

Development of Trade in Agriculture

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1 Introduction

1.1 Problem

Opening trade in agriculture would cause immense changes within developed countries. Before, while and after the Council Meeting in Cancun, newspapers wrote about the pros and, especially within developed countries, about the cons on agreeing on free trade in agriculture. Those newspapers failed to point out the huge gap between WTO members' interests. Most economic experts¹ agree that free trade supports economic growth:²

"My fundamental belief, however, is that trade liberalization aids growth, which, in turn, aids poverty alleviation."³

Politicians are concerned about quick changes and their voters' interests. In fact, it is questionable whether the governments saw a *Zone of Possible Agreement*⁴ at the time of the Council Meeting in Cancun. Governments are moving towards accepting the economic arguments on growth. The concerns are shifting to questions such as: how much can we liberalise assuring country specific interests such as security and natural scenery? By when do we have to adopt the necessary changes to smoothly transfer the highly protected agricultural sector into a free market economy?

1.2 The Aim of This Paper

This paper aims to apply the leading economic theory of comparative advantage to the agriculture sector. Case-citations involving the Agreement on Agriculture, AoA, help to explain the AoA and what it comprises. Finally, the effect of the expiration of the so-called Peace Clause will highlight the stage of liberalization reached. It will do so by looking at the Green Box Measures, which were protected by part of the Peace Clause.

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¹ KRUGMAN PAUL R. / OBSTFELD MAURICE, *International Economics Theory and Policy* (Addison-Wesley Publishing, Reading, Massachusetts/Madrid, 6th edition, 2002), pp.199-203 Case Study on Europe's Common Agricultural Policy: how a guaranteed priced caused Europe to subsidise Exports. Case Study on an Import Quota in Practice: U.S. Sugar: how U.S. Consumers were to pay 40% more for their sugar.

² ANDERSON KYM, How Can Agricultural Trade Reform Reduce Poverty? (<http://www.adelaide.edu.au/cies/0321.pdf>, published July 3, 2003, last visited December 27, 2003)

³ WINTERS ALAN L., *Trade Policies for Poverty Alleviation*, in: HOEKMAN BERNARD / MATTOO AADITYA / ENGLISH PHILIP (eds.), *Development, Trade and the WTO: A Handbook* (The World Bank, Washington, 2002), pp. 28-37

⁴ FISHER ROGER / URY WILLIAM, *Getting to Yes: Negotiating an agreement without giving in* (Random House Business Books, London, 1999), pp. 101-11 The Zone of Possible Agreement, ZOPA is an enhancement of the following theory: Before negotiation once shall set a Best Alternative to a Negotiated Agreement, BATNA, in order to analyse the own situation and to prevent loss. A ZOPA between parties only exists, if there would be a solution the negotiating parties could agree on, meaning that their BATNA allows a solution.

1.3 Structure

The Introduction briefly documents the long history of development in agriculture. Moving to economic theories, the paper outlines comparative advantage as it would be applied to agriculture. Chapter three introduces the use and necessity of transitional periods by using examples and then focuses on the implementation periods used in the AoA. The paper quotes decisions from the Panel and the Appellate Body concerning the protection in agriculture related to Article 13 in the AoA. Within the following Chapter five, the expiration of the Peace Clause and its effect is analysed. The final Chapter comprises the conclusion. The author has focused on the wording of the Agreements and is aware that experts might challenge conclusions thereof.

2 Development in Agriculture and Economic Theories

2.1 The Agricultural Surplus⁵

The development of the first civilizations commenced 5000 years ago. Mesopotamia⁶ was the first country using its agricultural surplus to create wealth by trading. The rivers were serving the crop fields with the necessary water and led to huge crops. People used the extra time to create art, for trade and to establish a political system. Trade in agriculture was the start for civilization.

2.2 Mercantilism⁷

Following the creation of civilization, monarchs and rulers established territories and with it customs duties. In the 17th century, scholars proposed to simplify exports and to reduce imports. This mercantilism approach was established by corresponding rules and regulations, which protected home industries by customs duties or prohibiting entrance of the foreign goods⁸. The British and French procedure found imitators. Consequently trade slowed.

⁵ Oriental Institute Museum in Chicago, visited in summer 2001.

⁶ This is the Name of the Area between Tigris and Euphrates Rivers, nowadays part of Iraq and Syria. <http://www.headfilm.ch/films/06026.html>

⁷ COTIER THOMAS / OESCH MATTHIAS, Lecture Materials: Europäisches und Schweizerisches Aussenwirtschaftsrecht im Rahmen der WTO: Economic, Legal and Public Choice Theory including excerpts of 1. Mun Thomas (1571-1641), one of the first representing the mercantilism theory from England 2. Colbert Jean-Baptiste (1619-1683), French Treasurer describes to Louis XIV the problem of increased prices caused by the Dutch import and export duties. He requested own merchant ships, firstly to avoid such increased prices and secondly to gain duties for themselves by transferring products thru France.

