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Think Big and Ignore the Law: U.S. Corn and Ethanol Subsidies and WTO Law

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Phoenix X. F. Cai*

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INTRODUCTION

Everyone should care about what happens at the WTO in Geneva. It affects our lives in large and small ways. Decisions taken in Geneva affect the price of food on our table, gas at the pump, and the prices and availability of most of what we buy.

Even though at first glance, this Article deals with a specialized and esoteric field of international trade law, its sweep is much broader. The agricultural subsidies debate is highly salient in current political context of high food costs, high fuel prices and Doha development round sensitivities. 2008 has seen rocketing food and fuel prices, food rationing in many countries, and the controversial passage of the 2007 Farm Bill over a presidential veto, all of which has brought agricultural policies greater attention than in the past. At the same time, Doha Round ministerial negotiations resumed in July 2008, which seeks to significantly reform the agricultural subsidies regime, among other things, in order to ensure that the world trading system more fully benefits developing countries. Thus, the subject of this article is both timely and salient.

At the heart of this Article is an in-depth exploration Brazil’s victorious challenge to U.S. cotton subsidies in the U.S. - Upland Cotton case. The case is significant in a number of ways discussed in detail in this Article in section III.D. Moreover, the arguments Brazil raised in the case apply to corn and ethanol subsidies as well. As Doha talks continue to stall, challenges by a developing or middle-income nations to U.S. corn and other subsidies becomes more likely.

Beyond the exploration of the doctrinal and practical implications of the U.S. – Upland Cotton case, this Article also makes a number of broader theoretical and policy points. First, the case provides a useful lens through which to view the role of developing nations and their access to WTO’s dispute settlement process. Agricultural subsidies litigation may well open the floodgates to greater activism and participation in dispute settlement proceedings.

Second, this Article applies a theory of relative judicial power, the idea that the WTO’s appellate body is powerful relative to other international adjudicative bodies only because the political branch (the WTO General Council consisting of all member-nations) have failed to exhibit political leadership. It argues that agriculture provides a unique opportunity for the members of the WTO to reverse the trend of political capitulation.

A third and related point is that Doha represents an opportunity for not just the usual players (U.S., E.U., China, Japan, India, and Russia) but also emerging blocs of developing nations to play a leadership role in agriculture. Both developing and developed nations must yield in order for a consensus to emerge from future Doha talks. Failure of Doha to achieve meaningful reform would be a devastating blow to the legitimacy and continued viability of the WTO as an institution. However imperfect the
WTO may be, it would be a shame to abandon it now to fragmented bilateralism and opportunistic protectionism.

The Article proceeds in six parts.\(^1\) Part I explains the extremely complex WTO regime on agriculture and subsidies, with particular emphasis on the delicate interplay between multiple WTO agreements. It also highlights the main ways in which U.S. subsidies programs conflict with WTO rules on agriculture and subsidies. Part II discusses the U.S. – Upland Cotton case\(^2\) in detail, highlighting in particular the implications for other U.S. commodity subsidy programs, including corn. Part III examines the legal and political likelihood of a new WTO challenge against U.S. corn and ethanol subsidies and suggests that such a challenge is highly probable. Part VI analyzes the significance of the U.S. – Upland Cotton Case. Part V presents a normative lesson for international governance derived from the cases and agreements considered in this Article. Part VI concludes with a call to reverse the trend of political capitulation and bring Doha to a successful conclusion.

I. THE REGULATION OF AGRICULTURAL SUBSIDIES

A. WTO Rules

The WTO legal regime for agricultural subsidies is extremely complicated. Two different agreements apply and the interplay between them is intricate, to say the least. The Uruguay Round of negotiations,\(^3\)

\(^1\) Before proceeding, a few short notes on scope are in order. First, this Article will not focus on U.S. farm policy in general. Rather Farm Bills are considered only to the extent that they contribute to an understanding of the potential conflicts between U.S. subsidy policies and WTO rules. Second, this Article focuses primarily on the international regulation of agricultural subsidies and does not consider in any detail the domestic regulatory and legal regime, which is subject to international scrutiny at the WTO level.


