19

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Implications of WTO Litigation for the WTO Agricultural Negotiations

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INTRODUCTION

The WTO dispute settlement mechanism is designed primarily for resolving differences in interpretation of current agreements and dissuading Member countries from taking actions that contravene multilateral trade rules. As such, it is an essential part of a well-functioning multilateral trade system. But a Member state's decision to submit a complaint before the WTO dispute settlement mechanism is increasingly seen as an effective means to apply pressure on other countries to change policies. Though such pressure is clearly most effective when potential rule violations are involved, non-violation complaints are also possible. Thus, the initiation of complaints leading to litigation is in effect a political decision to pursue trade objectives through the legal instruments of the WTO.

The WTO litigation process is being increasingly used in cases involving agricultural subsidies and other central aspects of farm policies. The link between the legal and the political aspects of the dispute settlement process is highlighted by these actions. The recent *US-Cotton* and *EU-Sugar* cases in particular demonstrate the close links between negotiations, litigation and changes in domestic farm programs. Other significant cases, such as those relating to Chilean price bands and to Canadian dairy policy, further represent a trend whereby the scope for domestic agricultural policies is becoming defined as much through the WTO legal rulings as through multilateral negotiations.

The implications of this recent spate of litigation for the Doha Round of negotiations and for the reform of domestic policies need to be fully understood. This is necessary in order to ensure that legal rulings and multilateral negotiation processes do not become antagonistic. At best a healthy tension between the litigation and negotiation processes of the WTO may lead to more informed and precise negotiated outcomes. At worst such confrontations run the danger of eroding the political support for the WTO and weaken the trade regime. An active and effective WTO dispute settlement mechanism is needed to play a constructive role in making clearer the limits on domestic action already agreed in the WTO negotiations (e.g. the definition of prohibited and actionable subsidies to agricultural producers) and interpreting the scope for action by countries for such domestic stabilization measures as price bands.

At times when negotiations are underway, litigation takes on additional significance. The outcome of the litigation can have important implications for the balance of advantage in the negotiations. Some countries may feel that they are negotiating under duress from an ongoing WTO adjudication of a complaint by a WTO Panel or the threat of such a complaint. Others may feel that litigation is necessary to enable countries to take full advantage of past concessions and therefore pave the way for future negotiations. A fresh look needs to be taken at the interrelationship of the WTO legislative and judicial processes in the present search for improved trade rules for agriculture. This

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includes an examination of the relative attraction of each of these processes for particular groups of countries and the dangers that may arise from outcomes that are perceived as mutually incompatible.

In addition to the impacts on domestic policy change, on the progress and process of negotiations, litigation can also have important implications for the political support for the WTO and the credibility of its dispute settlement process as a whole. Overuse of this mechanism may lead to both gridlock in the litigation machinery and reduced effectiveness of WTO Panel rulings as check on domestic policies. Bureaucratic, as well as political, interests may delay implementation of Panel rulings and cause the process to lose effectiveness.

OVERVIEW

This paper addresses these issues at greater length. The first section provides an overview of the linkages between litigation and legislation in the process of defining and developing appropriate trade rules for agriculture. The second section elaborates on the way in which litigation has been used in cases of agricultural trade policy. The main implications of two important subsidy cases (*US-Cotton* and *EU-Sugar*) that potentially impinge on the current Doha Round of negotiations, together with the first major challenge to an agricultural program (*Canada-Dairy*) that set the scene for the Sugar case are discussed in the third section. The paper's fourth section focuses on the definition of subsidies as applied to agriculture and of the way in which the definitions of the WTO Subsidies and Countervailing Measures Agreement (SCM) differ from those of the Uruguay Round Agreement on Agriculture (URAA). The fifth section deals with an issue of market access, specifically the scope for WTO-compatible defense at the border against price fluctuations. The price-band method of stabilizing domestic prices was challenged in the WTO (*Chile-Price Bands*) and found in some respects to be not in compliance. Implications are drawn for developing countries seeking stabilizing import policies, and linkages are made with current WTO safeguards and with proposed new Special Safeguard Mechanism (SSM) for developing countries.

The concluding section suggests ways to reconcile the impact of Panel reports and the progress of negotiations, to mediate between the general and the agriculture-specific disciplines on subsidies, and to link the unilateral and the multilateral approaches to price-linked tariff barriers. In this way, the adjudicative and legislative processes of WTO can reaffirm rather than undermine each other.

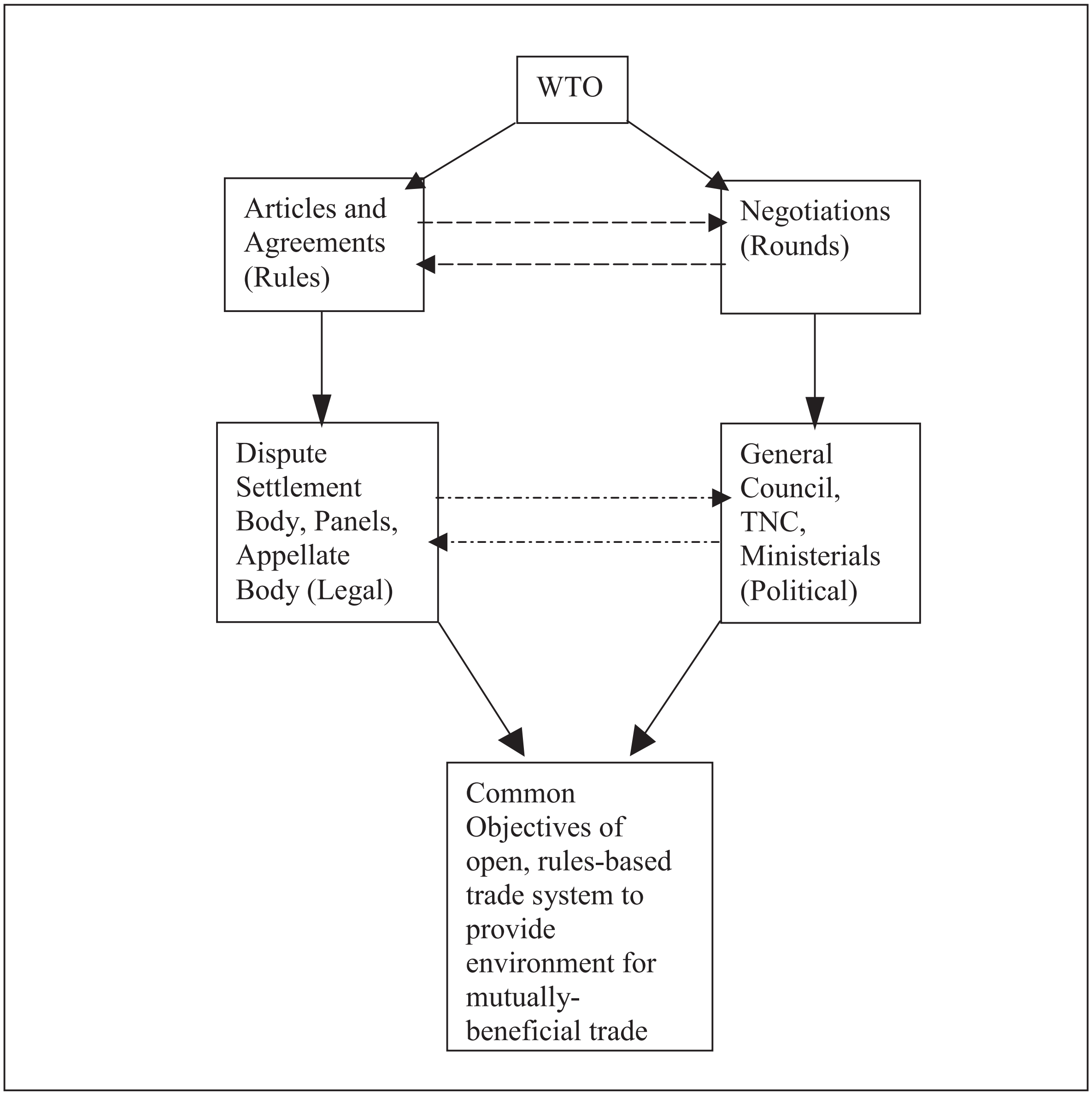
I. LITIGATION AND NEGOTIATION

The WTO profits from the synergy between its two primary functions: the negotiation of mutually-advantageous trade rules, along with the schedules of tariffs that define a Members' obligation to the trade system, and the process of consultation, discussion and (if necessary) litigation to resolve disputes that makes the rules and schedules credible. In order to explore further the way in which rule-making and rule-enforcing functions of the WTO interact in the case of agriculture, it may be useful to illustrate these linkages, as is in Figure 1.