⁸ KOOPMANN GEORG / FRANZMEYER FRITZ, Weltwirtschaft und Internationale Arbeitsteilung in: Bundeszentrale für politische Bildung, http://www.bpb.de/publikationen/ET1XFA,1,0,Weltwirtschaft_und_internationale_Arbeitsteilung.html, last visited January 4, 2004

2.3 Liberalism

In the 19th century, two British experts, Adam Smith⁹ and David Ricardo¹⁰ developed new theories challenging mercantilism. The later developed the theory of comparative advantage; countries gain out of trade even if all their products are more expensive than other countries' products. With regard to the proportional efforts of the production, a country can gain with trade by focusing to produce the goods with the relatively less effort.

Table 1¹¹

| Comparative Advantage | |
|---|-------------------------------|
| Country A | Country B |
| 10 people producing cheese | 9 people producing cheese |
| 12 people producing wine | 8 people producing wine |
| It makes sense for A to buy wine and cheese from B | |
| Assuming A produces cheese only | Assuming B produces wine only |
| If B gives up on the cheese sector, A will produce more cheese. It will only need 10 people to get the amount needed. | |
| If A gives up on the wine production, B can produce enough to cover A's need, by using 8 people from the former cheese production industry. | |
| Gain 2 labourers | Gain 1 labour |

In the above table, Country A and Country B are both gaining. Ricardo introduced this theory to argue against the Corn Laws. This legislation discouraged imports of grain, using fees. Ricardo, as a trader, had a personal interest to support the businessmen in London and to prevent idle farmers¹² from gaining through this legislation. His arguments were yet concerned with reciprocal benefits between countries. The Corn Laws were abolished. Between 1850 and 1879 Ricardo's theory influenced European trade to historically reach the peak in free trade, comprising agriculture.¹³ As for now, "Ricardo's model of trade remains one of the great insights in economics"¹⁴

⁹ ADAM SMITH (1723-1790), *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776; reprinted by Random House, Inc./Modern Library Edition, New York, 1994), pp. 481-82

¹⁰ DAVID RICARDO (1772-1823), *The Principles of Political Economy and Taxation* (1819, reprinted by J.M. Dent & Sons Ltd./Charles E. Tuttle Co., Inc., London/Rutland, 1973), pp. 81-3

¹¹ KRUGMAN, as note 1 above, pp.20; WEISS WOLFGANG / CHRISTOPH HERMANN, *Welthandelsrecht. Studium und Praxis* (Verlag C.H. Beck, München, 2003), pp. 10

¹² KRUGMAN, as note 1 above, pp. 59. This is Ricardo's perspective; he was a hard-working capitalist.

¹³ BAIROCH PAUL, *Economics and World History: Myths and Paradoxes* (The University of Chicago Press, Chicago, 1993), pp. 16, 22-29

¹⁴ KRUGMAN, as note 12 above. Corn Laws were adopted by Britain right after the Napoleon war (around 1815).

2.4 Protectionism in Agriculture

One could ask why countries wouldn't follow the comparative advantage theory but instead highly protect their agriculture sectors? A number of different circumstances led to the political decision to protect rather than to liberalize this sector. In the middle of the 19th century, the US encouraged commercial farming by establishing the necessary infrastructure for the flow of trade and creating the Agriculture Department to do research. More commercial interaction led to increased agricultural productivity. Ironically therefore the governmental intervention had to increase in order to deal with the surplus production. After all the efforts on the infrastructure had just started to pay back, the Great Depression occurred in the 1930's. The governments felt already committed. Farmers' incomes were directly government supported. This kept agriculture afloat. Further the costs for the agriculture support became distributed over many consumers such that it would hardly hurt their purse. This was the basis for subsidies to follow.¹⁵ Could politicians be blamed for a short-term planning horizon increasing the costs for a protected agricultural sector to the amount that it hurt the world's economic growth? No. These actions are based on concerns and deep convictions that nutrition for their own people needs to be grown within the country.¹⁶

There are some writers¹⁷ though who believe that economic growth has reduced worldwide poverty in the three recent decades. They go on arguing that there is more potential for the world economy to grow and to have a poverty reducing effect by liberalizing agriculture.¹⁸ Economists certainly agree on the negative effect of subsidies concerning consumers and the world price.¹⁹

In the 20th century, protectionism in agriculture was mainly caused by the threat that the US would otherwise leave the GATT System. The US in the 1950's protected its agriculture industry to further boost its economy. In the 1970's the EU became a net food exporter and challenged the US position. The EU as well as the US used their legal system to support their farmers with subsidies and other measures.²⁰

After all this resistance to apply the economic theory in the agricultural sector, the AoA was signed in 1994 within the Uruguay Round. Some might argue that the increased protection

¹⁵ SHEINGATE ADAM D., *The Rise of the Agricultural Welfare State* (Princeton University Press, Princeton/Oxford, 2001), pp. 14-37. Chapter 1 History, Policy and Institutions compares the US, Japan and France approach towards agriculture and ends by asking whether agriculture is a special case.

