576 tons in 1995, to 583 tons in the first half of 1996. However, it has also been noted that there is an important difference between the imports of the products under investigation and those of milk powder. The milk powder imported by ROK in 1993-1994 was to supplement the shortage of domestic raw milk and milk powder, and was allocated to users at reasonable prices.”

Thus, Korea admits a simultaneity between the decline of imports of milk powder and the increase in imports of SMPP but attempts to show that the imports of milk powder were not damaging while imports of SMPP were. However, it is fundamental to Korea’s safeguard measure (see Paragraph III.1 of the Notification of 1 April 1997) that SMPP is a “directly competitive product” for raw milk and milk powder and that it was used for the same purposes. If imported milk powder was apt to “supplement the shortage of domestic raw milk and milk powder” then so should imported SMPP.

4.531 Korea also alleges that milk powder “was allocated to users at reasonable prices”, and suggests that SMPP was not. However, Korea’s Notification is noteworthy for its absence of any price analysis and the Korea’s injury determination in Paragraph IV.3.4 of the Notification of 1 April 1997 makes no reference to low prices for SMPP. Korea cannot therefore rely on differences of prices which it has not investigated in its consideration of causal link.

(c) Review of demand

4.532 In paragraph V.2.3.6 of the Notification of 1 April 1997 Korea examines demand. The European Communities disagree that the demand trends for processed products can be dismissed as Korea does in that paragraph V.2.3.6. A substantial part of the increased imports may well have been used for processing into other dairy products such as ice cream, confectionery, yoghurt, cheese because of increased demand for these products. Korea admits that production and consumption of certain dairy products increased during the investigation period, but has declined to give precise figures, so this cannot be comprehensively verified. Instead Korea rather peremptorily concludes that, “no connection could be established between the effect on these dairy products and injury to domestic

industry”.²³⁵ The logic behind this conclusion is not clear, since it is based on the prior assumption that the raw milk and milk powder industry has suffered serious injury.

(d) Review of government price decisions

4.533 The brevity of Korea’s examination of this issue in Paragraph V.2.4 of the Notification of 1 April 1997 belies its importance. It can be quoted in full:

“The price of raw milk is determined by the government by taking into account production costs, influence on domestic commodity prices, domestic supply and demand, etc. The price set by the government is not an obligatory price but rather a base price for contracts between dairy farmers and milk processing firms. Therefore, this did not affect the domestic industry adversely. If the government had not set a base price and the livestock cooperatives had refused to collect raw milk, dairy farmers would have been directly injured.”

4.534 The point about government price increases for raw milk is that they are likely to increase costs and supply beyond what the market for milk powder can bear and will give rise to precisely the difficulties of increasing stocks and pressure on margins for processing companies that are in evidence here. That is why the issue should have been examined seriously by Korea.

4.535 The European Communities do not know what Korea means by the term “base price”. It has always understood the price set by the Korean Government to be always followed in practice. However, Korea has itself stated elsewhere in the same Notification that the price of raw milk “is maintained at a stable level fixed by the government” and that the price of raw milk was also increased twice during the investigation reference period.²³⁶

4.536 The European Communities submit that the last sentence of this Paragraph V.2.4 appears to be an admission that dairy farmers have not been injured since the government has set a base price and the livestock cooperatives have not refused to collect raw milk.

(e) Other factor - Imports of SMPP by the domestic industry

4.537 Korea did not consider the effect of imports of SMPP by the domestic industry during the period of investigation. This is an essential condition for establishing a causal link. Since Korea failed to address this issue it cannot be determined whether, even if it is assumed that injury was suffered by the Korean industry, a causal link can be established between increased imports and the condition of the domestic industry.

4.538 The European Communities submit that any problems that domestic industry may have been suffering are not caused by imports of SMPP but by other factors and in particular by the inevitable conflict between a government policy of fixing and regularly increasing the domestic price for raw milk paid to dairy farmers causing increased production and a higher cost of milk for milk processors and co-operatives with insufficiently rising domestic demand. By wrongly attributing these problems to imports of SMPP on the basis of an inadequate and incomplete investigation of causal link, Korea has violated Article 4.2(b) second sentence.

(b) Response by Korea

4.539 **Korea** responds to the EC arguments as follows:

²³⁵ Notification of 1 April 1997, p.17, para. 2.3.6.

²³⁶ Notification of 1 April 1997, p. 10, para IV.3.7.

(i) *Consideration of causation*

4.540 Korea established a clear and strong causal link between the increased imports of SMPP and the serious injury suffered by the domestic industry.²³⁷ This link relies on an understanding of the relationship between the supply of raw milk and the production of milk powder. Korea found that the increased imports of the cheaper SMPP replaced raw milk and domestic milk powder in a number of key uses. Demand for domestic products decreased as a result of an increase in the import of cheaper SMPP, which in turn suppressed the sales price of domestic products. Further, the reduction in demand for domestic products resulted in more raw milk having to be collected by the livestock cooperatives to be turned into milk powder. As the demand and price of milk powder had been suppressed by the imports of SMPP, both losses and inventory increased, with the consequent inability to operate at a reasonable level of profit, increase of debt, and failure by the cooperatives and farmers to invest in the dairy industry.

4.541 Korea determined that increased imports of SMPP gained a significant proportion of the Korean milk powder market at the expense of domestic milk powder.²³⁸

MILK POWDER MARKET SHARE OF SMPP

	1993	1994	1995	1996 (1-6)
Total Consumption in the Milk Powder Market (tonnes) (A)	30,181	40,532	46,254	23,532
Imports of SMPP (tonnes) (B)	3,217	15,561	28,007	16,320
SMPP's Share of the Milk Powder Market (%) (B/A)	10.7	38.4	60.6	69.4

4.542 Korea also determined that increased imports were significantly undercutting the prices of domestic producers.²³⁹

PRICE COMPARISON BETWEEN DOMESTIC PRODUCTS AND SMPP

	1993	1994	1995	1996 (1-4)
Price of Raw Milk²⁴⁰ (Won/kg) (A)	4,100	4,100	4,100	4,560
Price of Domestic Milk Powder (Won/kg) (B)	5,354	5,296	5,388	4,994
Price of SMPP in Korea (Won/kg) (C)	2,590	2,500	2,530	2,971
Difference (C-A)	-1,510	-1,600	-1,570	-1,589
Difference (C-B)	-2,764	-2,796	-2,858	-2,023

This wide price differential between domestic milk powder and imported SMPP forced Korean producers to lower their price of domestic milk powder to levels that eventually could not even cover costs.

4.543 In addition to the suppression of prices for both raw milk and domestic milk powder and the attendant losses connected with this suppression, SMPP imports increasingly displaced domestic inputs in the production of downstream products. During the investigation period, Korea determined

²³⁷ See, Notification V.

²³⁸ See, Notification V.1.1.

²³⁹ See, Notification V.1.2.

²⁴⁰ The price of raw milk was calculated by taking into account that 10 units of raw milk are used to produce one unit of milk powder.

that consumption of flavoured and fermented milk, which use the cheaper imported SMPP, increased at the expense of white milk, which can only be made from domestic raw milk²⁴¹.

CHANGE IN MARKET SHARE FOR MILK PRODUCTS

	<i>1993</i>	<i>1994</i>	<i>1995</i>	<i>1996.1-6</i>
<i>White Milk</i>	63.0%	61.4%	57.8%	53.7%
<i>Flavoured Milk</i>	6.0%	7.9%	11.2%	11.7%
<i>Fermented Milk</i>	22.8%	23.5%	23.6%	26.2%

Prior to the market liberalization in 1993, the production of flavoured milk remained constant. It is only after the surge in imports of SMPP into the Korean market that the production of flavoured milk increased at the expense of white milk. Looking at the production ratio of Korean white milk and comparing it to the increase in production of flavoured milk, the effect of SMPP imports on consumption of domestic raw milk is pronounced.²⁴²

CHANGES IN MARKET SHARE OF WHITE MILK AND FLAVOURED MILK

	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>1993</i>	<i>1994</i>	<i>1995</i>	<i>1996(1-6)</i>
<i>White Milk</i>	92.9%	92.4%	92.4%	91.3%	88.6%	83.8%	82.1%
<i>Flavoured Milk</i>	7.1%	7.6%	7.6%	8.7%	11.4%	16.2%	17.9%

Indeed, the usage rate of imported SMPP by the five leading processing companies which manufacture final dairy products using SMPP showed a significant increase.²⁴³

USAGE RATE OF SMPP BY PROCESSING COMPANIES

<i>Year</i>	<i>Usage Rate</i>
1993	3%
1994	23.8%
1995	29%
1996 (1-4)	53.3%

The impact of SMPP's replacement of domestic raw milk and milk powder can also be witnessed in the decreased profitability of the livestock cooperatives, which are owned by dairy farmers. Their decreased income had repercussions on other elements affecting the overall health of the domestic industry, including, for example, profitability, inventory, employment and the inability to invest in research and development.

4.544 Further, during the period of investigation, imports of SMPP increased at a more rapid rate than the decline in imports of skimmed and whole milk powder.

²⁴¹ Source: MAF

²⁴² See, Notification V.1.3.

²⁴³ Source: MAF

**DIFFERENCES IN THE VOLUME OF IMPORTED
MILK POWDER AND SMPP**
(UNIT: TONNES)

<i>Year</i>	<i>Imported Milk Powder</i>	<i>SMPP</i> ²⁴⁴	<i>Difference</i>
1993	14,843	3,217	-11,626
1994	11,581	15,561	3,980
1995	7,576	28,007	20,431
1996 (1-6)	583	16,320	15,737

4.545 Against this background, Korea reached the conclusion that serious injury to the Korean dairy industry had been clearly caused by the increased imports in that:

- (a) Korean market share of raw milk and milk powder decreased;
- (b) Market share of Korean white milk (which can only be made from domestic raw milk) declined, while market share of flavoured and fermented milks (which can, and did, use imported milk powder) increased;
- (c) Under normal market conditions, milk processing companies purchase raw milk and domestic milk powder as inputs for the production of end products. Because raw milk is perishable, excess raw milk not sold to the domestic market, or used by the processing companies, must be sold to the cooperatives for conversion into milk powder. During the investigation period, the processing companies increasingly replaced raw milk and domestic milk powder with much cheaper SMPP. As a result, excess raw milk was converted into unsaleable milk powder which remained in inventory and accumulated to high levels;
- (d) As inventory levels increased, the livestock cooperatives were compelled to sell the milk powder stock at prices below their production costs and saddled with a heavier debt load that in turn contributed to the higher leverage ratio and further depletion of capital;
- (e) The membership of the NLCF increased during the investigation period. This increase was a direct result of the increase in imports of SMPP, since, as these replaced Korean raw milk, farmers that had previously sold raw milk directly to processing companies were now unable to do so because they were faced with stiff competition from the cheaper imported SMPP. In order to find an outlet for the raw milk, they had to sell to cooperatives, and in order to sell to cooperatives, they had to be members of those cooperatives;
- (f) As Korea has no developed export market for the accumulated milk powder, and in any case would be price-uncompetitive when compared to the subsidized or dumped milk powder available in the world market, there was no effective outlet for this inventory, thus only having a suppressive effect within Korea;
- (g) The losses incurred by Korean milk powder producers were substantial and increased over the investigation period. These losses were in large part attributable to price suppression and displacement of raw milk and milk powder by the imports of the cheaper SMPP;

²⁴⁴ See, Notification IV.2.

- (h) As a direct result of the above, average household debt of dairy farmers doubled during the investigation period, and despite the long-term loans (which were unrelated to an increase or decrease in production) provided to virtually all dairy farmers, employment of Korean dairy farmers fell by approximately 5,500 households. The decrease in the number of farms was propelled by the cooperatives' inability to compensate fully the dairy farmers for their raw milk, because SMPP was replacing domestic products, causing a rise in inventory and decreasing profits. During difficult periods, including during the investigation period, the livestock cooperatives are required to purchase raw milk from dairy farms and pay 70-80 per cent in cash and the remainder in milk powder, further exacerbating the harm to operating margins of the dairy farms;²⁴⁵
- (i) The severe revenue problems suffered by the cooperatives were in large part passed onto the farmers. These problems caused disinvestment and severely limited investment in dairy production techniques and R&D in the milk powder sector, which produces only two types of milk powder, as compared to the multitude of milk powder types produced by the major exporting countries.

(ii) *Other potential causal factors analysed and discounted*

4.546 In addition, Korea considered other factors which could have been a cause of the serious injury noted above.²⁴⁶ Korea undertook an extensive analysis of the effect of the «milk quality» controversy on inventory. It rejected the analyses suggested by both the KFIA²⁴⁷ and the exporters, and used its own, which led it to conclude that the effect of the controversy lasted three months and ceased to be a cause of reduced raw milk demand by January 1996.²⁴⁸

4.547 Korea also considered whether the increase in imports of SMPP during the period under investigation had led to a decrease in the overall imports of milk powder.²⁴⁹ Imports of milk powder were within the import framework for milk powders negotiated by Korea as part of the Uruguay Round. Under this framework, milk powder (as opposed to SMPP) was subject to an agreed tariff rate of 220 per cent which permitted its import to be controlled in an agreed and transparent manner. However, imports of SMPP circumvented this structure and were able to be imported at a much lower tariff rate than milk powder. The increased imports of SMPP far outweighed the drop in imports of milk powder paying the agreed tariff rate, and so there was no reason to conclude that the effect of the increase in imports of SMPP was offset by the decrease in milk powder.

4.548 In relation to demand, Korea considered whether the serious injury was caused by changes in domestic demand, and concluded that such changes did not cause serious injury. The European Communities dispute Korea's conclusion that "no connection could be established between the effect on these dairy products and injury to the domestic industry²⁵⁰." However, it is clear that there is no necessary connection between an increase in production and consumption of products using SMPP on the one hand, and injury to the domestic industry on the other. As noted above, no individual criteria of serious injury can be determinative on its own, and must be considered in conjunction with all other relevant criteria.

²⁴⁵ See, Exhibit Korea-1.

²⁴⁶ See, Notification at Paragraph V.2

²⁴⁷ See, Notification at Paragraph V.2.1.a.

²⁴⁸ See, Notification at Paragraph V.2.1.

²⁴⁹ See, Notification at Paragraph V.2.2

²⁵⁰ See, Notification at V.2.3.6.

(c) Additional arguments by the European Communities made at the first meeting of the Panel with the parties

4.549 At the first meeting of the panel with the parties, the **European Communities** further advanced their arguments under Article 4.2(a) as follows:

(i) Invocation of new arguments

4.550 The **European Communities** based their analysis of the lack of causal link first on the reasons given by Korea in its Notification of 1 April 1997 and second on a consideration of factors which Korea had failed to consider or make allowance for.

4.551 In the EC view Korea in its First Written Submission seeks to rely on a completely different reasoning in order to try to establish causation. There is little similarity between Korea's First Written Submission on this point and Section V.1 of the Notification and Korea is clearly trying to justify its measure *ex post*. Most notable are arguments for the first time about the increasing membership of the NLCF, the unavailability of any export market, "price suppression", the "displacement" of domestic milk and milk powder by imported SMPP, the doubling of dairy farm debt and finally disinvestment and limited investment in Research and Development. The European Communities submit that the safeguard measure must be judged in the basis of the reasons given in the Notification and that *ex post* rationalizations are not admissible.

4.552 In particular the European Communities take issue with Korea's contention that it determined that increased imports were significantly undercutting domestic production. There was no investigation of this matter and no consideration of the proper relationship between the prices of imported SMPP and domestic milk powder.

4.553 In any event, The European Communities believe that the new reasoning also does not establish any causal link. However, regarding the notion that imports forced an increase in the membership of the NLCF and therefore injury, the European Communities note with interest the affirmation by Korea that the membership of the NLCF now accounts for 99 per cent of dairy farmers and that the NLCF has committed itself to pay the Korean Government recommended prices. Assuming this to be true, the European Communities do not see how it helps to establish causality. This high membership demonstrates that the dairy farmers are shielded from any possible adverse effects. The cause of the increased stock levels of NLCF members would seem to be sales to it by dairy farmers. This would therefore represent one part of the Korean industry (dairy farmers) causing injury to another part (co-operatives) and establishes no direct link with imports.

(ii) The consequences of the "pus milk" scandal

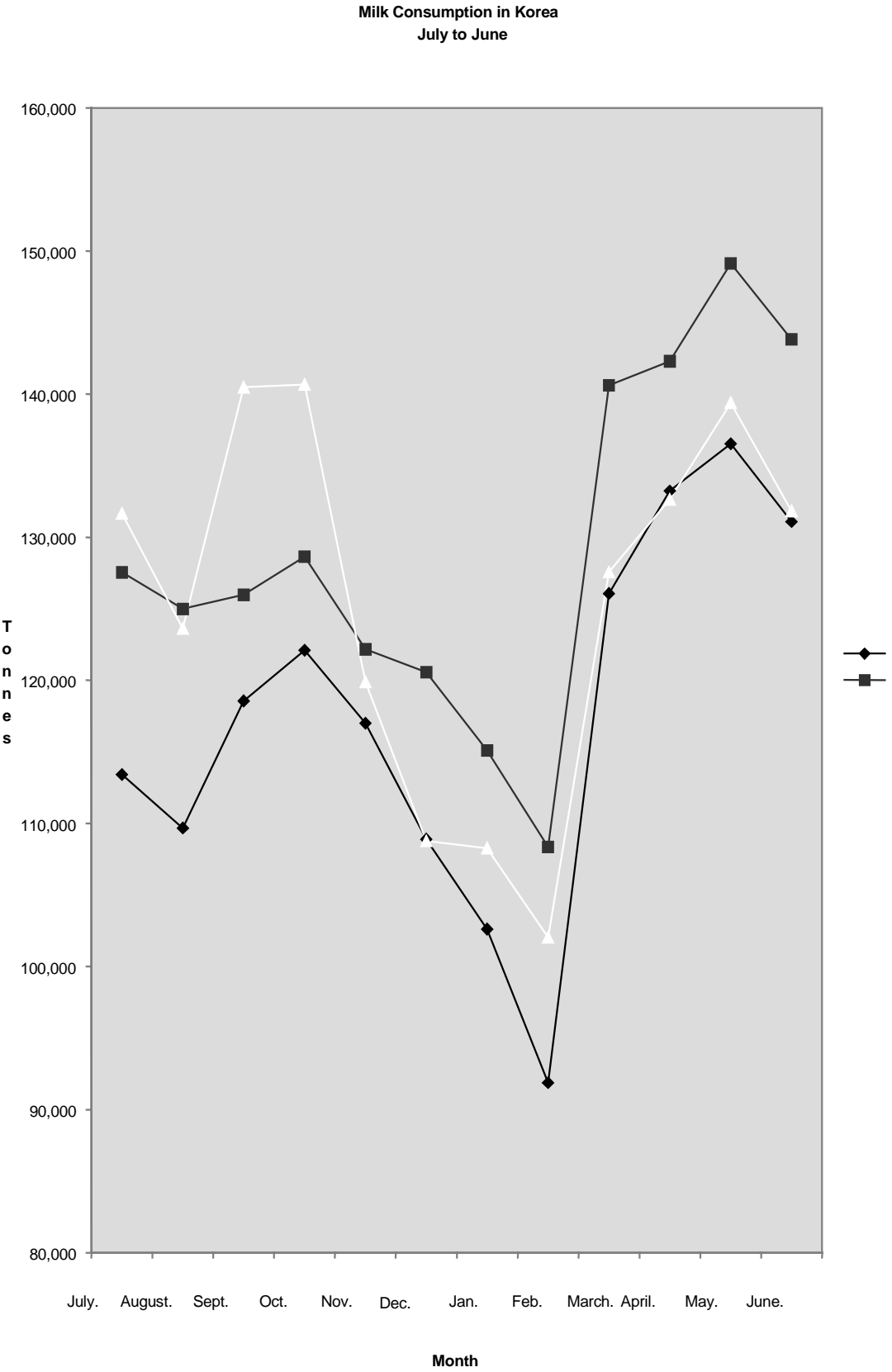
4.554 In the EC view the real cause of the increase in stocks in late 1995-1996 was, the "pus milk" scandal. At the end of 1995, the Korean public reduced its milk consumption when certain dairies started to accuse others of supplying "pus milk" from cows with mastitis. There was no doubt no truth in these allegations but they were made and did have an effect. The European Communities submitted a press Article describing the background to this issue.

4.555 Korea is fairly brief on this matter in its First Written Submission. Its explanation is worth quoting:

"Korea undertook an extensive analysis of the effect of the «milk quality» controversy on inventory. It rejected the analyses suggested by both the KFIA and the exporters, and used its own, which led it to conclude that the effect of the controversy lasted three months and ceased to be a cause of reduced raw milk demand by January 1996" (footnotes omitted).

No detail is given of the analyses which led to this conclusion.

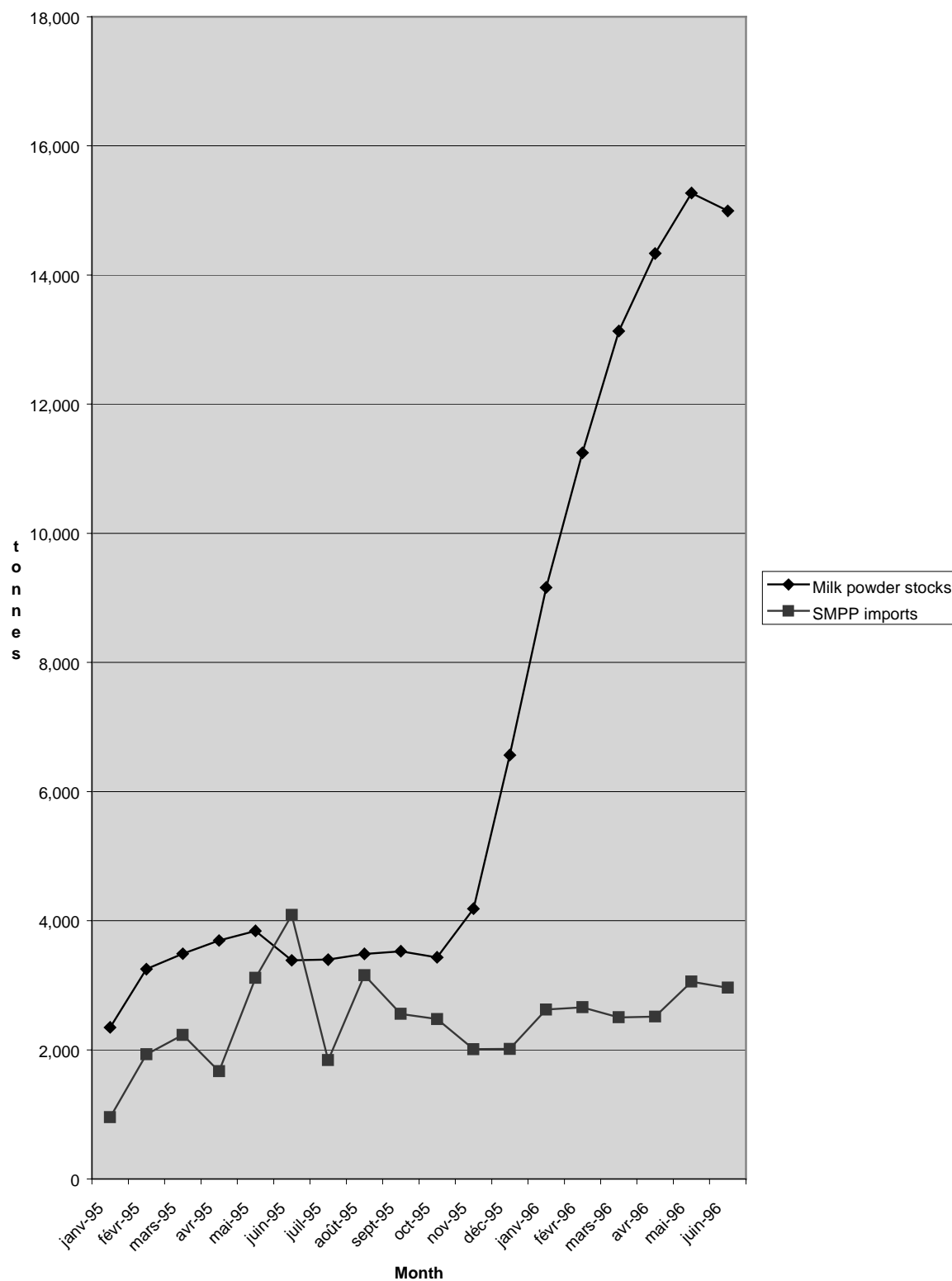
4.556 The Notification of 1 April 1997 had stated that the KFIA had failed to take account of the seasonal variations. The graph below, submitted by the European Communities, show a clear seasonal variation in milk consumption in Korea with a substantial decrease in winter. It also shows that milk consumption was increasing in each period. In 1995-96 there is a sudden dramatic drop which exceeds the previous seasonal variations and brings consumption back to levels of three years earlier. It is easy to understand why this, against a background of increasing dairy production and inflexible supply due to *de facto* assured prices would have led to the increase of stocks.



4.557 The European Communities therefore maintain that the situation of the Korean industry could not be considered to be one of “significant impairment” necessary to establish “serious injury” and in any event had nothing to do with rising imports of SMPP but was instead the result of the “pus milk scandal” in conjunction with rising and inflexible production caused by high quasi-guaranteed prices.

4.558 The European Communities submitted a graph (reproduced below) illustrating their conclusion on this matter. It shows the development of imports of SMPP and the evolution of stocks. Increased stock levels is a problem which arose from November 1995. It shows no correlation at all with imports of SMPP but very much so with the “pus milk scandal”.

Milk Powder Stocks And Imports of SMPP



(d) Rebuttal arguments made by the European Communities

4.559 The **European Communities** made the following arguments in rebuttal:

4.560 Korea's measure cannot be justified on the basis of reasons which were not considered by the investigating authorities and are not reflected in Korea's 24 March Notification. In any event those put forward by Korea in its First Written Submission do not establish a causal link between imports of SMPP and the injury allegedly suffered by the Korean domestic industry. In particular, the European Communities recall that Korea did not demonstrate any causal effect between *prices* of imported SMPP and those of domestic milk powder or raw milk.

4.561 Furthermore, as regards the effects of the milk quality scandal, the European Communities note that Korea alleges to have relied on three econometric models to dismiss the importance of the quality scandal in explaining the situation of its domestic industry. Having examined the information included in the "OAI Report" which Korea has referred to, the European Communities consider that such information does not provide the explanation that Korea claims and that it has therefore not established that the "Pus Milk" Scandal did not cause or contribute to the injury.

4.562 First of all, the calculations of those models are based on production of milk, not on consumption.²⁵¹ The European Communities assume that production refers to white milk since only this, and not production of raw milk would approximate to consumption of white milk, because of the short shelf life of white milk. It is also remarkable that Korea considers that "there are various factors that can influence milk consumption, such as, among others, the change of consumption patterns, weather, etc." This statement is used to explain away the relevance of the milk quality scandal, but these factors are nowhere considered when examining the impact of imports of SMPP.

4.563 But the most important point is that Korea's deductions from its own figures and models²⁵² involve completely circular reasoning. Each of the three graphs deriving from the econometric models shows a decrease in milk production lasting through June 1996 (and possibly beyond, as no figures are given beyond that date): in June 1996 a decrease of between 13,000 and 17,000 tonnes of milk production is still evident (depending on which model is considered). These results are dismissed by the statement, "The gap shown from February 1996 is attributable to factors other than quality dispute."²⁵³ Which other factors? Were these investigated? And where are the results of such investigation given?

4.564 The OAI Report also notes that "The investigation authority drew this conclusion on the basis of the nature and short duration of the quality dispute."²⁵⁴ The issue at stake is not the duration of the dispute, but the duration of its remaining in the public consciousness so as to affect consumption of milk – this is likely to be considerably longer than the dispute itself, but Korea failed to conduct any research to establish the length of this latter period of time. Thus Korea's conclusion that the "Pus Milk" Scandal did not have a lasting effect on stocks is not supported by its own models and is derived from and peremptory statement that it was of short duration. As stated above the reasoning is circular.

4.565 The European Communities affirm that Korea's attempted *ex post* justifications are not based on the investigation and therefore not admissible. In addition the further information Korea has supplied to attempt to dismiss the "Pus Milk" Scandal as a factor shows circular reasoning and simply confirms that this factor was not properly considered.

²⁵¹ See, the OAI Report, Exhibit Korea-14, p. 68-70.

²⁵² See, the OAI Report, graph on p. 70.

²⁵³ See, the OAI Report, p. 69.

²⁵⁴ *Id.*

(e) **Rebuttal arguments made by Korea**

4.566 **Korea** makes the following rebuttal arguments:

4.567 Based on its examination of the dairy industry, the Korean authorities concluded that the ease with which imported SMPP could replace domestic raw milk and milk powder meant that SMPP was an effective substitute for domestic raw milk and milk powder in most industrial uses. This was evidenced by the increased amount of SMPP used by the major food processing companies. Given this fundamental fact, the Korean authorities then examined the price at which the SMPP was imported into Korea and found that it considerably undercut the domestic price of both raw milk and milk powder. This price undercutting not only caused a drop in the consumption of domestic milk powder but also reduced raw milk consumption. Conversely, the market share of SMPP in uses such as flavoured and fermented milks increased dramatically at the expense of domestic milk powder and raw milk. Also, the absolute increase in imports of SMPP far outweighed any drop in the imports of milk powder.

4.568 The price undercutting caused an increase in inventory of milk powder. A further consequence of the imports of cheap SMPP was that the percentage of raw milk collected from dairy farms by livestock cooperatives for conversion into milk powder increased as processing companies which traditionally purchased raw milk from dairy households opted to buy the cheaper imported SMPP. The increase in inventory, combined with the relatively limited shelf-life of milk powder, caused the market price of milk powder to become depressed still further.

4.569 Strong competition from cheap imported SMPP also caused a drop in the revenue and profitability of the dairy households, the cooperatives, and the processing companies. The dairy households now had more limited sales opportunities for their raw milk, which out of necessity had to be turned into milk powder, thus increasing the supply of milk powder and inventory, and depressing its price. The losses on sales of milk powder affected the revenue and profitability of the processing companies and the cooperatives, and as the cooperatives are owned by the Korean dairy farmers, these farmers bore part of their losses.

4.570 Decline in profitability of the entire domestic industry also caused an increase in unemployment and a drop in the level of investment in dairy farming, including, *inter alia*, research and development.

4.571 In particular, Korea considers that the investigation demonstrated the existence of a causal link²⁵⁵ based on the Korean authorities' examination of the following:

(i) *Substitution of domestic product by SMPP*

4.572 The authorities examined the extent to which cheap SMPP imports replaced domestic products and stated that:

“[a]n analysis of the written answers submitted by Lotte Confectionery and four other manufacturers shows SMPP replaced domestic product as the share of SMPP used by these companies grew from 3.0 per cent in 1993 to 53.3 per cent in the January-April

²⁵⁵ Korea again reminds the Panel that the EC has accepted that the competent authorities published (a) “a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law” and (b) “promptly, in accordance with the provisions of Article 3, a detailed analysis of the case under investigation as well as a demonstration of the relevance of the factors examined.”

period of 1996. The decrease in the purchase of domestic product by users affected the level of inventory of domestic milk powder.^{256,}

SUBSTITUTION OF SMPP²⁵⁷
(UNIT: TONNES)

			93	94	95	Jan.-Apr 1996
Lotte	SMPP		-	x,xxx	x,xxx	Xxx
	Domestic	Raw milk	xxx	xxx	xxx	Xxx
		Milk powder	x,xxx	x,xxx	xxx	Xxx
Lotte Samgang	SMPP		-	xxx	-	-
	Domestic	Raw milk	xx	-	-	Xxx
		Milk powder	xxx	xxx	xxx	Xxx
Crown	SMPP		xxx	xxx	xxx	Xxx
	Domestic	Raw milk	-	-	-	-
		Milk powder	-	-	-	-
Haitai	SMPP		xx	xxx	x,xxx	Xxx
	Domestic	Raw milk	xxx	xxx	-	-
		Milk powder	xxx	xxx	x	x
Korean Yakult	SMPP		-	-	xxx	x,xxx
	Domestic	Raw milk	xx,xxx	xx,xxx	Xx,xxx	xx,xxx
		Milk powder	x,xxx	x,xxx	x,xxx	xxx
	SMPP (calculated in terms of raw milk, A)		341 (3,410)	3,298 (32,980)	3,777 (37,770)	2,382 (23,820)
	Domestic	Raw milk	46,305	50,036	47,310	12,635
		Milk powder	6,351	5,551	4,523	821
		Total (calculated in terms of raw milk, B)	109,815	105,546	92,540	20,845
	Share(A/<A+B>, %)		3.0	23.8	29.0	53.3

Source : Written answers of users provided to the KTC

Note : 1. The total amount of raw milk, milk and skimmed milk
2. The share is computerized by using the figures calculated in terms of domestic raw milk.

(ii) *Effect of the increased import of SMPP on domestic prices*

4.573 The Korean authorities next determined the effect of the increased imports of SMPP on domestic prices. The authorities examined the following:

“Import price (Won/kg) of SMPP was 1,750 Won in 1993, 1,689 Won in 1994, 1,709 Won in 1995, and 2,008 Won in the January-April period of 1996. Its sales price (Won/kg) was 2,590 Won in 1993, 2,500 Won in 1994, 2,530 Won in 1995, and 2,971 Won in the January-April period of 1996²⁵⁸.”

²⁵⁶ OAI Report at 66.

²⁵⁷ OAI Report at 28.

²⁵⁸ OAI Report at 62. See, also Notification at IV.3.7.

As for the domestic milk powder, the sales price (Won/kg) was 5,354 Won in 1993, 5,294 Won in 1994, 5,388 Won in 1995, and 4,994 Won in the January-to-April period of 1996.²⁵⁹

PRICE COMPARISON BETWEEN IMPORTS AND DOMESTIC PRODUCTS²⁶⁰

(unit: Won/kg, Won, %)

		93	94	95	96.1-4
SMPP	Import Price (CIF)	1,750	1,689	1,709	2,008
	Domestic Sales Price (A)	2,590	2,500	2,530	2,971
Domestic Products	Sales Price (B)	5,354	5,294	5,388	4,994
	Manufacturing Cost (C)	5,158	5,426	5,860	6,178
	Difference (B-C)	196	- 132	- 472	- 1,184
Price Gap	B-A	2,764	2,794	2,858	2,023
SMPP's Domestic Market Share(%)		1.6	7.0	12.2	14.0

- Notes:
- 1) US\$=800 Won
 - 2) Domestic Sales Price = Import Price + (Import Price x Customs Duty (40 per cent)) + (Import Price x Expenses and Profit (8 per cent))
 - 3) Domestic Products are based on milk powder.
 - 4) SMPP Market Share = Amount Imported/Amount Consumed
 - 5) Sales Price is average sales price of milk powder produced by the livestock cooperatives.
 - 6) Manufacturing cost is the average manufacturing cost of milk powder produced by the livestock cooperatives.
 - 7) As of August 1996, domestic skimmed milk powder sells at 3,800 Won/kg and the imported SMPP sells at 2,956 Won/kg, the margin being 844 Won/kg.