Multilateral trade negotiations in general and the WTO in particular are the province of diplomats in Geneva, public officials in the capitals, and politicians, who define negotiating mandates in conjunction with domestic interest groups, and then reach mutually satisfactory agreements. However, the novel aspect of WTO is that it then subjects the interpretation and enforcement of these negotiated agreements to an independent adjudicative process: the WTO dispute settlement mechanism. The comfortable cushion of ambiguous generalities in negotiated agreements is then given more precise interpretation, as needed, to resolve actual disputes - not by the original negotiating parties but by an independent panel of trade experts and lawyers. In such circumstances, it is predictable that WTO dispute settlement mechanism on occasion will be subject to criticisms of overreaching its mandate or role.

Commentators have pointed to a growth in the "legal culture" of the WTO, suggesting that the dispute settlement process has moved ahead of the legislative function: attempting to clarify rules in effect creates new rules that may deviate from those that were intended.[1] Such criticism and concerns represent the growing pains of an independent international dispute resolution mechanism. Consequently, the analysis of interrelationship between the negotiation and litigation processes of WTO should be conducted in the context of special characteristics of the WTO dispute settlement mechanism as a nascent independent adjudicative organization.

Figure 1: Relationship between Legal and Political Aspects of the WTO System



At one level there is a simple sequential relationship between legal and political processes. Disputes are about the past: negotiations are about the future. One cannot litigate rules that do not yet exist, or negotiate agreements that are already on the books. But this avoids the reality that existing rules are subject to periodic re-interpretation and re-affirmation and whether the rules are enforced depends on the political calculus of the parties involved. Thus, at any one time the same contentious trade issue is likely to be both a legal question relating to the conformity of a Member's actions with existing rules and a political question discussed as a matter of commercial policy by all of the interested parties. The decision to litigate is itself an inherently political one tempered by the legal merits of the

[1] See Barfield, 2001.

case. The end-point of litigation is not only a legal decision but a political agreement to accept the findings and make the necessary changes. The domestic lawmaker is elected and her constituents may not agree that the Appellate Body of the WTO should have the last word on matters of policy.

The connections between litigation and legislation work in both directions. Rules may have to be clarified by litigation, in so far as it is impossible to write rules in such a way that every actual circumstance is unequivocally categorized as in or out of conformity. In fact, the more detailed the rules, the more difficult it may be to apply to situations that may not have existed at the time the rules were written. Rule-clarification is therefore a dynamic process that is essential to the longevity of the WTO articles. But the act of clarifying agreed rules often reveals the need to fill in the gaps or the "interstices" in the laws. It is of course desirable that the Member states address this need in their negotiations and modify the agreement. However, in absence of that it is often left to the adjudicative process to supplement the body of law with interstitial rule making that is necessary to adjudicate the disputes before it. As such, litigation can in effect be a catalyst for new rules as it clarifies those already in existence. On the other hand, the negotiations that ensue can obviate the need for further litigation by coming to an agreement that does not need to be adjudicated. The acceptance of a negotiated package can signal a political decision not to pursue further litigation, and any subsequent decision to restart the challenge may be interpreted as a political act even if the legal justification is apparent.

More generally, litigation can influence the climate for negotiation. Negotiators may feel themselves to be operating "in the shadow of the law" and this can work either to speed up the negotiating process or to delay it.[2] Similarly, once talks have started, such negotiations can delay the process of litigation. These relationships can be seen at present in the area of agriculture, where important legal decisions have come at a time of intensive negotiations in the WTO Doha Round.

II. TRADE LITIGATION AND AGRICULTURE

Agricultural disputes are conducted and resolved under the same framework as those relating to other goods, services and intellectual property protection. The Dispute Settlement (DS) System of the WTO is a central element in providing security and predictability to the multilateral trading system. By most accounts and most measures, the operation of the dispute settlement system in the WTO has been a success. A recent high-level report concluded that WTO Members appear to find it useful as a tool for enhancing their trade diplomacy and securing solid and reasonably timely responses to practical trade problems.[3] By the end of 2004, Members had brought a total of 324 complaints to the WTO, compared to the less than 300 cases submitted to GATT dispute settlement in 47 years. This suggests that the new system is proving quite useful to Members.[4]

Moreover, developing countries are increasingly utilizing the DS procedure. One observer has divided the first ten years' operation of the WTO dispute settlement system into two parts. The first half of that period — from 1995 through 1999 — was characterized by extensive use of the system by the United States initially, and later by the European Union.[5] In the 2000-2004 period, there was a noticeable drop in the US and EU consultation requests. In contrast, developing countries' use of the system increased dramatically. They seem to have found the DS to be a useful mechanism to deal with a wide range of trade disputes. Developing countries utilize the DS system not only against developed countries' trade remedy measures, but also to contest the WTO conformity on the agricultural policies of the US and the EU. An example of this is the multi-country challenge led by Brazil to the EU sugar program (DS265, 266, and 283), and the Brazilian challenge to US cotton subsidies (DS267), as discussed in more detail below.

[2] See Steinberg, 2002.

[3] See The Sutherland Report, 2004.

[4] See Zimmermann, 2005.

[5] See Davey, 2005.

Undoubtedly, the DS system has made a notable contribution to the "WTO law."[6] Thus far, approximately 88 first-level Panel reports and 58 Appellate Body reports have been adopted. WTO dispute settlement proceedings have produced a significant corpus of legal decisions that help to establish WTO law.[7] It is generally agreed that the strictest type of precedent, as utilized in many common law jurisdictions, is not applicable in international proceedings. However, it is quite clear that some degree of "precedent" motivates the WTO DS processes. Both Panels and the Appellate Body frequently support their decisions by extensive citation and quotation of prior decisions.[8]

Litigation and the Uruguay Round Agreement on Agriculture

The Uruguay Round, by strengthening the legal structure of the multilateral trade system, increased the benefits of litigation. It is no longer possible to block the selection of a dispute panel, the disputes cannot be protracted and panel decisions can no longer be blocked by the unsuccessful parties.[9] The cost of bringing a dispute is still a deterrent, particularly for small countries, but the Dispute Settlement Understanding (DSU) is considered to be an essential part of the credibility of the new WTO.

Agricultural disputes were naturally among those that were referred to the new machinery. The Uruguay Round Agreement on Agriculture (URAA) constituted a negotiated solution to several trade issues in agriculture. The URAA mandated the removal of non-tariff border measures and the binding of most tariffs. It introduced the Special Safeguard for Agriculture (SSG) as a new safeguard mechanism and Tariff-Rate Quotas (TRQs) to maintain access in cases where non-tariff measures were converted to tariffs. It circumscribed the use of export subsidies, and introduced a classification of domestic support instruments that attempted to limit the use of trade-distorting subsidies. The URAA also implemented notification procedures for agricultural policies, as well as improved notification commitments for State Trading activities. But each of these issues left room for interpretation and were grist for the litigation mill.

Consultation is the first step in dispute resolution. Among the Members' consultation requests, there were 55 complaints filed under the URAA. These agricultural disputes have had an important impact on the interpretation and practice of the WTO agreements. Many of these related to the conformity of government actions with the disciplines reflected in the schedules agreed as part of the Uruguay Round outcome. Commitments on subsidy levels are treaty provisions, and the commitments in a Member's Schedule are "an integral part" of the URAA and other WTO agreements (WT/DS265/R, paragraph 7.128). Conformity with scheduled commitments is a necessary but not a sufficient condition for escaping challenge. Panels have made clear that compliance with a Domestic Support commitment in a Member's Schedule does not in itself preempt or exclude the operation of other WTO obligations (WT/DS267/R, paras. 7.1066-7.1067).