\(^3\) The Uruguay Round (1986-1994) of multilateral trade talks led to the idea of creating an umbrella World Trade Organization. The Uruguay Round realized the need for a more adjudicative process for dispute settlement, a reformation of trade in textiles and agriculture, and an expansion of the trade agreements to include intellectual property and trade in services. On April 15, 1994, 123 participating countries, including the United States, signed the agreement for the formation of the WTO. Under the WTO, the General Agreement on Tariffs and Trade [hereinafter, GATT] still serves as the WTO’s umbrella treaty for trade in goods. See generally, WTO, The Uruguay
which created the WTO, subjected agricultural subsidies to serious restrictions under international trade rules for the first time\textsuperscript{4} under the Subsidies and Countervailing Measures Agreement (the “SCM Agreement”)\textsuperscript{5} and the Agreement on Agriculture.\textsuperscript{6} The SCM Agreement applies to subsidies and countervailing duties generally, across all industries, not just agriculture. Although trade in agriculture has been subject to the GATT from the very beginning, it was always singled out for special treatment due to its particular social, cultural, and political importance.\textsuperscript{7} The Agreement on Agriculture formalized the special

\textsuperscript{4}Certain provisions in the GATT did apply to agricultural products prior to the creation of the WTO agreements during the Uruguay Round, such as, to a limited extent, GATT Article XVI. See Fabian Delcros, The Legal Status of Agriculture in the World Trade Organization, 36(2) J. WORLD TRADE 219, 223-23 (2002).


\textsuperscript{7}Agricultural trade is an area subject to intense government intervention and other protectionist measures that conflict with the free trade regime. Most developed nations and many developing nations still give high levels of tariff and non-tariff protection to agriculture and agriculture was not the subject of serious negotiated discipline until 1994. Many reasons have been offer for this exceptionism, many of them rooted in culture, history and politics. Agricultural food production has deep cultural and historical significance for all human societies. Even industrialized nations still, to some extent, cling to the myth and romance of the small family farm as a symbol of agrarian utopianism. Although farming requires intense effort, it is also extremely unpredictable and subject to the vicissitudes of rainfall, weather, and conditions beyond human control. Thus, many countries provide farmers assistance to weather such hardships. In addition, many nations cleave to the belief that protecting domestic food supply by assisting domestic farmers is a matter of national interest. For example, American farm policy is still very much driven by notions of “food security” and “food supply autonomy. In addition, nations that rely extensively on a single food crop, such as rice for many Asian nations, are often reluctant to rely on food imports of that staple crop. Lastly, the farming industry wields significant political clout. This remains true in developing countries where agriculture comprises a large share of the gross domestic product (“GDP”) and in countries like the United States where agriculture represents only 1% of the GDP.
treatment by subjecting trade in agriculture to its own regime within the WTO. Subsidies for agricultural products are regulated by both the Agreement on Agriculture and the SCM Agreement.

However, the two agreements are not co-equal. The SCM Agreement is somewhat subservient to the Agreement on Agriculture pursuant to an extraordinary “supremacy clause” in the Agreement on Agriculture. Article 21 of the Agreement on Agriculture explicitly states that provisions in other WTO agreements are subject to the Agreement on Agriculture. This provision sets the stage for the complicated interplay between the SCM Agreement and the Agreement on Agriculture.

B. The SCM Agreement

The SCM Agreement regulates all subsidies in any economic sector. In broad terms, it differentiates between legal and non-legal subsidies and allows for the imposition of WTO-consistent countervailing duties on subsidized imports to off-set the effects of illegal or actionable

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8 While the Agreement on Agriculture is the principal document governing trade in agriculture, it does not operate in a vacuum. As a WTO agreement, it is subject, of course, to dispute settlement procedures of the WTO as well as pre-WTO GATT jurisprudence dealing with agricultural trade. In addition, there are complex linkages to other WTO agreements, such as the SCM Agreement, discussed in detail infra Note 5. Agriculture is also subject to special safeguards rules under the Safeguards Agreement, permitting trade restrictions of agricultural products and product standards and health and safety standards under the SPS Agreement.

