THE EVILS OF A LONG PEACE:

LEGAL CONSEQUENCES OF WTO "PEACE CLAUSE" EXPIRY AND PRACTICAL ISSUES FOR NEW LITIGATION OVER FARM SUBSIDIES

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The WTO's "Peace Clause," *Agreement on Agriculture* Article 13, during its effective period has prevented most types of legal challenges to most agricultural subsidies. It was devised in part to provide shelter for developed countries migrating their farm supports from more to less explicitly trade-distorting forms, and it has succeeded in that shielding function. It was also designed to provide, by expiring in 2003 after nine years, an action-forcing event and some momentum for further farm subsidy negotiations.[2] It is less clear, given what has happened so far in the post Uruguay Round agriculture talks, whether the Peace Clause has succeeded in that second respect.

In any event, its effective period is now basically over. Absent extension (entailing significant new progress in the stalled Doha Development Agenda or "DDA" talks), WTO Members with the most substantial agricultural support measures, including mega-members the EU and the United States, could face formal complaints about a wide range of export and (especially) domestic subsidies. This paper briefly summarizes the legal consequences of Article 13's expiry, identifies some practical issues for post-expiry litigation over farm subsidies, and then considers some key inconsistencies that will have to be resolved if indeed the WTO's farm support regime and its general (industrial) subsidy regime are to be merged into a unitary subsidy discipline system based on the *Agreement on Subsidies and Countervailing Measures* ("ASCM").

Although most discussions of the Peace Clause quickly become debates over what new promises the major developed WTO Members should make in the current agriculture negotiations, the main focus here is on what they have already promised. Specifically, and in addition to whatever quantitative limitations they may have scheduled for farm supports, they have agreed *not* to cause "injury," "serious prejudice," or "nullification or impairment" with their farm subsidies. The complaints which the Peace Clause has held at bay for nine years are complaints seeking to enforce that promise.

I. Legal Consequences of Expiry

Neither the Peace Clause nor its expiry affects the "legality" of farm subsidies. It is, rather, a "do not sue" provision. With expiration, suits can be filed according to the scheme in the attached diagram. Both export subsidies and domestic subsidies will be:

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1 Juvenal, *Satires*, VI, l. 292 (A.D. c. 55-130) ("We are now suffering the evils of a long peace.") (translated from Latin by G.G. Ramsay, Loeb Classical Library).

2 USTR Charlene Barshefsky in 2000 cited "the expiration of the agricultural 'peace clause' in 2003" as one of the factors that would "move the negotiations forward." Testimony before House Committee on Ways and Means, Subcommittee on Trade (Feb. 8, 2000), *available at* <http://www.ustr.gov/speech-test/barshefsky/barshefsky_t33.pdf>.

- "prohibited" -- challengeable without any showing of adverse trade effects -- to the extent they exceed any numerical commitments scheduled by the bestowing Member;[3] and

- actionable even within those limitations, to the extent that a complainant can demonstrate adverse trade effects in one of the forms set out in ASCM Part III (injury to an importing Member's domestic industry, serious prejudice to a Member's trade interests, or nullification/impairment of tariff concessions).

It will also be possible to include all export and domestic subsidies in countervailing duty investigations carried out under the national laws of importing countries.

While it is clear enough that the obligation to exercise "due restraint" will no longer prevent the filing of complaints, it is less clear what a complainant will actually have to show in order to prevail. Cases challenging "prohibited" subsidies, for which some precedents do exist, are likely to be rare since they depend on subsidization exceeding scheduled numerical limits (which could only happen intentionally). Cases challenging "actionable" subsidies are, for various reasons,[4] likely to fall mainly under ASCM Article 5(c) which allows for action based on "serious prejudice to the interests of another Member." Article 6.3 sets out criteria for showing serious prejudice based on lost exports, significant price undercutting, or an increase in the world market share of the subsidizing Member in a "particular subsidized primary product or commodity." Beyond that level of generality, however, it is not clear yet – although the *United States - Upland Cotton* case filed by Brazil bears watching -- what sorts of evidence will suffice to show that actionable subsidies are "causing" serious prejudice.