4.574 The Korean authorities then explained:

- (a) "The sales price of SMPP undercut the sales price of the domestic milk powder by 2,764 Won in 1993, 2,796 Won in 1994, 2,858 Won in 1995, and 2,023 Won in the January-April period of 1996. Because the sales price of SMPP was approximately half the price of domestic milk powder, the volume of import of SMPP increased rapidly during the period of investigation.
- (b) Because SMPP penetrated the domestic market by taking an increasingly large market share and significantly undercutting the price of domestic milk powder, the price of domestic milk was depressed from 5,354 Won in 1993 to 4,994 Won in the January-April period of 1996.
- (c) As the increased import of SMPP depressed domestic price of milk powder, domestic producers' losses grew larger as the domestic sales price could not be increased to keep pace with the rate of production cost increase. These losses were 196 Won in 1993, turning to a loss of 132 Won in 1994, a larger loss of 472 Won in 1995 and a further loss of 1,184 Won in the January-April period of 1996.
- (d) In sum, it is apparent that the increase of SMPP and its rapid rise in the market share caused a depression of the domestic sales price which fell below the production cost as of 1994. The large losses have been increasing and this combined with domestic sales price below production cost are causing injury to the domestic industry.²⁶¹

²⁵⁹ OAI Report at 63. See, also Notification at V.1.2.

²⁶⁰ OAI Report at 63. See, also Notification at V.1.2.

²⁶¹ OAI Report at 63. See, also Notification at V.1.2. Korea submits the following regarding the EC's arguments:

4.575 Therefore, the Korean authorities found that the sales prices for imports of SMPP were significantly undercutting the sales prices of domestic milk powder. As a result, the price of domestic milk powder was severely depressed causing serious injury to the domestic industry.

(iii) *Livestock cooperatives' volume of raw milk collected*

4.576 The Korean authorities also examined the effect of the low price of SMPP imports on the amount of raw milk collected by the livestock cooperatives. The authorities stated:

"The livestock cooperatives' volume of raw milk collected from dairy households was 40.56 per cent in 1990. The rate grew to 41.36 per cent in 1993, to 42.80 per cent in 1994, to 44.30 per cent in 1995, and to 45.30 per cent in January-June period of 1996."²⁶²

"The increased import of SMPP caused the livestock cooperatives to increase their purchase of raw milk from dairy households, because processing companies that traditionally purchased raw milk from dairy households opted to purchase the much cheaper SMPP. The increased collection of raw milk by the livestock cooperatives caused the deterioration of their business operation, because the displaced raw milk had to be converted into milk powder inventory (see VI.2.A. first paragraph)."²⁶³

LIVESTOCK COOPERATIVES' VOLUME OF RAW MILK COLLECTED²⁶⁴
(UNIT:%)

	1990	1991	1992	1993	1994	1995	1996.1-6
Cooperatives' Portion	40.56	41.14	40.19	41.36	42.8	44.3	45.3
Compared Against Basis Year	100	101.4	99	101.9	105.5	109.2	112

Data: Provided by the MAF and NLCF to the KTC
Note: Basis year 1990

4.577 In Korea's view, the above table refutes the EC argument that raw milk collection by the cooperatives was "slowly but steadily rising" and the increases in SMPP imports "did not affect a trend." As the table shows, the cooperatives' portion actually declined to below its 1990 level in 1992 and the portion increased substantially during the investigation period by approximately 12 per cent from 1990 to June 1996 and by 10 per cent from 1993 to June 1996.

(iv) *Production of white milk and flavoured milk*

4.578 The Korean authorities also examined the extent to which the cheaper SMPP caused the shift from the production of white milk (which can only use domestic raw milk as an input) to the production of flavoured milk. The authorities stated:

In its First Submission, the EC contends that the competent authorities limited their analysis to whether increased market share caused a decrease in domestic milk powder price. Korea, however, directs the Panel to the price information for SMPP on page 63 of the OAI Report and in section V.1.2 of the Notification.

In its First Submission, the EC argues that the competent authorities focused solely on the decline in domestic milk powder prices at the end of the investigation. To the contrary, the competent authorities examined the decline in price at the end of the period, the declining price in real terms (i.e., price adjusted by the overall inflation rate) compared to increases in production costs, and the significant difference in price levels between imports of SMPP and domestic milk powder.

In its First Submission and in its Oral Statement, the EC makes several statements that demonstrate it has, intentionally or unintentionally, ignored the OAI Report and the Notification. Korea refers the EC to the OAI Report at 63 and the Notification at IV.3.7 and V.1.2.

²⁶² OAI Report at 64.

²⁶³ OAI Report at 64. See, also Notification at V.1.3.

²⁶⁴ OAI Report at 64.

“Of the total amount of milk produced, white milk accounted for 92.9 per cent in 1990, 92.4 per cent in 1991 and 92.4 per cent in 1992, maintaining almost the same level. However, the share of white milk decreased with the rapid increase in import of SMPP. The share of white milk fell to 91.3 per cent in 1993, to 88.6 per cent in 1994, to 83.8 per cent in 1995, and to 82.1 per cent in the January-June period of 1996.

The decline in the production of white milk occurred because the domestic producer chose to use the cheaper SMPP to produce flavoured milk which was favoured by the wholesalers and retailers for the product’s higher profit margin.

The decline in the share of white milk which can only be produced from domestic raw milk depressed the demand for domestic raw milk.²⁶⁵”

PORTION OF WHITE MILK IN RELATION TO FLAVOURED MILK PRODUCED
(UNIT : %)

	1990	1991	1992	1993	1994	1995	1996.1-6
White Milk	92.9	92.4	92.4	91.3	88.6	83.8	82.1
Flavoured Milk	7.1	7.6	7.6	8.7	11.4	16.2	17.9

Data: Provided by the MAF to the KTC

4.579 Thus, the cheap SMPP caused a shift of production from white milk to flavoured milk. This shift led to a decline in the use of raw milk by the milk processing companies which in turn led to the increased collection of raw milk by the livestock cooperatives for conversion into milk powder. Contrary to the EC contention, the Korean authorities considered that the shift to flavoured milk production was not the result of consumer preferences but because the cheaper SMPP allowed for the realization of higher profit margins. The European Communities are simply expressing their disagreement with the judgement of the Korean authorities without any evidence. However, the Korean authorities must be accorded due deference in interpreting the data collected rather than being second guessed by a third party.

(v) *Impact of SMPP on the sale of domestic products*

4.580 The Korean authorities examined the impact of cheap SMPP imports on the sale of domestic products. First, with respect to the decline in price, the authorities stated that “[t]he comparatively cheaper priced SMPP and the increased volume of SMPP caused the sales price of domestic milk powder to fall [in real and nominal terms], resulting in the loss of sales revenue in the [specified amounts from 1993 to] the first four months of 1996.” Second, with respect to the loss of sales revenue due to loss of customers, “[b]ecause the imported SMPP is cheaper than the domestic raw milk and milk powder, [two entities] incurred a loss in sales revenue amounting to a total of x,xxx million Won in the period of 1995 to April 1996 as a consequence of their erosion of the customer base²⁶⁶.”

(vi) *Market share of SMPP against total demand*

4.581 With regard to the market share taken by the increased imports of SMPP, the Korean authorities found that:

“Import of SMPP amounted to 3,217 tons in 1993, 15,561 tons in 1994, 28,007 tons in 1995, and 16,320 tons in the January-to-June [period] of 1996. In terms of the

²⁶⁵ OAI Report at 64. See, also Notification at V.1.4.

²⁶⁶ OAI Report at 66.

increase rate, it was 384.0 per cent in 1994, 80.0 per cent in 1995, and 16.9 per cent in the January-June period of 1996.

The market share of SMPP against total demand was 1.6 per cent in 1993, 7.0 per cent in 1994, 12.2 per cent in 1995, and 14.1 per cent in the January-June period of 1996, the rate growing larger every year.²⁶⁷,

CHANGES IN MARKET SHARE OF SMPP
(UNIT: TON)

	1993	1994		1995		1996.1-6	
			Increase rate(%)		Increase rate(%)		Increase rate(%)
Total Demand (A)	2,205,063	2,218,548	9.6	2,303,795	3.8	1,153,964	- 2.3
Production (B)	1,857,873	1,917,398	3.2	1,998,445	4.2	1,069,224	4.4
Import of SMPP (C)	3,217	15,561	384.0	28,007	80.0	16,320	16.9
Market Share of SMPP (C/A, %)	1.6	7.0	-	12.2	-	14.1	-

Data: provided by MAF and KITA to the KTC

4.582 Therefore, the Korean authorities found that SMPP's share of total demand (which includes domestic raw milk, domestic milk powder, imported milk powder and imported SMPP) increased during the investigation period from 1.6 per cent in 1993 to 14.1 per cent in the first half of 1996, representing a net increase in market share of 12.5 per cent.

4.583 The Korean authorities determined the extent to which increased imports of SMPP replaced decreased imports of milk powder. The Korean authorities noted:

"As the import of SMPP increased, its market share in the milk powder sector rose from 10.7 per cent in 1993 to 38.4 per cent in 1994, further to 60.6 per cent in 1995 and to 69.4 per cent in the January-June period of 1996."²⁶⁸

As the import of SMPP increased, however, the amount of milk powder imported decreased from 14,843 tons in 1993 to 11,581 tons in 1994, to 7,576 tons in 1995, and further down to 583 tons in the January-June period of 1996.²⁶⁹

²⁶⁷ OAI Report at 58 and 59. See, also Notification at V.1.1.

²⁶⁸ OAI Report at 60.

²⁶⁹ OAI Report at 61. See, also Notification at V.1.1.

CHANGES IN MILK POWDER PRODUCTS DOMESTICALLY CONSUMED²⁷⁰
(UNIT: TONNES)

		1993	1994		1995		1996.1-6	
				Increase rate(%)		Increase rate(%)		Increase rate(%)
Milk Powder Consumed (A)		30,181	40,532	34.3	46,254	14.1	23,532	14.5
-Domestic Milk Powder Consumed		12,191	12,468	2.3	10,690	- 14.3	6,629	11.6
Supply	Production (B)	13,512	9,495	- 29.7	15,719	65.6	15,058	93.3
	Amount Imported	18,060	27,142	50.3	35,583	30.9	16,903	5.0
	-Milk Powder	14,843	11,581	- 22.0	7,576	- 35.0	583	- 84.0
	- SMPP (C)	3,217	15,561	384.0	28,007	80.0	16,320	16.9
	Total	31,572	36,637	16.0	51,302	40.0	31,961	25.9
Inventory		4,509	1,517	- 66.4	6,565	332.8	14,994	342.7
SMPP's Market Share (C/A)		10.7	38.4	-	60.6	-	69.4	-

Data: provided by MAF, KITA to the KTC

4.584 The imports of milk powder essentially entered at a tariff rate exceeding 200 per cent, while imports of SMPP entered at a rate of only 40 per cent.²⁷¹ Given the tariff differential, imports of SMPP replaced the entire volume of imported milk powder during the investigation period and also captured all of the 90 per cent increased volume of total milk powder and SMPP imports.²⁷² Thus, the European Communities claim argument that "much of the increase" of SMPP was at the expense of imported milk powder ignores the fact that the Korean authorities determined that the imports of SMPP far outweighed the decline in milk powder imports.²⁷³

(vii) *The Korean authorities considered the extent to which other factors were causing injury to the domestic industry*

4.585 The Korean authorities evaluated the following other factors:

(a) *The milk quality dispute*

4.586 The Korean authorities evaluated the arguments presented by interested parties, including the Korea Food Industry Association ("KFIA") and the Korea Dairy Cow Breeding Association ("Breeding Association").²⁷⁴ The KFIA contended that the milk quality dispute contributed 87.17 per cent to the rise in the milk powder inventory and the increase in SMPP contributed 4.80 per cent.²⁷⁵ The Breeding Association contended that increased imports of SMPP contributed 61.9 per cent to the increased milk powder inventory and the milk quality dispute contributed 17.0 per cent.²⁷⁶

4.587 The Korean authorities rejected the analysis of the KFIA based on flaws in its data and analysis.²⁷⁷ The authorities also rejected the Breeding Association's analysis because it failed to submit basic materials to support its claims.²⁷⁸ Instead, the authorities developed three statistical and

²⁷⁰ OAI Report at 61.

²⁷¹ *Id.*

²⁷² *Id.* See, OAI Report at 61; Notification at V.2.2 ("the imports of products under investigation grew by 24,790 tons, while those of milk powder fell by 7,267 ton.

²⁷³ OAI Report at 61; Notification at V.2.2.

²⁷⁴ OAI Report at 67-68. See, also Notification at V.2.1.

²⁷⁵ OAI Report at 67. See, also Notification at V.2.1.a.

²⁷⁶ OAI Report at 67.

²⁷⁷ See, OAI Report at 68; Notification at V.2.1.a.

²⁷⁸ See, OAI Report at 68.

econometric models for estimating the volume of milk production for the period covering November 1995 to June 1996, assuming the quality dispute had not occurred.²⁷⁹ The authorities concluded that “[b]ased on the results of three models, the figures reflecting the difference between estimated and actual volume of milk production indicate that the quality dispute no longer had effect as of January 1996.”²⁸⁰ As part of the OAI’s investigation to determine causality, the OAI also employed a commonly-used econometric technique called the “Granger causality test”. The test results, checking up to six lags in variables to maximize accuracy, indicated that the increased imports of SMPP caused serious injury to the domestic industry.²⁸¹ Taken together, the Korean authorities determined that while the milk quality dispute had an effect for a few months, the imports of SMPP had a negative effect on the domestic industry throughout the entire investigation period.

(b) *Influence of reduced imports of milk powder*

4.588 The Korean authorities evaluated the influence of reduced imports of milk powder in its causation analysis. The Korean authorities essentially determined that:

“[d]uring the period of 1993-1995 the imports of products under investigation grew by 24,790 tons, while those of milk powder fell by 7,267 tons. Therefore, the decreased imports of milk powder had a very slight, albeit positive, impact on the injury to the domestic industry compared with the increased imports of the products under investigation.”²⁸²

(c) *Review of demand*

4.589 The Korean authorities also examined other factors potentially causing serious injury to the domestic industry relating to demand for domestic raw milk and milk powder. With respect to consumption, they stated that “given the overall increase in consumption, the injury to the domestic industry is not attributable to a decrease in consumption.”²⁸³ With respect to whether the shift to flavoured milk from white milk was based on changing consumer preferences, the authorities found that the shift was “attributable to milk processors seeking to change the production structure in order to maximize their profits through the use of cheaper imported products, as opposed to changes in consumer preference.”²⁸⁴ With respect to consumption of final dairy products, they determined that dairy products consumption increased during the period from 1993 to June 1996, and “[t]herefore, it was not regarded as a cause of injury to the domestic industry.”²⁸⁵

4.590 With respect to the effect of the situation in other dairy products sectors, the Korean authorities examined the white milk, milk powder preparation, evaporated milk, butter, and cheese sectors. Because the production and consumption of these dairy products increased during the period

²⁷⁹ *Id.* In its First Submission, the EC contends that the competent authorities “fail[ed] to make any analysis” of the effects of the milk quality dispute. In its Oral Statement, the EC states that “[n]o detail is given of the analyses which led to this remarkable conclusion” and that the milk quality dispute was “lightly dismissed.” Korea again suggests that the EC review the OAI Report of which it has had a copy in English at least since early 1997.

²⁸⁰ OAI Report at 69.

²⁸¹ The Granger causality test indicated for example, that the increased imports of SMPP caused an increase in milk powder inventory at 5 per cent level of significance. In hypothesis testing 5 per cent level of significance means that the level of confidence of the test result is 95 per cent (see, for example, Damodar N. Gujarati, *Basic Econometrics*, 2nd. Edition, McGraw Hill: NY, 1988, p. 99).

²⁸² Notification at V.2.2.

²⁸³ Notification at V.2.3.1.

²⁸⁴ Notification at V.2.3.2. In its Oral Statement, the EC disagrees with the competent authorities’ judgement on this issue. Korea considers that the EC should not be allowed to assume the role of the investigating authority.

²⁸⁵ Notification at V.2.3.3.

of the survey and because their use of domestic raw milk and domestic milk powder also increased, the authorities found that “no connection could be established between the effect on these dairy products and injury to [the] domestic industry.”²⁸⁶

(d) Review of price decision by the government

4.591 Finally, the Korean authorities evaluated any potential injury caused by the suggested government price for raw milk. The authorities found that the suggestion of such a price did not adversely affect the domestic industry because it was not obligatory and was intended as a suggested reference price for contracts between dairy households and milk processing firms.²⁸⁷

(f) Additional arguments by the European Communities made at the second meeting of the Panel with the parties

4.592 At the second meeting of the panel with the parties, the **European Communities** further advanced their arguments under Article 4.2(b) as follows:

4.593 The European Communities point to the flaws in the conclusions drawn from by Korea from its econometric models. The models do show a shortfall in consumption continuing until June 1996 but it is then stated at pages 68 to 70 of the OAI Report that this cannot be due to the milk quality dispute as this ended in February. No other explanation is advanced for the shortfall. This is perfectly circular reasoning.

4.594 Korea alleges it performed a “Granger causality test”, without in any way explaining where it is to be found in the OAI Report, how this test works, precisely what its results demonstrated, what variables were used in relation to “checking lags”, what level of statistical accuracy was demonstrated in the test results, etc. This test has never been mentioned before by Korea and cannot be taken seriously without considerably more information being given as to its nature and its application to this situation. Indeed, the European Communities asked, what happens when it is applied to the milk quality scandal?

(g) Additional arguments by Korea made at the second meeting of the Panel with the parties

4.595 At the second meeting of the panel with the parties, **Korea** further advanced its arguments under Article 4.2(b) as follows:

4.596 The European Communities argue that the econometric models used by the OAI were flawed in that they examined production, instead of consumption. Korea notes that:

- (a) The OAI assumed that production is equal to the consumption of milk, which is a realistic assumption, and the difference between production and consumption data was so small as to be statistically insignificant;
- (b) The statistical and econometric models actually focussed on the difference between actual and forecasted production, and not production itself; and
- (c) Finally, and most importantly, the Granger Causality test, which checked the causality from increase of imports of SMPP to increase in inventory did not use data such as production or consumption.

²⁸⁶ Notification at V.2.3.6.

²⁸⁷ See, Notification at V.2.4.

4.597 In response to a question by the Panel²⁸⁸, **Korea** explained that in order to establish any causal relationship between the imports of SMPP and the increase in inventory, the OAI used the econometric technique referred to as “Granger Causality” test. The following parameters or techniques were applied:

The period of the data covered January 1993 to June 1996;
The statistical software “Eviews” was used
X-11 Arima multiplicative method was used to remove seasonality;
Since the level terms of most variables are non-stationary, a unit root test was applied, this being an augmented Dickey-Fuller test, with constant and no-trend term;
Akaike information criterion was adopted to get optimal lags in the right-hand variable; and
Lags up to six were checked on the right-hand side of the equation used in the Augmented Dickey-Fuller test.

The calculated ADF statistics were the following:

level of import of SMPP was -1.163, which is not significant at any reasonable level of significance;
level of inventory of milk powder was 0.284, which is not significant at any reasonable level of significance;
first differentiated value of import of SMPP was -8.159, which is significant at 1 per cent level of significance; and
first differentiated value of inventory was -2.976, which is significant at 5 per cent level of significance.

4.598 Therefore the calculated ADF statistics showed that the import of SMPP and inventory of milk powder are integrated of order one, like most other macroeconomic time series. As the first differenced variables were revealed to be stationary, they were used to obtain the result of causality tests. The most commonly used causality test is the Granger test, and this was used to obtain the result. Pairwise Granger causality tests, checking lags up to 6, revealed that imports of SMPP caused an increased in inventory of milk powder at 5 per cent in four out of six cases and at 10 per cent in one case. The causation was negated at 10 per cent only in one out of six cases. The calculated F statistics were the following:

one lag case:	F(1,36) =	1.850;
two lag case:	F(2,34) =	2.733;
three lag case:	F(3,32) =	3.583;
four lag case:	F(4,30) =	5.681;
five lag case:	F(5,28) =	4.314;
six lag case:	F(6,26) =	5.394.

4.599 Therefore, on the basis of the above, the OAI concluded that the econometric causality tests revealed a causal relationship running from the import of SMPP to the increase in inventory of milk powder.

4.600 In response to a question by the Panel²⁸⁹, **Korea** clarified the substitutability of raw milk, milk powder and SMPP. As stated in Section II.2 of the OAI Report, SMPP can substitute domestically

²⁸⁸ The Panel recalls that the question was: “How was the ‘Granger’ test applied in this case?”

²⁸⁹ The Panel recalls that the question was: “In Korea's first submission, it is stated that SMPP products are competing directly with domestically-produced raw milk and pure milk powders. Could Korea elaborate? Does this mean that 1 unit (say 1 Kg) of SMPP can substitute 1 unit of milk powder and/or 1 unit of raw milk for the production of downstream products? Please provide the Panel with exact figures for each of the downstream product (e.g., yoghurt, flavoured milk, ice-cream, cheese etc...). Was the Korean Trade

produced raw milk and milk powder to produce flavoured milk, fermented milk, ice cream and cookies. Based on the import clearance document submitted by foreign exporters, the Korean authorities verified that SMPP can be used to produce milk based beverages, ice cream and cookies. That the imported SMPP and domestic milk powder are in directly competitive relationship is evidenced by the fact that the primary difference between the two products is that the former contains 75 per cent to 85 per cent milk powder and 15 per cent to 25 per cent whey or malt concentrate.²⁹⁰ Moreover, for commercial purposes, the imported SMPP and domestic products share common end uses. Imported SMPP and domestic products can be used to produce flavoured milk, fermented milk, ice cream and cookies.²⁹¹ As a further indication that the imported SMPP and domestic products are directly competitive products, the Korean authorities found that, of the total purchase of basic materials, five dairy processing companies increased their purchases of SMPP from 3 per cent in 1993 to 23.8 per cent in 1994, 29 per cent in 1995 and 53.3 per cent in January-April 1996.²⁹²

4.601 In producing flavoured milk and cookies, one unit (1 kilogram) of SMPP can substitute one unit (1 kilogram) of milk powder or ten units of raw milk. In producing ice cream and fermented milk, one unit of domestic milk powder can be replaced by anywhere between 0.8 to 1.2 units of SMPP, depending on the dairy processing company. The Korean authorities decided that the use of one to one substitution rate between imported SMPP and domestic milk powder to produce ice cream and fermented milk was appropriate because, based on the data collected, the usage rate would average out to one unit to one unit rate.

4.602 The Korean authorities were aware that (1) the domestic products and the imported SMPP had physical differences but shared common end uses and (2) substitutability between the imported SMPP and domestic milk powder was on a one unit to one unit basis and that ten units of raw milk are needed to produce one unit of milk powder. The conversion rate of ten raw milk units to one milk powder unit is reflected in various places of the OAI Report. For instance, charts in Sections III.5.A and VI.2.A reflect this conversion rate. The substitution rate of one unit to one unit between SMPP and milk powder is reflected in the Note at the bottom of the chart in Section III.5.A which states "for computation of demand and self sufficiency rates, the amounts of SMPP and imported milk powder calculated in terms of domestically produced raw milk were used." Although this is not the most eloquent translation, it indicates that the Korean authorities were familiar with the fact that ten units of domestic raw milk were equivalent to one unit of SMPP or one unit of imported milk powder.

H. CLAIMS UNDER ARTICLE 5.1 OF THE AGREEMENT ON SAFEGUARDS

(a) Claim by the European Communities

4.603 The **European Communities** claim that Korea violated Article 5.1 of the Agreement on Safeguards by failing to show that the measure was necessary to prevent or remedy serious injury and to facilitate adjustment; by failing to demonstrate that a quota was the most suitable to prevent or remedy serious injury and to facilitate adjustment; and by imposing a quota lower than the average of imports in the last representative three-year period preceding the application of the measure for which statistics were available. The following are the EC arguments in support of these claims:

4.604 Article 5.1 of the Agreement on Safeguards provides that

"A Member shall apply safeguard measures only to the extent necessary to prevent or remedy serious injury and to facilitate adjustment. If a quantitative restriction is used,

Commission aware of these facts at the time of its investigation? Did it take them into account in its report and if so how, and where is it indicated in the OAI Report?

²⁹⁰ See, OAI Report at Section II.4

²⁹¹ See, OAI Report at Section IV.1.B.(4).(a)

²⁹² See, OAI Report at Section IV.1.B.(4).(B).(i)

such a measure shall not reduce the quantity of imports below the level of a recent period which shall be the average of imports in the last three representative years for which statistics are available, unless clear justification is given that a different level is necessary to prevent or remedy serious injury. Members should choose measures most suitable for the achievement of these objectives”.

Even if Korea’s analysis of serious injury and causation were correct, the European Communities submit that Korea violated Article 5.1 of the Agreement on Safeguards by failing to show that the quota which it applied was necessary and the most suitable to remedy the injury and facilitate adjustment.

4.605 The fact that safeguard measures are “limitative and deprivational in character or tenor and impact upon Member Countries and their rights and privileges and upon private persons and their acts” was clearly recognized by the Appellate Body in its report in *US - Underwear*.²⁹³ In the light of that characterization, the Appellate Body drew the conclusion that an importing Member should not be allowed “an enhanced ability to restrict the entry into its territory of goods in the exportation of which no unfair trade such as dumping or fraud or deception of origin is alleged to be proven” by taking safeguard action beyond the strict limits laid down in the relevant WTO provisions, which would result in “excluding more goods from the territory of the importing Member”.²⁹⁴

4.606 Some of the limits built in the WTO safeguard measures regime relate to the measures themselves, notably to their scope, level and type. Those limits are laid down in Article 5.1. Besides recalling that safeguard measures must be necessary to remedy serious injury, as provided for in Article XIX:1(a),²⁹⁵ Article 5.1 of the Agreement on Safeguards further requires that the temporary protection from foreign competition must be *necessary to facilitate adjustment*.²⁹⁶ The rationale for this provision is clearly that protection of an inefficient industry sector with no recovery prospects by means of safeguard measures should be excluded.

4.607 It follows from the foregoing that a Member of the WTO seeking to take a measure under the Agreement on Safeguards must show that such a measure is, in its scope and level, necessary to remedy the injury suffered by the domestic industry and necessary to facilitate its adjustment. In this respect the European Communities note that Korea failed to provide any justification as to the reasons why the quantitative restrictions applied were necessary to remedy the alleged serious injury and to facilitate adjustment. In particular, Korea did not submit any information as to adjustment plans to restore the domestic industry’s competitiveness while temporarily shielding it from foreign competition. On the contrary, Korea took safeguard action in the context of a protected market. It is clear to the European Communities by omitting to give any consideration to adjustment plans, *a fortiori* Korea has failed to examine how that measure could be necessary, or even helpful, to their implementation.

4.608 For these reasons, the European Communities submit that Korea violated its obligations under Article 5.1, first sentence of the Agreement on Safeguards.

²⁹³ See, Appellate Body report in *US - Underwear*, 10 February 1997, p. 9.

²⁹⁴ *Id.*

²⁹⁵ Article XIX:1(a) refers, in virtually identical terms, to the “extent and time necessary to remedy the injury”.

²⁹⁶ See, also the Preamble of the Agreement on Safeguards, second to last paragraph, “[r]ecognizing the importance of structural adjustment and the need to enhance rather than limit competition in international markets”.

(i) *The most suitable measures to remedy serious injury and facilitate adjustment*

4.609 Article 5.1, last sentence, of the Agreement on Safeguards, further building upon the remedial character and the adjustment objective of safeguard measures, also requires Members to "choose measures most suitable for the achievement of these objectives." The ordinary meaning of this clause already suggests that both the objective to remedy the injury and the objective to facilitate adjustment also limit the *type* of measure which a Member may adopt, in addition to its level or scope. This construction is further reinforced in the light of the principle of effective interpretation of treaties, based on which where a treaty provision can be subject to several possible interpretations, preference should be accorded to the one giving that provision its effect.²⁹⁷ In fact, if the second sentence of Article 5.1 were also to be interpreted as a limit to the level or scope of a measure, rather than as including some additional element, it would be redundant in the light of the first sentence.

4.610 The conclusion that the choice of the type of safeguard measure is limited under Article 5.1 of the Agreement on Safeguards is confirmed if that provision is interpreted in its context. In fact the Agreement on Safeguards includes a partially different regime for quotas and tariff measures. In the first place, a maximum limit to the level of protection, additional to the injury level and the adjustment required, is imposed by Article 5.1, second sentence, providing that "if a quantitative restriction is used, such a measure shall not reduce the quantity of imports below the level of a recent period which shall be the average of imports in the last three representative years for which statistics are available." Second, in case of provisional measures Article 6 of the Agreement on Safeguards limits the possibility of action to tariff measures only. Also, the different nature and impact of the various protection measures has been expressly recognized in the regulatory framework established by the WTO Agreement and its annexes. Specifically, Members recognized that "price-based measures", that is, "measures with an impact on the price of imported goods" "have the least disruptive effect on trade".²⁹⁸

4.611 It follows from the foregoing that if a WTO Member seeks to take a safeguard measure, the choice of the type of measure also needs to be justified in terms of its adequacy to remedy injury and facilitate adjustment. The European Communities therefore conclude that, by failing to consider whether other types of measure than a quota would be the most suitable to remedy serious injury and to facilitate adjustment, Korea further violated its obligations under Article 5.1 of the Agreement on Safeguards.

(ii) *Quota lower than average of imports in the last representative three-year period preceding the application of the measures for which statistics were available*

4.612 Article 5.1, second sentence, of the Agreement on Safeguards provides that

"if a quantitative restriction is *used*, such a measure *shall not* reduce the quantity of imports below the level of a recent period which *shall* be the average of imports in the *last three representative* years for which statistics are *available*, unless *clear justification* is given that a different level is *necessary* to prevent or remedy serious injury." (emphasis added).

²⁹⁷ The principle of effectiveness in treaty interpretation was recognized as an appropriate interpreting principle by the Appellate Body in *US - Underwear*, p. 5.

²⁹⁸ See, the *Understanding on the Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994*, para. 2. Para. 3 is even more explicit in providing that "Members shall seek to avoid the imposition of new quantitative restrictions for balance-of-payments purposes unless, because of a critical balance of payments situation, price-based measures cannot arrest a sharp deterioration (...). In those cases in which a Member applies quantitative restrictions, it shall provide justifications as to the reasons why price-based measures are not an adequate instrument to deal with the balance-of-payments situation."

4.613 The average of imports into Korea for July 1993-June 1996 was lower than the average for the period January 1994-December 1996. The European Communities submit that, by calculating the quota level on the basis of import data relating to the period July 1993-June 1996, rather than to the period January 1994-December 1996, the Korean authorities violated Article 5.1 of the Agreement on Safeguards, second sentence, since July 1993 - June 1996 data did not relate to the “last three representative years for which statistics are available” and the resulting quota was lower than allowed by that provision, without justification being provided.

4.614 In order to demonstrate this claim the European Communities first examine the meaning of Article 5.1, second sentence of the Agreement on Safeguards, and then turns to the three years which are relevant under that provision.

(a) *Article 5.1 of the Agreement on Safeguards*

4.615 Article 5.1 of the Agreement on Safeguards is clearly intended to avoid the quota being set at a level unrelated to historical import flows prior to its imposition, which would prove particularly disruptive for exporters. By limiting in principle the minimum quota level to the average of the last three representative years the Agreement on Safeguards establishes a presumption that for quotas such level is the maximum restriction which would be justifiable as “necessary” within the meaning of Article 5.1 Agreement on Safeguards. It is only if the Member seeking to apply a safeguard measure in the form of a quota is able to show that a quota level based on those data is not sufficient to remedy the serious injury in a specific case that a lower quota may be imposed. Since Korea has not considered the issue of necessity at all, it has taken no steps to rebut this presumption.

(b) *The last three representative years for which statistics are available*

4.616 In order to determine the “last three representative years” which Korea should have used in setting the quota level, the following issues must be addressed: (i) the starting time from which to calculate the three years, (ii) the availability of statistics for those three years and (iii) the representativity of those data.

(1) *Starting time*

4.617 As regards the relevant time to decide which are the last three years’ available import statistics pursuant to Article 5.1 Agreement on Safeguards, the ordinary meaning of the provision already makes clear that it is the moment when a decision to take a measure in the form of a quota has been taken and the quota level is to be decided. The context of the second sentence of Article 5.1 further reinforces that interpretation. In fact the first sentence of Article 5.1 makes clear that the provision relates to the time when a Member “applies” safeguard measures. The Appellate Body Report *US - Underwear* removed any doubt as to the meaning of the term, by pointing out that the word “apply”, when used as here in respect of a governmental measure - whether a statute or an administrative regulation – means, in ordinary acceptance, putting such measure into operation.”²⁹⁹ Thus, the European Communities submit that the starting time for the assessment of the “last three years” is the moment when action in the form of a quota was taken and the quota was calculated. Therefore, it is from that moment that a country should look retrospectively at imports trends until it finds three representative years of data. A final decision on a definitive safeguard measure in the form of a quota was taken by Korea on 7 March 1997.³⁰⁰

²⁹⁹ *Id.*, p. 8.

³⁰⁰ See, WTO Doc. G/SG/N//10/KOR/1/Suppl/1, 1 April 1997, p.1 (Exhibit EC-10).

(2) Availability of the data relating to the relevant period

4.618 The import statistics considered by the KTC in determining the appropriate level of the quantitative restriction relate to the period July 1993 through June 1996.³⁰¹ While data relating to that period were certainly “available” within the meaning of Article 5.1 when the quantitative restriction level was set, it remains to be clarified whether more recent information was also available. In this respect the European Communities submit that, as made clear from Korea's Statistical Yearbook of Foreign Trade for 1996³⁰², import data relating to the whole 1996 were available to the Korean authorities before the amount of quota was finally calculated and that these data should therefore have formed the basis for calculation of the quota level.

(3) Representativity

4.619 The European Communities submit that Korea completely failed to address, either expressly or impliedly, the issue of whether the statistics on which it relied to set the quota level were indeed “representative”. The ordinary meaning of the term and its context make clear that “representative” refers to import trends. The aim is to avoid the inclusion of periods where trade flows were abnormal. However, no such evaluation of the quality of the data relied upon is included in any of Korea's notifications to the WTO.

4.620 Moreover, the European Communities further contend that, if such evaluation had been carried out, it would have led to exclude data relating to the second semester of 1993 as not “representative” within the meaning of Article 5.1 of the Agreement on Safeguards. As indicated in Korea's Schedule of concessions, imports of item 1901.90.2000 (“food preparations”) into Korea were still subject to Balance-of-Payment restrictions during that period.³⁰³ Therefore, although the relevant tariff rates had been lowered to 40 per cent as of the beginning of 1993, their imports did not take place under conditions which would have made them “representative”. This is an additional reason to conclude that Korea should have based its quota on the period January 1994-December 1996. In the light of the foregoing the European Communities consider that Korea based its calculation of the quota level on data that did not relate to the last three representative years available within the meaning of Article 5.1 of the Agreement on Safeguards.