It is perhaps surprising that, with all the new rules incorporated in the URAA, not more major agricultural cases have been brought. This is not wholly a reflection of the careful drafting of the agreement and the meticulous compliance with its provisions by all Members. Ambiguities were not entirely absent and even major countries have slipped from grace on occasions. The lack of testing of the new rules may reflect the importance of the schedules in increasing transparency and the usefulness of the Agricultural Committee and its system of notifications. There may also have been a marked reluctance to use Panels to attack government action in agriculture for fear of tit-for-tat action. In addition, the poor record of success in pre-WTO cases involving agriculture may have deterred Members from using the DSU. Under the GATT, few cases had been successful in curbing subsidies. One exception

[6] See Jackson, Davey and Sykes, 2002; p.270.

[7] Some have argued that the WTO DS system has been more an exercise in policy-making than an exercise in even-handed interpretation of the carefully negotiated language of WTO agreements. See John Greenwald, "WTO Dispute Settlement: An Exercise in Trade Law Legislation?" Journal of International Economic Law, Vol. 6 No. 1, Oxford University Press 2003.

[8] See The Sutherland Report, 2004.

[9] A Panel report, as amended by the Appellate Body, can only be rejected by a unanimous decision by the Dispute Settlement Board.

was the oilseed case brought by the US against the EC. Resolution of that case had unlocked the door for the agreement on agriculture in the Uruguay Round.[10] And, until the end of 2003, the Peace Clause had an impact, specifically sheltering subsidies from the impact of the SCM Agreement.[11]

Though few cases challenged key aspects of developed country policies, several involved related issues, such as the use of sanitary and phytosanitary measures (the EC hormones restriction, Australian salmon and the Japanese fruit testing cases, for example). In each of these cases, the Panels found for the plaintiffs[12] and set a strict judicial standard for compliance with the WTO rules (in these cases the Sanitary and Phytosanitary Agreement). This may itself have emboldened Members to initiate actions as they recognized a more assertive judiciary that was seemingly unimpressed with the political implications of their decisions.

The apparent "moratorium" on significant challenges to key agricultural policy provisions changed radically in 2003, with the cotton and sugar cases coming in quick succession. A number of factors seem to have been at work. First, there was no longer any Peace Clause to give shelter, as it expired at the start of 2004. In addition, the trade talks were going relatively slowly, having started in March 2000 and sauntered along missing deadlines and lacking political commitment. Developing countries were also growing in confidence over the use of the WTO DS processes. Furthermore, there was some ground breaking case law in WTO disputes, including most notably the case that directly challenged a Member's domestic policy, that of the objection by New Zealand and the US to Canadian dairy policy. The success of that challenge led directly to the *EU-Sugar* case discussed in detail below.

III. AGRICULTURAL SUBSIDY CASES

Most agricultural cases since the Uruguay Round have been about market access rather than the more sensitive aspects of domestic or export subsidies. This emphasis is changing over time, as subsidy cases become more significant. Table 1 gives a list of 23 cases involving agricultural products that resulted in the establishment of Panels since the start of 2002.[13]

Seven of these involve import measures, another three are disputes over customs classification, and a further five involve anti-dumping or countervailing duty (CVD) actions. In addition, two more are about import licenses and excise duties. Although the cases that actually involve subsidies (domestic and export) are only a small fraction of the total agricultural conflicts, they have the most significance for rule changes through negotiations. Four such subsidy cases are listed in the table, but there are only two distinct cases, *US-Cotton* and *EU-Sugar*, as the challenge to EU sugar policy is listed as three disputes.[14] Nevertheless there is no doubt that these two cases are the most important of the agricultural disputes in the last few years. Together with that of the earlier *Canada-Dairy* case, it is these two disputes that are redefining the concept of a subsidy and the usefulness of the "boxes" of the URAA. A brief account of each of these cases is given below.

[10] See Josling and Tangermann, 2003.

[11] See Steinberg and Josling, 2004.

[12] See Josling, Roberts and Orden, 2004.

[13] There were 83 such Panels altogether, so agricultural products featured in about a quarter. This is well beyond the share of agricultural goods in trade, but reflects the significance of such conflicts in trade relations and the extensive policy involvement in agricultural markets.

[14] Another case, US-FSC/ETI, also considered agricultural subsidies as part of its terms of reference but has less direct implications for agricultural policy.

Table 1: WTO disputes initiated since January 2002 related to agricultural products

WTO number	Plaintiff	Defendant	Product	Issue area
DS 330	EC	Argentina	Olive Oil	CVD
DS 329	Mexico	Panama	Milk Products	Classification
DS 314	EC	Mexico	Olive Oil	CVD
DS 310	Canada	US	Hard Wheat	Anti-dumping
DS 297	Hungary	Croatia	Live Animals	Import measures
DS 295	US	Mexico	Beef, rice	Anti-dumping
DS 290	Australia	EC	Wines	IP (GIs)
DS 289	Poland	Czech Rep	Pigmeat	Additional duty
DS 286	Thailand	EC	Poultry	Classification
DS 284	Nicaragua	Mexico	Black Beans	Import measures
DS 283	Thailand	EC	Sugar	Export subsidies
DS 276	Canada	US	Wheat	Exports, imports
DS 275	US	Venezuela	Agric. products	Import licenses
DS 272	Argentina	Peru	Vegetable oils	Anti-dumping
DS 271	Philippines	Australia	Pineapple	Import measures
DS 270	Philippines	Australia	Fresh fruits and vegetables	Import measures
DS 269	Brazil	EC	Poultry	Classification
DS 267	Brazil	US	Cotton	Subsidies
DS 266	Brazil	EC	Sugar	Export subsidies
DS 265	Australia	EC	Sugar	Export subsidies
DS 263	Argentina	EC	Wine	Import measures
DS 250	Brazil	US	Citrus products	Excise tax
DS 245	US	Japan	Apples	Import measures

Source: WTO website

The Canadian Dairy Case

In the aftermath of the Uruguay Round, the Government of Canada instituted a new policy designed to assist exporters of dairy products (mainly cheese) made with expensive domestic milk. A separate "export" class of milk was defined which could be sold at a price lower than that for domestic use.[15] The architects of the policy no doubt assumed that, as no government funds were involved, such a scheme would not be seen by trading partners as an export subsidy.

[15] Prior to 1995, the Canadian Dairy Commission, the Federal body charged with the management of the dairy market and the co-ordination of the Provincial Milk Marketing Boards through the National Milk Marketing Plan, assisted exports through levies paid by dairy farmers. The new regulation at issue established five Special Milk Classes (Classes 5(a) through 5(e)) for milk and dairy products not exclusively for the domestic market. This Class 5 milk is sold at negotiated prices or set by formula based on US industrial milk. The Special Milk Classes 5(d) and (e) were the focus of the dispute, and covered exports of cheese and dried milk mainly to the US and the UK, as well as surplus milk from the domestic market.

New Zealand, supported by the US, took issue with the policy and, after the requisite consultations, it became the subject of a WTO dispute.[16] The Panel ruled that the program did indeed constitute a subsidy to exports as it resulted from government action even though no funds were involved.[17] The Canadian policy was changed to reduce the role of the government, leaving it up to the private sector to negotiate sales of the milk for processing and sale to export destinations.[18] New Zealand and the US were not convinced that this had solved the problem. The Panel was asked to rule on the new policy, and again found it to be in violation of Canada's export subsidy commitments on the grounds that the price of domestic milk was controlled by the government and that this in itself could be enough to subsidize exports.[19] Importantly, the Appellate Body in ruling on the second case directed the Panel to use the test of whether the cost of the milk to the export processors was less than the cost of production incurred by the farmers. The Panel reconvened and decided that as most farmers produced for both the domestic and the foreign market, they in effect sold the milk surplus to their domestic allotment at a "subsidized" price.

The case was settled when the Canadian provinces abolished their CEM programs. Changes in the Federal programs are ongoing. New Zealand and the US have withdrawn their request for sanctions, and argued that the outcome vindicated the working of the DS machinery. But the significance of the outcome of the challenge by New Zealand and the US to the Canadian dairy policy was soon obvious to export interests in other countries. If selling farm products for exporting (or processing for export) at a price less than the cost of production was indeed regarded as an export subsidy then any situation where high, administered domestic prices coexisted with exports might be shown to be contrary to the WTO — or at least would need to be counted against the export subsidy commitments. Sugar and dairy policies in the EU were obvious targets (see below) but other cases will soon emerge.