9 Agreement on Agriculture, supra note 6, art. 21.

10 Id. art 21.1; Article 21 provides that “[t]he provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this agreement.” see also Declors, supra note __, 248.

11 For a succinct and persuasive discussion of the economic and political rationale for regulating subsidies, see Michael K. Young, United States Trade Law and Policy 68-70 (2001).

12 Actionable, yellow and non-actionable

13 Under the WTO system, member nations confronted with illegal subsidies may choose between either multilateral solution or a unilateral one, but not simultaneously or cumulatively. The aggrieved party can initiate a WTO dispute settlement procedure to seek the removal of the subsidy by another WTO member. In this dispute, the SCM Agreement governs. In the alternative, it can choose to unilaterally impose a countervailing (or off-setting) duty on the subsidized import. The unilateral approach usually begins when a domestic industry injured by subsidized imports from another country initiates a countervailing duty investigation under its country’s domestic laws. If the investigation finds that the subsidy is present and is more than de minimus (more than 1% of the ad valorem value), then it can impose a duty on the subsidized import
Again, in broad terms, the SCM Agreement is primarily aimed not at the complete elimination of subsidies, but rather at limiting the use of the most trade-distorting subsidies, such as export subsidies.

The SCM recognizes and distinguishes three categories of subsidies: 1) prohibited subsidies, commonly called red light subsidies, 2) actionable subsidies, commonly called yellow light subsidies, and 3) green light subsidies. Green light subsidies are defined in Article 8 of the SCM Agreement as subsidies that were given a “safe harbor” from challenge for a six year period. However, Article 8 expired in 2000 when members were unable to agree on retaining it. Thus, green light subsidies no longer exist, unless they should be revived in subsequent negotiations. Therefore, the SCM Agreement distinguishes between prohibited and actionable subsidies.

(1) Prohibited or Red Light Subsidies

Prohibited or red light subsidies are the most trading distorting subsidies.\(^{15}\) They consist of export subsidies and import substitution subsidies.\(^{16}\) Export subsidies are those given by a government on the condition that the subsidized product is exported. They are \textit{per se} illegal due to their direct and serious trade-distorting effects.\(^{17}\) A second category of red light subsidies consist of government payments for the purpose of buying domestic goods rather than imported goods for use in domestic manufacturing. They are essentially payments to domestic producers for import substitution or domestic content. They lower the cost of domestic content and obviously suppress foreign imports by making it artificially cheaper to buy domestic content. To give a simple example of both types of

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\(^{14}\) The SCM agreement and GATT allow for the imposition of countervailing duties as a remedy against trade distorting subsidies.

\(^{15}\) SCM Agreement, \textit{supra} note 5, arts. 3 & 4.

\(^{16}\) SCM Agreement, \textit{supra} note 5, art. 3.1.

prohibited subsidies, imagine that the U.S. gives a $.50/bushel subsidy for all corn that is exported as well as a separate $0.50/bushel subsidy to any U.S. ethanol producer who purchases American corn for use in ethanol production. The first would be a red light export subsidy and the second a red light import substitution or domestic content subsidy.

Both export subsidies and import substitution subsidies are presumptively illegal under the SCM Agreement without any further showing of adverse effect or serious prejudice, whereas such analysis is required for actionable subsidies, discussed below. This is important to keep in mind when considering the interplay between the Agriculture Agreement and SCM Agreement. The presumption of illegality of red light subsidies applies to agricultural subsidies as well. Annex I of the SCM Agreement provides an illustrative list of red light subsidies.\(^{18}\) All of them are per se illegal, regardless of the sectors covered. Thus, if an agricultural subsidy falls under one of these prohibited categories under the SCM Agreement, it is per se illegal.