4.621 In response to a question of the Panel³⁰⁴ the **European Communities** further clarified their arguments under Article 5:

4.622 The first and second sentences of Article 5.1 contain complementary obligations which all have to be respected. The first and third sentences of Article 5.1 apply on their face to all safeguard measures. The second sentence contains an additional obligation which only applies to quantitative restrictions.

4.623 Also in response to a question of the Panel³⁰⁵ the **European Communities** further argued:

³⁰¹ See, Exhibit EC-8.

³⁰² See, Exhibit EC-20.

³⁰³ See, Exhibit EC-17.

³⁰⁴ The Panel recalls that the question was: "If a quota is established based on the level of imports for the three representative years, does the importing country still have an obligation to prove that such level was necessary? In other words does the level established pursuant to the three representative years constitute a minimum quota, the level of which must still be proven to be "necessary"? Please comment and discuss the relationship between the first and second sentence of Article 5.1 of the Agreement on Safeguards.

³⁰⁵ The panel recalls that the question was: "If there is no such period of three representative years because good under investigation have been the object of restrictions (GATT/WTO compatible or not) how should the importing country proceed to assess such necessary level of quota?"

4.624 The second sentence of Article 5.1 contains an additional obligation for quantitative restrictions. If there is no representative three year period the Member must then base its measure on “the level necessary to prevent or remedy serious injury”, according to the second part of that sentence. The rule in the first part may still be relevant as a guide.

(b) Response by Korea

4.625 **Korea** responds to the EC arguments as follows:

4.626 Korea based its quota level on the average of imports for the three years from July 1993-June 1996. Korea initiated its safeguards investigation in May 1996. After that date, imports of SMPP would be expected to increase abnormally, as foreign exporters and their Korean customers increase their volume of imports in anticipation of a safeguards measure. In fact, the use of three «representative» years was intended to prevent foreign exporters from manipulating quota levels by flooding the market with imports just prior to the decision to impose a safeguard measure. Therefore, Korea considered that the second half of 1996 was not «representative,» and it excluded imports from this period in calculating the quota level. Korea considered that the quota levels chosen were the most suitable for achieving the “objectives” identified in Article 5.1, *i.e.*, preventing or remedying the serious injury and facilitating adjustment to the domestic industry in Korea.³⁰⁶

4.627 Pursuant to a question by the Panel³⁰⁷ **Korea** further clarified its arguments under Article 5 as follows:

4.628 In the view of Korea, the first two sentences of Article 5.1 of the Agreement on Safeguards do not impose a general obligation on Members to demonstrate that the specific level of quota that they decided to impose as a safeguard measure is necessary to prevent or remedy serious injury and to facilitate adjustment. Such an obligation only arises if the level of such quota is lower than the average imports during the three most recent representative years for which statistics are available. As the wording of the second sentence of Article 5.1 makes clear, Members must only justify the level of quotas if it is different (*i.e.*, lower) than the average imports during the three most recent representative years.

4.629 The first clause of Article 5.1 does not impose any obligation but merely states a basic principle regarding the application of safeguard measures. This basic principle is that Members should apply safeguard measures only to the extent necessary to achieve the objectives of safeguard measures (*i.e.*, to prevent or remedy serious injury and to facilitate adjustment). This basic principle is generally applicable whether the safeguard measure imposed is a tariff, a tariff-quota, or a quota. The first clause of Article 5.1 cannot be read as imposing an obligation on Members to demonstrate that a particular level of tariff or quota is necessary to prevent or remedy serious injury and to facilitate adjustment. Article 5.1 does not identify objective criteria that may be used to calculate the level of tariff, tariff-quota, or quota that would “remedy” serious injury or “facilitate adjustment” under the unique circumstances facing particular industries.

4.630 The second sentence of Article 5.1 only applies when a Member imposes a safeguard measure in the form of a quota. To give Members useful guidance, the drafters of this sentence established a

³⁰⁶ See, Exhibit Korea-8 in which only one of the seven KTC commissioners considered that a tariff rate quota was the more appropriate measures for dealing with the serious injury caused by the increased imports.

³⁰⁷ The Panel recalls that the question was: "If a quota is established based on the level of imports for the three representative years, does the importing country still have an obligation to prove that such level was necessary? In other words, does the level established pursuant to the three representative years constitute a minimum quota, the level of which must still be proven to be 'necessary'? Please comment and discuss the relationship between the first and second sentence of Article 5.1 of the Agreement on Safeguards."

minimum quota level that would be deemed necessary to achieve the objectives of imposing a safeguard measure. This level is set at the average of imports during the three most recent representative years for which statistics are available. To the extent that the quota is set at that level or at a higher level, Members are not required to prove that this quota level is necessary. This is not a strict minimum quota, however because the second sentence of Article 5.1 permits a Member to set a quota at a lower level than the average imports during the three most recent representative years, provided it presents clear justification that such lower level is necessary. If a Member decides to impose a quota that is not lower than the average imports during the three most recent representative years, it is not required to provide any explanation or justification as to the necessity of this quota level.

4.631 With regard to tariff-based safeguard measures, Article 5.1 does not obligate Members to provide any explanation or justification of the level of such measures. It is not for Korea to speculate why the drafters felt that a benchmark was necessary for quotas but not for tariff-based measures. The fact that the second sentence of Article 5.1 only refers to quotas, however, can only mean that there is no requirement to demonstrate that the level of a tariff-based measure is necessary to achieve the objectives pursued. In Korea's view, the obligation to justify the level of the safeguard measure only exists if the measure is a quota and if such quota is set at a level lower than the average imports during the three most recent representative years for which statistics are available.

4.632 In this case, Korea determined that application of a safeguard measure was necessary to remedy serious injury and facilitate adjustment because "[w]hile it was determined that the domestic industry has been suffering from serious injury caused by increased imports, the injury has not been relieved even by the continuing efforts of the relevant authorities and the petitioner. In this regard, it is agreed that the appropriate relief measures should be taken to resolve the problem."³⁰⁸ Based on the guidance provided in the second sentence of Article 5.1, Korea rejected the alternatives suggested by the petitioner and recommended a quota at a level based on the three most recent representative years for which statistics were available.³⁰⁹

4.633 In response to another question by the Panel³¹⁰ **Korea** also argued that:

4.634 In the view of Korea, Article 5.1 does not impose an obligation on Members to demonstrate that a particular level of a tariff (or tariff-quota) is necessary or that it is the most suitable means to remedy injury and facilitate the adjustment. In this respect, it is important to distinguish between two issues: (i) whether the particular type of safeguard measure (*i.e.*, tariff, quota, tariff-quota) is the most suitable means for achieving the objectives sought, and (ii) whether the level of the tariff, quota, or tariff-quota imposed (as the most suitable measure) is necessary to achieve such objectives. In this regard it is necessary to consider the first and third sentences of Article 5.1. The first sentence states the basic principle that a safeguard measure should be applied only to the extent necessary to prevent or remedy serious injury and to facilitate adjustment. The third sentence of Article 5.1 provides there is no obligation to demonstrate that a tariff (or tariff-quota) is the most suitable measure to achieve these objectives, nor to demonstrate that the level of such tariff (or tariff-quota) is necessary or appropriate to achieve these objectives.

4.635 In this case, it is noteworthy that the KTC Commissioners examined the relief measures requested by the petitioner, including:

³⁰⁸ See, Exhibit Korea-8, at 3.

³⁰⁹ *Id.*

³¹⁰ The Panel recalls that the question was: "Do you consider that under Article 5.1 of the Agreement on Safeguards the importing country needs to show that a safeguard measure, in the form of a tariff (or tariff-quota), is necessary and the most suitable means to remedy the injury and facilitate the adjustment? Do you need to show that the level of the tariff (or tariff-quota) was appropriate?"

reclassify the tariff treatment of SMPP into the same category of dutiable items as skimmed or whole milk powder;
increase the customs duties on SMPP to the level of milk powder for four years; and
restrict the import volume to 10,000 tons per year for four years.³¹¹

4.636 The KTC stated that:

[b]efore recommending the relief measures, the KTC commissioners agreed that close considerations should be made beforehand for each relief measure on its impacts on the domestic dairy industry, national economy, and bilateral/multilateral trade. In this regard, the KTC examined the information investigated by the OAI, the relevant articles of the multilateral regulations, the opinions of authorities concerned, and the relief measures stipulated in the Foreign Trade Act and the Enforcement Decree of the Act. Based on all these examinations, the KTC reviewed the petitioner's request for relief measures.³¹²

Korea also examined whether a tariff-quota would be more appropriate and what the appropriate duration for the application of the measure should be.³¹³ Based on its examination, the KTC recommended that the appropriate duration of the measure was four years and that the measure should be in the form of a quantitative restriction in the amount not exceeding the average of the import levels for the three most recent representative years for which statistics were available.³¹⁴

4.637 In another response to a Panel question, **Korea** further clarified its arguments on the "representative" three-year period for purposes of Article 5.1:

4.638 Korea considers that each of the three years prior to the filing of a safeguards petition is normally representative of the import levels on which a quota restriction may be based, absent clear justification otherwise and notwithstanding the existence of import restrictions during any particular year. The "representative" nature of imports under Article 5.1 of the Agreement on Safeguards must be determined with reference to the normal level of imports for the particular Member concerned, regardless of any import "restrictions" then in force. Notably, "representative" under Article 5.1 cannot reasonably be interpreted to mean "fully liberalized" or absent any tariff or non-tariff restriction potentially affecting imports.

(c) Additional arguments by the European Communities made at the first meeting of the Panel with the parties

4.639 At the first meeting of the panel with the parties, the **European Communities** further advanced their arguments under Article 5.1 as follows:

4.640 The **European Communities** noted that in their endeavours to justify the exclusion of the second semester of 1996 by saying that in that period imports would have "increased abnormally" in anticipation of the measure. The **European Communities** would like to recall that in 1996 imports recorded an increase of approximately 15 per cent as compared to 1995, which increase appears much less "abnormal" *i.e.*, more "representative", than the increases of approximately 384 per cent from 1993 to 1994 and 80 per cent from 1994 to 1995. The **European Communities** would also recall that, as demonstrated by its Exhibit EC-20 and not contested by Korea, full 1996 data were available when the quota was finally decided.

³¹¹ See, Exhibit Korea-8, at 3.

³¹² *Id.* at 3-4.

³¹³ *Id.* at 4-5 (see minority opinion of Jeong Mun-Su).

³¹⁴ *Id.* at 4.

(d) Additional arguments by Korea made at the first meeting of the Panel with the parties

4.641 At the first meeting of the panel with the parties, **Korea** further advanced its arguments under Article 5.1 as follows:

4.642 Korea not only fully complied with its obligations under Article 5 of the Agreement on Safeguards, but also exercised its good faith in expanding the amount of the quota based on requests during consultations from the **European Communities** and other WTO Members. In its decision of 2 December 1996, the KTC Commissioner evaluated the appropriate relief measures, stating that “[b]efore recommending the relief measures, the KTC commissioners agreed that close considerations should be made beforehand for each relief measure on its impacts on the domestic dairy industry, national economy, and bilateral/multilateral trade.”³¹⁵ The KTC then listed the information examined regarding the range of proposed relief measures. A majority of the KTC Commissioners then determined that a quota was the most suitable relief measure, with one commissioner offering a minority opinion that a tariff-rate quota would be preferable.

4.643 Korea does not understand the EC argument that Korea failed to consider whether other types of measures would have been more suitable.³¹⁶ In Korea's view, the European Communities are simply wrong.

4.644 The volume of the quota was based on the average level of imports of the three most recent representative years for which statistics were then available, from June 1993 to June 1996. Korea refused to increase the quota further by including the remainder of 1996 in the historical bases for calculating the quota. This period was not representative because exporters can be expected to increase artificially the volume of their exports in anticipation of the safeguard measure.

4.645 During consultations under Article 12.3 of the Agreement on Safeguards, the European Communities objected to the calculation of the quota level. After considering the European Communities concerns, Korea decided, in good faith, and without being obligated to do so, to raise the quota level by almost 5,000 tons.

(e) Rebuttal arguments made by the European Communities

4.646 The **European Communities** made the following arguments in rebuttal:

4.647 In the EC view a “necessity” requirement is embodied in Article 5.1 of the Agreement on Safeguards, which requirement must be met in order for a measure to be authorized under that provision. A general “necessity” requirement is laid down in the first sentence. Furthermore, there is a specification of that requirement for safeguard measures in the form of quantitative restrictions to the effect that, in principle, quota level lower than the average of imports in the three representative years is not (never) necessary, unless clear justification is given in this respect. Of course, this principle cannot entail at all that whichever is in compliance with that threshold is automatically necessary.

4.648 The European Communities further maintain that the years used by Korea to calculate its quota level were not the “last three representative available”. In the case at issue in this dispute, Korea has neither calculated the quota consistently with this required threshold nor, *a fortiori*, has been able to show that it did.

4.649 The interpretation of Article 5.1 of the Agreement on Safeguards, in the light of its wording, context and purpose and in accordance with the principle of effective treaty interpretation, mandates

³¹⁵ See, Exhibit Korea-8.

³¹⁶ *Id.*

this conclusion: each provision was drafted with its own meaning and must be given its autonomous meaning when being interpreted. On the contrary, by denying the binding character of the necessity requirement except within very strict limits, Korea is trying to unduly reduce the scope of its obligations under the WTO Agreements, and thus the rights arising thereunder to the European Communities. Reduction or modification of rights and obligations is emphatically not allowed under the WTO.³¹⁷

(i) *Necessity is a requirement laid down in Article 5.1, first sentence in respect of all safeguard measures*

(a) *Wording*

4.650 The European Communities reiterate that the term “necessity” is binding language, both in the first and in the second sentence of Article 5.1 of the Agreement on Safeguards. Both sentences impose obligations upon WTO Members wishing to adopt safeguard measures to do so only to the extent they are necessary to prevent or remedy serious injury and to facilitate adjustment, although the second is a specification of the first one, applicable in respect of one type of measure only. As the Appellate Body pointed out in *US - Underwear*, far from suggesting non-binding character,

“a contention of necessity may be seen to assume that no other recourse is available to the importing country.”³¹⁸

4.651 The European Communities find it curious that, in trying to unduly restrict its obligations and EC rights under the Agreement on Safeguards, just as it does for its obligations arising under Article XIX of GATT, Korea is using the opposite tactics. In the case of Article XIX, lack of repetition of the “unforeseen developments” requirement in the Agreement on Safeguards is deemed to show its abrogation by the latter. In the case of Article 5.1 of the Agreement on Safeguards, in spite of repetition of the word “necessary” in two consecutive sentences of the same Article, Korea is able to deny the binding character of the word in the first sentence but finds unexpectedly that it is binding in the second sentence— be it by further limiting the scope of that more specific obligation.

(b) *Context*

4.652 The same conclusion is compelled by the interpretation of the provision in its context. First, the term “necessary” is reiterated in the second sentence of Article 5.1, which constitutes the most immediate “context” of the first sentence. Repetition of a term which is binding by its ordinary meaning confirms that use of that term is not accidental or inaccurate, and instead represents a deliberate choice of the drafters. Second, the same term is used elsewhere in the WTO system - notably in provisions derogating from the liberalization principle embodied therein - with the same binding meaning. Article XIX itself embodies virtually identical language and authorizes safeguard measures “to the extent and for such time as may be necessary to prevent or remedy serious injury”. Furthermore, Article XX of GATT allows measures to be taken if *e.g.*, “(a) necessary to protect public morals”, “(b) necessary to protect human health”.

4.653 Comparison with other WTO Agreements regulating trade defence measures also shows that when the drafters have wanted to be permissive as to the maximum level allowed for one of such measures they have used much less strong language. Article 9 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (“the Anti-Dumping Agreement”),

³¹⁷ See, Article 3.2 and 3.9 of the DSU, respectively providing: “Recommendations and rulings of the DSB cannot add or diminish the rights and obligations provided in the covered agreements” and “The provisions of this Understanding are without prejudice to the rights of Members to seek authoritative interpretation of provisions of a covered agreement through decision-making under the WTO Agreement” (emphasis added).

³¹⁸ See, Appellate Body Report in *US - Underwear*, 10 February 1997, WT/DS24/AB/R, p. 11.

provides on the one hand, that anti-dumping duties can never exceed the dumping margin. By contrast, it further stipulates that:

“It is desirable that the imposition [of an anti-dumping duty in cases where all requirements for the imposition have been fulfilled] be permissive and that the duty be less than the margin if such lesser duty would be adequate to remedy the injury to the domestic industry.”

This provision shows that the drafters of the WTO Agreement have chosen a much softer language when intending to express an absence of obligation. It also shows that there is a difference in the regime adopted for dumping measures and for safeguard measures, which is otherwise logical having regard to the different situation – unfair trade practices, fair trade - which dumping and safeguard measures are respectively aimed to remedy.

(c) *Purpose*

4.654 The purpose of the “necessity” requirement is to avoid that measures, which are recognized as “limitative and deprivational in character or tenor and impact upon Member Countries and their rights and privileges and upon private persons and their acts”,³¹⁹ not be abused. In the light of that characterization, in *US - Underwear*, the Appellate Body drew the conclusion that an importing Member should not be allowed “an enhanced ability to restrict the entry into its territory of goods in the exportation of which no unfair trade such as dumping or fraud or deception of origin is alleged or proven”³²⁰ by taking safeguard action beyond the strict limits laid down in the relevant WTO provisions, if that action would result in “excluding more goods from the territory of the importing Member.”³²¹ As already noted, the aim of the Agreement on Safeguards is to “clarify and strengthen” and to “re-establish multilateral control” over safeguards³²² rather than to broaden the authorization to apply them.

4.655 That the safeguard measure at issue in this dispute was not “necessary” to remedy serious injury flows from the fact that there was no such injury, and certainly not serious injury resulting from the imports of SMPP. Furthermore, irrespective of whether a country is always obliged to introduce a structural adjustment plan together with a safeguard measure, in this particular case Korea did, by its own admission, introduce the Dairy Industry Plan “to facilitate adequate adjustment in the Korean dairy sector”, but did not show the necessity of the measure to attain the adjustment objective. There was no mention of the link between the measure and the adjustment objective within the broader framework of actions taken in this connection. Accordingly, the European Communities reiterate their conclusion that Korea did not show that the measure it adopted was “necessary”, thereby violating Article 5.1 of the Agreement on Safeguards.

(ii) *The necessity requirement is strengthened in Article 5.1, second sentence in respect of safeguard measures taking the form of quantitative restrictions*

4.656 As Korea itself admits, by virtue of the second sentence of Article 5.1 a necessity requirement is imposed in respect of safeguard measures taking the form of quantitative restrictions. Article 5.1 of the Agreement on Safeguards is clearly intended to avoid a quota being set at a level unrelated to

³¹⁹ See, Appellate Body Report in *US - Underwear*, 10 February 1997, WT/DS24/AB/R, p. 9 (emphasis added).

³²⁰ *Id.*

³²¹ *Id.* (emphasis added).

³²² See, Preamble of the Agreement on Safeguards, second last para., whereby Members “[recognize] the importance of structural adjustment and the need to enhance rather than limit competition in international markets”.

historical import flows prior to its imposition, which would prove particularly disruptive for exporters: in other words, a quota which would afford an importing country

“an enhanced ability to restrict the entry into its territory of goods in the exportation of which no unfair trade such as dumping or fraud or deception of origin is alleged to be proven”³²³

4.657 The prohibitive, rather than permissive, language of the provision limits in principle the minimum quota level to the average of the last three representative years the Agreement on Safeguards and establishes a presumption that for quotas such level is the maximum restriction which would be justifiable as “necessary” within the meaning of its Article 5.1: “such a measure shall not reduce the quantity of imports below the level of a recent period”. It is only if the Member seeking to apply a safeguard measure in the form of a quota is able to show that a quota level based on those data is not sufficient to remedy the serious injury in a specific case that a lower quota may be imposed, and then only if “clear justification” is provided. Therefore, the second sentence of Article 5.1 embodies an “enhanced requirement” of necessity when Members want to impose a safeguard measure in the form of a quantitative restriction.

4.658 That in principle a quota level below the three representative years is not (never) “necessary” does not entail at all, and indeed is quite the opposite of, saying that whichever quota is in compliance with that threshold is automatically “necessary” and authorized. First, because the first sentence of Article 5.1, which is binding, has general scope (that is, applies to all measures). Second, because if it could be admitted that a quota in accordance with the three-year threshold is “automatically” necessary without demonstration (as suggested by Korea), one would arrive at the unreasonable and absurd result that “necessity” must be shown in respect of a tariff measure, or any measure other than quota, and not for a quota. Of course, Korea can arrive at this unreasonable and false conclusion because it starts from a wrong premise (*i.e.*, that the first sentence does not impose any obligation on WTO Members).

(iii) *Korea has imposed a quantitative restriction at a level which is below the average laid down in Article 5.1, second sentence, without “clear justification”*

4.659 The European Communities maintain that the “three most recent years for which statistics are available” are to be assessed relative to the moment when the quantitative measure is imposed. Because Article 5.1 of the Agreement on Safeguards regulates the “application” of safeguard measures, *i.e.*, the moment when measures are taken, it is appropriate to consider that moment to assess the relevant three years retrospectively. Furthermore, that sentence uses the term “recent period” in connection with the reference to imposition of the measure. It is otherwise logical that calculation of the level of a measure follows the decision to adopt a measure.

4.660 On the contrary, there is no reference, in the second sentence of Article 5.1, to the initiation of the proceeding. It is clear that referring to that moment could allow the importing country to purposefully choose the initiation time of an investigation. As to availability of data, February 1997 data for all 1996 were available – a fact that is evidenced by Exhibit EC-20 and that Korea has not challenged.

4.661 As to representativity of the data, imports of the second semester of 1996 could not be excluded on grounds of non-representativity, certainly not on the criterion invoked by Korea because there is no “manipulation” by exporters in the sense (massive, or “abnormal” raise in imports) given by Korea to the term. The increase in imports from 1995 to 1996 is lower than the increase from 1994 to 1995, yet Korea had no difficulty in considering “representative” both 1994 and 1995.

³²³ See, Appellate Body Report in *US - Underwear*, 10 February 1997, WT/DS24/AB/R, p. 9.

4.662 In any event, Korea took into account data relating to a period (June 1996) subsequent to the initiation of the investigation³²⁴, and itself contradicts the criterion which it now proposes. The possible attempts of the exporters to increase exports ahead of the adoption of safeguard measures either are presumed to materialize with opening, or are not. Moreover, in *US - Underwear* the Appellate Body, after having referred to the binding character inherent in the word “necessity”, as lack of alternatives available to the importing country, concluded that the need to prevent or deal with a “flood of imports”, invoked by the United States to justify retroactive application of its measure, could have been dealt with by measures alternative to such a supplementary restriction – for example with the adoption of urgency measures. The European Communities note that analogous measures are equally available under the Agreement on Safeguards.³²⁵

4.663 The European Communities maintain that full 1996 data were more “representative”³²⁶ than the second semester of 1993, relied upon by Korea, and notes that there is no trace of explanation about representativity in the Notice of 7 March 1997, by which Korea finally imposed the safeguard measure at issue in this dispute.³²⁷ Therefore, even as regards the representativity of the data used to calculate the quota, Korea’s measure did not meet Article 5.1 requirements and should be found to be in violation thereof.

(iv) *Korea has not shown that the measures were the “most suitable” for the achievement of their objectives*

4.664 Regarding the “suitability” of the measure chosen, in the EC view Korea arrives at the final reduction of its Article 5.1 obligations, by denying the binding character of this requirement without any reasoning. At the same time, Korea again refers to the OAI Report in support of its position. The European Communities assert that the OAI Report is not an appropriate source of information to evaluate Korea’s compliance with its obligations arising under Article XIX of GATT and the Agreement on Safeguards. In connection with this specific requirement it would add that, just as for the other requirements imposed by Article 5.1 of the Agreement on Safeguards, there is no explanation of Korea’s choice to impose a quantitative measure in the only document which followed the 1 April Notification to the Committee on Safeguards, and by which Korea definitively imposed the measure. As Korea changed the reference period for calculating the quota as compared to what it had announced in January 1997, and did not refer to any other documents as possible sources of explanation in its Notice, it did not come to a definitive reasoning in this respect. This further confirms that its measure is inconsistent with the requirements of Article 5.1. The EC considers that it is not sufficient for the investigation authorities to note the arguments and conclude. They must state its reasons. In particular, it is not sufficient and legitimate to examine only the measures requested by a petitioner in order to comply with the requirement to choose the “most suitable measure” pursuant to Article 5.1, third sentence of the Agreement on Safeguards. This represents an undue

³²⁴ See, WTO Doc. G/SG/N/6/KOR/2, 1 July 1996 (Exhibit EC-1)

³²⁵ See, Article 6 of the Agreement, reading: “In critical circumstances where delay would cause damage which would be difficult to repair, a Member may take a provisional safeguard measure pursuant to a preliminary determination that there is clear evidence that increased imports have caused or threaten to cause serious injury.” To be noted that Article 6.11 of the Agreement on Textiles and Clothing is drafted in extremely similar conditions: “11. In highly unusual circumstances, where delay would cause damage which would be difficult to repair, [safeguard] action under paragraph 10 may be taken provisionally on the conditions that the request for consultations and notification to the TMB shall be effected within no more than five working days after taking the action”

³²⁶ The EC agrees with Korea’s reply to a question of the Panel, that “representative” does not necessarily means “fully liberalized”, it rather means “not abnormal”. For example, customs tariffs resulting from bindings are not “extraordinary” restrictions in the WTO system, therefore it seems clear that their presence would not deny representativity of a given period. On the contrary, measures taken for Balance-of-Payment reasons are clearly exceptional measures and may possibly have a more uncertain impact.

³²⁷ See, Exhibit EC-9, corresponding to Exhibit-Korea-9.

weakening of that requirement and would leave the decision within the hands of the very industry seeking safeguard protection.

(f) Rebuttal arguments made by Korea

4.665 **Korea** makes the following rebuttal arguments:

4.666 In its Report, the OAI concluded with a section on remedies. This section, after setting out in full the provisions of Articles 8 and 12 of the *Agreement on Safeguards* stated:

“In light of trade relations, if import is restricted by means of tariff rate increase or quantitative restriction, EU member states, Australia and New Zealand, which are leading exporters, may protest. Therefore, it is advised that, before a safeguard measure is taken, bilateral consultations should be held with the major exporting countries.

After rendering a determination on injury to the domestic industry, the KTC must notify the WTO Committee on Safeguards of such determination.

Meanwhile, the WTO Agreement on Safeguards stipulates that if a safeguard measure is taken due to the absolute increase of import volume, as is the case in this investigation, interested Members cannot take retaliatory measures within three years after the effective date of the measure.”³²⁸

4.667 The KTC Commissioners then examined and rejected the relief measures requested by the petitioner. In rejecting the alternatives suggested by the petitioner, and instead recommending to the Minister of Agriculture and Forestry a quota at a level based on the three most recent representative years for which statistics were available³²⁹, the KTC stated that:

“[b]efore recommending the relief measures, the KTC commissioners agreed that close considerations should be made beforehand for each relief measure on its impacts on the domestic dairy industry, national economy, and bilateral/multilateral trade. In this regard, the KTC examined the information investigated by the OAI, the relevant articles of the multilateral regulations, the opinions of authorities concerned, and the relief measures stipulated in the Foreign Trade Act and the Enforcement Decree of the Act. Based on all these examinations, the KTC reviewed the petitioner’s request for relief measures.”³³⁰

4.668 The Korean authorities also examined whether a tariff-quota would be more appropriate and what the appropriate duration for the application of the measure should be.³³¹ Based on its examination, the KTC recommended that the appropriate duration of the measure was four years and that the measure should be in the form of a quantitative restriction in the amount not exceeding the average of the import levels for the three most recent representative years for which statistics were available.³³²

4.669 The first notification by Korea, which referred to the nature of the safeguard measure, set out the following amounts³³³:

³²⁸ OAI Report at 74.

³²⁹ *Id.*

³³⁰ *Id.* at 3-4.

³³¹ *Id.* at 4-5.

³³² *Id.* at 4.

³³³ G/SG/N/10/KOR/1 (27 January 1997)

Year 1	Year 2	Year 3	Year 4
15,595 tonnes	16,483.9 tonnes	17,372.8 tonnes	18,261.7 tonnes

Following prior consultations in Geneva on 4 and 5 February 1997, between Korea on the one hand, and the European Communities, Australia and New Zealand on the other, Korea decided to increase the level of its quota as an act of good faith intended to provide some level of concessions to its trading partners. In its final Notification under Article 12.1(c) of the Agreement on Safeguards³³⁴, Korea set out the following quota amounts:

March 7 1997 - February 1998	March 1998- February 1999	March 1999- February 2000	March 2000- February 2001
20,521 tonnes	21,691 tonnes	22,927 tonnes	24,234 tonnes

This represents an average increase of over 5,000 tonnes in the level of the quota in each of the four years of the safeguard measure, and a total of 21,659 tonnes more imports than originally proposed in accordance with the provisions of Article 5.

4.670 Korea recalled its answers to the Panel's questions regarding the nature of the safeguard measure and the level of quota if a quota is chosen, which can be found at paragraphs 4.634 and 4.628

4.671 In Korea's view, provided the level of quota was equivalent to or not less than the average of the import levels for the three most recent representative years for which statistics were available, the Korean authorities were not required to show that the nature of the measure, or its level, were "necessary".

(g) Additional arguments by the European Communities made at the second meeting of the Panel with the parties

4.672 At the second meeting of the panel with the parties, the **European Communities** further advanced their arguments under Article 5.1 as follows:

(i) Both the first and the second sentence of Article 5.1 impose obligations on Members, having regard to their wording, context and object and purpose

4.673 The European Communities assert that Korea has provided no explanation for its interpretation that the first sentence of Article 5.1. is non-binding, except to say that the first sentence does not include "objective criteria that may be used to calculate the level of tariff, tariff quota, or quota that would 'remedy' serious injury or 'facilitate adjustment.'" It is hard to see from where Korea has drawn this criterion to decide whether the language of the first sentence is binding or not. In any event, in the first sentence of Article 5.1, too reference to injury and adjustment is made, and therefore a threshold is set to determine the level of protection allowed. Also, several other "'necessity' clauses" exist both in GATT and in the other WTO Agreements. The binding character of those clauses is not questioned even in the absence of precise or objective or objective criteria which might be used to calculate the level of tariffs as Korea maintains.

4.674 The European Communities recalled their arguments set out in paragraphs 4.650- 4.655 above.

³³⁴ G/SG/N/10/KOR/1/Suppl. 1 (1 April 1997), section 2,

4.675 In the EC view what Korea should have assessed, and did not, is whether the measure chosen was really necessary. The only reference to this issue is in the passage of Exhibit Korea-8 ("Determination of a Relief Measure by the Korean Trade Commission", which is the KTC's Recommendation of relief measures to the Ministry of Agriculture) quoted by Korea in reply to a question of the Panel: [w]hile it was determined that the domestic industry has been suffering from serious injury caused by increased imports, the injury has not been relieved even by the continuing efforts of the relevant authorities and the petitioner. In this regard, it is agreed that the appropriate relief measures should be taken to resolve the problem".

4.676 As regards Exhibit Korea-8 in particular, the European Communities would observe the following. First, it is, by its nature, an interim, preparatory document, not a final one. It is not final, as shown by the fact that the measures were eventually changed after the consultations with other WTO Members. Second, it is not a decision, but merely a recommendation to the final decision-making authority, notably the MAF, to take a given safeguard measure. Looking at the content of Exhibit Korea-8, it simply states a conclusion as to the necessity of a measure, certainly does not show the necessity. For instance, which efforts were ever undertaken to solve the difficulties in an alternative way remains unclear.

(ii) *The second sentence of Article 5.1 imposes a specific obligation in respect of quantitative measures*

4.677 The three-year period used by Korea was not the most recent available: as of February 1997, all import data for 1996 were published in Korea's Statistical Yearbook of Foreign Trade (Exhibit EC-20). Presumably, those data were available to the Korean authorities as internal information even in advance of publication. In any event, the European Communities recall that it was precisely in February 1997 that a new calculation of the quota level was performed, following the bilateral consultations under Article 12.3 of the Agreement on Safeguards.

4.678 The data used by Korea were less representative because they included a period where the product at issue was under import restrictions for Balance-of-Payment reasons, which is a temporary and exceptional measure and is not a normal tariff restriction. On the other hand, the import data for the second semester of 1996 were not, as Korea argues, affected by exporters' attempt to export massively in advance of the imposition of the measure. Indeed the import increase from 1995 to 1996 was lower than, for instance, between 1994 and 1995, the data of which Korea had no difficulty to retain as representative.

(iii) *The third sentence of Article 5.1 requires that the "most suitable measure" be selected*

4.679 The European Communities note that Korea, while referring extensively to the OAI Report, which in the EC view does not represent Korea's final position on the measures, reports that its Korean authorities considered a certain amount of information and certain sources of information (notably information investigated by the OAI, multilateral regulations, opinions of authorities concerned, measures mentioned in its domestic legislation) when deciding the measure, and that they concluded in a certain way. The European Communities consider that it is not sufficient for the authorities to note the arguments and conclude. They must state reasons. In particular, it is not sufficient and legitimate to examine only the measures requested by a petitioner in order to comply with the requirement to choose the "most suitable measure" pursuant to Article 5.1, third sentence of the Agreement on Safeguards. This represents an undue weakening of that requirement and would leave the decision within the hands of the very industry seeking safeguard protection.

(h) Additional arguments by Korea made at the second meeting of the Panel with the parties

4.680 At the second meeting of the panel with the parties, **Korea** further advanced its arguments under Article 5.1 as follows:

4.681 Korea is of the view that there is a requirement on the investigating authority under Article 5.1 to investigate whether a quota or some other safeguard measure is the most appropriate method of offsetting the serious injury caused by the increased imports. In this case, this obligation was discharged by the KTC Commissioners.³³⁵ As to the level of any quota decided upon, Korea reiterates that under Article 5.1 where a Member intends to impose a quota at a level equivalent to or higher than the level of imports during the three most recent representative years for which statistics are available, then it is not required to justify that level of quota. However, should a Member seek to impose a lower level, then, but only then is a justification required as to why that lower level was necessary.

4.682 The European Communities suggest that Korea is trying: “to unduly reduce the scope of its obligations under the WTO Agreements, and thus the rights arising thereunder to the European Communities.” In order to defend its position, Korea has to rebut the EC incorrect assertions. It is inherent in the nature of disputes that the assertion of rights by one party affects the obligations of the other party or parties. It is simply not helpful for the European Communities to argue that by raising a defence, Korea is seeking to deny the EC rights.