¹⁶ Nowadays, within industrialised countries, the issue of independency and security is rather connected to countries food standards and ethical qualities than to former causes such as war. ANDERSON KIM, *Domestic Agricultural Policy Objectives and Trade Liberalization: Synergies and Trade-Offs* (<http://www.adelaide.edu.au/cies/9808.pdf>, published October 1998, last visited, December 30, 2003), p. 12 sees the economically interdependence of states as a way to prevent wars. Further Article XXI (b) (iii) GATT provides 'Security Exceptions' allowing countries to take necessary actions in time of war.

¹⁷ ANDERSON KYM, as note 2 above

¹⁸ MCCULLOCH NEIL / WINTERS ALAN L. / CIRERA XAVIER, *Trade Liberalization and Poverty: A Handbook* (Centre for Economic Research, London, 2001) pointing out that the large distortion in agricultural trade and the relation to economic growth especially for the poor.

WINTERS ALAN L., as note 3 above

¹⁹ KRUGMAN, as note 1 above

²⁰ AILEEN KWA / WALDEN BELLO, *Guide to the Agreement on Agriculture: Technicalities and Trade Tricks Explained*, <http://www.focusweb.org/publications/1998/AOA.pdf>, December 1998 pp. 11-12, last visited January 23, 2004

within the EC and therefore the decreased gain for the US was responsible for the opening. However Members of the WTO were able to agree, by using transition periods.

3 Excursus: Transition Periods in the WTO

As identified above, implementing changes can be troublesome for governments. The following paragraphs are examples whereby participation in the WTO requires such changes from developing countries as well as from developed countries. Using transition periods helps to buffer negotiated onerous commitments. The Peace Clause is an example discussed in Chapter 5.

3.1 Examples of Transition Periods in the WTO

As part of Special and Differential Treatment, agreements often provide developing countries²¹ and least developing countries, LDCs,²² with more time to implement their commitments. The Agreement on Trade-Related Aspects of Intellectual Property Rights, TRIPS-Agreement, within its Part VI provides 'Transitional Arrangement': next to the status of the country, the development within the field of intellectual property rights is relevant. Countries have to fulfill their obligations within 1 to 10 years.

Another example is the Agreement on Textiles and Clothing, ATC. It also provides for implementation periods. Three stages allow developed countries to adopt the necessary changes within their home market so as to prepare their sector before being fully implemented into the WTO system. The sole purpose is to follow the theory of liberalism within a sector that would especially support trade possibilities for developing countries. The last stage will be ending by the end of 2004.²³

3.2 Transitional Periods within the AoA

Like the ATC, the Agreement on Agriculture, AoA, established stages to implement commitments.

²¹ Members of the WTO can define whether they consider themselves to be a developing or a developed country. Considering that developing countries can be provided with preferential treatment, other members can challenge the choice of a country. As for the Status of LDCs, the U.N. List is relevant. http://www.wto.org/english/tratop_e/devel_e/d1who_e.htm, last visited January 2, 2004

²² WTO, Least-developed countries, http://www.wto.org/english/thewto_e/whatis_e/tif_e/org7_e.htm, last visited January 2, 2004. Currently there are 49 LDCs listed, thereof 30 are members of the WTO.

²³ CHAKRAVARTHI RAGHAVAN, EC's Snail-Pace Textiles and Clothing Liberalization, 26 July 2000 <http://www.twinside.org.sg/title/snail.htm>, last visited January 4, 2004; The WTO Agreement on Textiles and Clothing (ATC) 1995-2004 http://www.wto.org/english/tratop_e/texti_e/texintro_e.htm, last visited January 4, 2004

Table 2

| Transition Periods in the Agreement on Agriculture - AoA | | | |
|---|---|---|--|
| Immediate integral part of GATT | Implementation Period 1 | Initiation of further negotiations due before 2000 | Implementation Period 2 For Article 13 |
| 1995 | 1995 – 2001 | Article 20 | 1995-2004 |
| <ul style="list-style-type: none"> ■ Member's scheduled commitments ■ Prevent circumvention on export subsidy commitments ■ Sanitary & Phytosanitary Agreement | <ul style="list-style-type: none"> ■ Domestic support Annex 4 ■ Market access Annex 5 ■ Export subsidy Article 9 AoA | <ul style="list-style-type: none"> ■ Proposals from Members, 2000 ■ Doha Declaration, 2001 ■ Ending January 2005 | <ul style="list-style-type: none"> ■ Due Restraint Peace Clause |