(2) Actionable or Yellow Light Subsidies

Actionable or yellow light subsidies may or may not be illegal under the SCM Agreement depending on their trade-distorting effect. Under Article 5 of the SCM Agreement, they can be illegal if they result in “adverse effects” to other countries.\(^{19}\) Article 5 provides several ways for aggrieved countries to prove adverse effects,\(^{20}\) but in practice the most relevant one\(^ {21}\) is a showing of “serious prejudice”\(^ {22}\) either in the form of

\(^{18}\) SCM Agreement, supra note 5, Annex I.

\(^{19}\) SCM Agreement, supra note 5, Art. 5.

\(^{20}\) Id. art 5. (“No Member should cause, through the use of any subsidy...adverse effects to the interests of other Members....”). Article 5 identifies three types of adverse effects: “(a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits accruing directly to other Members under GATT 1994 ...[and] (c) serious prejudice to the interests of another Member.”


\(^{22}\) SCM Agreement, supra note 5, art 5. For an excellent exposition of the challenges involved in prosecuting “injury to domestic industry” or “nullification and impairment” claims, see Richard H. Steinberg & Timothy E. Josling, When the Peace Ends: The Vulnerability of EC and US Agricultural Subsidies to WTO Legal Challenge, 6 J. INT’L ECON. L. 369, 379-85 (2003).
price suppression or market share loss. This Article will give some specific examples of how Brazil successfully argued serious prejudice in the Upland Cotton case under both methods below in Section II. For now, a general understanding of the two methods will suffice. A subsidy will be actionable if it is found to lower the price for the subsidized commodity in an applicable market. Likewise, a subsidy will also be actionable if the aggrieved party can show that the subsidy enabled a country to take a portion of the aggrieved party’s market share for that commodity.

Another simple example illustrates the analysis for actionable subsidies. Assume that the U.S. $0.50/bushel for corn subsidy we saw earlier was not tied to exports or domestic content for manufacturing, but consists instead of a simple direct payment of $0.50/bushel to all U.S. corn growers. Assume also that Mexico wished to allege before the WTO that the subsidy is highly trade-distorting and thus illegal. Mexico would not be able to argue that this subsidy is per se illegal because it is not linked to exports or domestic content. It is an actionable or yellow light subsidy and Mexico would need to show serious prejudice. Mexico would prevail if it succeeded in proving, for example, either (a) the price of corn in North America fell substantially, say by $0.40/bushel after the subsidy was imposed or (b) the percentage of corn sold by Mexican farmers in North America fell by a significant percentage, say 40%, after the creation of the subsidy.

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23 See SCM Agreement, supra note 5 arts. 6.3(a)–(d). Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:

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

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

(c) the effect of the subsidy is a significant price undercutting by the subsidized product 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; or

(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 three years and this increase follows a consistent trend over a period when subsidies have been granted.

24 These examples are intentionally grossly simplified for the purpose of explaining how the SCM Agreement distinguishes between types of subsidies. In reality, subsidies are structured in complicated ways and their effects are not clear-cut, requiring intense economic analysis to prove serious prejudice.
(C) The Agreement on Agriculture

