When Serious Prejudice Fails to Impose Serious Consequences: Agricultural Subsidies and the Efficacy of the WTO's Article 6.3 Serious Prejudice Claims

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WHEN SERIOUS PREJUDICE FAILS TO IMPOSE SERIOUS CONSEQUENCES:
AGRICULTURAL SUBSIDIES AND THE EFFICACY OF THE WTO’S ARTICLE 6.3
SERIOUS PREJUDICE CLAIMS

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I. INTRODUCTION

The traditionally unique status of agriculture as an exception to an otherwise increasingly liberalized, international trade regime has become a key challenge in defining the future of the World Trade Organization (“WTO”).\footnote{Jeffrey J. Steinle, The Problem Child of World Trade: Reform School for Agriculture, 4 MINN. J. GLOBAL TRADE 333 (1995).} Domestic agricultural production in the United States has been protected since the New Deal era, and has seen rekindling during various farming crises spanning to the present day.\footnote{Guadalupe T. Luna, The New Deal and Food Insecurity in the “Midst of Plenty”, 9 DRAKE J. AGRIC. L. 213 (2004) (Discussing the evolution of farm policy arising out of the New Deal as well as the treatment of “preferential” crops, notably cotton, corn, wheat, rice, peanuts, and tobacco).} Protectionism in the agricultural sector is often justified by factors that do not resonate with the general scheme of trade in manufactured goods. On political grounds, states desire self-sufficiency in order to avoid become a political subservient to trading partners who control their citizenry’s food supply.\footnote{Steinle, supra note 1, at 336 (“Cyclical prices, variable production needs, and unpredictable weather all affect farming. Governments claim to mitigate these risks by making certain guarantees to agricultural producers. Such support increases the attractiveness of farming and thereby maintains high and consistent output.”).} The particularly harsh conditions of a free-trade market in agriculture also compels those states to seek price stabilization measures in order to insulate their domestic farmers from volatility in the international markets.\footnote{See Anne O. Krueger et al., Agricultural Incentives in Developing Countries: Measuring the Effect of Sectoral and Economywide Policies, 2 WORLD BANK ECONOMIC REVIEW 255 (1988) (Discussing the impact of sector-specific and economywide policies amounting to a tax on exportable goods and a subsidy for importables with the effect of stabilizing domestic producer prices).} As a result of this predilection for preserving domestic agriculture, the sector has been largely exempted from the

\begin{footnotesize}
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\item Guadalupe T. Luna, The New Deal and Food Insecurity in the “Midst of Plenty”, 9 DRAKE J. AGRIC. L. 213 (2004) (Discussing the evolution of farm policy arising out of the New Deal as well as the treatment of “preferential” crops, notably cotton, corn, wheat, rice, peanuts, and tobacco).
\item Steinle, supra note 1, at 336 (“Cyclical prices, variable production needs, and unpredictable weather all affect farming. Governments claim to mitigate these risks by making certain guarantees to agricultural producers. Such support increases the attractiveness of farming and thereby maintains high and consistent output.”).
\item See Anne O. Krueger et al., Agricultural Incentives in Developing Countries: Measuring the Effect of Sectoral and Economywide Policies, 2 WORLD BANK ECONOMIC REVIEW 255 (1988) (Discussing the impact of sector-specific and economywide policies amounting to a tax on exportable goods and a subsidy for importables with the effect of stabilizing domestic producer prices).
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WTO’s blanket goals for trade liberalization. However, the WTO’s reduction commitments were one of the major achievements of the Uruguay Round.

Recent developments suggest a hastening of the convergence of agricultural trade with mainstream liberalization of manufactured goods. As a share of global GDP, trade in agricultural goods has fallen from around 10 percent in the 1960s to 3 percent in 2005. Concurrently, its share of global merchandise trade has deteriorated from 22 percent to 9 percent over the same time frame. Similarly, food expenditure has steadily reserved a smaller proportion of disposable personal income, dropping from as high as 22 percent in 1929 to 11 percent in 2009. These trends suggest that agriculture’s diminishing position in world trade and personal consumption weaken traditional arguments of food security and self-sufficiency in favor of trade protectionism in the sector. Naturally, most future welfare gains from trade liberalization are now concentrated in agriculture. Economic simulations have shown that it would be responsible for as much as 62 percent of the increase in global welfare from full trade liberalization.

Additionally, the 2004 expiration of exemptions through the Peace Clause exposes major Member states to liability for violations of various subsidy limits. Prior to 2004, the Peace


6 Id.


8 Anderson, *supra* note 5.

Clause precluded most dispute settlement challenges to failures to comply with liberalization commitments. The expiration of this clause, compounded with Brazil’s challenge of several key U.S. subsidy programs, as will be discussed below, offers credibility to the WTO’s dispute settlement mechanism as a means of litigating similar disputes. Richard Steinberg and Timothy Josling extensively covered the ramifications of allowing the Peace Clause to expire, along with the expectation that there would be some sort of reprieve in the impending Doha Round of negotiations.\(^\text{10}\) In fact, agricultural subsidization in general, and the cotton trade in particular, took center stage as the Cotton Initiative, composed of Benin, Burkina Faso, Chad, and Mali, insisted that the 2003 Ministerial Conference in Cancun deal with cotton as a stand-alone issue apart from general agricultural negotiations.\(^\text{11}\) Opposition from U.S. Trade Representative Robert Zoellick, the WTO Director-General, and the European Union, though, forced the initiative to withdraw.\(^\text{12}\) The failures of the Doha Round, however, dispelled any hopes for those states concerned with Peace Clause liability to reassess “box” classifications and circumvent reduction commitments for the near future. With no agreement in sight, litigation seemed to be the next enforcement mechanism replacing negotiations.\(^\text{13}\) This was the general context in which the Dispute Settlement Body (“DSB”) began to flex its muscle, issuing holdings of first impression


\(^{12}\) *Id.*

\(^{13}\) *Id.* at 348.
by finding actionable subsidies in the U.S. agricultural sector amounting to serious prejudice. The compounded failure of the Doha Round and expiration of the Peace Clause made these holdings especially critical as it is a liability of indeterminate scope that may potentially stifle immense flows of agricultural subsidies within developed markets.