The implementation period 1 provided six years (AoA Art 1(f)) for countries to adopt its obligations and began in 1995.²⁴ Therefore commitments²⁵ in Members' Schedules on export subsidies and domestic supports were to be met by 2001. These commitments were the first steps to integrate agriculture. Members further committed themselves to continue the reform process and agreed to substantial progressive reductions in support and protection as its long-term objectives described in the preamble and in Art. 20 AoA. It was the original mandate to initiate further negotiations one year before the end of the implementation period 1 - meaning the year 2000. Such negotiations proposals were submitted to the WTO and in November 2001, the Doha Ministerial Declaration accepted agriculture as:

"part of the single undertaking in which virtually all the linked negotiations are to end by 1 January 2005"²⁶

Article 13 AoA deserves special accentuation. The so-called Peace Clause, has its own implementation period 2: Article 1 (f) states that the implementation period for the purpose of Article 13 is a nine-year period commencing in 1995. Therefore the prevailing opinion²⁷ states

²⁴ BEIERLE THOMAS C., Agricultural Trade Liberalization - Uruguay, Doha, and Beyond, in: Journal of World Trade 36 (6) (December 2002), pp. 1086-1110

²⁵ The AoA Article 3 required for concessions and commitments in each members schedule (on 'export subsidies' and 'domestic support') to be incorporated as an integral part of GATT 1994, therefore by January 1, 1995. The Schedule could provide annually approaches reaching full implementation by 2001.

²⁶ The Doha Declaration, Implementation Decisions explained: Agriculture http://www.wto.org/english/tratop_e/dda_e/dohaexplained_e.htm#agriculture, last visited, January 6, 2004

²⁷ WILLIAMS FRANCE, Europe and International Economy: Farm subsidies could go under WTO plough, in: Financial Times, December 31, 2003. The EU and US within the schedule of its commitments used the term marketing year as allowed by Article 1 (i) AoA. Some lawyers argue that the expiration of the Peace Clause for those products listed will be in the middle of 2004;

that the implementation period expired by the end of 2003. The term implementation period might be misleading. Upon the Peace Clause's expiration the application of subsidies will be further restricted – discussed in Chapter 5.

4 Decisions concerning the AoA

4.1 The “EC-Bananas” Case²⁸

In addressing the applicability of the AoA concerning market access, the Appellate Body, AB stated:

“In addition, Article 13 of the Agreement on Agriculture provides that, during the implementation period for that agreement, Members may not bring dispute settlement actions under either Article XVI of the GATT 1994 or Part III of the Agreement on Subsidies and Countervailing Measures for domestic support measures or export subsidy measures *that conform fully with the provisions of the Agreement on Agriculture*.²⁹ With these examples in mind, we believe it is significant that Article 13 of the Agreement on Agriculture does not, by its terms, prevent dispute settlement actions relating to the consistency of market access concessions for agricultural products with Article XIII of the GATT 1994...(therefore) the negotiators of the Agreement on Agriculture did not hesitate to specify such limitations elsewhere in that agreement; had they intended to do so with respect to Article XIII of the GATT 1994, they could, and presumably would, have done so.”³⁰

The interpretation of the AB wording tells us two important things: First Article 13 covers the continuing protection for ‘domestic support’ and ‘export subsidy’ measures not beyond the AoA. Commitments and concessions already part of the AoA are subject to this exclusion. One could conclude that the expiration does therefore not have an impact at all. Chapter five will reply to this conclusion in the negative. Secondly the AoA within terms of the pillar ‘market access’ has to be applied in the context with GATT Article XIII.³¹ Combining this provision with Article 4.1 AoA, as the AB has done, raises questions in terms of Article 21.1 AoA, the applicability of the AoA:³²

STEINBERG RICHARD H. / JOSLING TIMOTHY E., When the Peace Ends: The Vulnerability of EC and US Agricultural Subsidies to WTO Legal Challenge, in: Journal of International Economic Law 6 (2) (June 2003), pp. 369-417
WT/DS103/R, WT/DS113/R New Zealand and US vs. Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products, 17 May 1999 the Panel at 7.21 stated: “Article 13 (c) (i) of the Agreement on Agriculture, export subsidies...are exempt

...for the duration of the “implementation period” (*in casu*, up to 31 December 2003)”

²⁸ WT/DS27/AB/R, Ecuador, Guatemala, Honduras, Mexico, US vs. EC – Regime for the Importation, Sale and Distribution of Bananas, 9 September 1997

²⁹ Accentuation added.