It is important to keep in mind that the Agreement on Agriculture was intended by its drafters as the first step in a series of meaningful reforms.\footnote{John Croome, Reshaping the World Trading System: A History of the Uruguay Round 11, 30-31 (1995) (detailing the negotiation history of the Uruguay Rounds and describing the agreement on agriculture as a crucial first step).} The preamble describes the Agreement as beginning “a process of reform of trade agriculture” leading to a trade regime as free from intervention, distortions and restrictions as possible.\footnote{The preamble of the Agreement on Agriculture declares that its goal is to “provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets.” Agreement on Agriculture, supra note 6, Preamble.} The Doha Development Agenda (“DDA”) of 2001\footnote{The Doha Development Agenda was announced in the Ministerial Conference Declaration launching the Doha Round of trade talks. See World Trade Organization, Ministerial Declaration of 14 November 2001, ¶¶13-14, WT/MIN(01)/DEC/1, 41 I.L.M. 746 (2002) [hereinafter Doha Declaration].} was meant to be the second step in this process. Even though agriculture is only one among many contentious trade issues, by placing it at center stage, the DDA has staked its success on achieving meaningful reforms in agriculture.\footnote{Sungjoon Cho, Doha’s Development, 25 BERKELEY J. INT’L L. 165, 170; see also Melaku Geboye Desta, Agriculture and the Doha Development Agenda: Any Hopes for Improvement?, in ESSAYS ON THE FUTURE OF THE WTO: FINDING A NEW BALANCE 149 (Kim Van der Borght et al. eds., 2003) (explaining that agriculture was the “deal-maker” the Doha conference); U.S. Gen. Accounting Office, World Trade Organization: Early Decisions Are Vital to Progress in Ongoing Negotiations, Report to Congressional Requesters 12-13 (Sept. 2000), available at http://www.gao.gov/new.items/d02879.pdf.} Therefore, it is of critical importance that Doha yields results on agriculture or the promise of both the Agreement on Agriculture (one of the culminations of the seven year-long Uruguay Round) and the Doha Round (now in its eighth year) shall go unfulfilled.

In keeping with the overall goal of the world trading regime to make regulation of trade as transparent as possible, the Agreement on Agriculture favors tariffication. It admonishes members to convert all non-tariff barriers into tariffs, which are initially set (“bound”) at generous levels, but which will be reduced by percentages to be agreed upon in future negotiations like Doha.\footnote{Agreement on Agriculture, supra note 6, art. 4.2.} One of the difficult issues in the Doha negotiations is how deeply...
to cut agricultural tariffs.\(^{30}\) In addition to lowering tariffs, members are also bound to reducing the levels of subsidies from their 1992 levels, the year chosen as the baseline for the Agreement on Agriculture. This means that the subsidies commitments in the Agreement on Agriculture represent “the ceiling, the upper bound of permissible protection to farm goods.”\(^{31}\)

Another highly contentious point in Doha is how to realize meaningful reductions in subsidies support.

Like the SCM Agreement, the Agreement on Agriculture also distinguishes between export subsidies and domestic support, and domestic support is further divided into sub-categories, known by their vernacular names as Amber Box, Blue Box and Green Box.\(^{32}\)

**(I) Export Subsidies**

Unlike the SCM Agreement, the Agreement on Agriculture does not deem export subsidies to be *per se* illegal.\(^{33}\) Rather, they are subject to limits on both value and quantities of products to be subsidized. Developed

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\(^{31}\) MITSUO MATSUSHITA, THOMAS J. SCHONBAUM & PETROS C. MATROVIDIS, *THE WORLD TRADE ORGANIZATION: LAW, PRACTICE, AND POLICY* 301 (2006); see also Article 3.2 of the Agreement on Agriculture, *supra* note 6, which provides, “[s]ubject to the provisions of Article 6, a Member shall not provide support in favor of domestic producers in excess of the commitment levels…of its schedule.” Article 6 exempts certain domestic measures from the calculation of its support and asserts that “a Member shall be considered to be in compliance with its domestic support compliance reduction commitments in any year in which its domestic support in favor of agricultural producers . . . does not exceed” levels specified in that Member’s commitment schedule. See Agreement on Agriculture, *supra* note 6, art. 6.1, 6.3.

\(^{32}\) WTO lawyers and policy-makers clearly love colors. The terms Amber Box, Blue Box and Green Box do not appear in the Agreement on Agriculture, but are used ubiquitously, both within the WTO and the academic literature. See World Trade Organization, Background, Domestic Support in Agriculture: The Boxes, http://www.wto.org/english/tratop_e/agric_e/agboxes_e.htm (last visited May. 13, 2008) [hereinafter The Boxes].