In the present context this outcome has another implication. The WTO rules and commitments are based on the notional separation of domestic support from market access and export competition. These aspects are clearly linked economically and politically, but it was assumed that they were at least possible to separate in administrative terms. But if an administered price can grant a subsidy on exports then the link between domestic support and export competition is exposed. In other words, the legal avenue has made obvious what the pillars of the URAA had attempted to conceal: that the root cause of trade problems is high domestic prices set by farm policy and that these have not been effectively reduced by the constraints imposed on the "at the border" instruments or on domestic subsidies.

The US Cotton Case

The case against US cotton subsidies appears also to question the distinction between Amber and Green Boxes.[20] The rulings of the Panel are best summarized by considering the nine elements of the US programs that were the subject of the challenge by Brazil (see Table 2). Five of these elements (direct payments, production flexibility contract payments, market loss assistance payments, counter-

[16] The dispute also included a complaint about the administration of Canadian dairy import regulations, but that raised different issues and will not be discussed here.

[17] The Panel report on the US case is to be found in WTO (1999), Canada — Measures Affecting the Importation of Milk and the Exportation of dairy Products (WT/DS103/R). The parallel New Zealand case has the WTO dispute number DS113.

[18] Canada abolished the Special Milk Class 9(e) and restricted sales under Class 5(d) to conform to its export subsidy commitments. A new milk category of Commercial Export Milk (CEM) was established.

[19] The challenge to Canadian dairy policy was not covered by the Peace Clause as it charged that the export subsidy commitments had been violated.

[20] Brazil requested consultations with the US on September 27, 2002. After three abortive discussions, a Panel was established on May 19, 2003 and issued a report on June 18, 2004. This ruling was appealed by the US, and the Appellate Body issued its report on March 3, 2005. The report as amended was adopted on March 21, 2005.

cyclical payments and marketing loan payments) relate to the major instruments of farm policy adopted for the "program crops" in the Farm Bills that cover the period 1999-2003.[21] Two more are specific to cotton (Step 2 subsidies and cottonseed payments), and the other two are of more general application (crop insurance and export credit guarantees). The Panel ruled basically on two issues: whether these subsidies were allowed or prohibited and whether they caused "serious prejudice" (even if allowed) to Brazil.

Table 2: US Cotton Programs and Main Elements in the Cotton Panel Ruling

Program	Panel Ruling	Remedy
Direct Payments (DP)	Not eligible for green box because of restrictions on use of land Do not cause significant price suppression on world markets	By implication, re-notify domestic support for past years
Production Flexibility Contract payments (PFC)	Not eligible for green box because of restrictions on use of land Do not cause significant price suppression on world markets	By implication, re-notify domestic support for past years
Market Loss Assistance payments (MLA)	Caused significant price suppression on world market	Take steps to remove the adverse effects or withdraw the subsidy
Counter-Cyclical Payments (CCP)	Caused significant price suppression on world market	Take steps to remove the adverse effects or withdraw the subsidy
Marketing Loan payments (ML)	Caused significant price suppression on world market	Take steps to remove the adverse effects or withdraw the subsidy
Step 2 payments	Caused significant price suppression on world market For domestic users, payments were import substitution subsidy For export users, payments were export subsidies not included in US schedule	Take steps to remove the adverse effects or withdraw the subsidy Remove prohibited import substitutions and export subsidies by July 2005
Cottonseed payments	Do not cause significant price suppression on world markets	No action implied
Crop Insurance	Do not cause significant price suppression on world markets	No action implied
Export Credit guarantees	Credit guarantees for cotton (and several other products) were export subsidies and were not included in US schedule. (Rice export subsidy exceeded its scheduled level)	Remove prohibited export subsidies by July 2005

Source: Authors, based on WTO Panel Report

The two subsidies that were not price-related (and which had therefore been notified by the US as being in the Green Box) were found not to be the cause of "price suppression" in world markets. They were, however, found to contain provisions that made them ineligible for the Green Box: specifically the restrictions on the alternative crops that farmers could grow on cotton land. These, the Panel decided, could keep more acres in that crop than would totally "decoupled" payments have done. The three subsidies that were price-related were found to have caused price suppression through their impact on keeping cotton production high in the US at a time of low world prices.[22]

The Panel ruled that the Step 2 subsidies paid to domestic users were prohibited under the Subsidies and Countervailing Measures Agreement (SCM) and the Step 2 subsidies available to export users were prohibited because they were not included in the US schedule of subsidies. Moreover, the Step 2 subsidies also caused significant price suppression in world markets. Cottonseed subsidies and crop insurance payments were deemed not to have caused price suppression, and were not prohibited subsidies.

[21] The two Farm Bills in question are the 1996 FAIR Act and 2002 FSRI Act. Production flexibility contract payments were authorized under the FAIR Act, and marketing loss assistance payments were added as emergency measures in 1998-2001. The FSRI Act replaced these with direct payments and counter-cyclical payments. Marketing loans for cotton have been in place since 1986 and Step 2 subsidies since 1990. The cottonseed payments are emergency payments authorized by the ARP Act in 2000. Crop insurance is authorized by separate legislation, the Federal Crop Insurance Act.

[22] The Panel rejected the US argument that the low world prices were from other causes and that the high US exports were an exception rather than the rule.

The final aspect of the US programs on which the Panel ruled was the set of export credit guarantees that are available to US firms when they sell into overseas markets where credit risks are a factor. The finding in this case was that the export credit guarantees given to cotton producers constituted an export subsidy, and since no such subsidy had been included in the US schedule it was in effect prohibited.[23]

The Panel ruling required the US to end the prohibited subsidies within six months of the adoption of the report or by July 1, 2005 at the latest. This ruling applied to the Step 2 payments, to both domestic and export users, and to the export credit guarantees for cotton. The US decided that it could make these changes in legislation without having to await the next Farm Bill expected in 2007. The Administration urged Congress to scrap the Step 2 payments, and these will cease at the end of the crop year, in August 2006. The US Department of Agriculture (USDA) has also proposed changes to the export credit arrangements by eliminating the one percent cap on the fees that are charged for borrowing through the GSM-102 program, and by terminating the GSM-103 program that provides for longer repayment periods.

More problematic for the US is how to adjust the programs that the Panel found to cause significant price suppression. Withdrawing the marketing loan and counter-cyclical payments would require major changes in the US legislation and could not easily be done outside the context of the next Farm Bill. Taking other steps to remove the adverse impacts on Brazil might seem easier to achieve, but any attempt to restrict US cotton exports could prove difficult. Compensation to Brazil for lost exports would also seem politically implausible, and a deal to boost Brazilian exports of other commodities would be similarly unpopular. So the prospect is for no change in these aspects of US policy at least until the 2007 Farm Bill, at which time the policies may in any case need to be modified as a result of the Doha Round.

An interesting side issue raised by the Panel report is the conclusion that the direct payments and production flexibility contract payments are not eligible for the Green Box. This would seem to indicate that countries might ask the US to resubmit notifications of domestic support for the years in question. This would almost certainly put the US in excess of its Amber Box limits, and raise serious problems with trading partners. Were this to be resolved by litigation (an easier task since no serious prejudice issues would be relevant) then the US would have to make major changes to its farm policy. But again, the chances are that these issues will be resolved in the context of the Doha Round.

The signal importance of the cotton case for WTO jurisprudence is that it clarifies several aspects of the application of WTO rules to agricultural subsidies. The Peace Clause effectively dissuaded Members from challenging agricultural subsidies under the SCM before 2004. Though the Panel ruled that the Peace Clause did not provide shelter for the US subsidies in question, the case is best considered as the first “post-Peace Clause” challenge to farm subsidies. The consistency of agricultural subsidies with the provisions of the SCM is a fertile ground for speculation. But the Panel indicates that, at least in this case, these restrictions are both onerous and comprehensive. Though the ruling on serious prejudice was based on the impact of US subsidies on world cotton prices, the same provision of the SCM also includes the effect of subsidies in impeding exporters in domestic and third country markets as well as the impact on market shares. Moreover, though it was not found germane to this case, the SCM has provisions for cases where the “threat” of serious prejudice exists.