³⁰ EC-Bananas, as note 28 above, para. 157. Stating that market access in Art. 4 AoA is consistent with other Agreements provisions – especially Art. XIII GATT. Exceptions have been explicitly formulated: Article 13

³¹ Article XIII GATT titled: Non-discriminatory Administration of Quantitative Restrictions.

³² CHAMBOVEY DIDIER, How the Expiry of the Peace Clause (Article 13 of the WTO Agreement on Agriculture) Might Alter Disciplines on Agricultural Subsidies in the WTO Framework, in: Journal of World Trade 36 (2) (April 2002), pp.305-52 at p. 308 states that the Multilateral Agreements as a general rule are applied cumulatively. He refers to several AB and Panel cases confirming this statement, only to continue contrarily, arguing that Article 21.1 AoA provides a basis to use the AoA as *lex specialis*.

"Article 21" Final Provision

1. The provision of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provision of this Agreement."³³

Developed Countries tend to argue this Article states that the AoA has to be applied as *lex specialis*.³⁴ Meaning that the other multilateral Agreements shall not be applied in the field of agriculture. The decision above as well as the overall approach taken by the AB strongly opposes this argument by applying provisions from GATT cumulatively to the provisions in the AoA. One could still argue that market access shall be treated different from the domestic support and export subsidy measures. This argument doesn't hold up either. Since the AoA as well as the SCMA refer to each other in the context of the Peace Clause, Chapter five, it seemed that agriculture was supposed to be involved into the WTO system as any other field.

4.2 The "US-FSC" Case³⁵

In February 2000, the AB decided on the US - "Foreign Sales Corporation", FSC, tax law. Para. 157 the AB concluded that the US has violated Article 10.1 and Article 8 AoA. It found the export subsidies provided through the named tax law as inconsistent with the obligation to avoid circumvention on "exports subsidies commitments"³⁶:

"the United States has acted inconsistently with its obligations under Article 10.1 of the *Agreement on Agriculture* by applying FSC export subsidies, with respect to both scheduled and unscheduled agricultural products, in a manner that, at the very least, threatens to circumvent its export subsidy commitments under Article 3.3 of the *Agreement on Agriculture*. Moreover, and in consequence, by providing export subsidies that are inconsistent with Article 10.1, the United States has acted inconsistently with its obligation under Article 8 of the *Agreement on Agriculture* "not to provide export subsidies *otherwise than in conformity with this Agreement*..."³⁷

Thus the AB does not allow other ways to subsidies exports then provided within the AoA and is therefore following the interpreting Article 10.1 AoA in context to Article 8 AoA. Scheduled and unscheduled products are treated the same way. The applicability of export subsidies is limited to the ones allowed within the AoA. The last arbitrator decision³⁸ on FSC

³³ World Trade Organization, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations* (World Trade Organization, Geneva, 2002), p. 47

³⁴ Brock Haus Enzyklopädie, (Brockhaus GmbH, Mannheim, 1990) "*lex specialis derogate legi generali*" the special rule has to be applied prior to the general rule.

³⁵ WT/DS108/AB/R, EU vs. US - Tax Treatment for "Foreign Sales Corporations", 24 February 2000

³⁶ WT/DS108/R, EU vs. US - Tax Treatment for "Foreign Sales Corporations", 8 October 1999, at 4.1264ff where the US tried to argue that the FSC is not an export subsidy for the purpose of the AoA.

³⁷ US-FSC, as note 35 above, para. 154

³⁸ WT/DS108/ARB, EU vs. US - Tax Treatment for "Foreign Sales Corporations", 30 August 2002, The US hasn't followed the obligation to withdraw the subsidies. Para.34 the arbitrator finds that the EC is allowed to take countermeasures in the amount of approximately four Billion Dollars annually.

concerned the amount on countermeasures. It is currently widely discussed as the EC is allowed to put sanctions in the amount of 4 Billion US Dollar annually³⁹.

4.3 The “Canada-Dairy” Case

This Case started in 1997 when the US⁴⁰ instituted legal proceedings against Canada. In 1998, New Zealand⁴¹ followed this approach. The latest AB decision on Canada-Dairy in 2002⁴² stated that Canada violated Article 9.1(c) AoA by its supportive measures. Canada supported its exports on certain dairy products. Canada achieved to export those products at the world price by requesting its own consumers to pay a higher price.