However bold the DSB’s recent findings to rekindle the debate over subsidy programs enacted to preserve domestic agricultural activity, the Panel’s treatment in United States – Upland Cotton of the standards set forth in the Agreement on Subsidies and Countervailing Measures (“SCM Agreement”) have agitated a number of inherent discontinuities in the foundations of the WTO and its dispute resolution mechanism. The DSB essentially conflated two legally distinct issues involved in Brazil’s complaint. The first issue, which preoccupied the Panel in its deliberations, was the issue of injury to the complainant as a result of actionable subsidies. A much greater issue, which was generally ignored, however, involves the implementation larger policy goals of the SCM Agreement and the Agreement on Agriculture to “provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time.” This paper will argue that the US - Upland Cotton holdings were detrimental to the success of such policy goals because of the DSB’s incapability to provide adequate disincentives in the form of countermeasures after the United States was held in noncompliance with the Panel’s holdings. The reason for this is twofold. The major issue, which


15 Lawrence D. Roberts, Beyond Notions of Diplomacy and Legalism: Building a Just Mechanism for WTO Dispute Resolution, 40 AM. BUS. L.J. 511, 560 (2003) (“If the WTO is to become more effective in achieving its goals, rulings must incorporate remedial approaches in addition to those that promote deterrence and enforcement.”).

will be addressed, is that the DSB’s permissive standing requirements precluded the Panel from imposing adequate retaliatory measures without seriously compromising its jurisdictional integrity. Furthermore, this problem also manifested itself in the Panel’s approach to the issue of whether the United States’ price-contingent subsidy programs amounted to serious prejudice. This finding was legally conflated with a prerequisite finding of significant price suppression, and will be discussed as a manifestation of the pervasive standing issue that existed from the beginning of the dispute. Thus, this paper will find that the Panel’s major hurdles in determining questions of serious prejudice were, in large part, responsible for the failure of the forthcoming Article 22.6 Panel in imposing countermeasures and retaliatory measures that would, in fact, succeed in either compensating a complainant like Brazil or properly incentivizing compliance with the Panel’s holdings.  

As such, the purpose of this paper is to argue that the DSB’s inability to affect a legally cogent remedy will frustrate future efforts by developing countries to use the WTO’s resolution mechanisms to enforce the de-subsidization of agricultural production in the developed world. On one front, the DSB must acknowledge the problem of subsidies in general, including agricultural subsidies in particular, as a multilateral one that cannot be resolved on a piecemeal, bilateral basis. Rather, the DSB’s approach to standing must also accommodate joint complaints in which all participants in a subsidy regime are compelled to de-subsidize simultaneously. Otherwise, the incentive to disregard any Panel holdings are much stronger, and the Panel will

face greater pressures to step outside its jurisdictional grounds in imposing countermeasures in order to deter present and future competitive disadvantages. Alternatively, the source of the DSB’s incapacity may be resolved through the Panel’s serious prejudice analysis, which found significant price suppression on the global market to be sufficient for a finding of serious prejudice to complainant’s domestic producers. The legal inquiries behind serious prejudice in *U.S. – Subsidies on Upland Cotton* must be reformed in order to ensure that a subsequent question of retaliatory concessions may be adequately addressed. Serious prejudice under Article 6.3 of the SCM Agreement needs a distinctive legal test that is outcome-determinative in order to ensure that future complainants will have sufficient recourse under Article 22.6 in the event of noncompliance. These reforms are also necessary to preserve the credibility of the DSB as a forum that Member states could rely on for enforcement of the WTO’s blanket agreements.

II. TRIAL AND APPELLATE PANEL DELIBERATIONS SURROUNDING FINDINGS OF SERIOUS PREJUDICE

In 2005, the WTO Dispute Settlement Body (DSB) found “Step 2” user-marketing payments and export credit guarantees to be prohibited subsidies under Article 3 of the SCM Agreement.\(^{18}\) The Appellate Body upheld both rulings.\(^{19}\) Four subsidies were also held to be actionable subsidies through a serious prejudice analysis under Agreement on Subsidies and

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Countervailing Measures (“SCM Agreement”) Article 5(c). This inquiry involved findings of significant price suppression on the world market, which purportedly constituted serious prejudice to Brazil’s domestic producers. In finding price suppression, the Panel looked for a slowing rate of growth or actual decline in price. The significance of that price suppression was a matter of magnitude, decided on an ad hoc basis without any disturbance from the Appellate Panel. Similarly, the Panel found that satisfying the provisions of Article 6.3 was enough to show serious prejudice under Article 5(c). This was a case of first impression regarding the implementation of Articles 5(c) and 6.3 for agricultural subsidies as well as the hybrid legal and economic analysis involved to justify the Panel’s holdings. Following the Appellate Body’s decisions, Congress repealed the Step 2 program but retained the marketing loan and countercyclical programs in the 2008 Farm Bill.

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20 Panel Report, supra note 14 (The actionable price-contingent subsidies were marketing loan program payments, Step 2 payments, market loss assistant payments, and countercyclical payments.).


23 Id.

24 Id. at 859

25 Id. at 859.

III. ARTICLE 22.6 PANEL’S DELIBERATIONS ADDRESSING ISSUES OF APPROPRIATE COUNTERMEASURES TO INDUCE COMPLIANCE

The Article 22.6 Panel analyzed the question of remedies with a balancing technique between compelling compliance and preserving its jurisdictional integrity.\(^{27}\) The DSB’s standing requirements surpass the traditional showing of injury ex post in order to protect those Members who have been precluded from pursuing their economic interests ex ante.\(^{28}\) Such a discretionary element to establish standing allows the WTO rules to be more concerned with competitive opportunities than actual trade. A violation of WTO obligations may well prevent Members from developing economic interests as easily as eroding existing economic relationships. Thus, the WTO rules are more concerned with competitive opportunities than actual trade.\(^{29}\) The panel in Korea – Dairy confirmed that the DSU has no requirement for an existing economic interest.\(^{30}\)

The guiding principle for the Panel’s determination of an appropriate level of countermeasures was that it must be “commensurate with the degree and nature of the adverse effects determined to exist.”\(^{31}\) The purpose of such concessions is meant to induce compliance given its temporary nature in the event that the Panel’s rulings are not implemented within a

\(^{27}\) Article 22.6 Panel, United States – Subsidies on Upland Cotton, ¶ 4.57, WT/DS267/ARB/2 (Aug. 31, 2009) [hereinafter Article 22.6 Panel].