[23] The ruling also declared the export credit guarantees for rice exceeded its allowed export subsidy limit, but did not find fault with other aspects of the program.

The case may or may not usher in a flurry of similar litigation: much depends on the success of the Doha Round in reducing subsidies. But the Panel report certainly gives encouragement to countries that have refrained from making challenges because they felt that Panels would have difficulties in finding evidence of serious prejudice. In markets where there are many factors contributing to the export performance of particular countries, establishing causal relationships is problematic. But the Panel seemed to be unphased by the conflicting opinions of expert witnesses on the magnitude and direction of the impact of US subsidies on world cotton prices. They made their ruling on the basis of a preponderance of evidence from economic studies that production of cotton in the US has a significant impact on the world market price. Though they avoided linking their decision to any particular study, they certainly paid more attention to such evidence than many previous Panels. So the Cotton Panel continues the trend toward rulings based on economic reasoning and quantification as a way of bringing precision to terms such as "substantial" and "significant" that pepper the rules on the trade impacts of subsidies. The cotton case is likely to be cited in many Panel reports in future years.

The EU Sugar Case

The impact of the Canadian dairy case on the approach taken by exporters toward farm policies in other countries can be seen in the challenge brought by Brazil, Australia and Thailand against the EU sugar subsidies.[24] Complaints about EU sugar policy are not new. Australia had challenged the European Community (EC) sugar regime in 1979 in the GATT and Brazil followed in 1980, but these were complicated by the fact that there was an International Sugar Agreement (ISA - to which the EC was not a signatory) that restricted exports. Under such circumstances the Panels were unable to determine the extent of injury that the plaintiffs had suffered and the policies continued unchecked.[25] The US also challenged the CAP sugar policy in the GATT in 1982, but no Panel was established. The EC indicated its willingness to join the ISA, and proceeded in turn to challenge the US sugar regime.

One of the contentions of these sugar exporters in the recent WTO case was that the EU grants *de facto* export subsidies by means of the high price paid for sugar used on the domestic market. The domestic market price is maintained for sugar produced under two quotas (the "A" and "B" quotas): production over those quotas (usually called "C" sugar) cannot be sold on the domestic market and receives no direct subsidy. At issue is whether the C sugar benefits indirectly as farmers can cover their fixed costs from returns from the high-price quotas. The analogy with the exported milk products from Canada is close if not exact. The complainants maintain that if such subsides were included, the EU would be in breach of its export subsidy commitments under the URAA.

A second contention was that the EU exports the equivalent of the 1.4 million tons of sugar that is imported under preferential agreements enshrined in the Cotonou Agreement with former colonies. This sugar is sold to the EU at the internal price but re-exported at the world price. This was not notified as a part of the EU's schedule of exports that benefit from subsidies: it was explicitly excluded in a footnote.

The Panel found, and the Appellate Body agreed, that the EU was in breach in both respects. The exports of C sugar did benefit from the high price of A and B quotas awarded to the same farms. As the C sugar was solely destined for exports, the effect was to cross-subsidize.[26] By implication, if C sugar were sold on the internal market to any extent, the argument would have required a further stage of showing that the exports were harming other exporters. But as the implicit financial benefits to producers of C sugar were not notified as export subsidies, they were *de facto* prohibited regardless of their market impact. Similarly, the Panel found that the re-export of the ACP (and Indian) sugar was prohibited, as it did not appear in the EU schedule.

[24] The Australian and Brazilian challenges were initiated in September 2002 and Thailand joined the complaint in March 2003. The dispute numbers are DS265, DS266 and DS283, respectively. The Panel report was presented on October 15, 2004 and was appealed. The Appellate Body gave their opinion on April 28, 2005 and the DSB accepted the report as modified.

[25] See Tangermann and Josling, 2003.

[26] Investigations of subsidies in non-agricultural markets often explore the possibility of cross-subsidization within firms. The economics of cross-subsidization is not as well accepted as the accounting conventions.

Thus, the *EU-Sugar* case differs from that of *US-Cotton* in that is centers primarily on the notification of export subsidies. The fact that these notifications were not challenged at the time raises questions about how the activities of the Agriculture Committee might be linked more usefully to the issue of the nature of these policies.

The sugar case is complicated by an additional element. If the EU cannot either re-export the ACP imports or sell C sugar on the world market, then the domestic price has to be reduced and/or the quotas have to be reduced. The EU Commission realized this link with reform of the EU sugar regime, and used the argument effectively to persuade Member states of the need for policy change. The political decision was made by the EU's Council of Ministers on November 22, 2005, to undertake a reform that cut the sugar price support level by 36 percent and compensated farmers with "decoupled" payments. Though the support price will stay significantly above the world price level, the incentive to produce for export (over and above the quota volume) will be significantly reduced. If the output falls as expected, the EU will come into compliance with the Panel ruling: cross subsidized production will not find its way into export markets, and the ACP sugar will be absorbed largely in the domestic market.

Suppliers of raw sugar to the EU have also been promised compensation. Under the Cotonou Agreement these suppliers benefit from guaranteed access at internal prices, and so will lose from the reduction in price levels. Though this preferential access is already under threat from the opening up of tariff and quota free access to the least developed countries under the "Everything but Arms" agreement of the EU, it remains of economic and political importance to a number of countries. On the one hand, they will also benefit from reductions in the sales of C sugar on world markets. The link with the trade negotiations is thus more complex than just the connection with the reform of the EC sugar regime.

IV. ALTERNATIVE CATEGORIES OF AGRICULTURAL SUBSIDIES

The cases discussed above center on the definition of a subsidy to agricultural producers. This section will discuss the emerging case law on the definition of subsidies as applied to agriculture and of the way in which the definitions of the WTO SCM differ from those of the URAA. This includes the problems of identifying subsidies and measuring their effects on other countries, and the implications on the WTO Doha Development Agenda agricultural negotiation and domestic policy.

Two Subsidy Disciplines: URAA and SCM

The distinction between the political decision in the URAA to classify subsidies on the basis of whether they were considered to be trade distorting (and therefore need to be reduced) on the one hand, and the political decision in the SCM to distinguish among prohibited and allowed subsidies on the other, is at the heart of the problem. Subsidies can be notified to the Agriculture Committee as Green Box policies by the country concerned and not be challenged. But a policy could still be actionable even if allowable, and could be found to cause serious prejudice.[27] Moreover, the treatment of agricultural subsidies in the URAA was premised on a firm distinction between domestic support and export subsidies, but both were legal if within the scheduled commitments. The *Canada-Dairy* case cast doubt on the validity of that distinction when applying WTO rules: domestic programs can have the effect of providing an export subsidy. The *EU-Sugar* case rested on the same premise, and the result

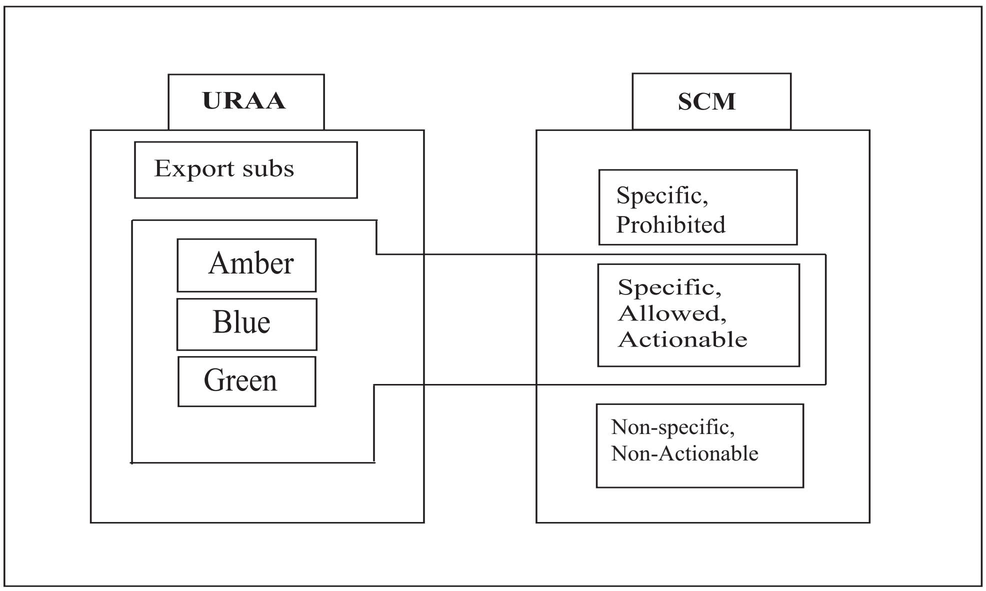
[27] A Panel could also later (as happened in the US cotton case) find that the policies in question did not fit under the definition of the Green Box, and thus were incorrectly notified. But this would only be a violation if it caused that country to exceed its scheduled subsidy commitments.

was similar. The SCM includes export subsidies as one of two types of prohibited subsidies (see Figure 2).