II. Practical Issues in New Farm Subsidy Litigation

Beyond the technical legal consequences, there are several practical issues that potential complainants and defendants will need to take into account. From the standpoint of a potential complainant, key concerns might include the following.

Fear of derailing DDA agriculture talks. Some officials and observers have expressed the view that litigating might be inconsistent with negotiating, and that the governments of export-oriented (mainly Cairns Group) countries have to choose between the two. Incumbent officials of the most likely defendants (EU and United States) have quite understandably done what they can to promote this view – suggesting that frustrated exporters hoping for a more forthcoming EU/U.S. approach in the DDA agriculture talks will harm their cause if they open a second front by litigating. I hold the opposite view -- that adverse litigation outcomes (or the imminent and very credible threat thereof) will

[3] Scheduled numerical limits are more significant for export than for domestic subsidies. The affected domestic subsidies are those classified in the "amber" and "blue" boxes (aid linked to output levels, and to output limitations, respectively).

[4] Among other things, a situation involving "injury" to an importing country's domestic industry is more likely to trigger a CVD case than a WTO case, while the non-violation nullification/impairment remedy is an "exceptional" one and notoriously difficult to utilize.

give the main farm subsidizers an additional reason to *make*, rather than a reason to withhold, negotiated concessions. In this view, litigating (where the facts warrant, of course) and negotiating are *complementary* means of motivating the reduction of particular trade-distorting subsidies, whereas failing to demonstrate a clear willingness to invoke dispute settlement may actually be the best way to keep the negotiations stalled. And of course, initiating a case does not necessarily mean pursuing it all the way through to judgment; merely waving around a ready-to-file complaint, or holding consultations under the DSU, may be sufficient to concentrate the minds of potential defendants.

Fear of retaliation. A related concern involves a broader hesitation to launch WTO cases against mega-Members who have many means available -- at least in principle -- to respond unpleasantly, both within and outside the DDA context and even outside the realm of trade relations altogether. The likelihood of such an "allergic reaction," however, should not be exaggerated as it would represent a fairly sharp departure from past practice. The U.S. Government has been especially tolerant of frequent WTO suits being brought against it. The broader and well-documented EU-US competition to curry favor with developing countries also greatly limits the likelihood of retaliation involving foreign aid flows and other potential points of leverage.

Cost and complexity. Some developing countries might not possess the in-house expertise to prepare and launch a major WTO subsidy case, and might at the same time be deterred by cost concerns from hiring private counsel. High-quality legal and economic representation in a complex dispute over subsidies and their trade effects is undeniably expensive. Yet, a careful cost-benefit review, taking into account the probability of success and likely commercial upside of various potential WTO claims, will almost certainly turn up some solid candidates. After all, the EU and United States alone are responsible for tens of billions of dollars annually in farm subsidies -- subsidies that exceed the GDPs of some developing countries and often exceed the value of a potential complainant's production of the like product. In addition, as noted above, preliminary "studies" and the like can be used to obtain significant policy/political benefits at a very moderate cost.

Effectiveness of remedy. Another concern for some WTO Members is uncertainty about their ability to secure an effective remedy even after winning a dispute settlement case. When contemplating litigation against major players like the United States and the EU, this is no minor matter. In the not-implausible scenario where neither compliance (likely in this area to entail legislative action) nor acceptable compensation can be obtained after a litigation "win," it may be difficult for a small and/or developing country to motivate change by suspending its own trade concessions on farm imports. This problem may, however, be solvable with some creative thinking. For example, DSU Article 22.3 allows retaliation in other goods sectors, or even suspension of concessions "under another covered agreement," where same-sector retaliation would not be "practicable or effective." In *EC-Bananas*, Ecuador was authorized to suspend obligations it had incurred under the *TRIPs Agreement*. This sort of approach is also worth considering for post-Peace Clause disputes, as holds the promise of being effective, on the one hand, while avoiding massive self-inflicted damage, on the other.