\(^{29}\) Id. at 33.


\(^{31}\) Article 22.6 Panel, supra note 27, at ¶3.33; see also Article 7.9 of the SCM Agreement.
reasonable period of time. However, the inflection point in these determinations occurred where the issue of serious prejudice came to issue in determining the proportionality of Brazil’s proposed countermeasures. Brazil was allowed to bring a complaint against the U.S. without having to prove any substantive legal interest in the matter. Simply showing that competitive opportunities were impeded sufficed for the purposes of the DSB’s deliberations. In fact, much of the serious prejudice analysis involved the world suppression of prices in the upland cotton market. However, upon addressing the issue of a proportionate countermeasure, the Panel concluded that although the purpose of the remedy is to induce compliance of a world suppression of prices, the actual remedy through which this would be accomplished was, at most, countermeasures that were proportionate to the harm of such price suppression to Brazil’s domestic markets.

As a result, the precarious position of the Article 22.6 Panel in DS267 discouraged the approval of remedies anywhere near the sum required to rationalize compliance. A US$143 million annual penalty in the face of nearly US$2.9 billion in annual “profits” earned as a result of these actionable subsidies would not compel compliance because the cost is not enough to justify the cancellation of programs that yield an additional US$2.75 billion for domestic producers and exporters of upland cotton under the same economic model. The rational decision of a major exporting Member would face this cost as one that would be justifiably incurred to retain WTO concessions with the remainder of the international market for the trade of such commodities.

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32 Article 22.6 Panel, supra note 27, at ¶4.57.

33 Id. at ¶4.91.

34 Id. at ¶ 4.120 (The Article 22.6 Panel restricted the remedy to Brazil’s market share of the international trade in upland cotton (5 percent of US$2.9 billion)).
The achievement of the WTO’s objectives in agriculture face major impediments, given the profound economic incentives not to comply with the DS267 holdings in this context. The Panel’s objectives would be achieved much more effectively through such proceedings between those Members whose economic interests are sufficient to allow any holding of DS267’s scope to be respected as a credible threat. Otherwise, the WTO’s objective to secure developing countries’ share in international trade would be achieved at the graver cost of disrupting the aim toward “an integrated, more viable and durable multilateral trading system” through a dispute settlement system intended to provide “security and predictability to the multilateral trading system.” The nuances of this argument will be addressed in the following sections, but on a more general basis it is important to reassert that the nature of the DSB as a young legal forum necessitates adequate remedial measures in order to ensure the credibility of its legal conclusions.

The Article 22.6 Panel essentially limited its authority in proposing remedial measures beyond the scope of the Member-to-Member litigation. Given Brazil’s relatively negligible market share, the ease through which developing countries could receive similar treatment is a discouraging factor for future litigation in the hopes of reaching an effective solution, especially among developing country complainants. By current precedent, remedies imposed for the benefit of developing countries whose markets have been affected by the United States’ significant price suppression on the world market would simply constitute incidental costs of a subsidy program.

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37 Id.
whose vast returns justify a continual place in domestic agricultural policy. The DS267 holdings would not have the anticipated effect of blocking further operation of those litigated price-contingent subsidies.

The two most feasible methods of resolving this issue will be addressed below. For one, the WTO may embrace a collective approach when it comes to the issue of countermeasures. As addressed below, the economic framework for agricultural is unique such that a limited, bilateral approach to countermeasures would not provide the adequate incentives to induce compliance, as is intended. Alternatively, the DSB may seek substantive changes in its serious prejudice analysis to ensure that those parties who successfully establish serious prejudice will also receive the benefits of adequate remedial measures in the event that the proper policy adjustments by respondents have not been made.

IV. ECONOMIC RELATIONSHIPS AND COMPLIANCE IN US – UPLAND COTTON

Three economic characteristics of agriculture – inelastic supply; lack of alternate uses for arable cropland; and inelastic demand – question the traditional economic reasoning that simple liberalization of trade policy would resolve significant price suppression in the world markets. However, the statutory construction of serious prejudice relies on an underlying premise that market distortions cause significant price suppression, and that such price suppression may amount to serious prejudice if carried out to a certain degree. A closer view at the economic forces at work in the agricultural sector, though, suggests that classical equilibrium theory may not even apply to such situations. While traditional markets may respond to price and quantity

38 Daniel De La Torre Ugarte and Alejandro Dellachiesa, Advancing the Agricultural Trade Agenda: Beyond Subsidies, 19 GEO. INT’L ENVTL. L. REV. 729 (2007).
fluctuations, the total production of agricultural goods has been found to be unresponsive to such variables.\textsuperscript{39} For example, drastic policy changes in the 1996 US Farm Bill resulted in a precipitous drop in crop prices, yet planted acreage experienced no such adjustment.\textsuperscript{40} Similarly, major cutbacks in Canada’s support programs (35 percent over a period of three years) resulted in only a one-percent decline in farmland use between 1996 and 2001.\textsuperscript{41} Such recent bouts of unresponsiveness to major market shocks suggest that price liberalization may not necessarily resolve the issue of overproduction. These empirical observations suggest that the assumption that free market adjustments will occur may be misguided.\textsuperscript{42} Rather, alternative mechanisms have been explored, such as the idea that endowed production capacity results from ecological resources and subsequent technological gains to exploit such advantages.\textsuperscript{43} With the top 20 of 226 countries containing 84 percent of the world’s arable land,\textsuperscript{44} the permanent endowment of fixed natural resources within a country’s borders may be the significant influence, thus challenging many policy justifications of trade liberalization in the sector. In the precedential \textit{US – Upland Cotton} case, Brazil enjoyed the particular advantage of actually having significant potential for expansion.\textsuperscript{45} Brazil has the potential to cultivate up to 170 billion hectares, nearly

\textsuperscript{39} \textit{Id.} at 731.