Thus any such subsidy is actionable since the expiry of the Peace Clause and the challenge does not have to show impacts on other countries. So a policy deemed under the URAA to be an aspect of domestic support can be declared by a Panel to be an export subsidy when viewed through the lens of the SCM.

The classification of policy instruments into export subsidies and domestic support is crucial if not central to the current round of negotiations. Export subsidies are expected to be phased out and domestic support payments are to be reduced. But at present, countries do not know what subsidies are likely to pass the test if examined by a Panel.

Figure 2: Relationship between Subsidy Categories in URAA and SCM



What does this imply for further negotiation on disciplines on the Boxes? Why negotiate separate restraints if they are to be ignored by Panels? These are the challenges that the cotton and sugar cases have raised. The SCM Agreement gives a legal definition of the term “subsidy”. According to that Agreement, a subsidy must have three basic elements:[28]

- it must be a financial contribution,
- it must be made by a government or any public body within the territory of a Member, and
- it must confer a benefit.

However, even if a measure is a subsidy under the definition of the SCM Agreement, it is not subject to the disciplines of the SCM Agreement unless the concerned subsidy is a specific subsidy.[29] Specific subsidies are divided into two categories: those that are prohibited and those that are allowed. Two types of subsidies are prohibited: export incentive subsidies that are contingent on export performance, and local content subsidies granted for use of domestic inputs over imported goods. The WTO SCM Agreement gives a clear process to identify actionable subsidies. All specific subsidies are actionable

[28] Agreement on Subsidies and Countervailing Measures, Article 1.

[29] Agreement on Subsidies and Countervailing Measures, Article 2.

under the SCM agreement. But the SCM agreement deals differently with prohibited subsidies and other actionable subsidies, depending upon the trade distorting nature of specific subsidies. For non-prohibited actionable subsidies, a Member can initiate remedial measures only if it can prove there is a serious prejudice to its interests. Serious prejudice may arise in any case where one or several of the following apply: displacing domestic imports; displacing exports to the third country; significant price undercutting; and increase in the world market share.[30]

The URAA, on the other hand permits domestic subsidies and (existing) export subsidies. However, Members undertake not to provide export subsidies except as specified in that Member's schedule, and gradually to reduce overall levels of domestic support, referred to as the Aggregate Measure of Support (AMS).

Subsidies that fall within the scope of the URAA include:

- Export subsidies permissible only for (a) products listed in a Member's Schedule; and (b) amounts (both in terms of quantity and budgetary outlay) not exceeding the maximum set out in the Schedule (WT/DS265/R, paras. 7.106-7.166).
- Export subsidies alleged to exceed Member's Commitments. (a) Complainant must establish that respondent exported quantities exceeding its commitment level; then (b) Respondent must establish that it did not grant export subsidies with respect to those quantities (paras. 7.17-7.37, and 7.271-7.273).
- Payments financed by virtue of government action. (a) These need not be contingent on exportation; focus is whether it is made on an export sale (paras. 7.271-7.279). (b) There must be "a demonstrative link" between the payment and government action (paras. 7.280-7.292).

Subsidies that fall within the scope of the SCM Agreement include:

- Export subsidies. (a) Export contingency need not be the sole condition; (b) export contingency under one set of circumstances sufficient; not vitiated by fact that other payments under a program are not conditioned upon exportation (paras. 7.699-7.741).
- Export Credit Programs. (a) No particular methodological approach required to assess whether premiums charged are inadequate to cover long-term operating costs and losses; (b) Not required to use the regulatory or accounting characterization of the Member (paras. 7.800-7.869).
- Subsidies that cause serious prejudice to another WTO Member. (a) This includes "threat" of serious prejudice (para. 7.191); (b) Focus is on the effects of a subsidy, not the nature of the subsidy itself (para. 7.1227); (c) Market analyzed can be the world market (paras. 7.1238-7.1240); (d) There must be causal link between the subsidy and the factor evidencing serious prejudice (paras. 7.1341-7.1344); (e) Precise quantification of effects not required (paras. 7.1167-7.1179).
- Subsidies that are specific to a particular firm or industry. Specificity can only be assessed on a case-by-case basis (para. 7.1142).

Several aspects of the treatment of agricultural subsidies pose questions that will have implications for current and future rounds of trade negotiations. Among the most fundamental question is how to treat agricultural subsidies and industrial subsidies more equally.

Whereas industrial subsidies have been put under considerable discipline in the WTO, the rules are much more lenient towards agricultural subsidies. The developed countries retain high level of domestic supports and export subsidies for their agriculture, but use countervailing measures for non-agricultural

[30] Agreement on Subsidies and Countervailing Measures, Article 6:3.

goods against developing countries. Many scholars view this asymmetry as a fundamental problem with the prevalent multilateral trading system.[31] In order to have a really successful Doha Development Agenda, the developed countries will need to take concrete measures to rectify the fundamental difference in WTO disciplines on agricultural and industrial subsidies.

V. AGRICULTURAL PRICE BANDS AND SAFEGUARDS

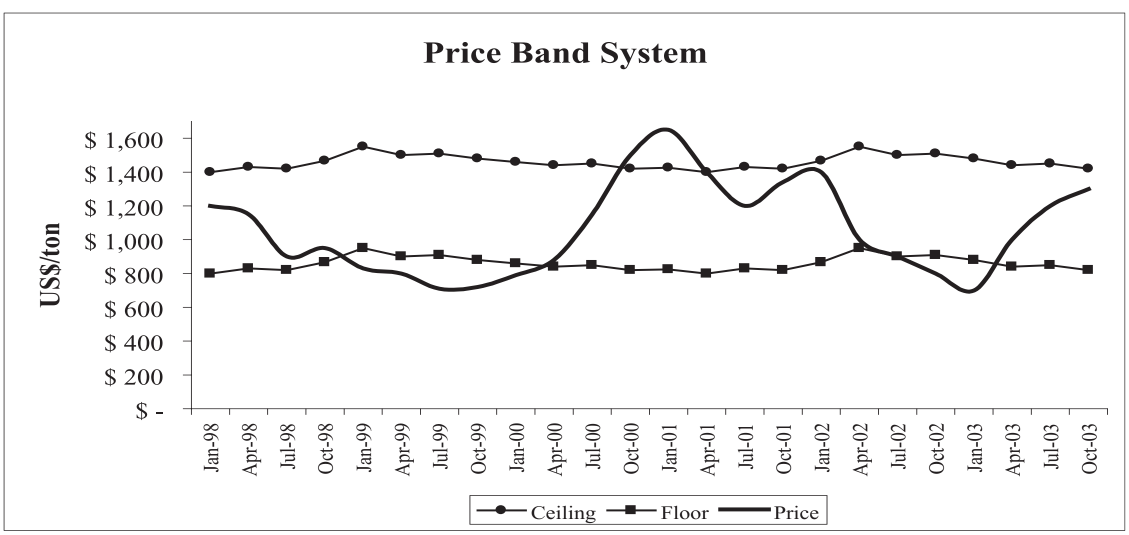
Importing countries have often sought ways of shielding domestic producers and consumers from price instability in world markets. Some countries, mainly in Central and South America, have adopted a Price Band System (PBS) with the purpose of stabilizing domestic prices and isolating their internal markets from international prices and seasonal pattern. A PBS "implies an organized effort to regulate a market so prices remain within a specified range"[32] by setting a minimum level (the floor) and a maximum level (the ceiling) between which the acquisition cost of imported products lies. The main elements defining a "price band" are (i) a product subject to be affected by the international prices; (ii) a policy that seeks to protect it; and (iii) a variable tariff imposed through a price band system.