4.683 Finally, Korea notes the rather curious reasoning used by the European Communities where they state that:

“That the safeguard measure at issue in this dispute was not “necessary” to remedy serious injury is flowing from the fact that there was no such injury, and certainly not serious injury resulting from the imports of SMPP.”

The European Communities appear to be saying no more than that if serious injury is found, then the safeguard measure was necessary. As the Korean authorities established serious injury, and set the level of quota at or above the level of imports in relation to the three most recent representative years for which statistics were available, this rather curious statement is redundant.

I. CLAIMS UNDER ARTICLE 12 OF THE AGREEMENT ON SAFEGUARD

(a) Claim by the European Communities

4.684 The **European Communities** claim that Korea violated its obligations under Article 12 of the Agreement on Safeguards by failing to comply with the notification requirements and by failing to provide adequate opportunity for prior consultations. The following are the EC arguments in support of that claim:

(i) Violation of Article 12.1-2 of the Agreement on Safeguards- Failure to comply with notification requirements

4.685 Article 12.1 of the Agreement on Safeguards provides that:

“A Member shall *immediately* notify the Committee on Safeguards upon:

³³⁵ See, Exhibit Korea-8.

- (a) initiating an investigatory process relating to serious injury or threat thereof and the reasons for it;
- (b) making a finding of serious injury or threat thereof caused by increased imports; and
- (c) taking a decision to apply or extend a safeguard measure.” (emphasis added)

Article 12.2 further provides:

“In making the notifications referred to in paragraphs 1(b) and 1(c), the Member proposing to apply or extend a safeguard measure shall provide the Committee on Safeguards with *all* pertinent information, which shall *include evidence* of serious injury or threat thereof caused by the increased imports, precise *description* of the product involved and the proposed measure, proposed date of introduction, expected duration and timetable for progressive liberalization. In the case of an extension of a measure, evidence that the industry concerned is adjusting shall also be provided. The Council for Trade in Goods or the Committee on Safeguards may request such additional information as they may consider necessary from the Member proposing to apply ... the measure.” (emphasis added)

4.686 The European Communities submit that, in failing to provide immediately the Safeguards Committee with the information required under Article 12.1-2 of the Agreement on Safeguards, Korea violated its obligations arising thereunder. It further submits that Korea failed to comply with its obligation laid down in Article 12.3 of the Agreement on Safeguards in respect of consultations. Furthermore, it considers that the insufficient amount of the information provided in the notifications was not justified on grounds of confidentiality pursuant to Article 12.11 of the Agreement on Safeguards.

4.687 In order to demonstrate this claim the European Communities first reviewed the general meaning and objective of procedural obligations in the Agreement on Safeguards, and then discussed the specific aspects relating to the violations of notification and consultation requirements.

(a) Objective and meaning of procedural obligations in respect of safeguard measures

4.688 In view of the limitative character of safeguard measures their inclusion in the WTO system is accompanied by limits to their use, so that the interests of all the parties are protected. This is particularly important as regards procedural requirements, like the notification obligations. As observed in the Panel report in *Guatemala - Anti-Dumping Investigation Regarding Portland Cement from Mexico* in respect of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (AD Agreement) “[a] key function of the notification requirements in the AD Agreement is to ensure that interested parties, including Members, are able to take whatever steps they deem appropriate to defend their interests. Where a required notification is not made in a timely fashion, the ability of the interested party to take such steps is vitiated”.³³⁶ Thus, the Panel made clear that failure to comply with such requirements amounts, in itself, to a violation of a WTO Member’s obligations under the AD Agreement. The Panel went on to add that “merely that the AD Agreement does not require some action following notification does not mean that nothing useful can take place following a timely notification, and that the exporting Member has therefore no interest in timely notification.”³³⁷ *A fortiori* this applies to a case like the one at stake, where, as will be shown below,

³³⁶ See, Panel Report in *Guatemala - Anti-Dumping Investigation Regarding Portland Cement from Mexico*, 19 June 1998, WT/DS60/R, para. 7.42.

³³⁷ *Id.*, at footnote 228.

consultations are mandated by the Agreement following notification and must take place on the basis of the information notified.

4.689 The European Communities also asserted that the notification requirements under Article 12.1-2 of the Agreement on Safeguards are clearly autonomous and additional to the transparency requirements imposed by Articles 3 and 4 of the agreement in respect of the domestic investigatory procedures. This is explained by a variety of considerations, including the possibility for the Members concerned to request consultations on the basis of that information and the general interest of all WTO Members, and not only those more directly concerned by the procedure, in monitoring compliance with the Agreement on Safeguards. Specifically as regards notifications under Article 12.1(b) and (c), as made clear from Article 12.3 one specific purpose is to offer the Members concerned an opportunity for adequate consultations. Effective exercise of these rights by WTO Members calls for a minimum guaranteed level of information officially transmitted in one of the working languages of the WTO.³³⁸ Therefore, compliance with Article 12 requirements must be reviewed regardless of the conclusions which may be drawn in respect of the domestic procedure documents and measures.

(b) Notifications under Article 12.1(a) and Article 12.1(b) of the Agreement on Safeguards

4.690 The European Communities consider that Korea failed to fulfil the obligations assumed under Article 12.1(a) and (b) of the Agreement on Safeguards, both in terms of timeliness and of sufficiency of its notifications.

4.691 Insofar as timeliness is concerned, the European Communities recall that the need for timely notifications is particularly stressed by the language of the opening clause of Article 12.1. In this respect, the European Communities note that a delay of 14 days (28 May 1996-11 June 1996) between the publication of the initiation decision and the date appearing on the relevant notification document cannot in principle be said to comply with the requirement of “immediate” notification “upon” initiation.³³⁹ The same conclusion applies in respect of a delay of 40 days (23 October 1996-2 December 1996) between the publication of the injury finding and the date of the document which was notified to the Safeguards Committee.³⁴⁰

4.692 The European Communities concede that the expression “immediately upon” may need to be interpreted also in the light of the type and amount of information to be provided and to the purposes for which the information may be used. Nevertheless, it submits that Korea’s notifications fell short of the standard laid down in Article 12.1(a) and (b) even making allowance for those considerations. The amount of information required for those notifications, which relate to interim stages of the investigatory process, is limited and, in any event, Korea did not even provide that information in full. The European Communities therefore conclude that Korea failed to notify “immediately” information concerning the initiation of the safeguard procedure and the finding of serious injury.

4.693 As regards the content of Korea’s notifications, the European Communities observe, in respect of the initiation notification³⁴¹, that no mention was made either of the conditions under which imports occurred, or of whether and on which basis serious injury or threat thereof was alleged by complainants in the domestic investigatory procedure, although, Article 12.1(a) includes an express reference to injury and the reasons therefor. The conditions under which the products investigated

³³⁸ It is clear in fact that the notifications serve, *inter alia*, the purpose of allowing review within the Safeguards Committee as expressly provided by Articles 13.1(f) and 13.2 of the Agreement on Safeguards. In this respect it should be recalled that Rule 35 of the Rules of Procedure for the Committee on Safeguards provides that “English, French and Spanish shall be the working languages” of that Committee.

³³⁹ See, WTO Doc. G/SG/N/6/KOR/2, 1 July 1996 (Exhibit EC-1).

³⁴⁰ See, WTO Doc. G/SG/N/8/KOR/1, 6 December 1996 (Exhibit EC-2).

³⁴¹ See, WTO Doc. G/SG/N/6/KOR/2, 1 July 1996 (Exhibit EC-1).

were imported should have likewise been mentioned, for their review equally constitutes a requirement for the adoption of a safeguard measure pursuant to Article 2 of the Agreement on Safeguards. Yet no mention in this respect is included in the initiation notification.

4.694 The inadequacy of the information provided by Korea is even more compelling relative to the injury notification.³⁴² The standard of notification in respect of injury findings is laid down in Article 12.2, which requires that “all pertinent information” must be supplied. Furthermore, in respect of the matters which are specifically mentioned as “pertinent information”, Article 12.2 determines the particular type of information that is required. Thus, as regards “serious injury or threat thereof caused by increased imports”, not any information, but evidence, must be provided in order to meet that standard. In the light of the context of Article 12.2, the “evidence” referred to cannot be but that mentioned in Article 4.2 of the Agreement on Safeguards, that is, in the first place, the “factors of an objective and quantifiable nature having a bearing on the situation of” the industry which are listed therein.

4.695 The European Communities note that no information of any kind, or evidence, was provided on the causal link between the increased imports and the serious injury. As to serious injury or threat thereof, the European Communities observe that most of the “factors” listed in Article 4.2 were neither mentioned, nor disregarded as not “pertinent”. As to the import trends and conditions, no addition to the information already provided in the initiation notification was made. Thus, the issue of the “conditions” under which the foreign products were imported was still not addressed.

4.696 No justification for the incompleteness of the information submitted was provided in either notification. In particular even assuming, *arguendo*, that the confidential nature of the information received relative to serious injury or threat thereof and on the conditions under which the investigated products were imported could have justified a complete withholding of information, *quod non*, no such explanation was made in either notification.

4.697 In the light of the foregoing the European Communities consider that Korea violated its obligations under Article 12.1(a) and (b) of the Agreement on Safeguards.

(c) *Notification under Article 12.1(c) of the Agreement on Safeguards*

4.698 The European Communities consider that, as in the case of the notifications under Article 12.(a) and (b) of the Agreement on Safeguards, that made pursuant to Article 12.1(c) was neither timely nor complete. However, in order to discuss compliance with Article 12.1(c) the document constituting the notification must first be identified. There appear to be at least three acts self-qualifying as notification or that could in any event be relevant in order to assess whether Article 12.1(c) was complied with.

- On 21 January 1997 Korea forwarded a document termed as “notification pursuant to Article 12.1(c)” that it “proposes to apply a safeguard measure”.³⁴³
- On 31 January Korea notified a “decision to apply a safeguard measure” pursuant to Article 9.1, footnote 2 of the Agreement on Safeguards. It is, however, explained in the same document that Korea is simply “considering relief to a domestic industry ... in the form of the imposition of quantitative restrictions”.³⁴⁴

³⁴² See, WTO Doc. G/SG/N/8/KOR/1, 6 December 1996 (Exhibit EC-2).

³⁴³ See, WTO Doc. G/SG/N/10/KOR/1, 27 January 1997, p. 1 (Exhibit EC-5).

³⁴⁴ See, WTO Doc. G/SG/N/11/KOR/1, 21 February 1997, p.1 (Exhibit EC-6).

- On 24 March 1997 Korea notified a “supplement” to its 21 January notification.³⁴⁵ In the meantime, as indicated in this document, a definitive safeguard measure had been published on 7 March, with immediate effect.

4.699 The European Communities note that, irrespective of the title given to the various documents mentioned above, the level of quantitative restrictions reported in the 24 March 1997 notification is different from the one reported in the documents previously notified, and is presumably based on different import statistics.³⁴⁶ Furthermore, according to the 24 March document the measure described therein had already entered into force on 7 March 1997. Therefore, that document is likely to constitute an autonomous and final notification distinguished from the one reported in the previous documents and is based on partially different import statistics.

4.700 The European Communities consider that inasmuch as the information included in the document of 24 March 1997 regarding the date of entry into force of a safeguard measure in the form of a quantitative restriction is correct, Korea failed to notify it “immediately ... upon taking a decision to apply ... a safeguard measure” in accordance with Article 12.1(c) of the Agreement on Safeguards.

4.701 Besides the lapse of time (17 days) between the entry into force of the safeguard measure (7 March) and the date of the notification to the Safeguards Committee, the required content and the purpose of this notification warrant the same conclusion. In fact this constitutes the final document on the basis of which consultations can take place under Article 12.3 of the Agreement on Safeguards, and therefore offers the last opportunity for informed bilateral consultations before possibly starting dispute settlement consultations. Seen from this perspective, failure to meet the notification standards has the specific consequence of impairing a Member’s provision of “adequate opportunity for prior consultations” within the meaning of Article 12.3 of the Agreement on Safeguards. As regards the required contents of the notification, the European Communities observe that in view of the length of the investigatory process and the previous notification requirements, much of the information should have been available even in English for long time, all the more so if already on 21 January Korea was able to announce “a decision to apply” a safeguard measure. This consideration further reinforces the conclusion that Korea failed to notify in time and thus violated Article 12.1(c) of the Agreement on Safeguards.

4.702 In the unlikely case that the 24 March document was considered to have been notified in time, the European Communities consider that the Panel should also find that it did not include “all pertinent information” and the notification was therefore not complete for purposes of Article 12.1(c). There is no explanation as to the basis for the calculation of the quota, and in particular, no reference to the last three representative years or to the necessity to depart from data relating to those years; that data on employment in a part of the domestic industry (raw milk production) is not provided;³⁴⁷ that for profits and losses, information for the same part of the domestic industry is also not provided.³⁴⁸ As with the notifications under Article 12.1(a) and (b), no justification was provided for withholding the missing information, either on grounds of confidentiality or on other grounds. In any event, confidentiality could obviously not have been invoked in respect of such information as the import data forming the basis for the calculation of the quantitative restrictions.

³⁴⁵ See, WTO Doc. G/SG/N/10/KOR/1/Suppl.1, 1 April 1997 (Exhibit EC-10).

³⁴⁶ Both the 21 January and 31 January documents refer to import statistics for 1993-1995 as the basis for calculating the quota level indicated therein. As the quota level included in the 24 March notification corresponds to that mentioned in the Notification of the Ministry of Trade, Industry and Energy of 7 March 1997 (Exhibit EC-9), the import data relied upon are presumably those mentioned in the 7 March Notification.

³⁴⁷ See, WTO Doc. G/SG/N/10/KOR/1/Suppl.1, 1 April 1997, p. 10, para. 3.6 (Exhibit EC-10).

³⁴⁸ *Id.*, para. 3.10.a.

4.703 If the notification dated 24 March 1997 was not to be considered the relevant notification under Article 12.1(c), the European Communities submit, in the alternative, that neither the document dated 21 January 1997 nor that dated 31 January 1997 were complete.³⁴⁹ Without the need to discuss them in any greater detail, this is made clear by the fact that Korea was indeed able to provide a significantly more detailed notification on 24 March 1997.

(ii) *Violation of Article 12.3 of the Agreement on Safeguards- Failure to provide adequate opportunity for prior consultations*

4.704 Article 12.3. of the Agreement on Safeguards provides that:

“A Member *proposing* to apply ... a safeguard measure shall provide *adequate* opportunity for *prior* consultations with those Members having a substantial interest as exporters of the product concerned, with a view to, *inter alia*, *reviewing the information provided under paragraph 2*, exchanging views on the *measure* and reaching an understanding on ways to achieve the *objective set out in paragraph 1 of Article 8*.”
(emphasis added)

Resulting from Korea's notification dated 24 March 1997, “in order to make its final decision on safeguard measures, Korea circulated a notification (G/SG/N/10/KOR/1 of 27 January 1997) to provide an opportunity for consultations with Member countries concerned in accordance with the Agreement on Safeguards. Korea then held bilateral consultations with the European Communities, Australia and New Zealand on 4 and 5 February 1997 in Geneva and also attended a special meeting of the Safeguards Committee on 21 February 1997”.³⁵⁰ The European Communities submit that consultations eventually afforded by Korea after their reiterated requests³⁵¹ failed to meet the standards laid down in Article 12.3 of the Agreement on Safeguards, and therefore Korea breached its obligations under that provision.

4.705 The European Communities first note that Article 12.3 expressly refers to a general standard of “adequacy” of the opportunity to consult, which is then clarified by reference to the subject matter of the consultations and their aim. The text of Article 12.3 makes clear that the purpose of the consultations is to foster an agreement between the WTO Members concerned or to ensure the maintenance of the balance of concessions pursuant to Article 8.1 of the Agreement on Safeguards. In particular Article 12.3, when specifying that it is for the Member “proposing to apply” to offer to consult, *inter alia*, on the “proposed measure”,³⁵² implies that consultations must take place before the measure is taken (*i.e.*, when it is still a “proposal”). This conclusion is reinforced if one has regard to the subject matter on which consultations must be afforded. In order for the opportunity to consult to be adequate pursuant to Article 12.3, consultations must take place on all the information provided under Article 12.2 of the Agreement on Safeguards. As already illustrated above, Article 12.2 in turn mentions “all pertinent information”, including the evidence specified therein, as the one to be supplied in the notifications of injury findings and of the results of the procedure. Therefore, any consultations falling short of a review of all pertinent information would obviously not meet the Article 12.3 standard. The purpose of Article 12.3 logically requires that such consultations must be

³⁴⁹ See, WTO Doc. G/SG/N/10/KOR/1, 27 January 1997 (Exhibit EC-5) and WTO Doc. G/SG/N/11/KOR/1, 21 February 1997 (Exhibit EC-6).

³⁵⁰ See, WTO Doc. G/SG/N/10/KOR/1/Suppl.1, p. 6, para. 7 (Exhibit EC-10). See, also WTO Doc. G/SG/11 of 18 March 1997, p. 1 (Communication from Korea on the results of consultations under Article 12.3 of the Agreement on Safeguards, Exhibit EC-7) and WTO Doc. G/SG/M/8, 10 June 1997, p. 2, para. 10 (Minutes of the special meeting of the Safeguards Committee held on 21 February 1997, Exhibit EC-8).

³⁵¹ See, WTO Doc. G/SG/7, 12 December 1996 and WTO Doc. G/SG/8, 17 December 1996 (Exhibits EC-3 and EC-4).

³⁵² It is only in the case of provisional safeguard measures that the Agreement on Safeguards (Article 12.4) makes an exception by allowing consultations to take place after adoption of the measure.

held on the basis of all the information required at a date prior to the application of the measure, so as to have a possibility to avoid it or ensure that the balance of concessions is preserved.

4.706 The European Communities believe they have already shown above that the documents notified by Korea, either before or after the date of the consultations, including the one dated 24 March 1997, were far from complete. Even assuming that the latter document were sufficiently detailed, the procedural history reported by Korea in its 24 March document omits to underline a crucial element, namely that consultations took place well before that document was supplied and when only the extremely limited information included in WTO Documents G/SG/N//6/KOR/2 (initiation notification), G/SG/N/8/KOR/1 (serious injury finding), G/SG/N/10/KOR/1 (Article 12.1(c) notification), and G/SG/N/11/KOR/1 (Article 9, footnote 2 notification) was available. It follows that by failing to provide all pertinent information in its notifications, and specifically in the ones made under Article 12.1(b) and (c) of the Agreement on Safeguards, in advance of consultations, Korea prevented WTO Members having a substantial interest as exporters from engaging in meaningful consultations, thus failing to provide them with an adequate opportunity in this respect. As a consequence, it also frustrated the further objective of those consultations, namely to reach an agreement or to ensure the maintenance of the balance of concessions as foreseen in Article 8.1 of the Agreement on Safeguards.

4.707 The European Communities further submit that if the document dated 21 January 1997 is found to be a notification of a “decision to apply a safeguard measure” within the meaning of Article 12.1(c) of the Agreement on Safeguards, by affording consultations on 4 February 1997 Korea frustrated the very purpose of the consultations under Article 12.3, which aim at finding a solution alternative to the imposition of a safeguard measure or at the least at enabling the Members concerned to influence the final decision. Thus, *a fortiori* in this case Korea should be found to have failed to comply with its obligation arising under Article 12.3 of the Agreement on Safeguards.

(b) Response by Korea

4.708 **Korea** responds to the EC arguments as follows:

4.709 On 28 May 1996, Korea initiated the safeguards investigation at issue. On 11 June 1996, Korea forwarded its notification of the initiation to the Committee on Safeguards under Article 12.1(a) of the Agreement on Safeguards.³⁵³ Consistent with the guidance issued by the Committee on Safeguards³⁵⁴, Korea identified the following in its notice: (1) the date of initiation of the investigation (28 May 1996); (2) the dairy products subject to the investigation, as identified by their HS numbers, and (3) the reasons for initiating the investigation, including that the investigation was initiated on the basis of a petition filed under Article 33(1) of the Foreign Trade Act and that the non-confidential evidence indicated the specified increase in imports. Notably, the Agreement on Safeguards does not impose obligations regarding the scope of the reasons that are necessary to justify the initiation of a safeguards investigation.

4.710 Article 12.2 of the Agreement on Safeguards provides that notifications under Article 12.1(b) and (c) of the Agreement on Safeguards must include all pertinent information, including «evidence of serious injury or threat thereof caused by increased imports, precise description of the product involved and the proposed measure, proposed date of introduction, expected duration and timetable for progressive liberalization.» In the Technical Cooperation Handbook on Notification Requirements (the «Handbook»), the Committee on Safeguards adopted guidance for Members on how to comply with these notification requirements, although it did not define, for example, the

³⁵³ G/SG/N/6/KOR/2 (1 July 1996).

³⁵⁴ Committee on Safeguards, Notification Under Article 12.1(a) of the Agreement on Safeguards on Initiation of an Investigation and the Reasons for It, G/SG/N/6 (7 February 1995).

amount of evidence that should be provided to comply with Article 12.2.³⁵⁵ According to the Handbook, a Member should provide:

- (a) evidence of serious injury or threat thereof caused by increased imports
- (b) information on whether there is an absolute increase in imports or an increase in imports relative to domestic production;
- (c) precise description of the product involved;
- (d) precise description of the proposed measure;
- (e) proposed date of introduction of the measure;
- (f) expected duration of the measure;
- (g) proposed date for review if applicable;
- (h) expected timetable for progressive liberalization, if applicable; and
- (i) other information if the measure is being extended.³⁵⁶

4.711 On 2 December 1996, Korea transmitted to the Committee on Safeguards its notification of a finding of serious injury caused by imports under Article 12.1(b) of the Agreement on Safeguards.³⁵⁷ The notification referred Members to the 23 October 1996 KTC finding, the report of which was publicly available. Consistent with the guidance in the Handbook, the notification also (1) summarized the evidence of serious injury caused by increased imports (2) provided information on whether there is an absolute increase in imports or an increase in imports relative to domestic production, (3) described the products involved, and (4) informed the Committee that no final decision had been made to impose a safeguard measure and, thus, no information was available on the measure.

4.712 After receiving two requests for consultations under Article 12.3 of the Agreement on Safeguards, Korea provided a preliminary notification under Article 12.1(c) on 21 January 1997.³⁵⁸ Although such preliminary notification was not required under Article 12, Korea considered that for prior consultations to be meaningful under Article 12.3, Members should have more information on the proposed measure.³⁵⁹ Thus, Korea's preliminary notification under Article 12.1(c) included the information from the 2 December 1996 notification as well as information on the proposed measure. Given its preliminary nature, Korea expressly reserved the right to provide further relevant information after the final decision was made. In addition, the notification provided dates that the Korean delegation was available for consultations and stated that the final decision was expected the week of 24 February 1997, after consultations had been held.

³⁵⁵ WT/TC/NOTIF/SG/1 (15 October 1996).

³⁵⁶ *Id.*

³⁵⁷ G/SG/N/8/KOR/1 (6 December 1996). This notification was provided to the Committee on Safeguards on the same day as the KTC issued its recommendations. *See*, Exhibit Korea-11.

³⁵⁸ G/SG/N/10/KOR/1 (27 January 1997).

³⁵⁹ Korea notes that it could have held consultations based solely on the notification under Article 12.1(b), given that consultations under Article 12.3 must necessarily be held prior to the final decision to impose a safeguard measure notified under Article 12.1(c). After the decision to impose the measure is made and final notification is provided under Article 12.1(c), consultations would not be meaningful because the consultations could not result in any consideration of Member's concerns prior to the final decision.

4.713 On 4 and 5 February 1997, Korea held consultations with the European Communities, Australia, and New Zealand under Article 12.3 of the Agreement on Safeguards. These consultations facilitated an exchange of views regarding the measure based on Korea's earlier notifications and on the publicly-available OAI Report.

4.714 On 24 March 1997, Korea provided the Committee on Safeguards with its final notification under Article 12.1(c) of the Agreement on Safeguards.³⁶⁰ Given the concerns raised by the European Communities and other Members regarding the scope of its earlier notifications, Korea, while not regarding itself as obliged to do so, expanded its discussion in its final notification on virtually every aspect of its 21 January 1997 notification.

4.715 Korea is of the view that it fully complied with its obligations under Article 12 of the Agreement on Safeguards. In fact, Korea took additional steps to ensure that Members were provided additional information to facilitate meaningful consultations.

(c) Rebuttal arguments made by the European Communities

4.716 The **European Communities** made the following arguments in rebuttal:

(i) *Violation of Article 12.1-3 of the Agreement on Safeguards - Failure to comply with notification and consultation requirements*

(a) *Notification requirements*

(1) Contents of the notifications

4.717 In this regard Korea alleges the consistency of its action with the "guidance issued by the "Committee on Safeguards" on the matter of notifications, notably the "Technical Cooperation Handbook on Notification Requirements" ("the Handbook").³⁶¹ However, by Korea's own admission, this Handbook does not define "the amount of evidence that should be provided to comply with Article 12.2 of the Agreement".

4.718 The European Communities do not accept that Korea's notification is consistent with the Handbook. In particular, the European Communities note that in Document G/SG/1 quoted by Korea, it is mentioned, *inter alia*, that parties should "1. Provide evidence of serious injury or threat thereof caused by increased imports."³⁶² As just noted, nowhere in the Handbook are the notions of "evidence", "serious injury", "causation" defined. It is therefore only by referring to Article 12 of the Agreement on Safeguards, as well as at the other provisions referred to therein, that these notions can be interpreted. In perfect consistence with this conclusion is the express disclaimer note at the opening of Document G/SG/1, reading as follows: "These formats are without prejudice to the interpretation of the relevant provisions in the Agreement on Safeguards by the competent bodies."³⁶³ Interpretation obviously concerns the Agreement on Safeguards and will be conducted in line with

³⁶⁰ See, G/SG/N/10/KOR/1/Suppl.1 (1 April 1997)..

³⁶¹ See, WTO Docs. WT/TC/NOTIF/SG/1, 15 October 1996 and G/SG/1, 1 July 1996; Korea's First Submission, para 142.

³⁶² See, WTO Doc. G/SG/1, Section II, item1.

³⁶³ See, WTO Doc. G/SG/1, p. 1. The EC would further recall that in *EC - Bananas* the Appellate Body made clear that a document not "endorsed by a formal decision of the CONTRACTING PARTIES" "cannot be considered as an authoritative interpretation" (see *EC - Bananas*, WT/DS27/AB/R, 9 September 1997, para 200). The EC considers that the Appellate Body's ruling in respect of GATT 1947 would apply in the present case *mutatis mutandis*, that is, consistently with Article IX:2 of the Agreement establishing the World Trade Organization, pursuant to which: "The Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of a Multilateral Trade Agreement in Annex 1."

the provisions thereof. The Handbook can therefore be of no guidance in deciding whether the information submitted to the Committee on Safeguards constituted “all pertinent information” within the meaning of the Article 12.2 of the Agreement on Safeguards.

(2) Timing of the notifications

4.719 The European Communities disagree with Korea’s statement that Korea’s Notification of 27 January 1997³⁶⁴ was not required under Article 12 of the Agreement on Safeguards if this is meant to imply that there is no obligation under Article 12.1(c) to notify “all pertinent information” prior to the application of a safeguard measure, with a view to, *inter alia*, holding consultations. This seems otherwise to contradict what Korea’s statement in its First Written Submission:

“Korea notes that it could have held consultations based solely on the notification under Article 12.1(b), given that consultations under Article 12.3 must necessarily be held prior to the final decision to impose a safeguard measure notified under Article 12.1(c). After the decision to impose the measure is made and final notification is provided under Article 12.1(c), consultations would not be meaningful because the consultations could not result in any consideration of Member’s concerns prior to the final decision.”
(emphasis added)

4.720 What Korea has overlooked in this striking admission is that meaningful consultations can only take place if Members are provided all the necessary information, notably that required by Article 12.2 of the Agreement on Safeguards.³⁶⁵ Therefore, the consultation objective contributes to define the timing of the notification and its content. Since consultations under Article 12.3 must cover “the information provided for under paragraph 2”, including on “the proposed measure”, Korea’s notification under Article 12.1(b) could not have been the exclusive basis for consultations.³⁶⁶ The European Communities would remind the Panel that Korea’s 1 April Notification, which was the most comprehensive document ever provided by Korea to the Committee on Safeguards under Article 12.1(c), was forwarded 17 days after the entry into force of the safeguard measure.

(b) Consultations

4.721 The foregoing observations on the content and timing of notifications also confirm the EC claim that Korea failed to provide “adequate opportunity for prior consultations” within the meaning of Article 12.3 of the Agreement on Safeguards. In fact, in view of the insufficient content and late submission of Korea’s notifications, consultations, which, by Korea’s own admission, can only be meaningful if preceding the adoption of the measure, could certainly not be based on “all pertinent information” in terms of Article 12.2, and could not therefore be “meaningful” in terms of Article 12.3. The European Communities therefore conclude that their claim of a violation of Article 12.3 of the Agreement on Safeguards has not been rebutted by Korea and should be upheld by the Panel.

³⁶⁴ See, WTO Doc. G/SG/N/10/KOR/1, 27 January 1997 (Exhibit EC-5).

³⁶⁵ The EC also points out in this connection that the Notification Handbook does not address the issue of the timing of notifications, except by repeating that they should be made “immediately” and by regulating the relationship between the one under Article 12.1(b) and the one under Article 12.1(c) of the Agreement on Safeguards. Therefore, in this respect too Korea, by referring to the Handbook, has certainly not rebutted the EC’s claim of violation of the requirement to “immediately notify”, which is laid down in Article 12.1 in respect of all three notifications mentioned.

³⁶⁶ See, WTO Doc. G/SG/N/8/KOR/1, 6 December 1996 (Exhibit EC-2), para 4, which reads: “Information on measure. The Korean Trade commission has not made a decision to apply a safeguard measure yet. Therefore, there is no information on such a measure at this time. The KTC will recommend to the relevant Minister an appropriate remedial measure within 45 days of the injury determination.”

4.722 At the second meeting of the panel with the parties, the **European Communities** further advanced their arguments under Article 12, by presenting its own version of the sequence of events leading up to dispute settlement consultations.

- 23 October 1996: Finding of serious injury by KTC
- 2 December 1996: First notification of serious injury under Article 12.1(c) of the Agreement on Safeguards.
- 11 December 1996: First request for consultations under Article 12.3 by the **European Communities**.
- 16 December 1996: Reiteration of the first request for consultations, since the **European Communities** received information about a 30-day deadline running from the date of the recommendation of the imposition of safeguard measures by the KTC to the competent authorities within the Korean Government. Hence, the suggested date for the consultations of 20 December. It should be noted that Korea finally agreed to hold consultations 73 days after the finding of serious injury was made.
- 28 January 1997: A set of written questions was sent by the **EC** Delegation in Geneva to the Korean Delegation with a view to preparing consultations under Article 12.3 of the Agreement on Safeguards.³⁶⁷ The European Communities never received a written reply to those questions. Furthermore during the consultations, Korea equally failed to reply satisfactorily and simply promised to provide further information on specific issues as requested by the European Communities which, with one exception, it never did.³⁶⁸
- 4 February 1997: Article 12.3 consultations. During the consultations, the Korean Delegation read out prepared answers to the questions sent by the European Communities on 28 January. Korea refused to hand over the written answers to the EC Delegation.
- 21 February 1997: Special meeting of the Committee on Safeguards. This meeting was requested by the European Communities based on Article 13 of the Agreement on Safeguards which relates to certain particular functions of that Committee, including general vigilance with respect to Members' actions related to safeguards.³⁶⁹ As can be clearly seen from the record of that meeting, Korea did not provide any further pertinent information on that occasion.
- 24 March 1997: Korea submitted the amended and extended version of the notification under Article 12.1(c). In the cover letter³⁷⁰ sent by the Korean Delegation in Geneva to the EC Delegation, the notification was described as being "also intended to serve as an overall response to the questions raised by the European delegation during the bilateral consultations on this matter." Again, the European Communities note that all pertinent information must be notified prior to the adoption of a measure (*i.e.*, in the present case, prior to 7

³⁶⁷ See, Exhibit EC-27.

³⁶⁸ See, Exhibit Annex EC 28.

³⁶⁹ See, WTO Doc. G/SG/M/8 10 June 1997, Minutes of the Special Meeting held on 21 February 1997, para 2.

³⁷⁰ See, Exhibit EC-29.

March 1997) with a view to allowing meaningful consultations, as set forth in Article 12.1-3.

- 3 September 1997: The European Communities sent a second set of questions³⁷¹ to Korea ahead of the first round of dispute settlement consultations under Article XXII:1 of GATT on 10 September. The European Communities never received a written reply.
- 19 September 1997: The European Communities sent a letter³⁷² restating questions asked during the first round of dispute settlement consultations under Article XXII:1 of GATT and one question posed during the consultations under Article 12.3 of the Agreement on Safeguards.
- 16 October 1997: Second round of dispute settlement consultations. Korea gave its sole written response to any of the EC questions. It handed over one page showing a table contained in the OAI Report concerning the development of production of other dairy products in response to the question asked on 4 February 1997 and restated on 19 September 1997, *i.e.*, eight months after the information was requested for the first time.

4.723 The conduct of the consultations as set out above shows that Korea can not rebut the EC claim that Korea violated its obligations under Article 12.1-3 of the Agreement on Safeguards in particular because it did not provide all pertinent information before or during the consultations under Article 12.3 of the Agreement on Safeguards, which could therefore not be "meaningful" in terms of Article 12.3.

4.724 In response to a question by the Panel³⁷³ the **European Communities** further clarified their position on Article 12 notifications:

4.725 Although the absence of a notification is a clearer violation than a deficient notification, the European Communities consider that the adequacy of a notification must be verified by the Panel in the same way as any other alleged violation of the WTO Agreements. A violation of a procedural obligation can in principle give rise to the same kind of finding as a substantive violation, and that is what the European Communities are requesting in this case.

4.726 There are however important distinctions to be made between some procedural and substantive violations when it comes to implementing a Panel report. The violation of a procedural obligation which only serves an objective of transparency, will not have the same consequences as the violation of a procedural obligation which is an indispensable precondition for a measure (*e.g.*, the obligation to conduct an investigation or to give adequate opportunity for prior consultations in order to review all pertinent information in the meaning of Article 12).

4.727 Also in response to a question of the Panel³⁷⁴ the **European Communities** clarified their position on the issue of the content of the notification:

³⁷¹ See, Exhibit EC-30.

³⁷² See, Exhibit EC-31.

³⁷³ The Panel recalls that the question was: "With regard to Article 12.1 and 12.2, do the parties believe that a distinction should be drawn between a complete or a deficient notification, or between the existence or the absence of such notification? What should the consequences be of the absence or the incompleteness of the notification with regard to the safeguard measure itself?"

³⁷⁴ The Panel recalls that the question was: "Is the concept of 'all pertinent information' an objective or subjective standard? Please comment on how your answer should affect the Panel's conclusion with regard to the consequences of such a standard not being met?"