\textsuperscript{40} \textit{Id.} at 742.

\textsuperscript{41} \textit{Id.} 743.

\textsuperscript{42} \textit{Id.} 741.

\textsuperscript{43} \textit{Id.} at 730.

\textsuperscript{44} \textit{Id.} at 732-33.

\textsuperscript{45} \textit{Id.}
the same producing hectares as in the United States in 2003. However, future litigants may not be so justified in arguing in favor of replicating the panel’s economic methods.

Although the DSB has shown a willingness to address Members’ grievances in agricultural trade, it cannot succeed without tailoring its actions to be consistent with the insurmountable force of economic incentives. The DSB’s legal approach in an otherwise diplomatic exchange increases predictability by clearly defining rules and standards, thus allowing Members to interact in a more rational manner. In this context, a finding of serious prejudice for a developing country with relatively negligible exposure to the international trade of a commodity ignores the reality that any given level of subsidy is determined as a reaction to similar subsidization by other states involved in the market. Forfeiture of this ability would result in a competitive disadvantage among subsidizing states. Governments, in fact, have unilateral incentives to offer export subsidies to their domestic firms in order to increase market share and domestic profitability. As a result, theoretical equilibrium involves positive production subsidies among the exporting states. Although their joint welfare would be higher if subsidy levels were reduced below this partial equilibrium, a single country’s decision to eliminate subsidies would simply shift market share to the subsidizing states and leave the

46 Id.

47 Roberts, supra note 15, at 525.


49 Id. at 7.

50 Id. at 14.
dissenting state in a relatively weaker position than before.\textsuperscript{51} Thus, absent international regulation and regular enforcement, the economic behavior of exporting states involves subsidization as a means of maintaining competitiveness.\textsuperscript{52}

The premise for which the upland cotton trade came to the fore was the United States’ relatively isolated position as a major exporter. The situation with upland cotton is peculiar in that the United States is the only major exporter of the commodity, providing an ideal test case for the application of serious prejudice.\textsuperscript{53} However, the subsidy programs under scrutiny challenges a common legal source of funding for all other major commodities at the heart of U.S. agricultural policy. Thus, the DSB proceedings constituted a credible threat to the legality of the remaining subsidies. This unique singular position, though, may be a critical distinguishing factor to isolate the Panel’s holdings in the event that they are introduced as precedent in future litigation. With nearly US$4.7 billion in counter cyclical payments and US$2 billion in market loss assistance from 1995-2006,\textsuperscript{54} the Panel’s objective would be to provide a strong disincentive to ensure that the marginal benefit from furthered price suppression in the world market does not exceed the marginal cost of maintaining the contested provisions of the 2008 Farm Bill.\textsuperscript{55} Brazil quantified this marginal cost as a combination of income losses on actual production and

\textsuperscript{51} Id. at 15.

\textsuperscript{52} Id. at 19.

\textsuperscript{53} Suwen Pan et al., supra note 9 (ex post simulation of elimination of U.S. cotton subsidies found that Australia, Africa, Brazil, and the former Soviet Union have the most to gain).

\textsuperscript{54} Farm Subsidy Database, Environmental Working Group, http://farm.ewg.org/farm.

replacement of foreign supply by U.S. production on the world market.\textsuperscript{56} The Panel determined that the adverse effects to world markets as a result of U.S. marketing loans and countercyclical payments in 2005 amounted to $2.905 billion.\textsuperscript{57} Based on this methodology, Brazil found US$1.037 billion as an appropriate disincentive that remains within the legal bounds of Article 7.9 of the SCM Agreement, requiring the countermeasure to be “commensurate with the degree and nature of the adverse effects determined to exist.”\textsuperscript{58} However, despite the fact that the Trial Panel based its finding of serious prejudice on significant price suppression on the world market, the Panel limited this plea for countermeasures by the damage specifically to Brazil’s domestic market, which amounted to US$134.3 million.\textsuperscript{59} Following modification to this model, the Panel pinned the damage to Brazil’s market opportunity at US$147.3 million.\textsuperscript{60}

The world’s largest subsidizers are the European Union, the United States, and Japan.\textsuperscript{61} As a percentage of total agricultural production, the top three provide subsidies that amount to 37 percent of total value of their agricultural production.\textsuperscript{62} The aforementioned non-cooperative game behavior manifested itself during the creation of the European Economic Community

\textsuperscript{56} Recourse to Arbitration by the United States under Article 22.6 of the DSU, United States – Subsidies on Upland Cotton, WT/DS267/ARB/2, ¶4.1 [hereinafter Article 22.6 Panel].
\textsuperscript{57} \textit{Id.} at ¶ 4.193 (p. 57 on pdf).
\textsuperscript{58} SCM Agreement, infra note 79, Article 7.9; see also Article 22.6 Panel, supra note 56, ¶4.2.
\textsuperscript{59} Article 22.6 Panel, supra note 56, ¶4.68.
\textsuperscript{60} \textit{Id.} at ¶4.195.
\textsuperscript{61} Kennedy, supra note 11, at 347.
\textsuperscript{62} \textit{Id.}
under the Treaty of Rome. In an attempt to reconcile a new customs union with the newly drafted GATT guidelines, the Common Agricultural Policy came to the fore as a necessary cost to preserve the region’s economic integrity among major trading powers like the United States. Substantive progress in de-subsidization efforts through GATT and eventually the WTO were, in fact, a U.S.-led response to concerns over growing dependence on the CAP for sector growth in the European Community. The most interesting actions in this context occurred as precursors to the Uruguay Round of negotiations. A complex agricultural trade war erupted between the U.S. and the EC in an effort to undermine their respective subsidy programs. In 1983, John Block, the U.S. Secretary of Agriculture, engineered a sale of one million metric tons of wheat to Egypt below market price, effectively pricing the Europeans out of that market. The EC reacted by selling one million metric tons of wheat to China under similar circumstances. Neither complained within the GATT framework for fear of having their own subsidy programs challenged. The lack of a proper legal forum led to a subsidy war in which the U.S. and EC were spending $35 billion in agricultural subsidies. The creation of the WTO and the seminal Agreement on Agriculture, though, ameliorated the fears of an ongoing subsidy war. In effect, the WTO provided a proper forum in which a simultaneous agreement to de-subsidize could be

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64 Id. at 16.