The Panel⁴³ concluded:

“We have found that the Canadian scheme is inconsistent with: (i) Canada's obligations under both Article 3.3 and Article 8 (through Article 9.1(a) and Article 9.1(c)); ~~or (ii) in the alternative, Canada's obligations under both Article 10.1 and Article 8, of the Agreement on Agriculture.~~ ⁴⁴ Therefore, the exemption provided for in Article 13(c)(i) of the Agreement on Agriculture from actions under Article 3 of the SCM Agreement for "export subsidies that conform fully to the provisions of Part V" of the Agreement on Agriculture, does not apply. In principle, the scheme could therefore also be subjected to an examination under Article 3 of the SCM Agreement. “

The AB declined the Panel's alternative finding under Article 10.1 AoA but upheld that Canada was violating Article 3.3 and Article 8 by providing subsidies subject to reduction commitments as described in Article 9.1 (c). Canada quantitatively exceeded its commitments provided in its specified schedule.⁴⁵ Proposing an examination under Article 3 SCMA proofs that in this case as well; the Panel follows the approach taken in the EC-Banana case to apply the multilateral agreement cumulative.

³⁹ European Commission, WTO Dispute Settlement Foreign Sales Corporations (FSC): Commission prepares for the imposition of countermeasures on US products, 5 November 2003. http://europa.eu.int/comm/trade/issues/respectrules/dispute/pr051103_en.htm, last visited January 11, 2004. The EU has set a deadline of January 1, 2004 but recently provided the US with another deadline until March 2004 before they are starting to apply the countermeasures; CHAKRAVARTHI RAGHAVAN, US corporate export tax breaks held illegal again, 15 February 2002 <http://www.twinside.org.sg/title/twe271c.htm>, last visited January 11, 2004; GRISWOLD DANIEL T., A Clean Escape from \$4 Billion in FSC Sanctions, in: Center for Trade Policy Studies, Free Trade Bulletin 4, May 2003, <http://www.freetrade.org/pubs/FTBs/FTB-004.pdf>, last visited January 9, 2004

⁴⁰ WT/DS103/1, US vs. Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products, Request for Consultations by the United States, 13 October 1997

⁴¹ WT/DS113/1, NZ vs. Canada - Measures Affecting Dairy Exports, Request for Consultations by New Zealand, 8 January 1998

⁴² WT/DS103/AB/RW2, WT/DS113/AB/RW2 New Zealand and US vs. Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products, 20 December 2002

⁴³ WT/DS103/R, WT/DS113/R, US and NZ vs. Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products, 17 May 1999, para. 7.136

⁴⁴ Strikethrough added reflects the decision by the AB.

⁴⁵ Canada-Dairy, as note 42 above, para. 159

5 Expiration of the Peace Clause Article 13 (a)

The quotation on the EC-Banana case already described that Article 13 provided extra protection for domestic support and export subsidy subject to the AoA. The Peace Clause prohibited dispute settlements applying GATT and SCMA for a nine-year period, therefore until the end of 2003 (Table 2).

Serious newspapers recently published⁴⁶ argue that the expiration of the Peace Clause will cause further litigation of those commitments to increase. This chapter is an essay to analyse the legal effect the expiration of Article 13 (a)⁴⁷ might have.

5.1 Applicability of the GATT and SCMA

Article 13 (a) AoA provides for 'domestic support' measures to be exempt from actions based on Article XVI GATT and Part III of the SCMA, covering Article 5 and 6⁴⁸.

Article 13: Due Restraint

During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures (referred to in this Article as the "Subsidies Agreement"):

(a) domestic support measures that conform fully to the provisions of Annex 2 to this Agreement shall be:

(i) non-actionable subsidies for purposes of countervailing duties;

(ii) exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement; and...⁴⁹

Article 13 (a) comprises Annex 2, the so-called Green Box Measures⁵⁰. Governments have been allowed to fund programmes as described in Annex 2, Paragraph 2. Those funding are to protect the environment, to help regional development and so on. Annex 2 Paragraph 1 defines that the domestic support measures are exempted from reduction commitments if they

"...meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production..."⁵¹

Two additional requirements were set forth:

⁴⁶ Ditching the peace, in: *The Economist*, January 1, 2004

http://www.economist.co.uk/agenda/displayStory.cfm?story_id=2296891, last visited January 19, 2004; WILLIAMS FRANCE, *Europe and International Economy: Farm subsidies could go under WTO plough*, in: *Financial Times*, December 31, 2003

⁴⁷ As pointed out this paper is focusing only on the green box measures. Leaving out the blue and amber box measures subject to Article 13 (b) and (c).

⁴⁸ CHAMBOVEY DIDIER, as note 32 above, refers to Article 31 SCMA that provides that Article 6.1 will be expiring by the end of 1999. Members have not renewed the provision.