4.728 The European Communities are of the view that “all pertinent information” is an objective standard because it is defined in Article 12.3 of the Agreement on Safeguards as including “evidence of serious injury or threat thereof caused by increased imports, precise description of the products involved and the proposed measure, proposed date of introduction, expected duration and timetable for progressive liberalization.” The Member proposing to apply safeguard measures may be obliged to provide further information since this list is not exclusive, but at least the items which are listed are objective standards and subject to review by the panel. Further guidance for the interpretation of the first item of this list, “evidence of serious injury or threat thereof caused by increased imports”, can be found in Article 4.2(a) and (b) of the Agreement on Safeguards.

4.729 The consequence of a finding of violation is not a matter for the Panel, as the panel in the Guatemala case correctly concluded.³⁷⁵

4.730 The Panel also requested³⁷⁶ the **European Communities** to clarify their position on the documents that Korea provided the Panel at the second meeting of the Panel with the parties regarding the consultations held with Korea.³⁷⁷ The EC answer was as follows:

4.731 The European Communities consider that the fact that the parties have provided details of the consultations under Article 12.3 to the panel means that the panel should take them into account in adjudicating this dispute and in its report in particular in reviewing whether Korea complied with Article 12.3.

(d) Rebuttal arguments made by Korea

4.732 **Korea** makes the following rebuttal arguments:

4.733 Korea reiterated its view that Korea’s notifications were:

- (a) timely;
- (b) adequate, in that they contained “all pertinent information”; and
- (c) permitted the parties to reach an agreement.

(i) The Timeliness of Notifications and Consultations

4.734 The notifications were timely in that they: Were provided to the Committee on Safeguards as soon as practically possible after the conclusion of the procedural step that triggered such notification; and permitted third parties sufficient time to prepare for and engage in meaningful prior consultations.

4.735 Korea notes that as to timeliness:

- (a) On 11 June 1996, Korea notified the WTO Committee on Safeguards under Article 12.1(a) of the Agreement on Safeguards regarding the KTC’s initiation of a safeguards investigation and the reasons supporting initiation;
- (b) The notification identified the date that the investigation was initiated (28 May 1996), the products subject to investigation (dairy products under the specified HS

³⁷⁵ See, Panel Report in *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, 19 June 1998, WT/DS60/R, para 8.3.

³⁷⁶ The panel recalls that the question was: “What judicial notice should the Panel now take of the consultations?”

³⁷⁷ See paragraph 4.751.

headings), and the reasons for the initiation (a petition filed under Article 33(1) of the Foreign Trade Act providing evidence of increased imports);

- (c) Following 26 days' public notice of the KTC hearing, and after having had the OAI's Interim Report for 8 days, representatives of EC Member States attended the KTC's Public Hearing held on 20 August 1996 and made substantive comments;
- (d) Representatives of the European Communities then had almost 2 months to make comments to the OAI concerning the material contained in the OAI's Interim Report and matters raised at the public hearing;
- (e) Dr. Beseler of DG1 of the European Commission then had an exchange of letters with the KTC, in which Director-General Kim again summarized the reason for the initiation of the KTC investigation and noted the steps taken by certain EC Member States to protect their commercial interests, *inter alia*, by attending the KTC hearing and obtaining copies of the OAI's Interim Report;³⁷⁸
- (f) The KTC, after a full deliberation of the final OAI Report, made a determination of serious injury on 23 October 1996, a summary of which was published in *Kwanbo* on 11 November 1996. It should be noted, *inter alia*, that the final three paragraphs of the OAI Report note Korea's international obligations and the necessity of both notification and prior consultation under the Agreement on Safeguards;
- (g) The European Communities raised the issue of the OAI's investigation at a regular meeting of the Committee on Safeguards on 25 October 1996. The comments made by the European Communities indicated that they were very well informed about the nature of the investigation underway, and they asked for further particulars regarding the conclusion of the OAI's investigation 2 days earlier. The Korean delegate:

"indicated that his delegation was not in a position to furnish additional information at the meeting. He asked any interested Members to address their questions to the Korean delegation in writing, and indicated that his delegation would do its best to provide the additional information requested, so long as such information was not confidential."³⁷⁹
- (h) On 2 December 1996, Korea transmitted to the Committee on Safeguards its notification of a finding of serious injury caused by imports under Article 12.1(b) of the Agreement on Safeguards.³⁸⁰ The notification referred Members to the 23 October 1996 OAI Report which was publicly available. The notification under Article 12.1(b):
 - (i) summarized the evidence of serious injury caused by increased imports;³⁸¹
 - (ii) provided information on whether there is an absolute increase in imports or an increase in imports relative to domestic production;

³⁷⁸ See, Exhibits Korea-15 and 16.

³⁷⁹ See, G/SG/M/7 (19 March 1997) at paragraph 24.

³⁸⁰ G/SG/N/8/KOR/1 (6 December 1996). This notification was provided to the Committee on Safeguards on the same day as the KTC issued its recommendations. See, Exhibit Korea-11.

³⁸¹ The non-confidential evidence that Korea deemed pertinent for purposes of the notification included evidence on (1) the increase of imports, share of domestic industry in consumption, and stock, (2) the sale price of imported goods and domestic goods, and manufacturing costs of domestic goods, and (3) the reduction of the number of dairy farming households and loss incurred by Livestock Cooperatives. Given that the KTC's Report was publicly available, Korea did not deem it necessary to delay its notification in order to translate the report.

- (iii) described the products involved; and
- (iv) stated that no final decision had been made to impose a safeguard measure and, thus, no information was available on the measure.
- (i) Korea's first notification under Article 12.1(c)³⁸² was made in a preliminary form to provide interested third parties with information about Korea's proposal to apply a safeguard measure; It should be noted that the obligation to file a notification under Article 12.1(c) arises upon "taking a decision to apply or extend a safeguard measure" which, as noted at paragraph 7 of that notification, was due to be taken not earlier than "the week beginning 24 February 1997." However, as noted above, Korea took the view that in order to provide for meaningful prior consultations under Article 12.3, it should circulate information "before it makes a final decision on the measure by the week beginning 24 February 1997";³⁸³ This preliminary notification was made 17 days prior to the actual consultations and 47 days prior to the actual imposition of what is intended to be an emergency measure.
- (j) It is noteworthy that the European Communities in their second request for consultations³⁸⁴ wished to provide only 4 days notice, which would not, in Korea's view, have provided sufficient opportunity to prepare for meaningful consultations. Further, the European Communities were able to provide Korea with 11 pages of detailed questions within 7 days of Korea's preliminary Article 12.1(c) notification. These are remarkably detailed questions and are obviously based on a close reading of the OAI Report. Korea answered within 6 days and before the consultations; during the course of the consultations on 4 and 5 February, the European Communities produced an English translation of the OAI Report, which it provided to the Korean delegation;
- (k) The European Communities had the opportunity to request, attend and address a Special Meeting of the Committee on Safeguards after its consultations but still prior to the imposition of the measure. It is clear from that meeting that all parties concerned had full access to all relevant information and that the matter was fully aired.
- (l) It is worthy of note that the Committee has the power to "request such additional information as they may consider necessary from the Member proposing to apply or extend the measure" (Article 12.2) and "to find, upon request of an affected Member, whether or not the procedural requirements of this Agreement have been complied with in connection with a safeguard measure, and report its findings to the Council for Trade in Goods" (Article 13.1(b)). The Committee did neither; and
- (m) Korea provided the Committee on Safeguards with an amended and extended version of the notification under Article 12.1(c)³⁸⁵ that fully set out all aspects of the safeguard measure imposed.
- (n) The earlier 21 January notification was amended *inter alia* to take into account the fact that, following on from consultations and as a demonstration of good faith, Korea reconsidered the base years for the establishment of the quota, thus increasing its amount by approximately 5,000 tonnes.

³⁸² See, G/SG/N/10/KOR/1 (27 January 1997).

³⁸³ *Id.*

³⁸⁴ See, G/SG/8 (17 December 1996).

³⁸⁵ See, G/SG/N/10/KOR/1/Suppl.1 (1 April 1997).

(ii) *The Adequacy of Notification and Consultations*

4.736 Korea's notifications were adequate in that they:

- (a) provided "all pertinent information" required by Article 12.2, *i.e.*:
 - evidence of serious injury or threat thereof caused by increased imports;
 - a precise description of the product involved;
 - the proposed measure;
 - the proposed date of introduction;
 - the expected duration;
 - a timetable for progressive liberalization; and
- (b) adhered to the format approved by the Committee on Safeguards³⁸⁶; and
- (c) permitted the European Commission to reach a settlement of the dispute, albeit one that was not accepted by the EC Member States.

4.737 Regarding the adequacy of information provided, Korea suggests that notifications under Article 12 serve a different function from the publication of information relating to the investigation by the Korean authority under Articles 3.1 and 4.2(c) of the Agreement on Safeguards, which state respectively:

"The competent authorities shall publish a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law."

"The competent authorities shall publish promptly, in accordance with the provisions of Article 3, a detailed analysis of the case under investigation as well as a demonstration of the relevance of the factors examined."

Notification is intended to provide the Committee on Safeguards with information which is to be disseminated to Members to facilitate meaningful prior consultations under Article 12.3 and, where appropriate, consultations under Article XXII GATT. This function is implied both by the structure of Article 12, which includes both notification and consultation, and by the final sentence of Article 12.2 which provides that "The Council for Trade in Goods or the Committee on Safeguards may request such additional information as they may consider necessary from the Member proposing to apply or extend the measure." Clearly, if the purpose of Article 12 were to replicate the exacting standards of Article 3 and 4.2(c), the final sentence of Article 12.2 would be redundant;

4.738 However, Korea does not view the notification procedure as a replacement for a third party Member's responsibility to be vigilant in international trade matters. Once a third party Member has been notified of the simple fact of the initiation of an investigation (and, where applicable, each of the subsequent stages), it must bear some responsibility for monitoring developments and for protecting its international law rights.

³⁸⁶ See, G/SG/M/1, 24 May 1995 paragraphs 35 and 36, which endorsed the suggested formats set out in the Note from the Chairman contained in G/SG/W/1 (23 February 1995). On 15 October 1996, the WTO Secretariat provided Members with the Technical Cooperation Handbook on Notification Requirements, WT/TC/NOTIF/SG1.

4.739 Indeed, Korea notes that the European Communities were extremely vigilant in this respect in that:

- (a) they attended the OAI public hearing on 20 August 1996;
- (b) they wrote to Dr. Kim of the KTC on 23 September 1996³⁸⁷ and received a reply from Director-General Kim on 11 October 1996.³⁸⁸ D-G Kim summarized the reason for the initiation of the KTC investigation and noted the steps taken by certain EC Member States to protect their commercial interests by, *inter alia*, attending the KTC hearing and obtaining copies of the OAI's Interim Report;
- (c) it raised issues concerning the nature of the KTC investigation at the regular meeting of the Committee on Safeguards on 25 October 1996;
- (d) it requested prior consultations with Korea on 11 and 16 December 1996;
- (e) on 28 January 1997, it provided Korea with 11 pages of questions concerning various aspects of Korea's investigation and the proposed safeguard measure;
- (f) on 3 February 1997, it received full responses to all questions posed to Korea;
- (g) it undertook prior consultations with Korea on 4 and 5 February 1997 in Geneva where it provided Korea with an English translation of the final OAI Report; and
- (h) it addressed a Special Meeting of the Committee on Safeguards on 21 February 1997 at which no further action was taken;

4.740 Korea is of the view that "all pertinent information" can only reasonably be interpreted as meaning all information required by Article 12.2 available at the time of the specific notification, that is, "evidence of serious injury or threat thereof caused by increased imports, precise description of the product involved and the proposed measure, proposed date of introduction, expected duration and timetable for progressive liberalization". "All pertinent information" does not and cannot, as the European Communities imply, mean all information and analysis produced during the investigation by the Korean authorities. In any thorough investigation, this information and analysis will run to thousands of pages and will be summarized and reported during the course of the national proceedings, as required by Article 3.1 of the Agreement on Safeguards, which again Korea notes the European Communities have conspicuously failed to use as a basis for any claims.

4.741 The requirement to provide "evidence of serious injury or threat thereof caused by increased imports" does not imply that the notifying party has to: provide further analysis, whether detailed or otherwise, of any evidence provided; or provide any separate analysis of causation³⁸⁹;

4.742 In Korea's view, the Committee on Safeguards and the WTO Secretariat acknowledge that certain legal systems may draw a distinction between "making a finding" (triggering a notification under Article 12.1(b)) and "taking a decision" (triggering a notification under Article 12.1(c)).³⁹⁰ Thus, in making a notification under both of these provisions, some information may not be available.

³⁸⁷ See, Exhibit Korea-15.

³⁸⁸ See, Exhibit Korea-16

³⁸⁹ See, G/SG/W/1 (23 February 1995) where, at Section VI, the obligation to "provide evidence of serious injury or threat thereof caused by increased imports" is distinguished from the obligation to "provide information on whether there is an absolute increase in imports relative to domestic production." If evidence of causation is a separate requirement, it would have been separated out as are serious injury and increase in imports.

³⁹⁰ *Id.*

In the case of Korea, it made a good faith attempt to provide relevant information that would assist prior consultations.

4.743 Finally, Korea notes that the notifications and prior consultations permitted the parties to reach a settlement³⁹¹. The European Communities in their Oral Statement argue that no binding settlement was reached between the parties. However, the European Communities cannot deny that an exchange of proposals leading to a settlement was made. If the notifications and prior consultations were inadequate as the European Communities suggest, no such proposal could have been made at all.

(iii) *Conclusion*

4.744 Korea takes its obligations under Articles 3.3 and 3.7 of the Understanding on Dispute Settlement to reach a “mutually acceptable” solution very seriously. It reiterates that it acted in good faith during all consultations and is pleased that the European Communities acknowledged this in their comments at the Oral Hearing. Korea also reiterates that it unilaterally increased the amount of its quota as part of its attempt to settle this dispute. However, Korea objects to the EC argument that Korea’s notification and consultations were inadequate when the real blame lies in the sectional interests of its Member States.

4.745 At the second meeting of the panel with the parties, **Korea** further advanced its defence on the EC claims under Article 12 as follows:

4.746 Notification and consultations are intended to provide the Committee on Safeguards with information that is to be disseminated to Members to facilitate meaningful prior consultations under Article 12.3, and where appropriate, consultations under Article XXII GATT 1994. Korea does not view its obligations under Article 12 as a complete replacement for the duty of its trading partners, including the European Communities, to be vigilant in international commercial matters, and to monitor the activities of its trading partners. Korea notes that the European Communities and certain other WTO Members were involved in every stage of the Korean investigation leading to the imposition of the safeguard measure. This involvement demonstrates both adequacy of published and publicly available information, and openness of the investigation procedure.

4.747 The European Communities addressed a regular³⁹² and special meeting³⁹³ of the Committee on Safeguards. While such meetings are not a replacement for the dispute settlement procedure, it is clear that although the European Communities had a full and fair opportunity to air their grievances, the Chairman of the Committee took note of the statements made, but made no recommendations and requested no further action.

4.748 Korea undertook extensive consultations with the European Communities, New Zealand and Australia prior to imposition of the safeguard measure. This process included answering very detailed questions on Korea’s investigation and on the process which would eventually lead to the imposition of the safeguard measure.

4.749 Each notification provided all the information available at the time of submission, and is consistent with the *pro forma* drafted by a Working Group of the Committee, agreed by the Committee on Safeguards in May 1995, and provided to all Members in a Handbook prepared by the Secretariat. Korea cannot accept the EC argument that “the Handbook can therefore be of no guidance in deciding whether the information submitted to the Committee on Safeguards constituted ‘all pertinent information.’” If the European Communities felt that the formats were inadequate, and

³⁹¹ See Korea's arguments in paragraph 4.6 above.

³⁹² See meeting of 25 October 1996, G/SG/M/7 (19 March 1997).

³⁹³ See meeting of 21 February 1997, G/S/M/8 (19 June 1997).

could not provide guidance to Members, it should have made these points at the time of their adoption by the Committee on Safeguards rather than seeking to raise such objections when it suits its arguments.

4.750 Korea cannot accept as the European Communities appear to imply that “all pertinent information” means all information and analysis produced during the investigation by competent authorities. This information and analysis is to be found within the documents produced in accordance with Articles 3 and 4.2(c), which the European Communities have chosen not to challenge.

4.751 The EC argument that no binding settlement of this case was reached wholly misses the point of Korea’s comments: clearly, the notification and prior consultations were sufficiently adequate to permit settlement. The fact that this could not be finalized by the European Communities, as a result of their internal procedures, is irrelevant. If the notifications and prior consultations were inadequate, as the European Communities suggest, no proposal to its Member States would or could have been made at all; Korea, mindful of the confidential nature of these consultations, had not provided the Panel with *proces verbal* containing the terms of settlement and all correspondence between the European Communities and Korea on this matter. Given the EC challenge to Korea to prove that a settlement was almost concluded, Korea provided the Panel with the following documents:³⁹⁴

- the various versions of the exchanged *proces verbal* including the final settlement; and
- the relevant correspondence accompanying these documents.

4.752 As the third sentence of Article 3.7 of the DSU unequivocally states “a solution mutually acceptable to the parties to the dispute and consistent with the covered agreements is clearly to be preferred.” It was pursuant to this Article of the DSU that Korea entered into settlement negotiations with the European Communities with a view to working out a mutually satisfactory solution. It was the European Communities, and not Korea, that breached the outcome of these good faith negotiations by failing to confirm this settlement with its Member States.

4.753 In response to a question of the Panel³⁹⁵ **Korea** further clarified its position on Article 12 notifications:

4.754 Korea is very clear that the complete absence of a notification must be distinguished from a notification. Further, there is a distinction between a complete and incomplete notification. In Korea’s view, the incompleteness of the notification cannot affect the validity of the underlying safeguard measure.

4.755 The European Communities suggested that a procedural violation, however insignificant or immaterial, *could* call in question the very existence of the safeguard measure. Further, Korea also understood the European Communities to be implying that a procedural violation of Article 12 could in some way also amount to a substantive violation.

4.756 Korea's view is that a procedural violation of Article 12 cannot be a substantive violation.

³⁹⁴ See, Korea Exhibit 18

³⁹⁵ The Panel recalls that the question was: "With regard to Article 12.1 and 12.2, do the parties believe that a distinction should be drawn between a complete or a deficient notification, or between the existence or the absence of such notification? What should the consequences be of the absence or the incompleteness of the notification with regard to the safeguard measure itself?"

4.757 Korea further notes that whether or not the safeguard had been implemented did not appear to alter the issue of whether or how a deficient notification could be remedied. Korea stated that should a Member be held by a panel to violate Article 12, then as is set out in Article 19.1 of the DSU, and as is normally the case, the Member in breach should be requested to bring its measures into conformity with the agreement under consideration. In a case such as this, the question has to be asked as to exactly how a Member could bring its notification into conformity. If the Member has imposed its safeguard measure, then entry into further (meaningful) consultations would not be pointless, but could facilitate a revision in that safeguard measure (for example an increase in quota, or decrease in a tariff). If the safeguard measure was otherwise wholly in conformity with the Agreement on Safeguards, it would then be inappropriate for a Panel to suggest that a Member should be required to withdraw that safeguard.

4.758 Also in response to a question by the Panel³⁹⁶ **Korea** clarified its position on the issue of the content of the notification:

4.759 Korea is of the view that "all pertinent information" should be and is based on an objective standard, that of the format. These replicate the structure and content of Article 12.2.

4.760 However, the European Communities appear to want a decision regarding the issue of what is the *precise content* of the term "all pertinent information". Korea suggests that the precise nature of "all pertinent information" will vary from case to case.

4.761 The Panel also requested³⁹⁷ **Korea** to clarify its position on the documents that it had provided the Panel regarding the consultations held with the European Communities. Korea's answer was as follows:

4.762 Korea is of the view that the evidential value of any fact supplied by the parties ultimately has to be assessed by the Panel, and possibly the Appellate Body. This is *a fortiori* the case where the parties appear to dispute those facts. Korea only notes that the documentation it has supplied concerning the consultations was merely provided to establish that these consultations were adequate enough to permit the European Communities and Korea to agree on the terms of settlement, albeit not legally binding.

V. THIRD PARTY ARGUMENTS

A. UNITED STATES

5.1 The **United States** made the following arguments as third party:

(a) Standard of Review

5.2 The United States agrees with Korea's assertions concerning the standard of review applicable in safeguard cases. The United States recalls the panel's determination in *US - Underwear*, as cited by Korea, wherein the panel concluded that its function was not to engage in a *de novo* review, but rather to examine the consistency of a Member's actions with its international obligations.³⁹⁸ The *US - Underwear* panel decided to make an objective assessment of the written decision of the US authorities embodying their determination and findings; this objective assessment

³⁹⁶ The Panel recalls that the question was: "Is the concept of "all pertinent information" an objective or subjective standard? Please comment on how your answer should affect the Panel's conclusion with regard to the consequences of such a standard not being met?"

³⁹⁷ The panel recalls that the question was: "What judicial notice should the Panel now take of the consultations?"

³⁹⁸ WT/DS24/R (8 November 1996) ¶ 7.12-7.13

entailed an examination of whether those authorities had examined all relevant facts before them, whether adequate explanation had been provided of how the facts as a whole supported the determination made, and, *consequently*, whether the determination made was consistent with the international obligations of the United States.³⁹⁹ Similarly, the panel on *US - Shirts and Blouses* followed this standard of review in its assessment of another textile safeguard action by the United States. The panel made a close examination of the written decision of the US authorities; it commented on factors addressed in the written decision, and dealt as well with the decision's failure to address certain factors, and with the issue of causation. Finally, the panel made an overall assessment of the US determination. However, at no time did the *US - Shirts and Blouses* panel engage in a *de novo* review. The findings of these two panels concerning the issue of standard of review were adopted by the DSB without any modification by the Appellate Body.

5.3 The standard articulated above is also the appropriate standard of review for disputes involving the application of the Agreement on Safeguards in the context of safeguard determinations made by national authorities. National authorities are in the best position to evaluate the facts and determine the applicable weight to be accorded to various factors. As the Appellate Body properly noted in *European Communities -- Measures Concerning Meat and Meat Products ("Hormones")*, panels "are poorly suited to engage in such review."⁴⁰⁰ The appellate body further noted in *Hormones* that the role of a panel is to make an objective assessment of the matter in dispute, both as to the facts and the law, as mandated by Article 11 of the DSU.⁴⁰¹ The United States submits that a panel would be assured of arriving at an "objective assessment" of the matter in dispute if it applied a standard of review, consistent with *US - Underwear* and *US - Shirts and Blouses*, that considers whether (a) the domestic authority has examined all relevant facts before it; (b) adequate explanation has been provided of how the facts as a whole supported the determination made; and (c) consequently, whether the determination made is consistent with the international obligations of the Member.

(b) The Agreement on Safeguards has Subsumed the Applicable Provisions of Article XIX of GATT

5.4 The United States disagrees with the EC assertion that a Member may only impose a safeguard measure if, *inter alia*, the increase in imports results "from both unforeseen developments and compliance with GATT obligations, including tariff liberalization according to a party's schedules of concessions." Article XIX:1(a) of the GATT must now be read in accordance with the rights and obligations set out in the Agreement on Safeguards, as required by Article 11.1(a) of that Agreement. The Agreement on Safeguards has defined, clarified, and in some cases modified, the package of rights and obligations of a potential user of safeguard measures, and Article 2 of the Agreement on Safeguards makes clear that a demonstration of "unforeseen developments" and a causal nexus to GATT obligations are no longer prerequisites to the application of a safeguard measure.

5.5 The Agreement on Safeguards clarifies and expands on the provisions of Article XIX, and establishes procedures for the application of safeguards measures. Thus, the preamble to the Agreement on Safeguards "recogniz[es] the need to *clarify* and reinforce the disciplines of GATT, and specifically those of its Article XIX", while Article 1 "establishes the rules for the application of the safeguard measures . . . provided for in Article XIX of GATT." The two agreements must be read *in tandem* and, together, they create a *new* package of rights and obligations which are distinct from the rights and obligations contained in the original GATT provision. The United States recalls that the Appellate Body arrived at a similar determination in *Desiccated Coconut*, wherein the Appellate Body, quoting the panel, asserted:

³⁹⁹ See, *US - Underwear* at 7.13.

⁴⁰⁰ WT/DS26/AB/R (16 January 1998), 117.

⁴⁰¹ *Hormones* at 118.

Article VI of GATT and the SCM Agreement represent a new and different package of rights and obligations, as among WTO Members, regarding the use of countervailing duties. . . . The SCM Agreements do not merely impose additional substantive and procedural obligations on a potential user of countervailing measures. Rather, the SCM Agreements and Article VI together define, clarify and in some cases modify the whole package of rights and obligations of a potential user of countervailing measures.⁴⁰²

5.6 In addition, the negotiators of the Agreement on Safeguards were specific in their intent to subsume Article XIX under the new regime established by the Agreement on Safeguards. Thus, Article 11.1(a) of the Agreement on Safeguards establishes the relationship between GATT Article XIX and the Agreement as follows:

A Member shall not take or seek any emergency action on imports of particular products as set forth in Article XIX of GATT unless such action conforms with the provisions of that Article applied in accordance with this Agreement.

The phrase “applied in accordance with this Agreement” is significant in that it demonstrates the intent of the negotiators to subsume Article XIX under the new rights and obligations created by the Agreement on Safeguards. This intention is made even more apparent when the language in Article 11.1(a) is contrasted, for example, with language in the *Agreement on Subsidies and Countervailing Measures* (“SCM Agreement”) where there is **not** a similar intent to subsume Article VI of GATT under the SCM Agreement. Thus, Article 10 of the SCM Agreement provides:

Members shall take all necessary steps to ensure that the imposition of a countervailing duty on any product of the territory of any Member imported into the territory of another Member is *in accordance with the provisions of Article VI of GATT and the terms of this Agreement*. (Emphasis added).

5.7 The explicit terms of the Agreement on Safeguards make clear that Article XIX does not maintain an existence separate and apart from the Agreement; rather, those provisions of Article XIX *that remain in force* are incorporated into the Agreement on Safeguards. Moreover, the Agreement on Safeguards does not merely establish a procedural framework for the application of GATT Article XIX. Instead, the Agreement subsumes Article XIX under its umbrella and thereby creates a new package of rights and obligations that defines, clarifies and, in some cases, modifies the rights and obligations articulated in Article XIX. In this instance, the Agreement on Safeguards modifies the package of rights to ensure that a Member may impose a safeguard action without regard to the question of whether the increase in imports (or threat thereof) was “as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions . . .” as originally articulated in Article XIX.⁴⁰³ Under this new regime, Article 2 establishes the threshold conditions a Member must satisfy before a safeguard measure properly can be imposed. This interpretation is further borne out by the fact that the negotiators of the Agreement on Safeguards conspicuously reiterated in Article 2 every sentence of Article XIX:1(a) **except** the language regarding “unforeseen developments” and GATT obligations.

⁴⁰² WT/DS22AB/R (21 February 1997), at p.16 (emphasis in original).

⁴⁰³ Indeed, such a modification was necessary in order to reflect actual practice. It is simply not credible to suggest that a trade Minister would negotiate a particular concession if it could be foreseen that such a concession would result in increased imports that, in turn, would seriously injure an industry in the country granting the concession. A Minister who engaged in such conduct would, quite properly, be relieved of his or her post. Thus, the use of the term “unforeseen developments” is surplusage because circumstances where increased imports cause or threaten serious injury are, almost by definition, “unforeseen”.

5.8 Accordingly, the United States respectfully submits the EC assertion that the safeguard measure imposed by Korea violates the “unforeseen developments” provision of Article XIX:1(a) of GATT is erroneous because Article 2 of the Agreement on Safeguards contains no such requirement.

(c) Safeguard Measures Must Be Imposed in Accordance with the Requirements of Article 4 of the Agreement on Safeguards

5.9 The United States agrees with the European Communities that a Member, in making its injury determination, must examine all of the relevant factors bearing on the condition of the industry as a whole, as required by Article 4 of the Agreement on Safeguards. To the extent that Korea examined relevant factors only with respect to the condition of a portion of an industry without relating that examination to the condition of the industry as a whole, Korea’s determination is deficient. Article 4.2(a) states that the Korean authorities in the Member “shall evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry, in particular . . .” (a list of factors follows). This requirement, read in conjunction with the definition of domestic industry in Article 4.1(c) -- “the producers as a whole . . . or those whose collective output . . . constitutes a major proportion of the total domestic production” -- indicates that the evaluation should be in terms of the whole industry, and not just one or another part of it. While injury to an industry can be analysed in terms of a portion of an industry, the implication is that information relating to a portion of the industry must be shown as relating to the condition of the industry as a whole. Thus, to the extent that Korea failed to examine all the relevant factors set out in Article 4.2(a), its investigation is deficient.

5.10 Similarly, the European Communities enumerate a number of factors that Korea allegedly failed to evaluate in arriving at its affirmative injury determination. In response to this claim, Korea furnished a number of tables and other information. It is unclear from Korea’s submission, however, whether this information was before the KTC and considered by the KTC when it made its determination, or whether this information was compiled after the fact to support the KTC’s determination. There are no citations to the record of the KTC investigation or to the KTC’s report demonstrating that such information was evaluated by the KTC. While a decision on the merits of the evidence submitted must be left to the discretion of the domestic competent authority, Article 4.2(a) clearly requires that the *competent authority* evaluate all such relevant evidence. If the KTC did indeed fail to evaluate relevant evidence, such an act would violate the explicit terms of Article 4.2(a).

(d) The Agreement on Safeguards Does Not Establish a Numerical Market Penetration Threshold

5.11 Both Korea and the European Communities erroneously suggest that there is an implicit but undefined numerical threshold in Article 4.2(a) relating to market share for determining whether increased imports are causing or threatening serious injury. The European Communities indicate that the 5.7 per cent decline in domestic market share of Korean raw milk and milk powder producers is too small to be a cause for concern, while Korea counters that the 5.7 per cent decline indicates serious injury to the domestic industry. In support of its position, Korea cites to the March 1998 affirmative injury determination of the US International Trade Commission (USITC) in *Wheat Gluten*, in which the USITC found that imports increased their share of the US market by 8.8 per cent during the period of investigation.

5.12 The United States submits that Article 4.2(a) contains no numerical test or threshold requirement for market penetration, explicit or implied. Instead, Article 4.2(a) requires that the competent authority evaluate “all relevant factors,” of which the percentage share of the domestic market is only one. If the percentage share change were taken as the sole benchmark, it would be contrary to the requirement that the competent authorities evaluate all relevant factors. As demonstrated by the USITC determination in *Wheat Gluten*, at the pages in the USITC report cited by Korea, the increase in market share held by imports was only one of several factors that the USITC

considered in determining that increased imports were a substantial cause of serious injury in that particular case.

5.13 Furthermore, no single number could logically serve as a benchmark for evaluating the significance of market penetration. The importance of any given change in market share will vary from case to case. Whether a change of 5.7 per cent is significant or insignificant will depend in large part on the nature of the product and the nature of competition in the market.

(e) The Agreement on Safeguards Does Not Require Adjustment Plans

5.14 The United States disagrees with the EC assertion that Korea violated Article 5.1, *inter alia*, because it “did not submit any information as to adjustment plans to restore the industry’s competitiveness. . .” and that “by omitting to give any consideration to adjustment plans, *a fortiori* Korea has failed to examine how its safeguard measure could be necessary or even helpful to their implementation.” The Agreement on Safeguards does *not* require that an industry submit an adjustment plan, thus, the Panel cannot read such a requirement into the Agreement. Article 5.1 provides solely that “[a] Member shall apply safeguard measures only to the extent necessary to prevent or remedy serious injury and to facilitate adjustment. . . .” Although submission and consideration of an adjustment plan may be desirable as a means of substantiating that a Member has satisfied the objective of Article 5.1, there is no specific *requirement* in the Article that either refers to adjustment plans or requires that a member consider such plans.

VI. INTERIM REVIEW

6.1 On 17 March 1999, The European Communities and Korea requested the Panel to review, in accordance with Article 15.2 of the DSU, certain aspects of the interim report that had been transmitted to the parties on 3 March 1999. The European Communities requested the Panel to hold an additional meeting. This additional meeting of the Panel with the parties took place on 22 March 1999.

6.2 We have reviewed the arguments and suggestions presented by the parties, and finalized our report, taking into account those comments by the parties which we considered justified. In doing so we have ensured that no new arguments were introduced at this stage of the panel process. In this context we have made slight modifications to certain paragraphs, including those made to paragraphs 4.325, 4.416 to 4.419, 4.449 and 4.452 of the descriptive part and paragraphs 7.16, 7.18, 7.23, 7.24, 7.30, 7.31, 7.46, 7.49, 7.55, 7.70, 7.72, 7.73, 7.75, 7.77, 7.78, 7.79, 7.86, 7.87, 7.96 and 7.116 of the findings. In addition, we have made other minor modifications including linguistic and typographical corrections.

VII. FINDINGS

A. PROCEDURAL MATTERS

7.1 In the present section, we address two procedural objections raised by Korea in its first submission. We also recall an oral ruling made at the end of the first substantive meeting of the Panel with the parties regarding Korea's request to file the English version of its OAI Report, at a date following the first substantive meeting of the Panel. Finally, we address Korea's challenge of the scope of this dispute, namely the consequences of the absence of any claim by the European Communities under Article 3 of the Agreement on Safeguards.

1. Insufficiency of the EC Request for Establishment of the Panel

7.2 Korea requests the Panel to reject the European Communities' complaint in its entirety on the basis of the insufficiency of its request for establishment of a panel, in violation of Article 6.2 of the

Understanding on the Rules and Procedures Governing the Settlement of Disputes ("DSU"). Korea argues that the EC panel request is in violation of Article 6.2 of the DSU as it simply lists four articles of the Agreement on Safeguards, which, it argues, is insufficient "especially in a request relating to the determination of a domestic authority...". For Korea the panel request must contain a detailed statement of the matter in dispute and the legal basis of the European Communities' claims, in order to permit the defendant to conduct an effective defense and the third parties to assess whether or not to intervene. Korea requests this Panel to refrain from following the interpretation given by the Appellate Body in the *EC - Bananas*⁴⁰⁴ case, where it was stated that it was sufficient under Article 6.2 of the DSU for a panel request to list the articles of the relevant agreements.

7.3 On this issue the European Communities refers the Panel to the conclusions of the Appellate Body in *EC - Bananas*:

"[we] accept the Panel's view that it was sufficient for the Complaining Parties to *list the provisions of the specific agreements alleged to have been violated* without setting out detailed arguments as to which specific aspects of the measures at issue relate to which specific provisions of those agreements".⁴⁰⁵ (emphasis added)

7.4 Article 6.2 of the DSU reads as follows:

"The request for the establishment of a panel shall be made in writing. It shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly".