\(^{33}\) As discussed infra in section ___ and ___, the Agreement on Agriculture prevails over conflicting provisions in the SCM Agreement because it is considered a more specific agreement than the SCM Agreement under the international law doctrine of *lex specialis*, which holds that the more specific agreement prevails over a general contemporaneous one. This means that in situations where both agreements arguably apply, the Agreement on Agriculture will govern. This interpretation is re-enforced by both Article 13 (the Peace Clause) and Article 21 (the Supremacy Clause) of the Agreement on Agriculture.
nations committed to cut export subsidies 36 percent by value and 21 percent by quantities of exported products over a six year period. Developing nations agreed to similar cuts of 24% and 14%, respectively, but over a ten year period. The poorest counties, the least developed countries (LDCs) were not required to commit to any reductions as most do not have the resources to significantly subsidize exports. At the Hong Kong Ministerial Conference in 2005, WTO members reached an agreement in principle to eliminate all agricultural export subsidies by 2013. However, the implementation of such an agreement is left to the Doha Round to resolve, and so far, it has been mired in controversy over myriad issues, such as market access, special safeguard mechanisms and subsidies.

While agricultural export subsidies are not per se illegal under the Agreement on Agriculture, they were immune from WTO challenge under the Peace Clause of the Agreement on Agriculture. However, now that the Peace Clause has expired, they ought to be subject to the general terms of the SCM Agreement. Even if there were not treated as per se illegal, they ought to be subject to the same serious prejudice analysis for yellow light subsidies under the SCM Agreement. Furthermore, it is quite clear that they would count against a country’s overall subsidy reduction commitments.

(2) Domestic Support

34 Agreement on Agriculture, supra note 6, arts. 3.3 & 8-9.
35 Id.
36 Id. art 15.2.
39 See discussion infra in section I.3.
40 The Hong Kong Ministerial Conference agreement for the complete elimination of export subsidies in agriculture suggests that members view them as prohibited.
41 All subsidies count towards a country’s total agricultural subsidy reduction commitments. See Agreement on Agriculture, supra note 6, arts. 6-7 (noting exemptions for a limited number of minimally distorting green box subsidies, referenced in Annex 2, and providing exceptions for developing nations).
Domestic support subsidies are limited by the Agreement on Agriculture to differing degrees depending on how much they distort production and trade. Even though domestic support are not tied to exports and thus do not exert the same direct distortions, they can nonetheless encourage over-production of a crop and thus depress prices for that crop. If that is the case, the subsidy is considered to be trade-distorting. The Agreement on Agriculture distinguishes between highly trade-distorting subsidies (Amber Box), minimally trade-distorting subsidies (Blue Box), and non-trade-distorting subsidies (Green Box).

(a) The Amber Box

Amber Box subsidies are considered to be the most trade-distorting. They include price support subsidies tied to the current market price of a product or subsidies directly related to production quantities. For example, a subsidy that calculates payments to corn farmers based on the difference between the guaranteed price (say $1.00/bushel) and the market price (say $0.80/bushel), resulting in a subsidy of $0.20/bushel would be an Amber Box subsidy. Formally, Article 6 of the Agreement on Agriculture defines Amber Box subsidies as all subsidies that do not fall into the Blue and Green Boxes.

Amber Box subsidies are subject to two important restrictions under the Agreement on Agriculture: de minimus limitations and Total Aggregate Measure of Support (“Total AMS”). Countries are allowed to make de minimus payments at agreed upon levels: 5% of agricultural production for developed countries, 10% for developing countries, and no limitation for LDCs. In addition, each country also agreed to slow down or reduce the use of these subsidies. Developed countries agreed to reduce their annual domestic support of their Total AMS (based on 1986-88 levels) by 20% over a six year implementation period beginning in 1995. Developing nations agreed to Total AMS reductions of 13% over a ten year period. LDC’s were again exempt. For the U.S. the Total AMS for Amber Box subsidies at the end the six year implementation period was approximately $19.2 billion. Any Amber Box spending by the U.S. in excess of $19.2 billion is vulnerable to WTO challenge. In determining the total amount of allowable subsidies, the characterization of the subsidy at issue as Amber or Green Box is therefore quite important.