As a trade policy instrument, price bands are a form of variable tariff.[33] At its simplest, a price band establishes the threshold floor and the threshold ceiling where the import price must be kept in order to isolate domestic producers from external or seasonal factors that may produce distortions in the domestic markets (the center zone). The application of the PBS's tariffs will change depending on the international price for the trading products:

- when the international price is in the center zone, the specific tariff is zero and only the *ad valorem* tariff is imposed;
- when the international price exceeds the threshold ceiling, the PBS reduces the *ad valorem* tariff and offsets the international price increase, keeping the import tariff constant at the ceiling price; and
- when the international price falls below the floor price, the specific tariff is increased to offset the decline, keeping the import tariff constant at the floor price.

The basic operation of a PBS is shown in Figure 3:

Figure 3: Illustration of the Price Band System



[31] See Pal and Das Gupta, 2005.

[32] See Skully, 2001

[33] Ibid.

This measure contains some elements that were challenged before the WTO dispute settlement system in the case *Chile — Price Band System and Safeguard Measures Relating to Certain Agricultural Products,*[34] ("*Chile — Price Band System*"). In that case Argentina raised some concerns about the PBS and other measures applied by Chile and their eventual inconsistency with the URAA. On the other hand, Chile claimed that its PBS is *not* a measure of the kind which has been required to be converted, but is rather a "system for determining the level of ordinary customs duties that will be applied between zero and the bound rate."[35]

In the *Chile — Price Band System* case*,* the Appellate Body concluded that the Chilean PBS does not comply with the URAA because it is a border measure "similar" to

- variable import levies and
- minimum import prices

and consequently it falls into the list of prohibited measures in footnote 1 of the Article 4.2 of the URAA. Moreover, the Appellate Body considered that Chile's PBS lacks transparency and predictability and impedes the transmission of international prices to the domestic market. The Appellate Body cautioned that its decision only applied to Chile's PBS and that it did not refer to any "other measure of any other WTO Member" or to the "price band systems in general, or the consistency with WTO obligations of any specific price band system that may be applied by any other Member."[36] Notwithstanding this caution, the consistency of the opinions rendered by scholars about the WTO jurisprudence allows the conclusion that the legal and economic analysis made by the Appellate Body in the *Chile — Price Band System* case would be applied to other price band or other similar systems.[37]

Therefore, it can be concluded that the decision issued by the Appellate Body condemns *per se* any PBS and other systems that also contain the core elements of Chile's PBS:

- **Objectives**: Isolation of the domestic prices from certain fluctuations of international prices,
- **Factors**: The existence of a "center zone" whose limits are the upper (ceiling) and lower (floor) thresholds for the tariff charged for the product,
- **Prices**: Comparison with a reference price or connected product price,
- **Implementation**: The PBS are established for long term periods (i.e. annually) on the basis of monthly average international prices recorded in the most relevant markets during a certain period of time, then it is adjusted according other criteria (i.e. inflation, insurance, transportation costs), and
- **Effects**: Insulation from external markets impeding the transmission of international prices into domestic markets and that the imports are not permitted entry at a price below the lower band.

Considering the uncertain nature of the PBS, it is unlikely that a PBS, or any other system that applies variable tariffs, may pass the test constructed by the Appellate Body in the *Chile — Price Band System* case. However, from a legal point of view, a Member can change its tariffs periodically without breaching WTO obligations provided that the tariff applied never goes beyond the bound tariff submitted in WTO Schedules. For instance, a Member could notify every Friday a new applied tariff for a product for the following week (without exceeding the bound tariff). This would be a *de facto* PBS that maybe would not breach the Member's commitments but may affect its credibility.

[34] Appellate Body Report, *Chile — Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted on October 23, 2002.

[35] Ibid. para. 215.

[36] Ibid. para. 203.

[37] See Jackson,1989; Croley and Jackson, 1996; Jackson, 2002; Palmeter and Mavroidis, 2004.

A possible solution to these measures established in domestic legislations - but breaching the WTO legal framework - is the temporary application of a special safeguard as set forth in the URAA (Article 5). Special safeguards operate as “an additional duty on top of applied tariffs in cases of import volume surges or import price falls”[38] and “can be activated by a volume-based trigger or a price-based trigger, but not both concurrently.”[39]

Members that have subjected their products to tariffication under the Uruguay Round and have also indicated in their Schedule that they are eligible for the application of a special safeguard may carry it out

- when the volume of imports of some agricultural product during any year exceeds a trigger level that shall be set according to the schedule based on market access opportunities during the three preceding years for which data are available, and
- when the price at which imports of some agricultural product, as determined on the basis of the c.i.f. import price[40] of the shipment concerned expressed in terms of its domestic currency, falls below a trigger price equal to the average 1986 to 1988 reference price for the product concerned.

Like a PBS, the special safeguard clause for agriculture works based on a “reference price”. Regarding the special safeguard based on the volume of imports, it is applied once the imports of a product entering the customs territory of a Member exceeds a trigger level which relates to the existing market access opportunity. The trigger level varies from 105 to 125 percent based on market access opportunities defined as imports as a percentage of the corresponding domestic consumption during the three preceding years for which data are available.

On the other hand, the special safeguard based on the price at which imports of a product may enter the customs territory of the Member are based on the c.i.f. import price of the shipment concerned expressed in terms of its domestic currency, when it falls below a trigger price equal to the average 1986 to 1988 reference price for the product concerned. The additional duty varies from 0 to 75 percent as determined by the difference between the c.i.f. import price of the shipment expressed in terms of the domestic currency and the trigger price.

If any Member wants to implement a special safeguard, it notifies the Committee on Agriculture and carries this out in a transparent manner. For perishable and seasonal products, the special safeguards is applied in such a manner as to take account of the specific characteristics of such products. But the special safeguard is only available to countries that underwent tariffication at the time of the Uruguay Round. Most developing countries did not do so at that time: they either had tariffs already (often as part of tariff reforms in the 1980s) or opted for ceiling bindings (usually at a higher level that were actually applied). As a result, the existing special safeguard is not widely used in developing countries.

In conclusion, the special safeguard clause for agriculture “has proved a useful instrument both to avoid disruption of domestic markets in those countries, as well as to address genuine import concerns”[41], but has only been available to developed countries. The issue under discussion in the current negotiations is whether it is an acceptable way to replace measures such as PBS and other variable tariffs for developing countries.

[38] Agriculture: Process of Analysis and Information Exchange. Informal Paper: AIE/20. “Article 5: Special Safeguard Provision”. Paper from New Zealand on March 5, 1998.

[39] Ibid.

[40] The Appellate Body has noted that the term “c.i.f. import price” is not defined in the *Agreement on Agriculture*, however, in international usage in international trade the term “c.i.f. import price” as “cost, insurance, and freight.” EC — Poultry, paras. 143-5.

[41] Agriculture: Process of Analysis and Information Exchange. Informal Paper: AIE/52. “Article 5: Special Safeguard Clause for Agriculture”. Paper from the European Community on March 10, 1999.

VI. CONCLUSION: RECONCILING LITIGATION WITH NEGOTIATION

In the light of the significance of the recent cases related to agricultural subsidies and the sensitivity of these issue in the Doha Round, one might conclude that litigation and negotiation are in conflict. The agricultural talks are contentious enough without having to dovetail in with the process of modifying policies to comply with Panel rulings. But the unusual confluence of these two aspects of the WTO presents some opportunities as well as potential hazards.

Litigation in the area of agricultural subsidies and trade policies is helping the ongoing process of policy and trade reform. It is steering countries toward less trade-distorting policies and instruments, though the Panels may often be somewhat unpredictable and erratic in reinforcing the message of reform. Usually, modifying policies to accord with Panel rulings is in the direction of reducing trade distortions. In other words, negotiations and litigation are complementary rather than alternative ways moving towards the objectives of a more open and more functional trade system for agricultural products.