⁴⁹ *The Legal Texts*, as note 33 above, pp. 43-44

⁵⁰ WTO, *The Boxes, Domestic support in agriculture*,

http://www.wto.org/english/tratop_e/agric_e/agboxes_e.htm, last visited January 7, 2004

⁵¹ *The Legal Texts*, as note 33 above, pp. 48

“(a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,
 (b) the support in question shall not have the effect of providing price support to producers;”⁵²

This Green Box Measures⁵³ are according to the expiration of the Peace Clause subject to the examination of violation according to GATT XVI and SCMA Part III. Further they can be purpose of countervailing measures fall under actionable subsidies.

▪ *Applicability of GATT Article XVI Section A*

Article XVI GATT para. 1⁵⁴ demands from contracting parties to notify other, possibly affected, parties about any subsidization, which could impact imports and exports. The subsidizing country has to explain the necessity of such supportive measures and commits itself to discuss the possibility of limiting the subsidization. It is questionable whether Article XVI GATT Section A provides the basis for enforceable claims, including countervailing measures. It's more likely a mechanism for consultation between members. Article XVI GATT, Section B provides additional provisions on 'export subsidies' and is therefore not subject to this issue.

▪ *Applicability of the SCMA Part III*

Part III SCMA titled 'actionable subsidies' demands for members not to cause any adverse effects to other member's interest. Serious prejudice and injury to another member would allow proceedings. The last sentence in either provision refers to Article 13, stating:

“This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture.”⁵⁵

Confirming the wording of the Peace Clause: agricultural product commitments, more precisely in context to Article 13 (a), the Green Box Measures are new subject to Part III, the so-called 'actionable subsidies' of the SCMA:

⁵² Id.

⁵³ Developing countries argue that governments used the Green Box Measures to legitimate their ongoing domestic support; BAUERT ALEX C., Süsse Schweiz; Green boxe als Versteck für Produktionsanreize? Schweiz als Beispiel: Vortrag vom 13. January 2004 backing up this view.

⁵⁴ The Legal Texts, as note 33 above, pp. 445:

“If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify the CONTRACTING PARTIES ...circumstances making the subsidization necessary... shall, upon request, discuss with the other contracting party... the possibility of limiting the subsidization”

⁵⁵ The Legal Texts, as note 33 above, pp. 235-237, Article 5 and 6 SCMA - last Paragraph.

Article 5: Adverse Effects

No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:

- (a) injury to the domestic industry of another Member;
- (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994;
- (c) serious prejudice to the interests of another Member.

With respect, it cannot be said that Green Box measures moved from being non-actionable subsidies to actionable subsidies. Comparing the provisions applied before and after the expiration of the Peace Clause it seems that the threshold decreased:

Table 3

| Threshold | |
|---|---|
| Before | After |
| <p>Annex 2 Paragraph 1 AoA</p> <ul style="list-style-type: none"> ■ Domestic Support shall have no trade-distorting effects | <p>Annex 2 Paragraph 1 AoA</p> <ul style="list-style-type: none"> ■ Domestic Support shall have no trade-distorting effects |
| | <p>Article 5 and 6 SCMA</p> <ul style="list-style-type: none"> ■ Domestic Support shall not injure the domestic industry of another Member; ■ Shall not nullify or impair benefits to another Member especially the benefits caused by negotiated commitments; ■ Shall not cause serious prejudice to the interests of another Member |

The provisions now applicable are pushing the liberalization in agriculture. There are two approaches to be taken. Either this effect is used to push negotiations between Members, or developing countries take a more aggressive approach in challenging Green Box and most probably other measures in front of the Dispute Settlement Body.

6 Conclusion

The Peace Clause has been with us since 1995. For almost a decade, WTO Members knew it would expire. It has not been discussed though because Members agreed to further progressively reduce export subsidies and domestic support.

The feeble argument that Members did not mean to liberalise agriculture within this breadth provokes distrust rather than provides an answer. For developed countries it is troublesome to see that within their own constituency, economists who are pro liberalisation are considered turncoats.⁵⁶

Whether the expiration of the Peace Clause is going to be the catalyst for more liberalization remains to be seen. Beside the lower threshold, the expiration could prompt a “now-its-our-time” attitude for the developing countries to challenge the protectionism.

Frequently an offence has to trigger countervailing measures before a Member follows its obligation. Some problems involving intimidating reactions, countervailing measures, as well as an increasing world prices would impact developing countries. Firstly, developing countries have to be aware of the strong opposition within developed countries that the agriculture industry can cause. Pressure on government will mean developed countries will likely react with intimidating actions as well as legal responses such as launching actions where developing countries fail to fulfil their commitments. Another problem facing developing countries are the countervailing measures. It is still undecided at what time a country can use countervailing measures. Are violations of commitments a basis to adopt countervailing measures right away or does a decision have to legitimate such actions? Even if developing countries choose to impose sanctions, they may not be effective since developing countries might not have sufficient imports to take such measures.⁵⁷ There is precedence for developing countries to use other sectors. In the EC-Banana arbitrator decision,⁵⁸ the arbitrator decided that because Ecuador didn't have enough imports of goods, it was allowed to use the non-related TRIPS agreement for countervailing measures to be effective. Could developing countries therefore take unilateral actions not following its TRIPS commitments, arguing that it does so to compensate its damages?