Demonstrating serious prejudice. A final practical concern is the potential difficulty in demonstrating, to the satisfaction of a panel sitting in Geneva, not only that conditions exist in the marketplace which amount to "serious prejudice," but also that actionable subsidies are *causing* those conditions. Complainants will undoubtedly require the help of skilled economists, as well as "translators" who can make the results of complex regression analyses, partial equilibrium models, and the like comprehensible to various lay audiences.

While daunting, the task of generating and communicating the guts of a serious prejudice claim is by no means an impossible one, and not different in kind from what those of us working on industrial subsidy issues have been doing for many years. The difficulty in farm subsidy cases will vary from sector to sector and also, to some extent, based on the types of subsidies involved. Although there is no question that subsidies currently classified in the agricultural "green" and "blue" boxes have trade effects which it will be possible to document in particular cases,[5] complainants will likely have an easier time challenging subsidies of the type classified in the "amber" box (supports with explicit output effects).

III. A Unified WTO Subsidy Regime?

Turning to the longer term, expiry of the Peace Clause represents a step in the direction of a unified WTO subsidy regime, applicable to all products. To be sure, it may be some time before agricultural trade is subject to all of the same WTO rules applicable to other products. But post-Peace Clause litigation based on Part III of the ASCM will, if it occurs, inevitably drive convergence of the *subsidy* rules. The process will be rocky, however, because there are some sharply differing instincts, preconceptions and assumptions which people from the "ag" and "industrial" worlds bring to bear on the issue of subsidies.

When China was negotiating the terms of its WTO accession, it was fashionable to speculate about "whether the WTO will change China or China will change the WTO." A similar question can be asked here: in the event that agriculture is to become subject to the general WTO subsidy regime (embodied in the ASCM), will the ASCM change agriculture or will agriculture change the ASCM?

A. The Overall Health of the ASCM Regime

To begin with a brief check-up on the general WTO subsidy regime to which agriculture may now become subject: what can -- briefly -- be said about that regime? Four points seem most salient.

[5] The vulnerability of "blue" subsidies (linked to acreage or other types of output constraints), for example, will depend on, among other things, the size of the market of the subsidizing country and whether the country is a net importer or net exporter of the product. If the country's market for the product is large and the country is a net importer, the subsidy can lead to displacement of foreign product by making otherwise marginal local producers competitive. Meanwhile, if the subsidizing country is a large net exporter of the agricultural product, a "blue" subsidy can displace competing foreign products in world markets, increase world market supply, and depress prices.

- *It appeared reasonably robust at the end of the Uruguay Round.* To be sure, claims that the ASCM represented a "major advance" in subsidy discipline were always somewhat exaggerated. The provisions most frequently cited in support of this claim -- the presumptions in Article 6.1 -- were not in fact terribly useful. The much-heralded new definition of a subsidy (Article 1) was almost comic in its odd and ungrammatical drafting, containing the seeds of many future fights. And, of course, the negotiators had agreed to an ill-advised experiment with "green lighting" various types of subsidies (Articles 8-9) as well as insulating most agricultural subsidies from challenge. Still, the Uruguay Round did not *appear*, when the negotiations ended, to have moved things backwards.

- *It has been gravely weakened by dispute settlement decisions.* These decisions have, for example, improperly narrowed the agreed definition of a subsidy (*Export Restraints*); added new constraints on the selection of commercial benchmarks used to measure subsidies in the form of "provision of goods for less than adequate remuneration" (*Softwood Lumber*); and inserted a "current benefit" test making it virtually impossible to reach allocated benefits arising from large non-recurring subsidies (*Privatization*). Thus, while reasonably strong on their face, the ASCM rules *as interpreted* are distressingly weak and permissive.