The impact of the cotton case on the current Doha Round negotiations shows this complementarity. At first, many in the US (and in Europe) saw the act of bringing the case as an unhelpful complication to the negotiation process. It engendered some of the same frustration that the two traditional agricultural superpowers felt when their joint paper of August 13, 2003 was countered by the formation of the G-20 to promote a more aggressive approach to reducing agricultural subsidies. The ability of the transatlantic partners to determine how far and fast to move on agriculture was being challenged by countries whose economic potential was becoming realized. Bargaining "in the shadow of the law" is not comfortable for politicians, who see their room for compromise constrained by legal interpretations of political negotiations. But in this instance the cotton case gave additional motivation for completing the Round. Politicians in developed countries have taken the prospect of a flurry of similar challenges through the WTO on established farm policies seriously. Changes to domestic policy are painful whether as a result of negotiations or litigation. But with litigation forcing the pace of change, the advantages of anticipating future cases by negotiating subsidy and tariff reductions are increased.

The same synergy is apparent in the case of the EU sugar policy. What at first seemed to be a bold challenge to an established part of the CAP by a group of low-cost exporters became the excuse for drawing the errant sugar regime into the fold of the new, more trade-friendly, CAP. The EU has a stronger bargaining position in the Doha Round as a result, and can gain from bringing its sugar policy into line with WTO rules.

Leaving aside the impact on the motivations and attitudes of negotiating partners, a good case can be made that the Doha Round is the appropriate venue for clarifying many of the issues raised by the cotton ruling. The question of whether restrictions on planting alternative crops (and the issue of whether changing the historical base on which decoupled payments are made invalidates such payments) are natural topics for resolution within the framework of the agricultural talks.[42] The export subsidy component of export credit guarantees is already due to be eliminated, along with other such export incentives, as a part of the agricultural agreement. Changes to the US export credit guarantee programs to conform to the Panel ruling could be coordinated with a schedule for export subsidy elimination.

Moreover, there is a congruity between the recommendations of the Cotton Panel and the pressure on cotton policy arising from the action of four African cotton exporters. This pressure resulted in a separate subcommittee of the Agriculture Committee being set up to ensure that significant reductions were agreed in the level of cotton subsidies in the US and the EU. The prospect of a deep cut in Amber Box payments would therefore be consistent with the resolution of the cotton case to the satisfaction of Brazil as well as being a contribution to the solution of the problems faced by the

[42] The July Framework Agreement includes a commitment to discuss the definition of Green Box subsidies, but such a discussion has not yet yielded any results.

Cotton Sub-Committee in ensuring that African cotton producing countries are satisfied. A significant reduction in the subsidies enjoyed by US cotton farmers, while politically difficult, is more likely as a result of this combination of events than from either litigation or negotiation alone.

The merging of the resolution of the cotton case and the outcome of the Round is not, however, likely to be without controversy. Brazil will argue that it should not spend at the bargaining table what it won in the Panel ruling. The Round has to offer more disciplines on subsidies than the cotton case imposes, not less. And Brazil can argue that it has already paid (in the Uruguay Round) for the benefits that the Panel ruling will give to its exporters. But such arguments neglect the political factors involved in a negotiation. One has to ask the question as to whether the Panel (and possibly other Panels reporting on agricultural subsidy issues) is disturbing the delicate balance of advantages that conclude negotiations by interpreting the WTO agreements in ways that the negotiators did not intend or understand. For instance, the producers of fruits and vegetables in the US can reasonably claim that no one considered that the restrictions on land use in program crop legislation had been bargained away as part of the Agreement on Agriculture. So there is a plausible argument that the Panel ruling needs to be factored into the current talks in order to maintain the political balance of advantages. But the Panel has certainly given some encouragement to those who seek to reduce developed country subsidies, and this may in the end be the dominant impact of the case.

It is also possible that litigation has improved the process of rule-making. It is certainly true that precise language may be difficult to agree on in a political negotiation, where a degree of ambiguity is desirable. But the confusion that has been generated by the agricultural subsidy cases suggests that the wording of the URAA was not adequate to give a clear direction as to what policies were or were not WTO-consistent. And the different classification employed in the SCA compounds the confusion. The problem is probably insoluble: the degree to which a particular subsidy causes serious prejudice is essentially a market phenomenon and not one that can be defined by the nature of the policy. So criteria that may seem to divide subsidies into those that distort trade and those that don’t may not be relevant in the essentially empirical question of whether the subsidy hurts farmers in another country.

Nor has the spate of litigation on agricultural issues led as yet to any negative impacts for the political support for the WTO. At present the subsidy cases have been accepted with a degree of equanimity in the US and the EU. Unlike the beef-hormone case, or the reaction that could follow a decision on GMOs, cotton and sugar subsidies are essentially minority programs held in place by strong political vested interest. There is little evidence of significant concerns by the farm sectors as a whole in the US and the EU over the negative ruling on support to these privileged sectors. This could change, however, in particular with cases involving corn or rice, where more farmers are involved. But at present the credibility of the WTO dispute settlement system seems largely intact.

The current movement toward further agricultural policy and trade reform is following two tracks. Litigation is clarifying some issues (such as what constitutes a subsidy) but it is not equipped to specify in detail what instruments are likely to prove best in a domestic setting.[43] On the other hand, negotiation seeking to revise rules and reduce protection cannot perform the task of ensuring that one country’s policies do not harm the interests of another. Though excessive litigation may weaken the trade system, current cases seem to have spurred the process of reform and given notice that actionability of subsidies under the WTO rules is the ultimate deterrent against trade distorting policies.

In the end, there will be a need to combine the two tracks. This would suggest that a resolution to the subsidy cases be folded in with the endgame of the Doha Round. In such a deal, the cotton, sugar,

[43] It is sometimes suggested that the WTO Panel should decline to resolve cases because lack of precise language in the negotiated agreement and rules. But as a nascent independent international dispute resolution body the WTO dispute settlement mechanism derives its credibility from adjudicating disputes brought before it and not from abstaining to do so.

and price-band issues would be resolved as part of the package with market access, domestic support and export competition. Certain actions could help to bring about such a cooperative solution. Countries should avoid bringing “nuisance” cases or those that are designed to pre-empt negotiations. They should also be sensitive to “unexpected” Panel result that clearly disturbs the balance of obligations and benefits in negotiated agreements. There should be the opportunity for negotiations subsequent to the Panel ruling to rebalance these obligations. Moreover, countries should be willing to suspend cases during negotiations if the issues concerned are being discussed in that context.

Perhaps the greatest need at the moment to prevent conflict between the legislative and the judicial functions of the WTO is to clarify the relationship between the URAA and the SCM. Countries should agree on the significance of notification under the URAA and whether it should have any bearing on actionability under the SCA. The notification process can be integrated with the categories of subsidies used in the SCM, so as to simplify the potential avenues of litigation on the acceptability of subsidies, for instance by forgoing the right to challenge measures that have been accepted as green. Some improvements in the monitoring process itself could help, even if not connected with the litigation. The Agricultural Committee could monitor more closely the notifications as to how they are classifying domestic support, as well as applying the decisions of the Panels to help countries avoid problems down the road. Notifications should be up-to-date and advance notification of significant changes in policy should be made. In addition steps to encourage mediated settlement to a trade dispute before a Panel is formed could be further bolstered.

The resort to the legal process of the WTO has attractions, particularly for farm commodity exporters who feel frustrated by the ability of importers to stall and resist trade reform. So far, this effort to test the WTO compliance of US and EU policies has been remarkably successful, both in terms of Panel reports that have not shied away from clear decisions. The lesson that other countries have learned is that a sound case can have results that would not seem possible from negotiations alone. But reliance on the dispute settlement process for forcing policy change in developed country policy carries with it dangers, as it pits the legal remedies in the WTO against the political process of negotiating domestic farm policy. This could seriously compromise the political acceptance of the multilateral trade rules and institutions that are currently in place. In other words, even if it may be useful to expose domestic support to the rigors of judicial decision, it may first be necessary for the politicians to accept the need for more restrictive trade rules. That is what needs to emerge from the Doha Round. If that political acceptance is missing then the attempts to restrict domestic farm policy by enforcing WTO trade rules will lead to continued conflict and ultimately failure. The issue of the trade impact of developed country subsides may create as many headaches for the judicial as for the political processes of the WTO.

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The International Food and Agricultural Trade Policy Council (IPC) convenes high-ranking government officials, farm leaders, agribusiness executives and agricultural trade experts from around the world and throughout the food chain to build consensus on practical solutions to food and agricultural trade problems.

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