7.5 We consider that a request for establishment of a panel is sufficiently detailed if it contains a description of the measures at issue and the claims, i.e. the violations alleged.⁴⁰⁶

7.6 We note that the EC request for establishment of a panel contains the following references:

"The contested safeguard measure was imposed in the form of an import quota on imports of certain dairy products (Korean CN codes 0404.90.0000, 0404.10.2190, 0404.10.2900 and 1901.90.2000) effective as of 7 March 1997 and made public through notification in the revision of "Separated Notice of Export-Import" and in "Detailed Principle of Import Licence on Imitation Milk Powder". ...

"Therefore, the EC requests that the panel consider and find that this measure is in breach of Korea's obligations under the provisions of the Agreement on Safeguards, in particular of Articles 2, 4, 5 and 12 of the said Agreement and in violation of Article XIX of GATT 1994."

7.7 We consider, therefore, that the EC request for establishment of a panel is sufficiently detailed as it contains a description of the measures at issue and the claims, i.e. the violations alleged.

⁴⁰⁴ *European Communities – Regime for the Importation, Sale and Distribution of Bananas ("EC-Bananas")*, adopted on 25 September 1997, WT/DS27/AB/R.

⁴⁰⁵ *EC - Bananas*, Appellate Body Report, para. 141.

⁴⁰⁶ See for instance, the Appellate Body statement in *EC - Bananas*, Appellate Body Report, para. 141. In the recent Report on *Guatemala – Antidumping Investigation Regarding Portland Cement from Mexico* (adopted on 25 November 1998, WT/DS60/AB/R) ("*Guatemala – Cement*") the Appellate Body reiterated that these were the two requirements prescribed by Article 6.2 of the DSU. We see no reason to depart from this position.

2. Lack of Economic Interest

7.8 Korea also claims that the European Communities admits having little or no commercial interest in bringing this matter before the Panel. For Korea this admission, coupled with the failure to settle the dispute during the consultations, suggests that the current proceeding is merely an attempt by the European Communities to use the DSU to establish a precedent on safeguards by way of an advisory opinion from the Panel. Korea argues that this goes against the spirit of the DSU which provides that formal dispute settlement should be reserved for disputes where Members consider, in good faith, that their interests are being impaired, and that Article 3.7 of the DSU specifically instructs Members to exercise restraint in bringing dispute settlement cases and articulates a preference for mutually agreed solutions over resort to formal dispute settlement.

7.9 The European Communities responds that in the *EC - Bananas* case, the Appellate Body, in reply to a similar objection by the European Communities, held that:

“a Member has broad discretion in deciding whether to bring a case against another Member under the DSU. The language of Article XXIII:1 of the GATT 1994 and of Article 3.7 of the DSU suggests, furthermore, that a Member is expected to be largely self-regulating in deciding whether any such action would be ‘fruitful’.”⁴⁰⁷

7.10 Korea also alleges that after intensive consultations the parties appeared to have settled their dispute. For Korea, the fact that the European Communities later withdrew its acceptance of the settlement proposed by Korea is evidence of lack of good faith on the part of the European Communities.

7.11 As to the alleged acceptance of a settlement offered by Korea, the European Communities responds that there never was any formal proposal or acceptance of a mutually agreed settlement. For the European Communities, each side negotiated in good faith in an effort to reach a mutually satisfactory solution in this case, but that solution did not materialise. The European Communities concludes by stating that if Korea wants to challenge the European Communities’ good faith in negotiations and in bringing this dispute, it must bear the burden of proving its allegations.

7.12 First, we note that Korea is not clear as to what it wants the Panel to do in response to its argument. Korea does not request the rejection of the complaint for lack of economic interest on the part of the European Communities or for lack of good faith on the part of the European Communities during the negotiations. However, assuming that Korea’s position is that there is a requirement for the European Communities to have some economic interest and that the European Communities has failed to meet it, the Panel would have to decide what action is appropriate. We consider therefore that we should rule on this issue.

7.13 Regarding Korea’s reference to the lack of economic interest of the European Communities, we consider that under the DSU there is no requirement that parties must have an economic interest. In *EC - Bananas*, the Appellate Body stated that the need for a “legal interest” could not be implied in the DSU or in any other provisions of the WTO Agreement and that Members were expected to be largely self-regulating in deciding whether any DSU procedure would be “fruitful”. We cannot read in the DSU any requirement for an “economic interest”. We also note the provisions of Article 3.8 of the DSU, pursuant to which nullification and impairment is presumed once violation is established.

7.14 Even assuming that there is some requirement for economic interest, we consider that the European Communities, as an exporter of milk products to Korea, had sufficient interest to initiate and proceed with these dispute settlement proceedings.

⁴⁰⁷ See *EC - Bananas*, Appellate Body Report, para. 135.

7.15 Concerning Korea's reference to the unsuccessful settlement negotiations, we can only note that the European Communities considers that the offers by Korea were not acceptable to it, and both parties admit that no formal settlement of the present dispute was ever reached and approved by the relevant national authorities. The DSU favours the conclusion of mutually acceptable solutions. We note that, for the present dispute, no mutually agreed solution was notified to the DSB. We can only recall that when a WTO Member considers that its rights have been nullified by the actions of another Member it is entitled⁴⁰⁸ (under Article 14 of the Safeguards Agreement and Articles XXII and XXIII of GATT 1994) to initiate the dispute settlement procedures envisaged in the DSU.

3. Submission of the OAI Report

7.16 In its first submission Korea refers to a report of the Korean Trade Commission (OAI Report)⁴⁰⁹ of which it submitted only a version in the Korean language. At the outset of the first substantive meeting of the Panel with the parties, the Panel stated that it was disappointed that Korea had filed only a Korean language version of the OAI Report. Although the Panel understood the difficulties involved with the translation of the investigation report, the Panel suggested to Korea that should it wish to refer to the OAI Report in support of its allegations, Korea should file a version of the report in one of the official languages of the WTO. Korea raised doubts as to whether the OAI report was relevant since in Korea's view the EC limited its complaints to the quality and depth of Korea's notification under Article 12. The Panel was not addressing the issue whether it was for Korea to submit such OAI Report but simply that any submission of evidence had to be done in one of the official languages of the WTO.

7.17 At the end of the first meeting of the Panel, Korea informed the Panel that it would need an additional period beyond what was scheduled for answers and rebuttals to submit an English version of the OAI Report.⁴¹⁰

7.18 The Panel informed Korea that if it intended to submit any piece of evidence, including the OAI Report, it should do so by 20 November 1998, that is, the deadline given to the parties to answer the questions posed to them during the first substantive meeting of the Panel. In this way parties would be able to submit full and useful rebuttals before the second meeting of the Panel. On 20 November 1998, Korea submitted, together with its answers to the questions submitted to it, an English version of the OAI Report, as Exhibit Korea-6.

7.19 We based our ruling on paragraph 5 of the Additional Rules of Procedure, adopted by the Panel pursuant to Article 12.1 of the DSU, which provides that:

⁴⁰⁸ See Appellate Body Report on *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, adopted on 23 May 1997, WT/DS33/AB/R ("*US – Shirts and Blouses*"), at page 13.

⁴⁰⁹ In its 2 December 1996 notification, G/SG/N/8/KOR/1, circulated on 6 December 1996 Korea stated that the term "OAI Report" is equivalent to the "KTC Report". Therefore, in our findings we shall refer to the report of the KTC's investigation as the "OAI Report".

⁴¹⁰ In response, the European Communities complained that it appeared to it that Korea had had *ex parte* communications with the Panel during which, according to the European Communities, the Panel had authorized Korea to submit an English version of the OAI Report after the rebuttals. The Panel immediately informed the parties that no members of the Panel (nor any one from the Secretariat) had communicated with Korea on this issue. The only reference to the filing of the OAI Report was contained in the transmission letter that Korea sent to the Panel with its first submission and which was copied to the parties. The latter part of this letter reads as follows: "Given the time constraint, Korea was unable to produce an official English version of the investigation report of the Korea Trade Commission. Only the original version (Korean version) is attached herewith. Korea will submit the English version as expeditiously as possible." Clearly there had been no *ex parte* communication.

"5. Parties shall submit all factual evidence to the Panel no later than during the first substantive meeting, except with respect to evidence necessary for purposes of rebuttals submissions or answers to questions. ... "

7.20 We also consider that this is in line with the two stage approach advocated by the Appellate Body in *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*.⁴¹¹

4. The absence of a claim by the European Communities under Article 3 of the Agreement on Safeguards

7.21 In its second submission, Korea argues that because the European Communities did not raise any claim under Article 3 or Article 4.2(c), the European Communities must be deemed to accept that the "competent authorities" in Korea have published: "a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law" (Article 3.1, final sentence). For Korea, since the European Communities has failed to invoke Article 3 of the Agreement on Safeguards, and has failed to raise claims under Article 4.2(c) of that Agreement, the European Communities is, therefore, only challenging the quality and depth of Korea's notifications under Article 12 of the Agreement on Safeguards. The European Communities agrees with Korea that it is not bringing a complaint under Article 3 of the Agreement on Safeguards, nor is it relying upon Article 4.2(c) thereof. For the European Communities this does not affect its right to challenge the substance of the OAI Report.

7.22 We agree with the European Communities that the absence of a claim under Article 3 of the Agreement on Safeguards means at most that the European Communities agrees that the report is WTO compatible for the purpose of Article 3.1 of the Agreement on Safeguards. The European Communities has the right to raise more specific claims under Article 4 of the Agreement on Safeguards and has done so. We consider that if a Member wants to challenge the WTO compatibility of the manner in which an "injury" determination was performed, or the choice of an appropriate measure to be imposed, this Member does not have to challenge the publication of the final report as such.

B. BURDEN OF PROOF

7.23 Korea alleges that the burden of proof is on the European Communities and adds that this burden "does not shift between the parties during the dispute". The European Communities does not submit any argument on the burden of proof.

7.24 In the context of the present dispute, which is concerned with the assessment of the WTO compatibility of a safeguard measure imposed by a national authority, we consider that it is for the European Communities to submit a *prima facie* case of violation of the Agreement on Safeguards, namely, to demonstrate that the Korean safeguard measures are not justified by reference to Articles 2, 4, 5 and 12 of the Agreement on Safeguards.⁴¹² We recall in this regard the statement of the Appellate Body in *EC – Hormones*⁴¹³ that "... a *prima facie* case is one which, in the absence of *effective refutation* by the defending party, requires a panel, as a matter of law, to rule in favour of the complaining party presenting the *prima facie* case". It is therefore for Korea to provide an "effective refutation" of the European Communities' case. In the present case, it is for Korea to

⁴¹¹ See Appellate Body Report in *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS57/AB/R, adopted on 22 April 1998, para. 79 ("*Argentina – Measures Affecting Apparel*").

⁴¹² See Appellate Body Report in *Australia – Measures Affecting Importation of Salmon*, adopted on 6 November 1998, WT/DS18/AB/R, ("*Australia – Salmon*"), paras. 257-261.

⁴¹³ Appellate Body Report on *European Communities – Measures Concerning Meat and Meat Products ("EC – Hormones")*, adopted on 13 February 1998, WT/DS26 and 48/AB/R, para. 104.

effectively refute the European Communities' evidence and arguments, by submitting its own evidence and arguments in support of its assertions that, at the time of its determination, Korea did respect the requirements of the Agreement on Safeguards.⁴¹⁴ As a matter of law the burden of proof rests with the European Communities, as complainant, and does not shift during the panel process. As a matter of process before the Panel, the European Communities will submit its arguments and evidence and Korea will respond to rebut the EC claims. At the end of this process, it is for the Panel to weigh and assess the evidence and arguments submitted by both parties in order to reach conclusions as to whether the EC claims are well-founded.

7.25 In the present case, after considering the extensive submissions of both parties, we must weigh the evidence submitted by each of them and assess the value of their legal arguments in view of the provisions of the Agreement on Safeguards to determine whether the European Communities' claims are well-founded.

C. STANDARD OF REVIEW

7.26 We note there are no specific provisions on standard of review in the Agreement on Safeguards. We consider, therefore, in line with the prescription of the Appellate Body in the *EC - Hormones* dispute, that in the absence of a specific standard of review for the relevant WTO multilateral trade agreement, the provisions of Article 11 of the DSU are applicable⁴¹⁵.

7.27 Article 11 of the DSU provides that "... a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements...".

7.28 Korea asks the Panel not to enter into a *de novo* review of its national authorities' determination to impose a safeguard measure. For Korea, the standard of review of Article 11 implies that the function of the Panel is to assess whether Korea (i) examined the relevant facts before it at the time of the investigation; and (ii) provided an adequate explanation of how the facts before it as a whole supported the determination made. Korea adds that a certain deference or latitude should be left to the national authorities.

7.29 The European Communities agrees that the standard is that established in Article 11 of the DSU and that the Panel should not perform a *de novo* assessment. In this context, the European Communities claims that it is not contesting the basic economic data produced by Korea but only their completeness and the conclusions drawn from them. The European Communities submits that the "objective assessment of the facts" referred to in Article 11 DSU cannot be satisfied by verifying what conclusions the investigating authority came to but must also include "how" it came to those conclusions, that is to say the national authority must provide a reasoned opinion explaining how such factors and arguments have led to its findings.

7.30 We consider that for the Panel to adopt a policy of total deference to the findings of the national authorities could not ensure an "objective assessment" as foreseen by Article 11 of the DSU. This conclusion is supported, in our view, by previous panel reports that have dealt with this issue⁴¹⁶.

⁴¹⁴ We note that this was the conclusion reached by the Panel in *US – Shirts and Blouses* (adopted on 27 May 1997, WT/DS33/R) para. 6.8: "... it was for India to submit a prima facie case of violation of the ATC, namely, that the restriction imposed by the United States did not respect the provisions of Articles 2.4 and 6 of the ATC. It was then for the United States to convince the Panel that, at the time of its determination, it had respected the requirements of Article 6 of the ATC." This was confirmed by the Appellate Body.

⁴¹⁵ *EC – Hormones*, Appellate Body Report, para. 116.

⁴¹⁶ We recall that in *United States - Restrictions on Imports of Cotton and Man-made Fibre Underwear* ("*US – Underwear*"), (adopted on 25 February 1997, WT/24/R), paras. 7.53-54, a case dealing with a safeguard action under the ATC, the panel reached the conclusions that the standard of review was that established in Article 11 of the DSU and commented on the implications of such standard of review for safeguard measures.

However, we do not see our review as a substitute for the proceedings conducted by national investigating authorities. Rather, we consider that the Panel's function is to assess objectively the review conducted by the national investigating authority, in this case the KTC. For us, an objective assessment entails an examination of whether the KTC had examined all facts in its possession or which it should have obtained in accordance with Article 4.2 of the Agreement on Safeguards (including facts which might detract from an affirmative determination in accordance with the last sentence of Article 4.2 of the Agreement on Safeguards), whether adequate explanation had been provided of how the facts as a whole supported the determination made, and, consequently, whether the determination made was consistent with the international obligations of Korea. Finally, we consider that the Panel should examine the analysis performed by the national authorities at the time of the investigation on the basis of the various national authorities' determinations and the evidence it had collected. In this case, this evidence is found mainly in the Report by the Office of Administrative Investigation ("OAI Report") and the subsequent determinations by the relevant Korean authorities⁴¹⁷. We note that the European Communities has initially relied on the notifications to the Committee on Safeguards to establish its claims. We are of the view that such notifications are not necessarily complete evidence of what the Korean national authorities actually did. Rather, the full reflection of the Korean investigation can only be found in the investigation report or the final determination by the Minister⁴¹⁸, and not (as argued by the European Communities at the first meeting of the Panel) in the notifications to the Committee on Safeguards. In its rebuttals and at the second meeting of the Panel with the parties, the European Communities, in support of its allegations, made reference to the OAI Report as well.

7.31 We consider, further, that Members are required, in their recommendations or determinations on the application of a safeguard measure, to explain how they considered the facts in their possession or which they should have obtained in accordance with Article 4.2 of the Agreement on Safeguards and why they concluded, at the time of the decision, that the measure to be applied was necessary to remedy the serious injury and facilitate the adjustment of the industry. This is not to say that the Panel interprets the Agreement on Safeguards as imposing on the importing Member any specific method either for collecting data or for considering and weighing all the relevant economic factors upon which the importing Member will decide whether there is need for a safeguard restraint.⁴¹⁹ Korea remains free to choose an appropriate method of assessing whether the state of its domestic industry was caused by imports of SMPP, or by other factors, but it must be in a position to demonstrate that it did address the relevant issues. We also consider that this standard of review is in line with GATT/WTO practice.

D. GENERAL PRINCIPLES OF INTERPRETATION

7.32 In its examination of the Agreement on Safeguards, the Panel is bound by the principles of interpretation of public international law (Article 3.2 of the DSU) which include Articles 31 and 32 of the Vienna Convention on the Law of Treaties. As provided in these articles and as applied by panels and the Appellate Body, we shall interpret the provisions of the Agreement on Safeguards on the basis of the ordinary meaning of the terms of its provisions in their context, in the light of the object and purpose of the Agreement on Safeguards, the GATT 1994 and the WTO Agreement. We note also

See also the Panel Report in *Brazil – Countervailing Duty Proceeding Concerning Imports of Milk Powder from the European Community*, adopted on 28 April 1994, SCM/179: "It was incumbent upon the investigating authorities to provide a reasoned opinion explaining how such facts and arguments had led to their finding.", para. 286.

⁴¹⁷ Evidence of what the Korean authorities did can also be found in the present case in: The Determination to Initiate an Investigation (17 May 1996, Exhibit Korea-3 and Exhibit Korea-4), Public Notice of Decision on Injury by the KTC (11 November 1996, Exhibit Korea-7), Public Notice of Implementation of Relief Measure by the Ministry of Commerce, Industry and Energy (7 March 1997, Exhibit Korea-9).

⁴¹⁸ See Section IV.B.2(b), *supra*.

⁴¹⁹ We note that a similar conclusion was reached by the Panel in *US – Shirts and Blouses*, para. 7.52.

Article XVI:1 of the WTO Agreement which provides that "... the WTO shall be guided by the decisions, procedures and customary practices followed by CONTRACTING PARTIES to GATT 1947 and the bodies established in the framework of GATT 1947".

E. CLAIMS UNDER ARTICLE XIX OF GATT

7.33 The European Communities initially makes two claims under Article XIX of GATT 1994. In its first submission it claims that Korea failed to examine whether the import trends of the products under investigation were the result of "unforeseen developments" as provided for in Article XIX:1(a). Korea responds that the text of the Agreement on Safeguards supports the interpretation that the provisions therein established are now the sole articulation of the rules that must be followed in the application of a safeguard measure. In its first submission the European Communities also argues that Korea failed to comply with its obligations under Article XIX:1(a) of GATT and Article 2 of the Agreement on Safeguards, to address whether the "conditions" under which importation of the products being investigated were of such a nature as to cause serious injury to the domestic industry producing like or directly competitive products. In its second submission, the European Communities argues that failing to examine under which conditions these increased imports occurred and in particular the prices at which the products were imported is a violation of the provisions of Article 2.1 of the Agreement on Safeguards (and the European Communities made no further reference to Article XIX:1(a) of GATT). Therefore, we shall examine the European Communities' claim that Korea failed to examine under which conditions these importations occurred only in relation to its claims under Article 2 of the Agreement on Safeguards.

7.34 The claim of the European Communities regarding "unforeseen developments" under Article XIX of GATT, the wording of which is not repeated in the Agreement on Safeguards, necessitates that we examine the relationship between the provisions of Article XIX of GATT and those of the Agreement on Safeguards.

7.35 The parties debated at length whether there is a conflict between the provisions of Article XIX of GATT and those of the Agreement on Safeguards and how the Panel should interpret the relationship between the terms of Article XIX:1 of GATT and the different terms used in Article 2.1 of the Agreement on Safeguards.⁴²⁰

7.36 Essentially, Korea argues that there is such a conflict, which should be resolved in favour of the exclusive application of the Agreement on Safeguards. The European Communities submits that all WTO obligations are generally cumulative. For the European Communities, the provisions of Article XIX of GATT, which are still fully applicable because there is no conflict between the provisions of the first paragraph of Article XIX and Article 2.1 of the Agreement on Safeguards, impose in addition to those of the Agreement on Safeguards, a condition that the increase of imports must be "the result of unforeseen developments".

7.37 We recall that the terms of a treaty must be interpreted with reference to their ordinary meaning taken in their context and in light of the object and purpose of the agreements examined. We also recall the principle of "effective interpretation" whereby all terms must be given their full meaning and must be interpreted with each other to avoid inconsistencies or "inutility"⁴²¹.

⁴²⁰ We refer to the European Communities' arguments and Korea's arguments in Section IV.C of this Panel Report.

⁴²¹ The principle of effective interpretation or "l'effet utile" or in latin *ut res magis valeat quam pereat* reflects the general rule of interpretation which requires that a treaty be interpreted to give meaning and effect to all the terms of the treaty. For instance one provision should not be given an interpretation that will result in nullifying the effect of another provision of the same treaty. For a discussion of this principle, see Yearbook of the International Law Commission, 1966, Vol II A/CN.4/SER.A/1966/Add.1 page 219 and following. See also

7.38 It is now well established that the WTO Agreement is a "Single Undertaking" and therefore all WTO obligations are generally cumulative and Members must comply with all of them simultaneously unless there is a formal "conflict" between them.⁴²² In the absence of conflict, there remain, however, difficult issues of interpretation for the reader to reconcile various provisions of a treaty as extensive as the WTO Agreement.⁴²³

7.39 We consider that the terms and prescriptions of Article XIX:1 of GATT are still generally applicable, as we are of the view that there is no conflict between the provisions of the Article XIX:1 of GATT and those of Article 2.1 of the Agreement on Safeguards. Our conclusion is based on our interpretation of the ordinary meaning of the terms of Article XIX:1 of GATT.

7.40 The first paragraph of Article XIX of GATT reads as follows:

Emergency Action on Imports of Particular Products

"1. (a) If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that Member in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the Member shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession."

Article 2.1 of the Agreement on Safeguards provides that

"A Member may apply a safeguard measure to a product only if that Member has determined, pursuant to the provisions set out below, that such product is being imported into its territory in such increased quantities, absolute or relative to domestic production, and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products."

7.41 We recall that the purpose of Article XIX was (and still is) to allow an importing Member to deviate temporarily from its obligations under Articles II and XI of GATT (i.e. to suspend its concessions or other obligations) in situations of increased imports causing serious injury to the

E.g., Corfu Channel Case (1949) I.C.J. Reports, p.24 (International Court of Justice); *Territorial Dispute Case* (Libyan Arab Jamahiriya v. Chad) (1994) I.C.J. Reports, p. 23 (International Court of Justice); Oppenheim's International Law (9th ed., Jennings and Watts eds., 1992), Volume 1, 1280-1281; P. Dallier and A. Pellet, Droit International Public, 5^e ed. (1994) para. 17.2); D. Carreau, Droit International, (1994) para. 369. See for instance the statement of the Appellate Body in *United States – Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/AB/R : "An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility"; also the Appellate Body Report on *Japan – Taxes*, page 12; Appellate Body Report on *US - Underwear*, adopted on 25 February 1997, WT/DS24/AB/R, page 16.

⁴²² The principle of interpretation against conflict has been confirmed by the Appellate Body in *Canada – Certain Measures Concerning Periodicals*, adopted on 30 July 1997, WT/DS31/AB/R, ("Canada Periodicals"), page 19; in *EC -Bananas*, paras 219-222; in *Guatemala – Cement*, para.65; and by the panel in *Indonesia – Certain Measures Affecting the Automobile Industry*, adopted 23 July 1998, WT/DS54, 55, 59 and 64/R (not appealed) ("Indonesia – Autos"), para. 14.28. For a definition of conflict, see for instance the Appellate Body statement in *Guatemala – Cement*, para. 65 or the Panel Report on *Indonesia – Autos*, para. 14.28.

⁴²³ See for instance the Panel and Appellate Body Reports in *Brazil – Measures Affecting Desiccated Coconut*, adopted on 20 March 1997, WT/DS22/R and WT/DS22/AB/R, ("Brazil – Desiccated Coconut") where it was concluded that although there is no strict conflict between them the provisions of Article VI of GATT must be reconciled with those of Article 32.3 and 32.4 of the SCM Agreement.

relevant domestic industry. We consider that the first paragraph of Article XIX provides only for that: an importing Member is "free", in situations where "any product is being imported into the territory of that Member in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products" to deviate temporarily from Articles II and XI of GATT.

7.42 We consider that the prior section of the sentence, "If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions..." does not add conditions for any measure to be applied pursuant to Article XIX but rather serves as an explanation of why an Article XIX measure may be needed, taking into account the fact that at the time (1947) the CONTRACTING PARTIES had just agreed (for the first time) on multilateral tariff bindings and on a general prohibition against quotas.

7.43 For us, the ordinary meaning of the terms "as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement" leads us to conclude that this proposition only describes generally the situations where the binding nature of the obligations contained in Articles II and XI of GATT may need to be set aside (for a certain period). In other words, this sentence could read

"If, notwithstanding this new set of rules that we have just agreed upon... which imply that a contracting party cannot use quotas (XI) or breach its bindings (II), one contracting party is faced with increased imports that are causing serious injury, that contracting party shall be free to suspend the obligation in whole or in part (XI) or to withdraw or modify the concession (II)."

7.44 The reference to "unforeseen developments" was probably considered necessary as negotiators had just ended a negotiating exercise which was based on expectations of trade increases (therefore foreseen developments) and where some quantitative restrictions were grand-fathered. We think that this reference to "unforeseen circumstances" must be interpreted within its context, namely in view of the rest of this proposition which provides that "... the effect of the obligations incurred by a contracting party under this Agreement ". These latter terms can only refer to the binding nature of the GATT prohibitions against breach of tariff concessions and the prohibition against quotas, as it would not be logical to conclude that a Trade Minister would have negotiated a particular concession if it could have been foreseen that such a concession would result in increased imports, that, in turn, would seriously injure an industry in the country granting the concession.

7.45 In other words, the proposition "as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement" does not address the conditions for Article XIX measures to be applied but rather explains why a provision such as Article XIX may be needed. For us, the object of this section of the first sentence of paragraph 1 of Article XIX cannot be anything else but a statement (of what we would now consider to be obvious) that because of the binding nature of the GATT obligations and concessions, tariffs and other obligations negotiated on the basis of trade expectations may need to be changed temporarily in light of actual unforeseen developments. Thus, the phrase "unforeseen circumstances" does not specify anything additional as to the conditions under which measures pursuant to Article XIX may be applied.

7.46 This interpretation is compatible with the object and purpose of GATT which was to ensure some certainty and predictability in tariff bindings and other GATT obligations. Our interpretation of

these provisions of Article XIX:1 of GATT is confirmed by the practice of the contracting parties⁴²⁴ over some 48 years and the adoption of the new Agreement on Safeguards.⁴²⁵

7.47 The adoption of the Agreement on Safeguards without this phrase "as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement " is logical. It was not necessary to refer to this context which had by then evolved. Members had since understood the GATT system of binding obligations. In support of this interpretation, we recall that in *Brazil – Dessicated Coconut* the Appellate Body made clear that some of the Annex 1A agreements represent an elaboration or evolution of the provisions of GATT 1994. Because Members had understood that this reference to "unforeseen developments" did not add to the rest of the paragraph (but rather described its context), there was no need to insert it explicitly in the Agreement on Safeguards.

7.48 Consequently, we reject the specific claim of the European Communities that Korea was wrong in failing to examine whether the import trends of the products under investigation were the result of "unforeseen developments" contrary to Article XIX:1(a), as we consider that Article XIX of GATT does not contain such a requirement.

F. VIOLATION OF ARTICLE 2.1 OF THE AGREEMENT ON SAFEGUARDS - FAILURE TO ANALYZE "UNDER SUCH CONDITIONS"

7.49 In its first submission, the European Communities argues that Korea violated Article 2.1 of the Agreement on Safeguards and Article XIX:1 of GATT because Korea failed to examine under which conditions the imports occurred and in particular Korea failed to consider the prices at which the product was imported. In its second submission, the European Communities limits that specific argument (failure to examine under which conditions the imports occurred) to its claim of violation of Article 2.1 of the Agreement on Safeguards only. Korea responds that there is no requirement to examine the prices of the imports with reference to those of the like or directly competitive products as such. Korea adds that it did consider, in its overall determination under Article 2 of the Agreement on Safeguards, whether the SMPP were imported into Korea in such increased quantities and under such conditions as to cause serious injury to the domestic industry that produces like or directly competitive products to SMPP. We shall examine this EC argument only with reference to its claim under Article 2 of the Agreement on Safeguards.

7.50 Article 2 of the Agreement on Safeguards reads:

"A Member may apply a safeguard measure to a product only if that Member has determined, pursuant to the provisions set out below, that such product is being imported into its territory in such increased quantities, absolute or relative to domestic production, *and under such conditions* as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products." (emphasis added).

7.51 Although the prices of the imported products will most often be a relevant factor indicating how the imports do, in fact, cause serious injury to the domestic industry, we note that there is no

⁴²⁴ Article XVI:1 of the Marrakesh Agreement Establishing the WTO.

⁴²⁵ In 1951, the Working Party on *"Withdrawal by the United States of a Tariff Concession under Article XIX"*, (except for the United States), agreed that unforeseen developments referred to events occurring after the negotiation of the relevant tariffs and, although the Working Party considered that this phrase contained a criterion to be respected, it rendered satisfaction of this criterion automatic, since it would not be reasonable to expect a contracting party to foresee that imports would cause serious injury to its domestic industry. Working Party on *Withdrawal by the United States of a Tariff Concession under Article XIX of the General Agreement ("Fur Felt Hat")*, GATT/CP.6/SR 19 (adopted 22.10.51).

explicit requirement in Article 2⁴²⁶, that the importing Member perform a price analysis of the imported products and the prices of the like or directly competitive products in the market of the importing country.

7.52 We consider that the phrase "and under such conditions" does not provide for an additional criterion or analytical requirement to be performed before an importing Member may impose a safeguard measure. We are of the view that the phrase "and under such conditions" qualifies and relates both to the circumstances under which the products under investigation are imported and to the circumstances of the market into which products are imported, both of which must be addressed by the importing country when performing its assessment as to whether the increased imports are causing serious injury to the domestic industry producing the like or directly competitive products. In this sense, we consider that the phrase "under such conditions" refers more generally to the obligation imposed on the importing country to perform an adequate assessment of the impact of the increased imports at issue and the specific market under investigation.

7.53 The European Communities raised various other arguments in support of its claims that Korea violated Article 4, and consequently Article 2, of the Agreement on Safeguards, namely that Korea did not adequately demonstrate the existence of serious injury and a causal link with the increased imports.⁴²⁷ We shall address the EC argument that Korea did not perform an adequate assessment of whether the products under investigation were being imported into its territory in such increased quantities and under such conditions as to cause serious injury to the domestic industry when we examine the European Communities' more specific claims of inadequate serious injury and causation assessments made pursuant to Article 4.1 and 4.2 of the Agreement on Safeguards. We note that a violation of Article 4.2 or 4.3 would constitute a violation of Article 2 of the Agreement on Safeguards.

G. CLAIMS UNDER ARTICLE 4.2 OF THE AGREEMENT ON SAFEGUARDS

1. Korea's examination of serious injury to the domestic industry

7.54 The European Communities claims that in its evaluation of serious injury to the domestic industry Korea failed to examine correctly all relevant factors of an objective and quantifiable nature having a bearing on the situation of the domestic industry. We note that the parties are in agreement that the appropriate definition of the domestic industry in this case comprises the producers of both raw milk and milk powder, as these two products are directly competitive with SMPP when used as input for the manufacturing of downstream dairy products such as flavoured milk, fermented milk and ice cream. Thus, the parties' disagreement regards the correct examination of the relevant factors of an objective and quantifiable nature having a bearing on the situation of this industry. We also note that the complex definition of the domestic industry as including producers of both a raw material and one of its downstream products has repercussions for how the serious injury assessment on the whole domestic industry as defined has to be performed.

7.55 In conducting our review of Korea's serious injury determination we are mindful of the obligations contained in Article 4.2 of the Agreement on Safeguards. This provision mandates that competent authorities when performing a serious injury investigation:

"...shall evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry, in particular, the rate and amount of the increase

⁴²⁶ Contrary to the explicit references to prices in Article 3 of the Agreement on Implementation of Article VI of GATT 1994 ("AD Agreement") and Article 15 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement").

⁴²⁷ In its request for a panel the European Communities claimed that the Korean determinations violated Articles 2, 4, 5 and 12 of the Agreement on Safeguards.

in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment."

This provision sets out the general principle regarding the economic factors which need to be considered in a serious injury investigation, and provides a list of factors that are *a priori* considered to be especially relevant and informative of the situation of the domestic industry. The use of the wording "in particular" makes it clear to us that, among "all relevant factors" that the investigating authorities "shall evaluate", the consideration of the factors listed is always relevant and therefore required, even though the authority may later dismiss some of them as not having a bearing on the situation of that industry. Under the applicable standard of review, our function is to assess whether Korea (i) examined all relevant facts in its possession or which it should have obtained in accordance with Article 4.2 of the Agreement on Safeguards at the time of the investigation; and (ii) provided an adequate explanation of how those facts as a whole supported the determination made. Thus, we shall examine whether at the time of the determination all factors listed in Article 4.2 were appropriately considered; whether the Korean authorities explained how each factor considered supports (or detracts from) a finding of serious injury; and whether valid reasons have been put forward for dismissing a considered factor as not being relevant to the serious injury determination in this case.

7.56 We note that previous panel decisions have applied similar tests in reviewing determinations by investigating authorities on the existence of serious damage in the context of a transitional safeguard under the Agreement on Textiles and Clothing, and of material injury under the Tokyo Round Agreement on the Implementation of Article VI (the Anti-Dumping Code). In *United States – Shirts and Blouses*, the panel stated that:

"The wording of the first sentence of Article 6.3 of the ATC imposes on the importing Member the obligation to examine, at the time of its determination, at least all of the factors listed in that paragraph. The importing Member may decide -- in its assessment of whether or not serious damage or actual threat thereof has been caused to the domestic industry -- that some of these factors carry more or less weight. At a minimum, the importing Member must be able to demonstrate that it has considered the relevance or otherwise of each of the factors listed in Article 6.3 of the ATC."⁴²⁸

7.57 Even more to the point the panel in *United States – Salmon*, set out the following test when reviewing a material injury determination:

"[A] review of whether a determination of material injury was in conformity with this requirement necessitated an examination of whether the investigating authorities had examined all relevant facts before them (including facts which might detract from an affirmative determination) and whether a reasonable explanation had been provided of how the facts as a whole supported the determination made by the investigating authorities."⁴²⁹

While the concepts of serious damage and material injury are not entirely analogous to the requirement of serious injury in the Agreement on Safeguards, we believe that the general considerations expressed by both panels on issues similar to those before us offer useful guidance as to how a panel should evaluate fulfilment of the serious injury requirement.