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42 Agreement on Agriculture, supra note 6, art. 6.4.

(b) The Blue Box

Blue Box subsidies are Amber Box subsidies that have been modified to lessen the trade-distorting effects as much as possible by imposing requirements for farmers to limit production. As such, they are often referred to as Amber Box with conditions. They are considered less trade-distorting than Amber Box subsidies because they limit rather than encourage production, and therefore are less likely to lower prices. Under the Agreement on Agriculture, Blue Box subsidies are also not subject to any caps or limits on spending. However, there is always the risk that Blue Box subsidies might be re-characterized as Amber Box ones and thus count against the Total AMS reduction commitments.

Blue Box subsidies are also a hot topic of negotiations in the Doha Round. Some countries believe that keeping the Blue Box unchanged is critical for easing the transition away from Amber Box subsidies without too much hardship on farmers. Other countries want to impose limits or reduction commitments on them. Others believe the category should be eliminated and all Blue Box subsidies should count as Amber Box ones.

The U.S. is pursuing a strategy that would expand the ambit of Blue Box subsidies. The U.S. eliminated the use of production limiting subsidies in the 1996 Farm Bill, but is currently pursuing the strategy of ensuring that counter-cyclical payments are shielded as Blue Box subsidies, either by creating a new category or by re-defining the existing definition of Blue Box subsidies.

44 Agreement on Agriculture, supra note 6, art. 6.5.


46 See The Boxes, supra note 32.

(c) The Green Box

Green Box subsidies are those that are not at all, or only minimally, trade-distorting.\(^{48}\) As such, they have to be completely decoupled from, or not contingent on, the production of any crop. They also have to not provide any price support or be linked to price levels.\(^{49}\) They are not considered trade-distorting because they are divorced from production levels or prices, and thus do not promote over-production or price suppression. Green Box subsidies are not subject to any caps or limits. Thus, countries should structure their subsidies as Green Box ones to the fullest extent possible. Examples of common Green Box subsidies include conservation and environmental measures, rural school construction or other rural improvement projects, research and education, regional development programs, disease and pest control, agricultural training and extension services, and other programs not tied to the production of any given crop.\(^{50}\)

The concept of Green Box subsidies as such is not under attack in the current round of negotiations. However, certain types of Green Box payments are contentious. Some countries have argued in Doha that some Green Box subsidies may not meet the minimally trade-distorting test, either because of the large amounts paid or the nature of the subsidies themselves. Examples of subsidies that may be reclassified or limited as a result of the Doha Round include direct payments to farmers\(^{51}\), decoupled income support\(^{52}\), and government support for income insurance and income guarantee or safety-net programs.\(^{53}\)

(3) Expiration of the Peace Clause

The Agreement on Agriculture contains an extraordinary due restraint\(^{54}\) clause in Article 13, known as the Peace Clause.\(^{55}\) The Peace Clause is the

\(^{48}\) Agreement on Agriculture, supra note 6, Annex 2, ¶1.

\(^{49}\) Agreement on Agriculture, supra note 6, Annex 2.

\(^{50}\) Id.

\(^{51}\) Agreement on Agriculture, supra note 6, Annex 2, ¶5.

\(^{52}\) Agreement on Agriculture, supra note 6, Annex 2, ¶6.

\(^{53}\) Agreement on Agriculture, supra note 6, Annex 2, ¶7. Government supported insurance programs that did generate enough revenue to cover expenses were struck down in Upland Cotton, see discussion infra section ___.

\(^{54}\) Article 13 of the Agreement on Agriculture is entitled “Due Restraint.” See Agreement on Agriculture, supra note 6, art. 13.