65 Id. at 21.

66 Id. at 33.

67 Id. at 33.

68 Id. at 34.
achieved through multilateral negotiation. Indeed, by 2005, the Common Agricultural Policy and Japan’s own subsidy programs came under attack by U.S. Trade Representative Robert Portman as a necessary condition in order for the United States to make similar concessions.69 The U.S. proposed a 60 percent cut in amber box subsidies, conditional on the EU and Japan cutting their own amber box programs as much as 83 percent.70

Empirical studies have also shown the use of indirect, macroeconomic policy in developing countries to manipulate such factors as the exchange rate in order to suppress producer prices.71 There is an exceptional effect in agriculture, where such indirect policies dominate any sector-specific ones.72 An overvalued exchange rate serves to stabilize producer prices and incidentally encourage imports. Moreover, further studies have shown that commodity price fluctuations have failed to produce any meaningful market reaction, as any individual price fluctuation of a commodity is distorted by economy-wide inflation and devaluation in exporting countries.73 In this context, the key factor in such price fluctuations is not an international alignment of individual commodities, but rather an alignment of the entire structure of prices in each country.74 The fiat currency system provides Member states with the ability to manipulate


70 Id.

71 Krueger, supra note 4, at 266.

72 Id. at 255.

73 BENN STEIL AND MANUEL HINDS, MONEY, MARKETS & SOVEREIGNTY 94 (Yale University Press 2009).

74 Id.
such factors, and further clouds the presupposed economic relationships between prices and output among trading nations. Such trends further distort the underlying economic relationships in international trade markets, complicating the incentives at play in situations that arise analogous to US – Upland Cotton.

Moreover, this behavior provides a strong disincentive for Members to follow any holdings that would place them in such a detrimental situation. This disincentive is particularly acute in weaker world prices or stronger exchange rates among subsidizing Members.\textsuperscript{75}

Particularly, the unilateral elimination of such subsidies will merely result in a transfer of wealth to other Members whose markets are also supported by similar subsidies.\textsuperscript{76} This established notion is contrary to the Panel’s willingness to approach serious prejudice as a matter that is independent of the complainant’s staying power. It also stands against the peculiar insistence of unilateral\textsuperscript{77} or piecemeal\textsuperscript{78} de-subsidization when it is, in fact, contrary to economic principle. Thus, the DSB’s reliance on unilateral activity to reform agricultural trade practices will inevitably face hostility and noncompliance by powerful Members in the face of adverse rulings.

\textsuperscript{75} OECD Report, \textit{A Forward-Looking Analysis of Export Subsidies in Agriculture}, 17.

\textsuperscript{76} \textsl{Id.}

\textsuperscript{77} Daniel Sumner, \textit{U.S. Farm Policy and WTO Compliance},
http://www.aei.org/docLib/20070515_sumnerWTOfinal.pdf (“The United States should consider unilaterally eliminating or altering its agriculture subsidy programs to preclude future WTO challenges and secure the benefits of freer trade for its farmers.”).

\textsuperscript{78} Oxfam Briefing Paper, \textit{Truth or Consequences: Why the EU and the USA Must Reform Their Subsidies, or Pay the Price},
V. THE EFFECT OF THE PANEL’S CHOSEN METHOD OF FINDING SERIOUS PREJUDICE

As mentioned before, one possible solution to the problem that has been identified is a substantive change in the DSB’s approach to serious prejudice analysis. As US – Upland Cotton is lauded as a case of first impression in applying serious prejudice analysis to agricultural subsidies, the inherent difficulties in the remedial stage requires a serious study of its legal application to an economically distinct environment. Article 5 of the SCM Agreement provides the legal framework for issues pertaining to serious prejudice.

Article 5 of the SCM Agreement states the following:

“No Member should cause, through the use of any subsidy…adverse effects to the interests of other Members, i.e.,:

(a) injury to the domestic industry of another Member;

…

(c) serious prejudice to the interests of another Member.”

Article 5(a), requiring a finding of injury to the domestic industry of another Member, is distinguished from Article 5(c) serious prejudice, which only requires a finding of price impact. The operation of Article 6.3 for a finding of Article 5(c) serious prejudice examines the effect of

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the volume of subsidized imports on prices in domestic markets for like products, and the consequent impact of those exports on such products.\textsuperscript{81}

The SCM Agreement’s foundation for a finding of serious prejudice reconciles the WTO’s mission of trade liberalization with a government’s desire for economic security and independence.\textsuperscript{82} These counteracting aims require a well-reasoned balancing inquiry in order to ensure an orderly harmonization in treatment between agricultural commodities and manufactured products under the WTO mandates.\textsuperscript{83}

In this spirit, the SCM Agreement has distinguished between situations where serious prejudice \textit{shall} be deemed to exist and where it \textit{may} exist.\textsuperscript{84} Serious prejudice is automatically established where,

(a) the total \textit{ad valorem} subsidization of a product exceeding 5 per cent;
(b) subsidies to cover operating losses sustained by an industry;
(c) subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems;
(d) direct forgiveness of debt, i.e., forgiveness of government-held debt, and grants to cover debt repayment.\textsuperscript{85}

\textsuperscript{81} Id.

\textsuperscript{82} Steinle, \textit{supra} note 1.

\textsuperscript{83} Id.

\textsuperscript{84} SCM Agreement, \textit{supra} note 79.