7.58 In our evaluation of Korea's serious injury determination there are three issues that we find particularly troublesome. First, we find that there is a lack of consideration in the OAI Report of

⁴²⁸ *US – Shirts and Blouses*, para. 7.26.

⁴²⁹ *United States – Imposition of Anti-Dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway*, adopted 27 April 1994, ADP/87, para. 492 ("*US – Salmon*").

some of the factors listed in Article 4.2. This is the case for instance for capacity utilization and productivity. In both cases Korea offers explanations in its submissions to the Panel of why it considered these factors not to bear on the situation of the domestic industry. While these explanations seem plausible, there is nothing in the OAI Report which would indicate to the Panel that these factors were taken into consideration in the serious injury finding of the Korean authorities. Second, as we noted above, the definition of the domestic industry in this case as comprising two different segments of the dairy products market has consequences for the evaluation of the situation of the industry. In assessing the serious injury to the whole domestic industry, we find that it is acceptable to analyze distinct market segments but, as stated above, all factors listed in Article 4.2 must be addressed. In considering each of the factors listed in Article 4.2, and any others found to be relevant by the authority, the investigating authority has two options: for each factor, the investigating authority can consider it either for all segments, or if it decides to examine it for only one or some segment(s), it must provide an explanation of how the segment(s) chosen is (are) objectively representative of the whole industry. A lack of consideration of all segments, without any explanation, is a flaw that we find present in Korea's analysis of the domestic industries' profits and losses, prices, debt to equity ratio, capital depletion and production cost. How Korea relates developments in one segment to its determination regarding the industry as a whole is for Korea to decide in the first instance. Our point here is that an analysis of only a segment of the domestic industry, without any explanation of its significance for the whole industry, will not satisfy the requirements of the Agreement on Safeguards. Third, we find that for certain factors considered by Korea it has failed to provide sufficient reasoning on some of the choices made in the analysis of such factors which may have affected the result of the consideration. Also, there is a lack of reasoning in some cases on how the factor considered supports (or detracts from) a finding of serious injury. This lack of explanation or reasoning is perceived in Korea's consideration of market share, production, profits and losses, employment and inventory.

7.59 Having laid out our overall concerns with Korea's compliance with its obligations under Article 4.2, we turn to the specifics of Korea's consideration of each of the factors listed in Article 4.2, as well as additional factors Korea considered in determining the existence of injury to the domestic industry. Since our task is to make an objective assessment of the factual considerations and reasoning of the Korean authorities in arriving at a finding of serious injury at the time of the determination, our analysis of Korea's compliance with the provisions in Article 4.2 will be on the basis of the OAI Report. We would also like to make it clear that even if we examine each one of the factors listed in Article 4.2 and others used by Korea, it is not our task to question the weight accorded to each factor for purposes of the final determination of serious injury. In this regard we concur with what the panel in *US – Shirts and Blouses* stated in examining the imposition of a safeguard measure under the ATC:

"This is not to say that the Panel interprets the ATC as imposing on the importing Member any specific method either for collecting data or for considering and weighing all the relevant economic factors upon which the importing Member will decide whether there is need for a safeguard restraint. The relative importance of particular factors including those listed in Article 6.3 of the ATC is for each Member to assess in the light of the circumstances of each case."⁴³⁰

(a) Increased imports

7.60 The European Communities argues that Korea excluded certain products (mixed products)⁴³¹ from the scope of application of the measure which were nevertheless included in the calculation of the increase in imports. Korea pointed out that the import volume of these products, found on page 7

⁴³⁰ *US – Shirts and Blouses*, para. 7.52.

⁴³¹ The excluded products are: milk mineral (calcium), concentrated product, Chilean special products and raw material for the production of Nestlé's Cerelac.

of the OAI Report,⁴³² shows that the excluded mixed products accounted for just 0.7, 0.8, 1.5 and 1.3 per cent of SMPP imports for the years 1993, 1994, 1995, and the first semester of 1996 respectively. After examining the figures pointed out by Korea, we consider that the excluded mixed product imports are a very minor portion of the SMPP imports. Thus, there is no basis for finding that Korea's decision not to exclude those products from the import increase calculation is inadequate for the purpose of Article 4.2 of the Agreement on Safeguards.

7.61 Based on the relevant sections in the OAI Report, we find that the Korean authorities' consideration of increased imports was adequate for the purposes of Article 4.2. Korea's assessment of the increased imports can be found from pages 32 through 35 of the OAI Report, where the progression of SMPP imports for the period under investigation both in absolute terms and relative to domestic production is detailed.

(b) Market share captured by imports

7.62 Korea's consideration of this factor can be found on page 35 of the OAI Report, where it states: "The market share of SMPP against the total demand was 1.6 per cent in 1993, 7.0 per cent in 1994, 12.2 per cent in 1995, and 14.1 per cent in Jan.-June in 1996, showing an upward trend." On its face this consideration of the total dairy market share captured by the increased imports of SMPP would seem to be correct and in compliance with the provisions of Article 4.2. However, we note that on page 16 of the OAI Report Korea defines the total market of basic materials for the production of dairy products in Korea as being composed of: raw milk produced by domestic dairy farms; milk powder produced from raw milk by processing companies, imported milk powder, imported basic materials for cheese, and other imports including SMPP. In a footnote on page 16 of the OAI Report the investigating authorities state:

"Considering the characteristics of the analysis, data on cheese import was excluded but import of cheese, which has direct influence on consumption of domestic raw milk, also has largely been increasing since import liberalization in 1995. Including the cheese import volume, the total demand comes to 2,027,713 tons in 1993, 2,249,958 tons in 1994, 2,414,525 tons in 1995, and 1,222,804 tons in Jan.-June 1996, showing the increase rates of 11.0 per cent in 1994, 7.3 per cent in 1995 and -1.4 per cent in Jan.-June 1996."

7.63 The Panel can only assume that this footnote actually refers to an exclusion of data on imported basic materials for cheese, since it would be these kinds of imports which would have a direct influence on consumption of raw milk. Also, the text that is being expanded upon in the footnote does not mention cheese as a finished product but imported basic materials for cheese. We find that this exclusion has not been sufficiently explained by Korea, even though it admits in the footnote quoted above, that these imports are part of the total market of basic materials for dairy products, that they affect consumption of raw milk and that they have increased significantly during the period of investigation. Such exclusion is not inconsequential as it may result in a decrease of the relevant market size, and a corresponding overestimation of the share of the market being captured by SMPP imports. We would like to make it clear that our view is not that this exclusion of imported basic materials for cheese from the total volume of the dairy market was necessarily incorrect. Rather, since Korea did not provide any reasoning as to why it chose to exclude this portion of the relevant market, we find that Korea's analysis of the market share captured by imports of SMPP was not adequately performed for the purpose of Article 4.2.

⁴³² See para. 4.370, *supra*.

(c) Sales

7.64 The Korean authorities' consideration of changes in the level of sales for the domestic industry was performed separately for raw milk and milk powder and can be found respectively at pages 38 and 45 of the OAI Report. Regarding raw milk consumption for the period of investigation the report states:

"The amount of domestic raw milk consumed was 1,844,463 tons in 1993, 1,947,128 tons in 1994, 1,947,965 tons in 1995, and 984,934 tons in the January-June period of 1996. The consumption increase rate was 5.6 per cent for 1994, 0.0 per cent for 1995, and -2.0 per cent for the January-June period of 1996."⁴³³

7.65 Regarding milk powder consumption the Korean authorities found:

"The amount of domestic milk powder consumed was 12,191 tons for 1993, 12,468 tons for 1994, 10,690 tons for 1995 and 2,741 tons for the January-April period of 1996. In terms of increase rate, it was 2.3 per cent in 1994, -14.3 per cent in 1995 and -40.9 per cent in the January-April period of 1996."⁴³⁴

7.66 We note that in the case of domestic raw milk and milk powder sales in Korea there is a decline in consumption. This decline could support the Korean authorities' finding of serious injury to the domestic industry. Thus, we find that this factor was adequately considered for the purpose of Article 4.2.

(d) Production

7.67 This factor was considered in the OAI Report for both the raw milk and the milk powder segments of the industry respectively at pages 38 and 45 of the OAI Report, where it is stated:

"The production amount of domestic raw milk was 1,857,873 tons in 1993, 1,917,398 tons in 1994, 1,998,445 tons in 1995, and 1,069,224 tons in the January-to-June period of 1996. The increase rate was 3.2 per cent for 1994, 4.2 per cent for 1995, and 4.4 per cent for the January-June period of 1996."⁴³⁵

"The amount of domestic milk powder produced was 13,512 tons for 1993, 9,495 tons for 1994, 15,719 tons for 1995, and 10,401 tons for the January-April period of 1996. In terms of the production increase rate, it was -29.7 per cent in 1994, 65.6 per cent in 1995 and 52.6 per cent in the January- to-April period of 1996."⁴³⁶

Korea later explains that it does not consider this factor to be relevant as "it was not an appropriate measure for determining the state of the domestic industry".⁴³⁷ However, this explanatory statement is made in the first submission of Korea to the Panel. We fail to find any analysis by the Korean authorities at the time of the investigation, as to how these figures on production are relevant (or not) to a finding of serious injury to the domestic production. Lacking this explanation it is not possible for us to discern whether the Korean authorities' dismissal of this factor as an indicator of serious injury to the domestic industry was appropriate. Thus, we find that this factor was not adequately considered for the purpose of Article 4.2.

⁴³³ OAI Report, page 38.

⁴³⁴ Id. at 45.

⁴³⁵ Id. at 38.

⁴³⁶ Id. at 45.

⁴³⁷ See para. 4.364, *supra*.

(e) Productivity

7.68 As described above the first task of the Panel is to examine whether all factors listed in Article 4.2 have been appropriately considered. We find that there is no mention of this factor in the OAI Report. While Korea in its submissions argues that "changes in productivity were not appropriate indicators of serious injury" and gives reasoning for this conclusion, this reasoning is not found in the OAI Report. There is no indication that Korea considered the productivity of the domestic industry when making a finding of serious injury. Thus, we find that this factor was not adequately considered for the purpose of Article 4.2.

(f) Capacity utilization

7.69 Just as in the case of productivity we fail to find any discussion in the OAI Report of the changes in capacity utilization of the domestic industry. Although this factor is mentioned in the Interim Draft Investigation Report⁴³⁸ it is not brought forward in the final OAI Report on which Korea based the adoption of its safeguard measure. Thus, we find this factor was not adequately considered for the purpose of Article 4.2.

(g) Profits and losses

7.70 The Korean authorities' consideration of this factor appears at page 41 of the OAI Report for the raw milk segment of the industry and page 49 for the milk powder segment of the industry. Regarding the raw milk segment the Korean authorities found that various livestock cooperatives had declining profits during the period, to the point where by the first semester of 1996 they were reporting losses of 17,546 million Won. Korea explained in the OAI Report that this analysis was carried out on the livestock cooperatives with the following reasoning: "since the livestock cooperatives, which are comprised of dairy households producing raw milk, distribute their profits to their members, the livestock cooperatives' profits and losses are directly linked to the raw milk producers' income."⁴³⁹

7.71 First, we note that the livestock cooperatives' business is not only the collection, distribution and sale of raw milk but also the processing of this raw milk into downstream dairy products for subsequent sale. Thus, the profits or losses of the livestock cooperatives do not reflect exclusively their activities in the raw milk sector but also other activities.

7.72 Second, the raw milk producers' profits or losses do not derive only from their investment in the livestock cooperatives, but also from the sale of raw milk to the livestock cooperatives. In its first submission⁴⁴⁰ Korea presents data on the profit margins for raw milk producers based on the difference between the reference sale prices and the production cost of raw milk. However, as admitted by Korea,⁴⁴¹ this analysis was not performed at the time of the investigation.

7.73 Third, we also gather from Korea's description of its analysis that it examined only some of the livestock cooperatives. However, there is no explanation of why this was done. Lacking any such explanation it is not possible for us to assess whether the selection of the livestock cooperatives rendered an objective picture of the situation of the whole domestic industry.

⁴³⁸ An extract of this draft report was submitted as Exhibit Korea-5.

⁴³⁹ OAI Report, page 41

⁴⁴⁰ See para. 4.343, *supra*.

⁴⁴¹ In its request for interim review, Korea submits that it "has never made any attempt to argue that [an analysis of the profits and losses of the raw milk producers] was conducted during the investigation".

7.74 Taken together the flaws in Korea's consideration of profits and losses in the raw milk segment of the industry outlined above lead us to find that this factor was not adequately considered for the purpose of Article 4.2.

7.75 Regarding the milk powder sector of the industry, we again find flaws in Korea's consideration of profits and losses. In examining the profits and losses of the milk powder sector the Korean authorities examined only two livestock cooperatives and four milk processing companies. Again, there is no explanation of why the an examination of only these companies would constitute an objective and representative picture of the situation of the whole domestic industry. Footnote 15 of the OAI Report contains a reference to the proportion of annual production by the chosen cooperatives and companies where the data have been deleted. Without any such explanation Korea has not demonstrated that it had considered the objectivity and representativeness of the sample. Thus, we find that for the purpose of Article 4.2 Korea has not adequately considered the profits and losses of the whole domestic industry.

(h) Employment

7.76 The analysis of changes in the levels of employment for the domestic industry was also performed by the Korean authorities first for the raw milk producers and then for the milk powder producers. Regarding the analysis of the employment in the raw milk sector, the Korean authorities chose to analyse whether there was a decrease in the number of dairy households. The reasons for this choice were explained to the Panel as follows:

"Korean dairy farms are on the whole small scale family businesses, and represent one part of the economic activity of some members of that family. It is not possible to determine how much time each person spends working on that business, and what proportion of that time is devoted to dairy production ... and so the Korean authorities used changes in the number of dairy households as a surrogate"⁴⁴²

This explanation was made in the oral statement at the second meeting of the Panel with the parties, and not in the OAI Report. We commend Korea for devising a surrogate methodology to measure the employment in the raw milk industry and not simply dismissing this factor as irrelevant or not quantifiable. Nevertheless, this deviation from normal practice should have been explained at the time of the decision in the OAI Report. Lacking this explanation in the OAI Report we find that this factor was not adequately considered for the purpose of Article 4.2.

7.77 Regarding the analysis of employment for the milk powder producers, the Korean authorities, explained in the OAI Report, that:

"As the milk powder production became automated, the number of workers employed in milk powder production decreased over the years. Currently, very few people are fully employed for the exclusive purpose of engaging in milk powder production. Workers producing other dairy products are used temporarily, when needs arise, to engage in milk powder production. Accordingly, employment and wage are insignificant factors in operating milk powder business"⁴⁴³

In the light of this explanation in the OAI Report, we find that, for the purpose of Article 4.2, Korea has adequately considered this factor for milk powder production.

⁴⁴² See para.4.513, *supra*.

⁴⁴³ OAI Report, page 48

(i) Inventory

7.78 Regarding this factor, Korea considered inventories of domestic milk powder only, since raw milk is not susceptible of stockage.⁴⁴⁴ There are two references to the inventory levels throughout the OAI Report (pages 38-39, and 46). We note that the figures at pages 38-39 are slightly different from those at page 46. Nevertheless, they both show an accumulation of stock for the period under investigation.⁴⁴⁵ We find, however, that there is no reasoning as to why such levels of inventory are indicative of serious injury or why they are negative for the domestic dairy industry. Again this explanation is made in the second submission of Korea, where it is stated:

"Increase of milk powder inventory is clear evidence of serious injury in this case not only to the milk powder industry, but also to the entire domestic industry. As explained above, raw milk that is not consumed has to be converted into, *inter alia*, milk powder. Conversion only increases supply and inventory of milk powder. Therefore, increased milk powder inventory not only indicates oversupply of milk powder but also demonstrates displacement of domestic raw milk by cheap imported SMPP, thus signifying serious injury to the entire domestic industry."⁴⁴⁶

The increased inventory incurred a significant amount of costs. Even if depreciation is disregarded, the cost of inventory amounted to 17.3 billion Won (approximately US \$21.6 million) during the investigation period. The inventory costs during the first six months of 1996 alone were 5.8 billion Won (approximately US \$7.3 million), and the domestic producers were compelled to incur the full inventory cost...⁴⁴⁷"

Thus, it is clear from the statement made in Korea's second submission that the level of inventories of milk powder found by the Korean authorities has negative consequences for the milk powder sector of the industry and could indicate that the domestic industry is injured. However, this reasoning provided in Korea's second submission is not discernible in the OAI Report, and it is only after it has been explained in the second submission that the precariousness of the situation of the domestic industry regarding this factor becomes evident. Thus, we find that this factor was not adequately considered for the purpose of Article 4.2.

(j) Price

7.79 This factor is not explicitly mentioned in the list of factors included in Article 4.2, however, Korea considered it in its investigation. The Korean authorities examined prices for milk powder and found that they were lower in the first half of 1996 than they were in 1993 at the beginning of the period of investigation.⁴⁴⁸ We note that milk powder prices had risen to a high level as recently as 1995. Taking into account the entire OAI Report, we consider that Korea has established that lower prices for milk powder are indicative of serious injury for the milk powder industry⁴⁴⁹. However, while there is an analysis of prices for the milk powder industry, we note that there is no explanation of the relationship between the price levels for milk powder and the serious injury alleged to be suffered by the whole domestic industry.

7.80 Indeed, Korea did not examine prices of raw milk in its investigation. In this regard Korea stated in its submissions that "there is no reliable way of arriving at an accurate or appropriate

⁴⁴⁴ OAI Report, page 38

⁴⁴⁵ See para. 4.323, *supra*.

⁴⁴⁶ See para.4.460, *supra*.

⁴⁴⁷ See para.4.462, *supra*.

⁴⁴⁸ OAI Report, page 47.

⁴⁴⁹ This reasoning can be found in the causation section of the OAI Report at page 62.

transaction price for raw milk in Korea"⁴⁵⁰ and "that any impact of declining domestic milk powder prices adversely affected the entire domestic industry, since raw milk producers own the livestock cooperatives."⁴⁵¹

7.81 We are of the view that conclusions about the prices of milk powder only, do not constitute a consideration of prices to the whole domestic industry which was defined as producers of raw milk and milk powder. The fact that it is the producers of raw milk who own the cooperatives does not exempt the Korean authorities from examining the particular conditions of the raw milk producers as this is a different segment of the industry from milk powder production. For this reason we find that Korea's consideration of the prices was incomplete as it only took into account one segment of the domestic industry. Thus, we find that this factor was not adequately considered for the purpose of Article 4.2.

7.82 Moreover, we note that even if actual transaction prices for raw milk in Korea were unavailable or it was not feasible to collect them given the large number of producers, there were several other avenues available to the Korean authorities that would have allowed them to calculate or construct an approximation of raw milk prices.⁴⁵² Such indicators, even if not one hundred per cent accurate could have enabled the Korean authorities to identify the existence of trends, either positive or negative, in the prices for raw milk. The choice of methodology to determine prices rests with the investigating authorities, but given that there were various options available in this case we find that the Korean authorities should have made an effort to determine the prices for raw milk, instead of dismissing this factor as not being quantifiable.

(k) Debt to equity ratio and capital depletion

7.83 These are two additional economic indicators that do not appear in the illustrative list of Article 4.2, which were considered by the Korean authorities. These factors were evaluated exclusively with regard to the livestock cooperatives. The results, presented at pages 43 and 44 of the OAI Report, only give information on a portion of the livestock cooperatives. It is impossible for us to assess if the data presented reflect the position of the whole domestic industry. Thus, we fail to see in the OAI Report any explanation as to why these two factors reflect serious injury, especially serious injury to the whole Korean domestic industry producing raw milk and milk powder. Thus, we find that this factor was not adequately considered for the purpose of Article 4.2.

(l) Production cost

7.84 The Korean authorities only examined the production cost of livestock cooperatives in the production of milk powder. In this examination the Korean authorities found:

"The manufacturing cost increased from 5,158 won/kg in 1993 to 5,426 won/kg in 1994, 5,860 won/kg in 1995 and 6,178 won/kg in the January-April period of 1996.

The difference between the sales price and the manufacturing cost was 196 won in 1993. However, it recorded -132 won in 1994 and the negative margin grew larger to -472 won in 1995 and further to -1,184 won in the January-to-April period of 1996."⁴⁵³

⁴⁵⁰ See para.4.504, *supra*.

⁴⁵¹ See para.4.449, *supra*.

⁴⁵² For example, Korea could have performed: (1) an analysis based on sampling of the raw milk producers, a methodology which was used by Korea elsewhere in its analysis; (2) a construction of the prices for raw milk based on the cost of production of raw milk producers, for which data appear to be on the record; on (3) a construction of the prices by making adjustments to the cost of raw materials reported by the milk powder producers.

⁴⁵³ OAI Report, page 53.

The Korean authorities concluded that there was a widening negative gap between the cost of manufacturing milk powder and its sale price. These sales below cost would indicate that livestock cooperatives were going through a difficult period. However, as this factor was only evaluated for a portion of the domestic industry (livestock cooperatives producing milk powder) it is not possible for us to assess the situation with regard to the whole domestic industry. We do not consider this factor to provide adequate support for the conclusion that there is serious injury to the domestic industry as defined by the Korean authorities. Thus, we find that this factor was not adequately considered for the purpose of Article 4.2.

(m) Conclusion

7.85 For the reasons described above, we find that Korea's determination of serious injury to the domestic production of raw milk and milk powder does not meet the requirements of Article 4.2 of the Agreement on Safeguards.

7.86 Article 2.1 permits the application of a safeguard measure only if, *inter alia*, there has been a determination of serious injury pursuant to Article 4.2. Since we find that Korea's determination of serious injury does not meet the requirements of Article 4.2, the application of the safeguard measure at issue would necessarily also violate Article 2.1 of the Agreement on Safeguards. We note that in its request for establishment of a panel, the European Communities claims generally that Korea violated Articles 2.1, 4.2(a), 4.2(b), 5.1 and 12.1 to 12.3 of the Agreement on Safeguards. However, in its submissions, the European Communities did not argue specifically, nor did it submit any evidence, in support of its claim under Article 2.1, other than those relating to "under such conditions" (as discussed in Section F *supra*).⁴⁵⁴ Therefore, we do not reach any conclusion on the issue of whether Korea's determination of serious injury violates the provisions of Article 2.1 of the Agreement on Safeguards.

2. Korea's examination of the causal link between increased imports and serious injury

7.87 We have already determined above that Korea's injury determination did not meet the requirements of Article 4.2 of the Agreement on Safeguards. We concluded that Korea did not address all injury factors listed in Article 4.2 of the Agreement on Safeguards. In addition, we concluded that when addressing factors listed in Article 4.2 of the Agreement on Safeguards, the OAI Report did not contain any reasoning, analysis or evidence in support of its findings and sometimes it limited its analysis to only one segment of the relevant domestic industry. Having reached these conclusions with regard to Korea's assessment of the injury factors, it is not necessary for us to reach any findings on whether Korea demonstrated that increased imports "caused" serious injury to the domestic industry producing like or directly competitive products. However, keeping in mind the conclusions of the Appellate Body in *Australia – Salmon*⁴⁵⁵, we would like to offer some general comments relevant to an analysis of a causal link between increased imports and injury, in the context of the Korean investigation.

7.88 We recall the provisions of Articles 2 and 4.2 of the Agreement on Safeguards:

"2.1 A Member may apply a safeguard measure to a product *only* if that Member has determined, pursuant to the provisions set out below, that such product is being imported into its territory in *such increased quantities*, absolute or relative to domestic production, *and under such conditions as to cause or threaten to cause* serious injury to the domestic industry that produces like or directly competitive products...

⁴⁵⁴ See the Appellate Body report on *Japan – Measures Affecting Agricultural Products* (WT/DS/76/AB/R), paras. 118 to 131.

⁴⁵⁵ *Australia – Salmon*, para. 223.

4.2. (a) In the investigation to determine *whether increased imports have caused or are threatening to cause serious injury* to a domestic industry under the terms of this Agreement, the competent authorities *shall evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry*, in particular, the rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment.

(b) The determination referred to in subparagraph (a) shall not be made *unless this investigation demonstrates, on the basis of objective evidence, the existence of the causal link between increased imports of the product concerned and serious injury or threat thereof*. When *factors other than increased imports are causing injury* to the domestic industry at the same time, *such injury shall not be attributed to increased imports*." (emphasis added)

7.89 In performing its causal link assessment, it is our view that the national authority needs to analyze and determine whether developments in the industry, considered by the national authority to demonstrate serious injury, have been caused by the increased imports. In its causation assessment, the national authority is obliged to evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry. In addition, if the national authority has identified factors other than increased imports which have caused injury to the domestic industry, it shall ensure that any injury caused by such factors is not considered to have been caused by the increased imports.

7.90 To establish a causal link, Korea has to demonstrate that the injury to its domestic industry results from increased imports. In other words, Korea has to demonstrate that the imports of SMPP cause injury to the domestic industry producing milk powder and raw milk. In addition, having analyzed the situation of the domestic industry, the Korean authority has the obligation not to attribute to the increased imports any injury caused by other factors.

7.91 For instance, the KTC needs to explain how the developments with respect to factors considered by the KTC to demonstrate serious injury, were caused by the imports of SMPP. This is to say that the KTC, in its analysis of the increased market share of SMPP for example, should have tried to explain how the imports of SMPP effectively displaced the domestic production of like or directly competitive products.

7.92 To take one example using only one factor for only one year we note that the OAI Report⁴⁵⁶ states that the most important increase of import of SMPP occurred from 1993 to 1994 (384 per cent). However, we know that during the first year under investigation (1994), domestic demand for raw milk and milk powder increased significantly. The OAI Report⁴⁵⁷ indicates: "... the large increase of dairy production in 1994 resulted from the drastically increased demand for market milk and fermented milk due to the quite warm winter". The Korean authorities found⁴⁵⁸ that from 1993 to 1994, total demand of raw milk increased by 9.6 per cent while domestic production only increased by 3.2 per cent. We consider, therefore, that in 1994, to meet the increased demand in raw milk it was necessary to increase imports of raw milk substitutes. The reasons for this are: first, raw milk supply (in the short term) is very rigid, as it depends upon the number of milk cows (head) which cannot be increased rapidly and; second, the import tariff on milk powder had been increased to a very high level (220 per cent) which constrained imports of milk powder. This situation therefore implied that the only way for Korea to respond to the increased demand was to import more of the low-tariff SMPP (39 to 40 per cent). In other words, in 1994 domestic demand for raw milk in Korea was

⁴⁵⁶ OAI Report, page 32.

⁴⁵⁷ OAI Report, page 14.

⁴⁵⁸ OAI Report, page 39.

larger than domestic production of raw milk. This had the effect of decreasing the production of milk powder (which is made from raw milk)⁴⁵⁹ and decreasing milk powder inventories⁴⁶⁰. It seems clear to us, that at least for 1994, the imports of SMPP cannot have caused injury to the domestic industry producing like or directly competitive products in Korea. On the contrary the increasing imports of SMPP were the result of the increasing needs for raw milk and milk powder substitutes by the Korean industry faced with the incapacity of the domestic production to fulfill the increasing demand for such products. In the OAI Report there is no analysis of the interaction of these various elements. However, any adequate causation assessment had to be performed for the overall injury determination.

7.93 As to other factors that may have caused injury to the domestic industry producing like or directly competitive products, we know, from the OAI Report, that domestic demand for raw milk was affected by other factors. For example, it is said in the footnote to page 16 of the OAI Report: "Considering ..., data on cheese import was excluded *but imports of cheese, which has direct influence on consumption of domestic raw milk*, also has largely been increasing since import liberalization in 1995...". As we mentioned before (see paragraphs 7.62 and 7.63 *supra*), this footnote must refer to an exclusion of data on imported basic material for cheese, as the text that is expanded upon does not mention cheese as a finished product but rather imported basic materials for cheese. In other words, it would be these imports of basic materials for cheese that would have a direct influence on consumption (demand) for raw milk.

7.94 Korea recognizes that the domestic production of cheese has decreased.⁴⁶¹ This decrease of cheese production directly affected the consumption of and demand for raw milk. However, the OAI Report does not contain any evaluation or analysis of the impact of this factor (i.e. increased imports of cheese or increased imports of basic material for cheese, and their impact on the reduced demand for cheese and consequently the reduced demand for domestic raw milk in making cheese).

7.95 The same line of reasoning holds for the other dairy products that use raw milk or milk powder as inputs which, according to Korea, also decreased. Therefore, the demand for raw milk and milk powder should have decreased as well. On page 14 of the OAI Report, the KTC notes that the domestic production of white milk, condensed milk, cheese and lactic-acid-producing beverages went down during the period of investigation. We know from Korea's domestic regulation⁴⁶² that SMPP cannot substitute for raw milk in the production of white milk, condensed milk, cheese, and lactic-acid-producing beverages. If the domestic production of these products went down as well, factors other than imports of SMPP must have caused the reduction of domestic production of these products which, in turn also must have had an impact on the reduced consumption of raw milk and milk powder. In compliance with the provisions of Article 4.2 of the Agreement on Safeguards, the causal link between increased imports of SMPP and the factors it found to demonstrate injury must also be assessed by the national authority.

7.96 This should not be construed to mean that the Panel interprets the Agreement on Safeguards as imposing on the importing Member any appropriate method either for collecting data or for considering and weighing all the relevant economic factors upon which the importing Member will decide whether there is need for a safeguard restraint. The relative importance of particular factors including those listed in Article 4 of the Agreement on Safeguards is for each Member to assess in the light of the circumstances of each case. Korea remains free to determine an appropriate method of assessing whether the state of its domestic industry was caused by imports of SMPP and how this analysis was performed. Korea also remains free to choose the method of assessing whether any serious injury to its domestic industry was caused by such other factors.

⁴⁵⁹ OAI Report, pages 58-60.

⁴⁶⁰ OAI Report, page 17.

⁴⁶¹ See the negative data in the OAI Report, page 14.

⁴⁶² See Food Industry Handbook, referred to in the OAI Report, page 26.

H. CLAIMS UNDER ARTICLE 5.1 OF THE AGREEMENT ON SAFEGUARDS

7.97 The European Communities argues that when a WTO Member takes a safeguard measure, it needs to prove that such measure was necessary and therefore should justify its "adequacy" in remedying injury and facilitating adjustment. The European Communities claims that (i) by omitting to give any consideration to adjustment plans, Korea violated Article 5.1, first sentence; (ii) by failing to consider whether types of measure other than a quota would be the most suitable to remedy serious injury or facilitate adjustment, Korea violated Article 5.1, first sentence; and (iii) by failing to show that the level of the quota itself was necessary to remedy serious injury or facilitate adjustment remedy, Korea violated its obligations under Article 5.1, first and second sentences. The European Communities also claims that by not choosing the appropriate three representative years (which should start as of the date of the imposition of the measure), without submitting a "clear justification that a different level was necessary to prevent or remedy the serious injury", Korea violated the provision of Article 5.1, second sentence.

7.98 Korea responds that since Article 5.1 states that "Members should choose measures most suitable for the achievement of these objectives," it complied with this provision, as it considered that the quotas at these levels for that period of 4 years, were the most suitable for remedying the serious injury and facilitating adjustment to the domestic industry in Korea. For Korea, there is no obligation to demonstrate that the type of measure is the most suitable measure to achieve these objectives. Korea adds that the Korean competent authorities did examine whether other types of measures, including tariff-quota, would be more appropriate. For Korea, there is no obligation to demonstrate that the level of such tariff is necessary or appropriate to achieve these objectives. In its view, the wording of the second sentence of Article 5.1 makes it clear that Members must only justify the level of quotas if it is different (*i.e.*, lower) than the average imports during the three most recent representative years. It based its quota level on the average of imports for the three years from July 1993 to June 1996, as it initiated its safeguards investigation in May 1996. The requirement for consideration of three "representative" years was intended to prevent foreign exporters from manipulating quota levels by flooding the market with imports just prior to the decision to impose a safeguard measure. Therefore, Korea considered that the second half of 1996 was not "representative", and it excluded imports from this period in calculating the quota level. Since it chose the appropriate three representative years, Korea argues that it did not have to provide any justification.

7.99 We are of the view that Article 5 of the Agreement on Safeguards establishes certain rules on the application of safeguard measures. In the view of the Panel these rules on the application of a measure come into play only after a decision has been taken to adopt a safeguard measure. The first sentence of Article 5.1 reads: "A Member shall apply safeguard measures only to the extent necessary to prevent or remedy serious injury and to facilitate adjustment." We believe that this provision is not concerned with the decision or even the right of a Member to adopt a safeguard measure. The general authorization for a Member to apply a safeguard measure is found in Article 2.1 of the Agreement on Safeguards, which provides that "[a] Member may apply a safeguard measure" (emphasis added) after that Member has made the injury and causation determination referred to in that article. The use of the verb "may" indicates that the decision whether to apply a measure or not, after the above-mentioned conditions have been evidenced, rests with the Member conducting the investigation. We find that in the context of the discretion authorized by Article 2.1 we cannot conclude that Article 5.1 requires a Member to further justify the necessity of applying a safeguard measure. In consequence the decision by a Member to adopt a safeguard measure once all the required conditions have been determined to exist can not be challenged by another Member under Article 5.1.

7.100 The fact that the Panel finds that, after full compliance with the provisions of Articles 2 and 4 of the Agreement on Safeguards, there is no obligation under Article 5.1 to justify the decision to adopt a safeguard measure does not mean, however, that the first sentence of Article 5.1 only "states a

basic principle"⁴⁶³ or "does not impose a general obligation".⁴⁶⁴ The first sentence of Article 5.1 does contain a very specific obligation. This obligation is to apply a measure that is commensurate with the goals of preventing or remedying the serious injury suffered by the domestic industry and of facilitating the adjustment of the domestic industry. Our interpretation of this obligation is bolstered by the last sentence of Article 5.1, which provides that Members "should choose measures most suitable for the achievement" of the objectives of preventing or remedying the serious injury and facilitating adjustment.

7.101 In our view a measure is defined by the following elements: product coverage, form, duration and level. Thus, in order to comply with Article 5.1 a Member must apply a measure which in its totality is no more restrictive than is necessary to prevent or remedy the serious injury and facilitate adjustment. In addition, it must be possible for a Panel to evaluate, in accordance with the applicable standard of review, whether a Member has acted in compliance with Article 5.1. Therefore, the Member applying the measure must provide a reasoned explanation as to how the authorities reached the conclusion that the particular measure in question satisfies all the requirements of Article 5.1. We consider that the obligations of the first sentence of Article 5.1 apply to all safeguard measures in their entirety.