- *It appears likely to be further weakened in the Doha Round.* For subsidies, the Doha Round is looking very much like a "Retrenchment Round." The proposals tabled to date are overwhelmingly weighted toward loosening direct disciplines on subsidies (*e.g.*, by making it harder to show export contingency) and/or making it harder to use the CVD remedy (itself a key discipline on subsidies).

- *It has other structural flaws that are causing more and more problems as time goes by.* These flaws include, for example, a bias against countries that rely primarily on direct rather than indirect taxes; an Illustrative List of Export Subsidies in Annex 1 whose legal and functional relationship to the other ASCM provisions is not at all clear; and a set of provisions on remedies (with concepts such as "withdrawal" of a subsidy or its injurious effect) that are subject to a wide variety of differing and conflicting interpretations.

So, while people from the "industrial subsidy" world may sometimes assume a superior air, the ASCM-based subsidy discipline system they have created is in some considerable disarray and appears to stand a good chance of deteriorating further.

B. Key Principles from Industrial Subsidy Cases

I will now turn to a few key principles learned in industrial subsidy disputes which may be relevant -- and may yield surprising results -- in farm subsidy disputes.

One principle, probably the most important, is that "decoupling" is not the cure-all that some commentators from the "ag" world seem to assume. "Coupled" subsidies are those most obviously connected to increased production, the simplest case being a per-unit-of-output cash grant. "Decoupling" is generally understood to mean converting such subsidies into programs that hand out money to a given population without regard to

what they have been doing, and with no restrictions on how they will use the subsidy proceeds. This creates the theoretical possibility that they will use the subsidy funds to buy high-tech stocks or invest in mutual funds -- *i.e.*, might do something other than increase their production of farm goods already in oversupply.

That is the theory. The reality, as disputes on the "industrial" side have taught us, is that while untied domestic subsidies may not affect production in exactly the same way as per-unit-of-output subsidies, the effect is not utterly different but rather *somewhat* different. Anyone who has spent time looking at untied domestic subsidies in the steel sector can confirm that they do, indeed, significantly influence output.

Moreover, some apparently decoupled subsidies may not be decoupled at all. It may seem obvious, for example, that a "grant" should be considered decoupled -- because the recipient firm can, in principle, use the grant proceeds to buy a certificate of deposit or throw a lavish party rather than using it to increase production. But debt forgiveness -- also considered a grant -- does not yield fresh cash that can be spent outside the recipient's main area of business. In industrial subsidy cases, debt relief which enables companies to stave off bankruptcy keeps them operating, and therefore does indeed have a significant impact on production (hence also prices, *etc*.). Disaster relief programs in agriculture may operate similarly, allowing continued production by enterprises which otherwise would be forced to exit the business.

Also relevant to whether *effective* decoupling has been achieved is the issue of governmental expectations and the participants' interest in *repeatedly* obtaining subsidies. In industrial cases, we have seen that even though a multinational firm receiving subsidies in country A could, in theory, use those subsidies to increase its output in country B, doing so would violate the expectations of the country A government and eliminate any chance of obtaining country A subsidies in the future. Such subsidies are, therefore, "tied" to the firm's country A production, regardless of the other theoretically possible uses. The same principle could apply in the case of farm subsidies that are based on the crop in which the recipient's land *used to be* planted during a recent representative period. If the recipient has reason to believe that future benefits will be lower to the extent subsidies already paid are put to "other" uses, then he may remain fully planted for that reason and there may be no effective decoupling.

A second principle is that subsidies provided for the purpose of enabling the recipient enterprise to close (or take out of production) certain parts of its productive plant can properly be allocated to items thereafter produced with the remaining assets. This principle, established in CVD cases involving industrial products, could have interesting implications for environmental programs under which farmers are paid not to cultivate on certain ecologically significant parts of their land. The prevailing assumption in the "ag" world seems to be that such a program could not confer a subsidy "with respect to" production on cultivated land. An ASCM panel might disagree.