\textsuperscript{85} Id. Article 6.1(a)-(d).
On the other hand, serious prejudice *may* arise in any of the following cases:

(a) the effect of the subsidy is to displace or impede the imports of like product into the market of the subsidizing Member;

(b) the effect of the subsidy is to displace or impede the exports of like product of another Member from a third country market;

(c) the effect of the subsidy is a significant price undercutting by the subsidized products as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;

(d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of 3 years and this increase must follow a consistent trend over a period when subsidies have been granted.\(^{86}\)

This distinction in the SCM Agreement recognizes the balancing interest between these counteracting aims. Article 6.1 provides a cause of action for unqualified market distortion, while Article 6.3 covers a wider range of market manipulations that may not necessarily amount to serious prejudice. Subsidies that fall within the strictures of Article 6.1 preserve markets and industries that would be theoretically inexistent absent such support. In the long term, profit-maximizing firms that suffer fundamental operating losses would shut down as scarce capital resources would be reallocated to more efficient uses. Thus, a subsidy program removed from

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\(^{86}\) Id. Article 6.3(a)-(d).
market forces that would serve to artificially maintain a price level, cover operating losses, or alleviate a firm’s debt liabilities to such a level as to preserve an economic activity that would otherwise be inexistent is an economic concern that the SCM Agreement has intended to legally constitute serious prejudice.

A finding of serious prejudice under the conditions set forth in Article 6.3 implicates a different set of circumstantial findings. Article 6.3 situations recognize the harm of trade distorting activities, but may be justified as a matter of circumstance. These relative distortions do not necessarily carry the same implicative weight as Article 6.1, and require a separate inquiry to determine whether the magnitude of the subsidy is such that similar long-term conclusions could be drawn. The lack of an enumerated standard does not preclude the Panel’s discretion to consider the consequential impact of their sufficiency argument.87

With an outcome-determinative inquiry into serious prejudice, the Panel should examine four permutations of this situation.

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According to the Panel Report, “significant” price suppression in Article 6.3(c) of the SCM Agreement operated as “a mechanism to filter out effects of insignificant degree or

magnitude.” As a result, the Panel reserved the discretion to find significance as a matter of degree. Without any additional findings, the Panel found, as a matter of the relative magnitude of U.S. production and exports, overall price trends, and nature of the subsidies, that the price suppression qualified as significant for purposes of Article 6.3(c).

The Panel addressed causation in the significant price suppression inquiry, and intended the finding of that effect to be sufficient for a finding of serious prejudice to the interests of the complainant. Because of the DSB’s permissive standing requirements, theses “interests” not only include past, quantifiable harms, but also the deprivation of future trade activity. However, while future harm has been determined through price suppression analysis, serious prejudice to the complainant’s interests is inferred from the world price trends. The causation analysis for the latter inquiry, though, is at best speculative given the predictable incentive-driven behavior of any respondent. The elimination of the subsidy of any one party to such litigation would not resolve the serious prejudice suffered by the complainant. Rather, the serious prejudice is caused by an economic game that would simply replace the respondent who is compelled to eliminate subsidies by transferring that portion of market share among the remaining subsidizing parties. With such an outcome, it is not likely for a complainant to find reprieve in litigation for future harm caused by a truly international, subsidized agricultural trade.

Thus, it would be speculative for a Panel to find that significant price suppression in the world market is sufficient for a finding of serious prejudice to the interests of the complainant. Since such a holding is intended to cover future displacement of market share along with past

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89 Id. at ¶ 7.1328.
90 Id. at ¶ 7.1322-7.1333.
injuries, a finder of fact must incorporate models of reactionary economic behavior in order to find whether past causation, before DSB action, necessarily carries over into ex post reactions of the respondent. If other non-party Members would simply overtake the market share of a recent withdrawal of the litigated Member, holding that Member as the cause of future serious prejudice would be unfounded. For this reason, it is important to pay particular attention to make the distinction between the market shares of economies involved in a dispute of this sort. The disparity between developed and developing economies in this context is particularly acute for this very reason. A Panel may find serious prejudice as a matter of price suppression trends on the world market, but the complainant’s recompense is necessarily limited by the damage that world trend has inflicted on its domestic market. Thus, the discontinuity between the act of legally finding serious prejudice and offering adequate countermeasures to compel compliance based upon that finding becomes problematic in certain situations. In litigating a dispute between two developed or two developing economies, the disparity between the effect on world prices versus that effect’s damage to domestic markets are minimal. These situations would not provoke any serious concern as to the DSB’s ability to authorize appropriate countermeasures to enforce their holdings. On the other hand, litigation between a developed and a developing economy aggravates this discontinuity to the point of threatening the viability of any panel’s finding in favor of complainants. Although these considerations are not enumerated in the SCM Agreement’s framework, they are critical factors in the actual operation of the cause of action to bring about a harmonization of agriculture with the WTO’s general liberalization mandates. Otherwise, these holdings, though legally groundbreaking, would be practically unenforceable. A separate, outcome-determinative inquiry of this sort is necessary to ensure that liability falls on those Members who have the proper capacity to remedy the injury.
VI. LEGAL ALTERNATIVES TO CURRENT SERIOUS PREJUDICE PRECEDENT

In clarifying what the outcome-determinative inquiry should be, the future likelihood of remedial measures should be taken into account. Where such a holding is intended to require major domestic policy reversals of the respondents, there must be a credible threat that they will be adequately enforced. Thus, this problem is not germane to disputes between two developed states or two developing states, as their productive capacities are sufficient such that countermeasures would proportionately comport with the threshold level that would actually induce compliance. However, where developing Member states are complainants against a developed Member, this outcome-determinative inquiry plays a major role in ensuring that the capacity disparity between the two would not be detrimental to the complaining party seeking a resolution for injury to its domestic markets. Given the predicted displacement behavior above, though, the issue is not simply inducing compliance by the respondent party, but incentivizing a multilateral de-subsidization in that particular dispute. Thus, finding serious prejudice must also involve recognition of the fact that causality is not conditioned on that one particular respondent’s actions, but rather one of a multilateral subsidy policy.