7.102 In the present case the European Communities argues that Korea has not fulfilled its obligations under Article 5.1 with respect to the justification of type and level of the measure at issue. In considering whether Korea has complied with its obligations under Article 5.1, we apply the standard of review set out in paragraphs 1.25 to 1.30. Thus, we need to consider whether the Korean authorities examined all relevant facts before them, whether adequate explanation was provided of how the facts as a whole supported the determination made, and, consequently, whether the determination made was consistent with the international obligations of Korea. In other words, Members are required, in their recommendations or determinations on the application of a safeguard measure, to explain how they considered the facts before them and why they concluded, at the time of the decision, that the measure to be applied was necessary to remedy the serious injury and facilitate the adjustment of the industry. Our task is not to determine for ourselves whether the measure applied by Korea is at a level that is no more restrictive than necessary to remedy the serious injury and facilitate adjustment. Rather, we must evaluate whether in deciding on the type and level of the measure to be applied, the Korean authorities considered relevant information and explained their decision that the measure chosen was no more restrictive than necessary to prevent or remedy serious injury to the Korean dairy industry and to facilitate the industry's adjustment.

7.103 In examining Korea's compliance with Article 5.1 we consider the Determination of Relief Measure, by the Korean Trade Commission dated 2 December 1996⁴⁶⁵ to be most relevant, as this document describes the measure adopted by the Korean authorities.⁴⁶⁶ It is this document which should, in our view, reflect the Korean authorities' considerations underlying the measure adopted.

7.104 Looking at the Determination of Relief Measure, we find a bare description of the elements of the measure. We note the absence of any discussion or analysis indicating the considerations underlying the choice of the measure adopted and any explanation as to why the Korean authorities concluded that the measure adopted was necessary to remedy the serious injury and facilitate adjustment. There is no reference to the measure, in any of the other determinations before or after the Determination of Relief Measure.

⁴⁶³ See para. 4.629, *supra*.

⁴⁶⁴ See para. 4.628, *supra*.

⁴⁶⁵ Exhibit Korea-8.

⁴⁶⁶ We recognize that there was a later decision to adjust the level of the measure. However, as this affected only one of the defining elements of the measure, we nonetheless focus on the 2 December 1996 Determination.

7.105 It appears from the evidence presented by Korea that the Korean authorities were aware of, and may even have considered, measures other than the quantitative restriction adopted.⁴⁶⁷ However, these potential measures are merely described in the determination. In our view mere description of the alternative measures considered is insufficient. There must be some discernible reasoning as to why the measure recommended or adopted is preferable to the others, specifically with respect to achieving the objectives of remedying the serious injury and facilitating adjustment.

7.106 Korea's Determination of Relief Measure lists different factors that appear to have been considered in deciding on the adoption of the measure to be applied. However, this is again merely descriptive, as is evident from the following paragraph:

"[b]efore recommending the relief measures, the KTC commissioners agreed that close considerations should be made beforehand for each relief measure on its impacts on the domestic dairy industry, national economy, and bilateral/multilateral trade. In this regard, the KTC examined the information investigated by the OAI, the relevant articles of the multilateral regulations, the opinions of authorities concerned, and the relief measures stipulated in the Foreign Trade Act and the Enforcement Decree of the Act. Based on all these examinations, the KTC reviewed the petitioner's request for relief measures."⁴⁶⁸

We do not see any explanation as to whether or how each of these factors shaped the Korean authorities' recommendation on the type, level and duration of the applied measure.

7.107 Indeed the Determination of Relief Measure simply continues:

"The KTC decided to recommend to the Minister of Agriculture and Forestry (MAF) that he permit the following in connection with the import restrictions on the products under investigation[:]

The import restriction on the products under investigation should be implemented for 4 years.

The restricted volume should amount to 15,595 tons (average import volume during the year of 1993 – 1995) in the first year of the total 4 years of relief measures period. From the second year, the yearly 5.7 per cent increase rate (average increase rate of total domestic demand during 1993 – 1995) over the preceeding year's restricted volume should be applied."

This recommendation does not contain any consideration or explanation of why the Korean authorities concluded that the recommended measure was necessary to prevent or remedy serious injury and facilitate the adjustment of the domestic industry.

7.108 We wish to make it clear that we do not interpret Article 5.1 as requiring the consideration of an adjustment plan by the authorities, as the European Communities asserts.⁴⁶⁹ The Panel finds no specific requirement that an adjustment plan as such must be requested and considered in the text of the Agreement on Safeguards. Although there are references to industry adjustment in two of its provisions,⁴⁷⁰ nothing in the text of the Agreement on Safeguards suggests that consideration of a

⁴⁶⁷ Other measures that may have been considered include those measures which were proposed by the petitioner (*see*, Exhibit Korea-8 at pg. 3) and the application of a tariff quota as recommended by Commissioner Jeong Mun-Su in his minority opinion (*id.* at pg. 4).

⁴⁶⁸ *Id.* at pg. 3.

⁴⁶⁹ See para. 4.611, *supra*.

⁴⁷⁰ Articles 5 and 7 of the Agreement on Safeguards.

specific adjustment plan is required before a measure can be adopted. Rather, we believe that the question of adjustment, along with the question of preventing or remedying serious injury, must be a part of the authorities' reasoned explanation of the measure it has chosen to apply. Nonetheless, we note that examination of an adjustment plan, within the context of the application of a safeguard measure, would be strong evidence that the authorities considered whether the measure was commensurate with the objective of preventing or remedying serious injury and facilitating adjustment.

7.109 In response to a question by the Panel,⁴⁷¹ Korea states that Article 5 "does not impose a general obligation on Members to demonstrate that the specific level of quota that they decided to impose as a safeguard measure is necessary to prevent or remedy serious injury and to facilitate adjustment". In our interpretation, Article 5.1 does not require a Member to demonstrate *ex posteriori* to the Panel that the measure adopted is effectively the most appropriate one. We consider rather, as we mentioned before, that Members are required, in their recommendations or determinations on the application of a safeguard measure, to explain how they considered the facts before them and why they concluded, at the time of the decision, that the measure to be applied was necessary to remedy the serious injury and facilitate the adjustment of the industry. It is such reasoning and explanation concerning the measure adopted, essential to evaluate Korea's compliance with Article 5.1, which we cannot discern in Korea's determination to apply a safeguard measure in the present case.

7.110 Korea argues that "provided the level of quota was equivalent to or not less than the average of the import levels for the three most recent representative years for which statistics were available, the Korean authorities were not required to show that the nature of the measure, or its level, were [*sic*] 'necessary'".⁴⁷² However, as explained above, we consider that the first sentence of Article 5.1 applies to all elements of a safeguard measure, including the level of any quota. In consequence, even assuming Korea based its quota level on the average imports levels for the last three representative years, this would not suffice to meet the requirements of Article 5.1, as the scope of that Article is greater than just the level of the applied quota. We conclude therefore that Korea's determination of the measure did not meet the requirements of Article 5 of the Agreement on Safeguards.

7.111 The European Communities also claims that Korea violates Article 5.1 because it applied a quota whose level was lower than the average of imports in the last representative three-year period preceeding the application of the measure for which statistics were available. Since we have already found that Korea's application of a measure was not consistent with the provisions of the first sentence of Article 5.1 which we consider to be generally applicable, also when a quantitative restriction based on the average import levels for the last three representative years is used, we do not address the question of whether the quota level was calculated consistently with the second sentence of Article 5.1.

I. CLAIMS UNDER ARTICLE 12

1. Incomplete and Untimely Notifications

(a) Arguments of the parties

7.112 The European Communities claims that Korea failed to notify its measure in a timely fashion and with sufficient detail contrary to Article 12.1 and 12.2 of the Safeguards Agreement. The European Communities argues that in view of the limitative character of safeguard measures, their inclusion in the WTO system is accompanied by limits to their use, so that the interests of all the parties may be protected. As regards notifications under Article 12.1(b) and (c), one specific purpose is to offer the Members concerned an opportunity for adequate consultations. Effective exercise of

⁴⁷¹ See para. 4.628, *supra*.

⁴⁷² See para. 4.671, *supra*.

these rights by WTO Members calls for a minimum guaranteed level of information officially transmitted in one of the working languages of the WTO.

7.113 Korea responds that its notifications are consistent with the guidance issued by the Committee on Safeguards and with the Technical Cooperation Handbook on Notification Requirements. For Korea, its notifications provided the European Communities with all pertinent information. In its view, the purpose of the notification pursuant to Article 12 is to provide the Committee on Safeguards with information which is to be disseminated to Members to facilitate meaningful prior consultations under Article 12.3 and, where appropriate, consultations under Article XXII of GATT 1994. This function is implied both by the structure of Article 12, which includes both notification and consultation, and by the final sentence of Article 12.2 which provides that "The Council for Trade in Goods or the Committee on Safeguards may request such additional information as they may consider necessary from the Member proposing to apply or extend the measure." For Korea, if the purpose of Article 12 were to replicate the exacting standards of Article 3 and 4.2(c), the final sentence of Article 12.2 would be redundant.

(b) The notifications under examination

7.114 We asked Korea to clarify for us the sequence of its WTO notifications. In light of its response, we understand that the following notifications were made:

- (a) 11 June 1996, G/SG/N/6/KOR/2, circulated on 1 July 1996. Notification of the KTC's decision to initiate an investigation on 17 May 1996. (Circulated as an Article 12.1(a) notification, of the initiation of an investigatory process relating to serious injury or threat thereof and the reasons for it). (See Exhibit EC-1).
- (b) 2 December 1996, G/SG/N/8/KOR/1, circulated on 6 December 1996. Notification of the completion of the report by the Office of Administration and Investigation (OAI) that provided the basis for the KTC's determination of injury (on 23 October 1996). This notification stated: "The Korean Trade Commission has not made a decision to apply a safeguard measure yet. Therefore, there is no information on such a measure at this time. The KTC will recommend to the relevant Minister an appropriate remedial measure within 45 days of the injury determination." This document was circulated as an Article 12.1(b) notification of a finding of serious injury or threat thereof caused by increased imports. (See Exhibit EC-2)

In this case, the KTC decided on the relief measure, namely the quota, on 2 December 1996, and recommended it on 6 December 1996 to the Minister for Agriculture and Forestry for his consideration.⁴⁷³ Korea stated that the KTC's recommendation on relief measures is not made public because it is only a recommendation that has no legal effect and that is subject to change by the relevant Minister.

- (c) 21 January 1997, G/SG/N/10/KOR/1, circulated on 27 January 1997, as an Article 12.1(c) notification of a decision to apply or extend a safeguard measure. In the notification Korea invited interested Members for consultations during the week of 3 February 1997, "before it makes a final decision on the measure by the week beginning 24 February 1997." (See Exhibit EC-5)
- (d) 31 January 1997, G/SG/N/11/KOR/1 circulated on 21 February 1997. Notification of non-application of the proposed safeguard measure to developing countries. (Footnote 2 of Article 9 of the Agreement on Safeguards). (See Exhibit EC-6)

⁴⁷³ See para. 4.113, *supra*.

- (e) 24 March 1997, G/SG/N/10/KOR/1/Suppl.1, circulated on 1 April 1997 as a supplemental notification under Article 12.1(c). Notification of the Minister of Agriculture and Forestry's decision of 1 March 1997 to impose a measure. This notification contained an attachment with further detailed information following the 6 February 1997 consultations and the special Committee on Safeguards meeting. (See Exhibit EC-10)

(c) Analysis of Article 12 of the Agreement on Safeguards

7.115 We shall proceed in the following way: First, we will examine the provisions of Article 12 generally in order to determine which WTO Members' actions or measures ought to be notified, the content of these notifications and their timing; Second, we shall examine each of Korea's notifications and assess their compatibility with the requirements of Article 12 of the Agreement on Safeguards.

(i) What actions must be notified

7.116 It is clear that the provisions of Article 12 of the Agreement on Safeguards prevail over the Guidance issued by the Committee on Safeguards⁴⁷⁴ (which contains a disclaimer to that effect) and the Technical Cooperation Handbook on Notification Requirements (prepared by the Secretariat but which explicitly states that it "does not constitute a legal interpretation of the notification obligations under the respective agreement(s)"). At issue in this case are the notifications required under Articles 12.1(a), (b) and (c).

7.117 The wording of Article 12 provides that a number of types of actions must be notified to the WTO Committee on Safeguards by Members proposing to use the provisions of the Agreement on Safeguards. Article 12.1 refers to three such actions, by inference Article 12.2-3 refers to a fourth item and Article 12.6 to a fifth item.

7.118 Article 12.1 requires notification to the Committee on Safeguards of (a) the initiation of an "investigatory process relating to serious injury or threat thereof and the reasons for it"; (b) any "findings of serious injury or threat thereof caused by increased imports"; and (c) any "decision to apply or extend a safeguard measure".

7.119 Articles 12.2 and 12.3 set forth the required content of such notifications, and provide as well certain guidance as to the sequence of events to be followed in the notifications and related consultations. These Articles read as follows:

"2. In making the notifications referred to in paragraphs 1(b) and 1(c), the Member proposing to apply or extend a safeguard measure shall provide the Committee on Safeguards with all pertinent information, which shall include evidence of serious injury or threat thereof caused by increased imports, precise description of the product involved and the proposed measure, proposed date of introduction, expected duration and timetable for progressive liberalization...."

"3. A Member proposing to apply or extend a safeguard measure shall provide adequate opportunity for prior consultations with those Members having a substantial interest as exporters of the product concerned, with a view to, *inter alia*, reviewing the information provided under paragraph 2, exchanging views on the measure and reaching an understanding on ways to achieve the objective set out in paragraph 1 of Article 8."

7.120 Although not explicitly listed in Article 12.1, the wording of Article 12.2 and 12.3 make it clear that any proposed measure must also be notified to the Committee on Safeguards. Article 12.2

⁴⁷⁴ See document G/SG/1.

provides that the notifications under Article 12.1(b) and 12.1(c) must contain information as to the basis for the serious injury finding, as well as information as to the "proposed" measure to be applied. Article 12.3 requires that the notifying Member provide an adequate opportunity for "prior consultations" with interested Members, that is, consultations prior to the actual application of the measure. Article 12.3 further requires that among the information to be discussed in the consultations is the information already notified under Article 12.1(b) and 12.1(c), i.e., the basis for the serious injury finding, and the details of the measure that the notifying Member proposes to apply. Thus, Article 12.1, 12.2 and 12.3 taken together makes it clear that before a definitive safeguard measure may be applied, the Member proposing to apply it must notify all the pertinent information regarding the proposed measure and the factual basis (the injury finding) for applying it, and must provide an opportunity for consultations with Members whose trade will be affected by the proposed measure. In other words, details of the measure proposed must be notified before it is applied, so that affected Members may consult about it before it takes effect. Therefore, we reject Korea's argument that it was not obliged to notify its proposed measure, but we note that Korea did do so.

7.121 Finally, pursuant to Article 12.6, a provisional measure shall also be notified to the Committee on Safeguards.

(ii) *The content of such notifications*

(1) 12.1(a)

7.122 Regarding the "content" of notifications under Article 12.1, we note that with regard to the notification of the initiation of an investigation, the terms of Article 12.1(a) only refer to the obligation to notify "initiating an investigatory process relating to serious injury or threat thereof and the reasons for it".

7.123 We also note that the notification under Article 12.1(a) does not have to take place before the investigation is initiated, but rather immediately upon its initiation. In this context, we recall that there is no individual country notification (as there exists for instance for antidumping actions) under the Agreement on Safeguards, presumably because in principle the safeguard measure is to be applied on an MFN basis. The purpose of the notification under paragraph 1(a) of Article 12 is to inform all WTO Members of the initiation of an investigation so that Members having a substantial interest may exercise their rights to participate in the investigation (provided for under Article 3.1) in the first instance and possibly to request consultations under Article 12.3.

(2) 12.1(b) and (c)

7.124 For the notifications envisaged under paragraphs 1(b) and (c) of Article 12, i.e. the finding of serious injury caused by imports, the proposed measure and the decision to apply a measure, we note that the terms of Article 12.2 provide for a standard expressed in terms of an overall and a specific requirement as to the content of these notifications. First, there is a reference to "all pertinent information" (the overall criterion) and then there is a list of factors (the specific criteria) presumed to be pertinent information for which information must be provided.

"12.2 In making the notifications referred to in paragraphs 1(b) and 1(c), the Member proposing to apply or extend a safeguard measure shall provide the Committee on Safeguards with all pertinent information, which shall include evidence of serious injury or threat thereof caused by increased imports, precise description of the product involved and the proposed measure, proposed date of introduction, expected duration and timetable for progressive liberalization." (emphasis added)

Article 12.2 refers thereby to six more specific items which must be covered by such notifications. Thus it is necessary to notify: (1) evidence of serious injury or threat thereof that was caused by

increased imports, (2) the precise description of the product involved, (3) the proposed measure, (4) the proposed date of introduction, (5) the expected duration and (6) the timetable for progressive liberalization.

7.125 In our examination of the context of the expression "all pertinent information" in Article 12.2, we note that the same word "pertinent" is also used in Article 3, with reference to the domestic publication of the overall report. But Article 12 refers to "all pertinent information", while Article 3 refers to "all pertinent issues of fact and law". The term "information" differs from "issues of fact and law", the former being more general. Based on the ordinary meaning of the terms and their context, a distinction may be made between the less stringent requirement of "all pertinent information" for the purpose of the WTO notification (Article 12), and "all pertinent issues of fact and law" for the purpose of the final report (Article 3) which must be published domestically. "Information" (Article 12) on a matter is certainly less comprehensive than a "report setting forth ... reasoned conclusions" (Article 3) on the same matter.

7.126 The term "pertinent information" ought to be interpreted taking into account the context of Article 12 and the object and purpose of the Agreement on Safeguards and its notification requirements. We think that the notification serves essentially a transparency and information purpose. In ensuring transparency⁴⁷⁵, Article 12 allows Members through the Committee on Safeguards to review the measures. Another purpose of the notification of the finding of serious injury and of the proposed measure is to inform Members of the circumstances of the case and the conclusions of the investigation together with the importing country's particular intentions. This allows any interested Member to decide whether to request consultations with the importing country which may lead to modification of the proposed measure(s) and/or compensation.⁴⁷⁶

7.127 We understand the European Communities to argue that, although in a summary form, Members should notify to the WTO (pursuant to Article 12 of the Agreement on Safeguards) everything they are required to publish domestically pursuant to Articles 3 and 4 of the Agreement on Safeguards. We consider that the standards of what must be published domestically and what ought to be notified to the WTO are different. If Members, when they negotiated the Agreement on Safeguards, intended that what was to be published domestically also had to be notified to the WTO, they could have made such a requirement clear by simply referring in Article 12 to the publication requirements mentioned in Articles 3 and 4. However, the ordinary meaning of the word "information" implies that the other Members must gain knowledge of the actions undertaken by the notifying Member. In this sense, the amount of information notified must be sufficient to be useful to Members with a substantial interest in the proposed safeguard measure. We note that while not required by the Agreement on Safeguards, and not included as an element of information in the agreed notification formats adopted by the Committee, it may be desirable for the notification to include a reference to the published report on the case referred to in Articles 3.1 and 4.2. Such reference would, however, not replace the requirements of Article 12. We note finally that the Committee has the power to

“request such additional information as they may consider necessary from the Member proposing to apply or extend the measure”.⁴⁷⁷

⁴⁷⁵ We recall the need for transparency of Members' actions as emphasized in the Marrakesh Decision on Notification Procedures.

⁴⁷⁶ Article 12.3 explicitly provides that among the topics to be discussed are the objective of Article 8.1, i.e. endeavouring to maintain a substantially equivalent level of concession and other obligations to that existing under GATT.

⁴⁷⁷ Article 12.2 of the Agreement on Safeguards.

(iii) *The timing of such notifications*

7.128 Article 12.1 provides that "A Member shall immediately notify the Committee on Safeguard upon ..." (emphasis added). The ordinary meaning of the term "immediately"⁴⁷⁸ introduces a certain notion of urgency. As discussed above, we believe that the text of Article 12.1, 12.2 and 12.3 makes clear that the notifications on the finding of serious injury and on the proposed measure shall in all cases precede the consultations referred to in Article 12.3. We note finally that no specific number of days is mentioned in Article 12. For us this implies that there is a need under the agreement to balance the requirement for some minimum level of information in a notification against the requirement for "immediate" notification. The more detail that is required, the less "instantly" Members will be able to notify. In this context we are also aware that Members whose official language is not a WTO working language, may encounter further delay in preparing their notifications.

7.129 We shall now proceed to examine the European Communities' claims with regard to the notifications made by Korea, and determine whether such notifications respect the requirements of Article 12 as to their content and timing.

(d) Examination of the specific notifications by Korea

(i) *Notification pursuant to Article 12.1(a): The initiation of the investigation - 1 July 1996, G/SG/N/6/KOR/2*

7.130 Korea's notification states the date of the initiation of the investigation, the products covered and then refers to two reasons for the initiation of the investigation: a petition was filed and the level of imports had increased. There is no explicit reference to any serious injury to the domestic industry, but Korea does refer to an initiation pursuant to Article 12.1(a) of the Agreement on Safeguards.

7.131 We disagree with the European Communities that such notification should necessarily include a discussion of all of the legal requirements for a safeguard action to be taken such as a discussion of the conditions of the markets, etc. We note that initiation is the beginning of the process, and the Agreement on Safeguards does not establish specific standards for the decision to initiate, as do Article 5 of the Agreement on the Implementation of Article VI of GATT 1994 and Article 11 of the Agreement on Subsidies and Countervailing Measures. Thus, to require a discussion in the notification of initiation of evidence regarding the elements that must be found to exist to impose a measure at the end of the investigation would impose a requirement at the initiation stage that is not required by the Agreement on Safeguards itself. We note in the first instance that whatever the relationship between the requirements of Article 12.2 regarding the contents of notifications and the contents of the investigation reports published pursuant to Articles 3.1 and 4.2, this question is not relevant to Article 12.1(a) notifications, as Article 12.2 specifically and exclusively addresses "notifications referred to in paragraphs [12.1(b) and [12.1(c)]".

7.132 The format agreed by the Committee for notifications under Article 12.1(a) is not legally binding, although helpful. The guidance in the format is general as to the kind of information to be provided, referring simply to examples of information on the reasons for initiation, and saying nothing about the level of detail of that information.

7.133 Although Korea's notification could usefully have included a reference to allegations of serious injury and a cross-reference to any domestic publication(s) in Korea, we think that this notification was sufficient to inform WTO Members adequately of Korea's initiation of an

⁴⁷⁸ The New Webster Encyclopedic Dictionary defines immediately as "without delay, straightaway"; the New Shorter Oxford Dictionary defines it as "without delay, at once, instantly".

investigation concerning a particular product, so that Members having an interest in the product could avail themselves of their right to participate in the domestic investigation process.

7.134 As to the timing of this notification, we note a delay of 14 days (28 May 1996 to 11 June 1996) between the publication of the initiation decision and its notification to the WTO.⁴⁷⁹ We recall that Members are required to notify the initiation of any investigation "immediately", although no specific time-period is identified. We note, moreover, that the content of the Article 12.1(a) notification is minimal. Recalling again the reasons for the requirement of a notification without delay, we believe that any delay in Article 12.1(a) notifications can be problematic. We therefore disagree with Korea that it satisfied the requirement for an immediate notification because it did so "as soon as practically possible". There is no basis in the wording of Article 12.1 to interpret the term "immediately" to mean "as soon as practically possible". In light of all of the foregoing considerations, we find that the 14-day period between Korea's initiation of the investigation and its presentation of the notification related thereto, does not respect the requirements for "immediate" notification and is in violation of Article 12.1 of the Agreement on Safeguards.

(ii) Notification Pursuant to Article 12.1(b) and 12.2 : Determination of serious injury caused by increased imports - 2 December 1996, G/SG/N/8/KOR/1

7.135 Korea's notification of the finding of serious injury caused by increased imports stated that imports had grown, that the domestic industry's share of domestic consumption had decreased and domestic stocks had increased. There is no explicit reference to any analysis of the level of sales, production, productivity, and employment as such, nor is there any reference to any causation element. We note that there is no cross-reference to the domestic publication of this finding of serious injury where the reader would find further information.

7.136 We consider, however, that this notification contains sufficient information on what Korea considered to be evidence of injury caused by increased imports as well as on the other listed items in Article 12.2. We note that there is no explicit requirement to explain how such injury has been caused by increased imports. Rather the requirement is to notify "evidence of injury caused". We note that the last sentence of Article 12.2 allows for the possibility to request additional information. We find that Korea's notification would permit the effective exercise of the right of other Members to request consultations. Consequently, we consider that the content of that Korean notification made pursuant to Article 12.1(b) meets the requirements of Article 12.2 of the Agreement on Safeguards.

7.137 As to the timing of such notification, we note that, although it was made two months prior to the consultations, a delay of 40 days (23 October 1996 to 2 December 1996) between the domestic publication of the injury finding and the date of that notification to the Committee on Safeguards took place. We find that this delay does not satisfy the requirements for an immediate notification and therefore is in violation of Article 12.1 of the Agreement on Safeguards.

(iii) Notification Pursuant to Article 12.1(c) and 12.2 : Proposed measure – 21 January 1997, G/SG/N/10/KOR/1

7.138 As we mentioned before, we are of the view that Members are obliged under Article 12.1(c) to notify any decision with regard to the proposed imposition of a safeguard measure. Korea did so on 21 January 1997.

7.139 Considering that an important purpose of the notifications of the serious injury determination and the proposed measure is to provide other Members with an effective possibility to request consultations, we examine only the notifications of 2 December 1996 and 21 January 1997 which are

⁴⁷⁹ We note, however, a period of 34 days between the domestic publication of the initiation decision, 28 May 1996, and the date of the circulation of the said notification to all WTO Members, i.e. 1 July 1996.

the only notifications which were circulated before the consultations of 6 February 1997. The notification of 2 December 1996 is discussed above. We consider that this notification contains sufficient information on what Korea considered to be evidence of injury caused by increased imports as well as on the other listed items in Article 12.2. We note that there is no explicit requirement to explain how such injury had been caused. Rather one of the listed factors is "evidence of injury caused by increased imports". We note again that the last sentence of Article 12.2 allows for the possibility to request additional information. Consequently, we consider that the content of that Korean notification of its proposed measure, made pursuant to Article 12.1(c), meets the requirements of Article 12.2 of the Agreement on Safeguards as it contains sufficient information on the proposed measure, e.g. its nature, scope and duration, to provide Members with a substantial interests with adequate information to request consultations.

7.140 As to its timing, we note that this notification took place more than 6 weeks after the decision on the proposed measure was taken (6 December 1996 to 21 January 1997). For us, this is not an "immediate" notification. We consider that this delay does not meet the requirements for an "immediate" notification and therefore is in violation of Article 12.1 of the Agreement on Safeguards.

(iv) Notification Pursuant to Article 12.1(c) : The taking of the safeguard measure – 24 March 1997, G/SG/N/10/KOR/1. Suppl.

7.141 Following the consultations with interested Members and the special meeting of the Committee on Safeguards, Korea notified a revised description of its investigation process and the measure it had by then imposed. This notification is, in the present case, the more complete one.

7.142 We consider that provision of additional notifications following consultations may be helpful in furthering multilateral transparency, that it may be evidence of adequate consultations and may also constitute a rectification of prior, incomplete notifications.⁴⁸⁰ In this context, we recall that one of the purposes of consultations is to review the Article 12.1(b) and (c) notifications, logically implying that such consultations may lead to revision and rectification of those notifications. The wording of Article 12.2 and 12.3 seems to confirm this possibility.

7.143 In our view notifications can always be revised. However, we cannot accept Korea's argument that the fact that the European Communities and Korea almost "settled" this case is evidence that the notification was sufficient. Parties may settle a case on the basis of additional information provided during the consultation and not contained in the prior notification.

7.144 As far as it covers Korea's final decision to take a safeguard measure⁴⁸¹, we find that the content of the Korean notification of 24 March 1997 meets the requirements of Article 12.1(c) and 12.2 of the Agreement on Safeguards.

7.145 As to the timing of this notification (as far as it covers Korea's final decision to take a safeguard measure), we note that Korea notified on 24 March 1997 that on 1 March 1997 a final decision had been taken to impose a quota as a safeguard measure. We fail to see how this can be viewed as an immediate notification. As far as it covers Korea's final decision to take a safeguard

⁴⁸⁰ In our view, in the event that a Member considers that it has to revise or to correct its notification, that Member may, but is not obligated to, offer further consultations on this revised notification before any definitive measure is imposed, in an attempt to prevent any eventual dispute settlement proceedings based on an alleged violation of Article 12.

⁴⁸¹ This notification can only be viewed as a notification of the final decision taken since it was notified and circulated only after the final decision was put into force; this notification cannot be taken into account for the purpose of assessing whether Korea complied with its obligation to notify its proposed measure since this notification took place after the consultations, and therefore cannot remedy the flaws in the previous notification.

measure, we find that the timing of the Korean notification of 24 March 1997 does not meet the requirements of Article 12.1 of the Agreement on Safeguards.

2. Claim of inadequate consultations

7.146 The European Communities first claim that since Korea's notifications, which serve as the basis for the consultations, were incomplete and untimely, the consultations were therefore inadequate. For the European Communities, in order for the opportunity to consult to be adequate pursuant to Article 12.3, consultations must take place on all the pertinent information to be provided under Article 12.2 in advance of the consultations, including the evidence to be supplied in the notifications of injury findings and of the results of the investigation.

7.147 The European Communities further argue that Article 12.3, when specifying that it is for the Member "proposing to apply a safeguard measure" to offer to consult, *inter alia*, on the "proposed measure", implies that consultations must take place before the measure is applied (i.e. when it is still a "proposal"). We agree with the European Communities on this issue. Notification of the proposed measure must take place before the consultations.

7.148 In the present case, a special meeting of the Committee on Safeguards took place on 21 February 1997 and Korea held bilateral consultations with the European Communities, Australia and New Zealand on 4 and 5 February 1997 in Geneva. By failing to provide all pertinent information in its notifications in advance of consultations (and specifically those notifications made pursuant to Article 12.1(b) and (c)), the European Communities argues that Korea prevented WTO Members having a substantial interest as exporters from engaging in meaningful consultations, thus failing to provide them with an adequate opportunity in this respect. As a consequence, it also frustrated the further objective of those consultations, namely to reach an agreement or to ensure the maintenance of the balance of concessions as foreseen in Article 8.1 of the Agreement on Safeguards.

7.149 Korea responds that after receiving two requests for consultations under Article 12.3 of the Agreement on Safeguards, it provided (although, according to Korea, this was not required) a preliminary notification of the proposed measure, under Article 12.1(c) on 21 January 1997. We have already mentioned that we consider that Members are under an obligation to notify any proposed measures and must also invite any interested party to consult on this issue. Korea adds that consultations were certainly fruitful as they almost resulted in a mutually agreed solution. The European Communities responds that the case was never settled but that in any case the information and responses submitted by Korea never provided it with all pertinent information.

7.150 We have found above that the content of Korea's notifications was in conformity with the provisions of Article 12. Moreover, we consider that consultations may be adequate even in circumstances where prior notifications of a finding of serious injury or of any proposed measure are incomplete. In fact one of the purposes of the consultations is to review the content of such notifications (and thereby augment it if necessary). During consultations parties usually exchange further information, exchange questions and answers and proceed to a thorough discussion of the national authority's determinations.

7.151 The parties have explicitly requested us to assess the compatibility of their consultations with the requirements of the Agreement on Safeguards, based on the chronology of events that they submitted to us.⁴⁸² We note that no formal mutually agreed solution was reached by the parties in this dispute, but we do not consider that the only criterion for assessing the adequacy of consultations is whether parties through such consultations settle their dispute. Many formal dispute settlement proceedings take place following consultations which are WTO compatible and which do not lead to a mutually agreed settlement of the dispute.

⁴⁸² See paras.4.730 and 4.762 *supra*.

7.152 In the present case we note that parties exchanged questions and answers. The European Communities claims that it has always been unsatisfied with the Korean's answers and notifications (together with Korea's determination). This may be the case and would explain why it decided to pursue dispute settlement proceedings, but it does not prove that Korea did not consult in good faith for the purpose of informing interested Members of its investigation, its conclusion and its proposed actions. We note also that Korea did impose a measure at a level and for a duration different, and less restrictive, than initially proposed. Consultations were certainly fruitful in this respect, albeit not sufficient to satisfy the European Communities.

7.153 We reject therefore the EC claim that Korea failed to provide adequate opportunity to consult. Moreover, it seems to us that such consultations have led to an important revision of the initial notification and that parties, at some point, entered into very serious negotiations and considered serious elements of a mutually agreed solution. The fact that this proposed settlement was not formalized through the acceptance by the relevant internal authorities of the European Communities is immaterial. What is relevant for the purpose of this EC claim, is the fact that the parties to these consultations were able to negotiate quite effectively, which, in our view, demonstrates that the consultations were adequate. For us, this is the purpose of any consultation process and the scope of the obligation contained in Article 12.3 of the Agreement on Safeguards, i.e. to favour efforts by the parties to reach a mutually agreed solution of their disagreement. In our view Korea has very well respected its obligation during the consultation process in this case. We therefore reject this EC claim made pursuant to Article 12.3 of the Agreement on Safeguards.

VIII. CONCLUSIONS AND RECOMMENDATIONS

8.1 In the light of the findings above, we conclude that the definitive safeguard measure was imposed inconsistently with the provisions of the Agreement on Safeguards in that

- (a) Korea's serious injury determination is not consistent with the provisions of Articles 4.2(a) of the Agreement on Safeguards;
- (b) Korea's determination of the appropriate safeguard measure is not consistent with the provisions of Article 5 of the Agreement on Safeguards;
- (c) Korea's notifications to the Committee on Safeguards (G/SG/N/6/KOR/2, G/SG/N/8/KOR/1, G/SG/N/10/KOR/1, G/SG/N/10/KOR/1. Suppl) were not timely and therefore are not consistent with the provisions of Article 12.1 of the Agreement on Safeguards.

8.2 In the light of the findings above, we reject

- (a) the European Communities' claim that Korea violated the provisions of Article XIX:1 of GATT by failing to examine the "unforeseen developments";
- (b) the European Communities' claim that Korea violated the provisions of Article 2.1 of the Agreement on Safeguards by failing to examine, as a separate and additional requirement, the "conditions" under which increased imports caused serious injury to the relevant domestic industry.
- (c) the European Communities' claims that the content of Korea's notifications to the Committee on Safeguards (G/SG/N/6/KOR/2, G/SG/N/8/KOR/1, G/SG/N/10/KOR/1, G/SG/N/10/KOR/1. Suppl) did not meet the requirements of Article 12.1, 12.2 and 12.3 of the Agreement on Safeguards.

- (d) the European Communities' claim that Korea violated the provisions of Article 12.3 of the Agreement on Safeguards in refusing to offer appropriate consultations to the European Communities.

8.3 Under Article 3.8 of the DSU, in cases where there is infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment of benefits under that agreement. Accordingly, we conclude that to the extent that Korea has acted inconsistently with the provisions of the Agreement on Safeguards, as described in paragraph 8.1 *supra*, it has nullified or impaired the benefits accruing to the European Communities under that agreement.

8.4 The Panel *recommends* that the Dispute Settlement Body request Korea to bring its measures into conformity with its obligations under the WTO Agreement.