If an effective means of eliminating the subsidies is found, the world price would increase quickly and dramatically.⁵⁹ This could be devastating for agriculture-importing emerging developing countries. This is foreseeable and therefore our transition periods should reflect this dynamic. This impact will end once the developing countries' exports increase as a response to the elimination of the former export subsidies.

⁵⁶ BECKER ELISABETH, Brazil case may break stalemate on trade, in: International Herald Tribune, The IHT Online, January 24, 2004 discussing the economic model presented by Daniel Sumner, Professor of agriculture economics at the University of California at Davis. His contra position causes fellow citizen representing the cotton industry to name him a turncoat.

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⁵⁷ STEINBERG RICHARD H. / JOSLING TOMOTHY E., When the Peace Ends: The Vulnerability of EC and US Agricultural Subsidies to WTO Legal Challenge, in: Journal of International Economic Law 6 (2) (June 2003), pp. 369-417

⁵⁸ WT/DS27/ARB/ECU, EC - Regime for the Importation, Sale and Distribution of Bananas - Recourse to Arbitration by the EC under Article 22.6 of the DSU, 24 March 2000

⁵⁹ BECKER ELISABETH, as note 56 above, Sumner Daniel research states that the world price of upland cotton would have increased by 12.6%, if farmers had not been subsidised.

Ditching the peace, as note 46 above, stating that:

“the EU is depressing world butter prices by as much as a fifth, according to one economic model”

Within a non-binding agreement, the APEC countries⁶⁰ decided to liberalize agriculture over the period to 2020. Would that be an accomplishable goal for the US and the EU? Would it be possible to limit the domestic support and the export subsidies to the amount not involving protectionism? The right balance would have to be found through further negotiations among members in order to avoid using the dispute settlement body.

⁶⁰ ANDERSON KYM, Agricultural Trade Reform and Poverty Reduction in Developing Countries, <http://www.adelaide.edu.au/cies/0234.pdf>, published November, 2002, last visited January 25, 2004

7 Appendices

Cases and Requests

Requests for Consultations

| | | |
|------------|--|-----------------|
| WT/DS103/1 | US vs. Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products | 13 October 1997 |
| WT/DS113/1 | NZ vs. Canada – Measures Affecting Dairy Exports | 8 January 1998 |

Request for the Establishment of a Panel

| | | |
|------------|--|-----------------|
| WT/DS267/7 | Brazil vs. US – Subsidies on Upland Cotton | 7 February 2003 |
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Panel

| | | |
|--------------------------|---|----------------|
| WT/DS103/R WT/DS113/R | US and NZ vs. Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products | 17 May 1999 |
| WT/DS108/R | EU vs. US – Tax Treatment for “Foreign Sales Corporations” | 8 October 1999 |

Appellate Body

| | | |
|----------------------|--|------------------|
| WT/DS27/AB/R | Ecuador, Guatemala, Honduras, Mexico, US vs. EC – Regime for the Importation, Sale and Distribution of Bananas | 9 September 1997 |
| WT/DS108/AB/R | EU vs. US – Tax Treatment for “Foreign Sales Corporations” | 24 February 2000 |
| WT/DS103/AB/R W2, | New Zealand and US vs. Canada – Measures Affecting the Importation of | 20 December 2002 |

| | | |
|---------------------|--|--|
| WT/DS113/AB/R W2 | Milk and the Exportation of Dairy Products Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products | |
|---------------------|--|--|

Arbitrator

| | | |
|-----------------|---|----------------|
| WT/DS108/ARB | EU vs. US - Tax Treatment for "Foreign Sales Corporations" | 30 August 2002 |
| WT/DS27/ARB/ECU | Equator vs. EC - Regime for the Importation, Sale and Distribution of Bananas - Recourse to Arbitration by the EC under Article 22.6 of the DSU | 24 March 2000 |

List of Abbreviations

| | |
|-------|--|
| AB | Appellate Body |
| ATC | Agreement on Textiles and Clothing |
| AoA | Agreement on Agriculture |
| DS | Dispute Settlement |
| EC | European Communities |
| FSC | Foreign Sales Corporation |
| GATT | General Agreement on Tariffs and Trade |
| NZ | New Zealand |
| para. | Paragraph |
| R | Report |
| SCMA | Agreement on Subsidies and Countervailing Measures |
| US | United States of America |
| TRIPS | Agreement on Trade-Related Aspects of Intellectual Property Rights |
| WTO | World Trade Organization |

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