In this sense, causality must be more profoundly addressed than it was in US – Upland Cotton. It must go beyond statistical causality issues into a more substantive inquiry about the mechanics of the economic interdependence that is actually at work in these situations. This issue must be discussed on two separate fronts. It is important to note the Article 22.6 Panel’s clarification that the issue is of serious prejudice to the particular complaining Member state. The damage to the complainant’s market in Article 6.3 factors must be to such an extent that a major subsidizer may be induced to actually alter the regime in the remedial stages of the proceedings.
For instance, the finder of fact should inquire as to the extent that a particular Member’s subsidy programs adversely affect an observed trend of price suppression in light of the fact that there are multiple players contributing to the trend. This inquiry should be outcome determinative in the sense that a finding of serious prejudice includes considerations of its adequate enforcement and assurances that an orderly dismantling of the subsidies actually occurs. Otherwise, an unbalanced de-subsidization will simply result in a market rebalancing, with price trends persisting to the detriment of the complaining Member.

As such, any serious finder of fact must also inquire as to some threshold proportionality between the complainant’s domestic market and the extent of the subsidy programs under review. This should also encourage a more collective approach toward litigating such issues, aiming to bring as many interested parties into the litigation as possible. The most efficient ideal would be toward a simultaneous liberalization, which is difficult to achieve in the DSB’s present bilateral approach through its legal proceedings. In US – Upland Cotton, the Panel’s serious prejudice holdings relied on a price suppression of world market prices despite the fact that this finding could not be adequately enforced in the remedial stage upon determination of appropriate countermeasures. Similarly, it paid no attention to other interested, subsidizing parties, such as the EU and Japan. Presumably, their effect was implicitly included in the various econometric models presented to the Panel. However, it would be a mistake to presume that the United States’ unilateral dismantling of subsidy programs would reverse these price trends, as the Sumner models suggest.

VII. INSTITUTIONAL CONCERNS ARISING OUT OF US – UPLAND COTTON AND COUNTERMEASURE PROCEDURES IN GENERAL
Given the relatively young forum in which such issues are litigated, the weight of holdings such as those in *US – Upland Cotton* may have very lasting effects on the DSB as a relevant forum for the litigation of future issues. A credible approach to an issue as weighty as government-sanctioned, multi-billion dollar trade subsidies would entrench the DSB as an appropriate forum for airing future grievances of Member states. Conversely, a faulty approach would discredit the forum, and presumably lead to greater reliance on bilateral and multilateral trading agreements, which are contracted outside the scope of the nations’ WTO obligations.

The objectives of the DSB are outlined in the Preamble of the WTO Agreement: “The Parties to this Agreement, Recognizing that their relations in the field of trade and economic endeavor should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world’s resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development.”

In order to fulfill these objectives, the DSB must be a forum, which is efficient and legitimate. It must be efficient in the sense that it must strive for minimizing the cost of litigating infringements of the underlying trade agreements. These costs are not only a matter

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91 WTO Preamble, http://www.wto.org/english/res_e/booksp_e/analytic_index_e/wto_agree_01_e.htm#p


93 *Id.*
of monetary expenditures on actual litigation, but the duration of disputes and the clarity of holdings in order to ensure that private parties respond accordingly, regardless of outcome. Similarly, that litigation must be legitimate by ensuring compliance with the DSB’s holdings, which are interpretations of the intended operation of the underlying trade agreements.

VIII. IMPLICATIONS OF PANEL HOLDINGS UPON THE CREDIBILITY OF THE DISPUTE SETTLEMENT BODY

Piecemeal reform will not work in favor of an aim to de-subsidize agricultural trade in accordance with the general objectives of the Agreement on Agriculture. The economic behavior of trading partners will counter any unilateral attempts at de-subsidization between industrialized and developing Member states. This is so because other subsidizing trading partners will simply overtake the lost market share as a result of de-subsidization. Thus, effective trade liberalization in the agricultural sector will be achieved through either (a) multilateral action, conceptually similar to those seen in the Doha Round, between major agricultural exporters to nullify the incentive to cheat, or (b) a simultaneous de-subsidization between subsidizing Members involved in litigation through the DSB.

The latter outcome will only be made possible by a willingness to conduct a thorough legal determination of the policy implications and favorable outcomes of serious prejudice inquiries. Legal jurisprudence in the serious prejudice arena must be reformed to limit a finding under Article 6.3 to those complainants whose injury will be large enough to allow any remedial 

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94 Id.
95 Id.
measures to actually compel compliance.\textsuperscript{97} Certain procedural improvements may also facilitate this outcome. Joint and several liability may serve these purposes in limited circumstances, but has been vehemently opposed by developed state Members as collective retaliation serves to balance negotiating power between developed and developing Members.\textsuperscript{98} Countersuits between major subsidizing Members may also provide potential to expedite the process of liberalization in the event that two major trading partners litigate a dispute through the DSB.

In the meantime, these recent holdings have rendered the DSB impotent in this process and have probably detracted further litigation in this arena.\textsuperscript{99} The remedies in \textit{United States – Upland Cotton} have revealed the DSB’s trouble in reconciling permissive standing requirements with properly directing Member states toward enumerated WTO objectives. The DSB’s limitation to providing Brazil countermeasures in the amount of their depressed market share weakens the incentives for future litigation, as Members may be discouraged to incur substantial litigation costs for non-compliance and nominal countermeasures.\textsuperscript{100} These outcomes were clearly factored into the United States’ strategy in handling the litigation, as efforts to improve efficiency are in their infant stages in the relatively young forum.\textsuperscript{101} Potential injury to

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\textsuperscript{99} Roberts, \textit{supra} note 15, at 559 (“Developing State Members lack the quantity of trade adequate to mount an enforcement threat through the withdrawal of concessions.”); see \textsc{Friedl Weiss, Improving WTO Dispute Settlement Procedures: Issues and Lessons From the Practice of Other International Courts and Tribunals} 382 (2000).

\textsuperscript{100} Roberts, \textit{supra} note 15, at 519.