A third principle is that the presence or absence or demonstrated price/output effects is not relevant to determining whether a particular transaction or government measure qualifies as a "subsidy" under the ASCM Article 1 definition. Among the reasons for focusing on the financial contribution itself, and not on price/output effects, in

making the "benefit" determination required under ASCM Article 1 is that while the effect of a subsidy can be less than the subsidy's face amount, it can also be greater. (Consider, for example, a subsidy used for industrial research that unexpectedly turns up a complete cure for cancer.) Interestingly, in a case brought under the "serious prejudice" standard, which entails carefully analyzing the effects of the subsidy, the possibility of effects far exceeding the subsidy's face amount must be squarely confronted. The prevailing assumption in the "ag" world seems to be that the face amount would constitute some sort of cap.[6] An ASCM panel might disagree.

A fourth key principle from industrial subsidy cases is that "specificity" determinations, required under ASCM Article 2, must be based on the potential of a subsidy program to distort what would otherwise be the market-driven allocation of resources in an economy. As the U.S. government has explained, the specificity test is an "initial screening mechanism to winnow out" only those subsidies which truly are spread in a broad and even manner throughout an economy, such as government-provided roads and public schools.[7] The detailed application of this principle to the case of farm subsidies -- including the question of how large a universe of agricultural subsidy recipients must be before it can no longer be deemed a "group" for specificity purposes -- remains unclear. Still, many more government measures are specific than most observers from the "ag" world seem to assume.

C. Unique Aspects of the Agriculture Subsidy Regime

The agricultural subsidy regime has at least two distinctive features that may complicate convergence: (1) the overlay of scheduled quantitative commitments on both export and total subsidization, and (2) the "box" system.

The **quantitative commitments**, once the Peace Clause has expired, will essentially substitute for the red-light "prohibition" established by ASCM Articles 3-4 for industrial products. In other words, whereas, on the industrial side, a prohibited subsidy will be defined as one contingent on exportation or on import substitution, in agriculture a prohibited subsidy will be defined as one exceeding scheduled quantitative (AMS or export subsidy) commitments. Which is the better way to delineate a set of subsidies that should be "prohibited?" Any answer here must consider the difficult calculation issues associated with quantitative commitments, *e.g.*, how to calculate total subsidization which is partly in grant form and partly in other forms such as soft loans or under-priced insurance policies? The practice of translating more complex subsidies into "grant equivalents" does not appear to be well-developed in the "ag" world.

The **"box" system** could be an even greater barrier to convergence, as it goes to the very heart of the strategy used to identify which subsidies can trigger

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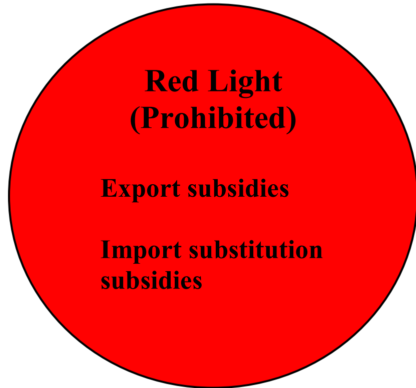
6 As noted above, focusing on the effects of the subsidy means asking a question which never has to be asked in the CVD context: what actually happened after the subsidy was bestowed *that would not have happened otherwise*? Insofar as the subsidy had to be used by human beings who were in a position to make choices, *what choices did they make*?

7 *See Statement of Administrative Action* accompanying the Uruguay Round Agreements Act, H.R. Doc. No. 316, Vol. 1, 103d Cong., 2d Sess. (1994) at 929-930.