\textsuperscript{101} \textit{Id.} at 559-60.
relationships with major trading partners also play a large role, especially in light of the limited
gains the DSB is willing to produce for its aggrieved Members.\textsuperscript{102}

\textbf{IX. LEGAL ALTERNATIVES TO COUNTERMEASURES ANALYSIS}

In light of all these considerations, the most effective and beneficial reforms may be in
the countermeasures arena. It not only provides the DSB with the most effective means of
reconciling any discrepancies from a complicated serious prejudice analysis, but also arms the
DSB with the appropriate firepower to maintain credibility by ensuring enforcement of its
holdings.

Thus, the ideal legal scheme through which the SCM Agreement’s policy goals would be
achieved must involve adversaries whose economic interest in the sector of issue are large
enough to force a remedy near the target Member’s cost of compliance. Otherwise, the DS267
holdings have the potential of suspending WTO concessions for developing countries to remedy
damages caused by the condemned price-contingent subsidies without adequately incentivizing
the actual removal of such practices. A subsidizing Member’s cost of compliance, based on
proceeds gained from price suppression of a world market, though, requires a complainant with a
comparable potential market share absent the alleged price suppression. The ideal situation
would be for such litigation, and subsequent countermeasures, to include enough of an economic
interest among complainants to allow adequate countermeasures without affecting the DSB’s
jurisdictional integrity. However, while the DSB is allowed to design Member-to-Member

\textsuperscript{102} Id. at 527.
countermeasures, there are no collective remedies or sanctions by the WTO Membership as a whole.\textsuperscript{103}

As the system currently stands, the implementation and enforcement processes rely on constant monitoring and deferring particularly contentious disputes to arbitration.\textsuperscript{104} The WTO rules are not “binding” in the legal sense, but rather collateral obligations to retain concessions that are conditional on every Member’s admittance.\textsuperscript{105} However, the very nature of countermeasures, distinct from the concept of compensation, is aimed at nullifying or impairing past damage to a Member’s markets.\textsuperscript{106} This form of remedy does not provide the adequate incentive to cease the actionable behavior, as would a resort to compensation.\textsuperscript{107} Besides these alternative forms of remedies, any type of collective enforcement would also serve to alleviate the pressure on weaker Members to bear the cost of litigation, and further stomach inefficient countermeasures as a result.\textsuperscript{108}

Alternatively, cost of compliance may also be a measure of the subsidizing Member’s justifiable cost of price stability. If one were to advance the theory that these subsidy programs are implemented in the interest of providing such stability, countermeasures could be designed to quantify and incentivize dismantling the subsidy through a marginal cost – benefit study.

\begin{itemize}
\item \textsuperscript{104} Id. at 337.
\item \textsuperscript{105} Id. at 340.
\item \textsuperscript{106} Id. at 344
\item \textsuperscript{107} Id.
\item \textsuperscript{108} Id. at 345.
\end{itemize}
Rational Member states provide subsidies in order to provide price stability for their citizenry so long as the marginal cost of providing them does not exceed the marginal benefit received.

X. **CONCLUSION**

DS267 provides precedential holdings in serious prejudice analysis as applied to actionable subsidies in the agricultural sector. Notwithstanding the boldness of the DSB in addressing agriculture, the persistent exception to international trade talks for the better part of the 20th century, the success of its program relies on a careful positioning of these legal holdings. Many institutional issues that do not plague historical legal forums suddenly come to the fore, as the DSB must maintain its relevance as a reliable legal forum to address its Members’ grievances. As such, the eventual failures of the DS267 holdings to compel any substantive change in subsidy policies from the United States suggests that there are other forces at work impeding the process that was overlooked by the trial panel.

Non-cooperative game theory contributes great insight to the issue, as one could view the larger economic incentives at work against the DS267 holdings. In recognizing these forces, there are a number of ways through with the DSB could reform itself, or its legal framework, to take account of those incentives. Otherwise, any legal advances in the forum will be inoperative as a commanding force over the behaviors of Member states. The DSB has the option of doing so by reconsidering its legal approach to serious prejudice to control for these adverse incentives. It may also do so for issues of countermeasures in order to encourage a more collective approach and provide the Panel with a credible threat to enforce its holdings. However, these factors are generally prudential, non-enumerated considerations that test the limits of the DSB’s authority as a flexible forum for hearing these disputes. An alternative approach to serious prejudice with the
aforementioned considerations may provide the DSB with the incremental improvements it needs to strengthen its authority over the litigation. Alternatively, substantive changes to the issue of countermeasures may require a concerted effort among Member states to force a reconsideration of the DSB’s mandated approach to such concessions. While a change on this front would be more politically contentious, it would relieve pressures on the substantive legal issues with the comfort that any of the hypothetical non-cooperative game theory outcomes mentioned above would be effectively adjusted for in the remedial stages of any dispute.

The context of these discussions remain particularly important as the stalling of the Doha Round has dispelled any hopes for a new multilateral agreement addressing these issues in the near term. Compounded with the expiration of the Peace Clause, the DSB will be charged with the responsibility of overseeing the growing friction in agricultural trade among its Member states. There has been criticism surrounding the latest stalled rounds of negotiations, which were intended to provide a new roadmap for expanding trade and aiding the developing world as a result.\(^\text{109}\) The United States’ and European Union’s domestic concerns have dominated policy in recent years in place of reforming policies in the international trade markets. This turn of events has left the WTO in a state of self-sufficiency, and its relevance as a policy forum will very much rely on its willingness and capability to effectively enforce its existing agreements. Given the fatal blow agriculture dealt to the Doha round, an upcoming cycle of serious prejudice challenges to actionable subsidies will be the key battleground to force these practices into compliance. Doing this successfully will allow disparate interests to focus less on temporary breaks through box reclassifications, and more toward a serious treatment of agricultural trade practices on the world stage. A pre-emptive realignment of economic incentives through the

DSB in such serious prejudice cases will greatly increase the likelihood of conclusive action when the time comes for a new round of multilateral negotiations.
SOURCE LIST


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