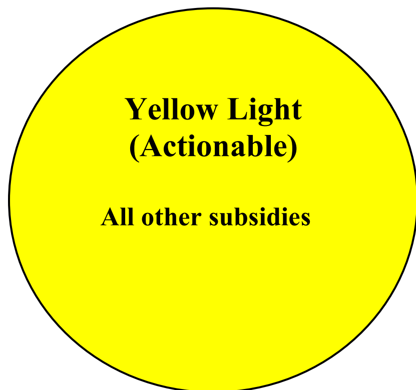
remedial/offsetting action. The *Agreement on Agriculture*'s amber, blue and green boxes group subsidy programs according to assumptions about how significantly they are likely to distort output and prices. With the Peace Clause's expiry, the relevance of these categorizations will be limited to the (probably) rare situation where subsidies exceed scheduled quantitative commitments. Meanwhile, domestic subsidies of all types will be actionable to the extent that they are shown to be connected to adverse trade effects. It will not be decisive what a subsidy is called, or what it ostensibly aims to encourage the recipient to do, or what its color would be in the amber/blue/green typology. Actionability will depend on a fact-based examination.

Such an approach will seem alien to much of the agriculture community, where the amber/blue/green system has (no pun intended) grown deep roots. For many in this community, relying solely on the injury test to sort acceptable from unacceptable subsidies seems draconian, and it simply makes sense for subsidies bearing labels like "environmental" to be in a separate class, exempt and immune whether or not they can be shown to distort trade. This instinct to rely on labels rather than economics when sorting subsidies is not unknown on the industrial side, where it gave rise to a 5-year experiment with "green lighting" under the ASCM (Articles 8-9 which were in force from 1995-2000) and has been discussed as a potential discipline tactic in the OECD steel subsidy negotiations (the EU being eager to green light the various normative categories of subsides which are exempt under the EU's own internal state aid rules). Still, the fact remains that the "mainstream" approach on the industrial side -- and the only approach reflected in the ASCM rules in effect today -- is to use the trade effects test as the unique mechanism for sorting subsidies. Here again, either the ASCM will have to change agriculture, or else agriculture will have to change the ASCM.

NON AGRICULTURE SUBSIDIES



- Part II SCM Agreement
- GATT
- CVD



- Part III SCM Agreement
- GATT
- CVD

AGRICULTURE SUBSIDIES WITH THE PEACE CLAUSE

Export Subsidies

- Within Scheduled Reduction Commitments
  - Exempt from SCM/GATT
  - "Due Restraint" on CVD
- Above Scheduled Reduction Commitments
  - Prohibited

Domestic Subsidies

Amber Box - "Trade Distorting"
Most production-related or other subsidies, if below commitment levels or *de minimis* (generally 5%)

- No SCM/GATT/Ag. Agreement actions (except payments to specific commodity > MY 1992 level)
- "Due Restraint" on CVD

Blue Box - "Less Trade Distorting"
Direct payments under production-limiting programs – no limit

- No SCM/GATT/Ag. Agreement actions
- "Due Restraint" on CVD

Green Box -"Non-Trade Distorting"
Non-price-support programs, e.g., direct payments to farmers "decoupled" from production, disaster relief, environmental subsidies, infrastructure creation, investment subsidies, retirement programs, etc.

- No SCM/GATT/Ag. Agreement actions
- Not actionable under CVD

- **Above Commitments or *De Minimis* Levels**
  - Prohibited by Parts II & IV of Ag. Agreement, and actionable under SCM Agreement and CVD

AGRICULTURE SUBSIDIES AFTER THE PEACE CLAUSE

Actionable
- Part III of SCM Agreement
- GATT, CVD

Prohibited
- Part II of SCM Agreement
- Parts II & V of Ag. Agreement

Actionable
- Part III of SCM Agreement
- GATT
- CVD

Actionable
- Part III of SCM Agreement
- GATT
- CVD

Actionable
- Part III of SCM Agreement
- GATT
- CVD

Prohibited/Actionable
- No change from before