\(^{55}\) Agreement on Agriculture, supra note 6, art. 13.
child of an interesting historical convergence that coincided with the Uruguay Round (1984-1994). At the time, the U.S. government favored the complete elimination of all agricultural export subsidies. The European Union in particular, which still heavily subsidizes its farming sector, resisted and insisted on a transition period for its farmers. The result was a last minute compromise, known as the Blair House Accord in November 1992, which became the Peace Clause.\(^{57}\)

The Peace Clause shielded agricultural subsidies from legal challenge under the SCM Agreement for a nine year period,\(^{58}\) so long as such subsidies did not exceed levels in 1992, the year chosen as the baseline. The immunity from WTO challenge worked so long as subsidies complied with the Agreement on Agriculture, including the limits on Amber Box spending. However, the nine year Peace Clause expired in January 1, 2004.\(^{59}\)

Despite the expiration of the Peace Clause, some commentators have espoused the position that Article 21 of the Agreement on Agriculture nonetheless shields agricultural subsidies from challenge per the SCM Agreement.\(^{60}\) Other scholars reach the same conclusion by relying on the principle that the more specific provisions of the Agreement on Agriculture should prevail over the general provisions of the SCM Agreement if the two ever conflict, even in the absence of the Peace Clause.\(^{61}\)

However, neither argument is very persuasive. Both Article 21 and the principle of specificity only dictate that the Agreement on Agriculture prevails over the SCM Agreement in the event of a direct conflict. For

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57 Id., 211.

58 Agreement on Agriculture, supra note 6, art. 1(f) (“implementation period” means the six-year period commencing in the year 1995, except that, for the purposes of Article 13, it means the nine-year period commencing in 1995.”).

59 Id.

60 See Delcros, supra note 4, 249-51; see also Agreement on Agriculture, supra note 6, art. 21.1 (“The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement.”).

61 See Didier Chambovey, 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, 36(2) J. WORLD TRADE 305, 310 (2002) (arguing that “the specificity of the [Agreement on Agriculture’s] rules on subsidies indicates that its object and purpose are to create a distinct legal regime, tailor-made for agricultural products, and that the general rule (the SCM Agreement) simply does not suit the particular conditions of agriculture.”).
example, a direct conflict exists between the SCM Agreement’s treatment of export subsidies as per se illegal and the Agreement on Agriculture’s characterization of them as not per se illegal but subject to negotiated reduction commitments. Because the latter is more specific, it governs.\textsuperscript{62} Similarly, because the related provisions on Amber Box caps in the Agreement on Agriculture are also more specific (and conflict with the SCM Agreement), they would also prevail.

In sharp contrast, no direct conflict exists with respect to the question of immunity from challenge because only one provision in either agreement speaks to that issue, i.e., Article 13 or the Peace Clause in the Agreement on Agriculture. Article 13 is also the only provision in the Agreement on Agriculture to refer directly to the SCM Agreement. The introduction of Article 13 makes it clear that it only protects agricultural subsidies from challenge “[d]uring the implementation period,” which expired January 1, 2004. A sensible interpretation of the Peace Clause can lead only to the conclusion that the Peace Clause no longer serves as a shield after January 1, 2004.

Moreover, any contrary interpretation of the Peace Clause’s effect violates another fundamental principle of international law with respect to treaty interpretation. The WTO dispute settlement bodies have made clear that they follow customary norms of treaty interpretation as enshrined in the 1969 Vienna Convention on the Law of Treaties.\textsuperscript{63} One such customary norm is to interpret treaties so as to not render any provision unnecessary or


Extending the protection of the Agreement on Agriculture to agricultural subsidies even with the expiration of the Peace Clause would render the Peace Clause both unnecessary and redundant. It is hard to believe that a controversial and specifically negotiated provision like the Peace Clause, which was added at the last minute in the Blair House Accord, would be intended by its drafters as mere verbiage. Moreover, this interpretation of the Peace Clause is consistent with the approach taken by the Appellate Body in U.S. – Upland Cotton.

In conclusion, the special immunity agricultural subsidies enjoyed disappeared with the expiration of the Peace Clause. The expiration of the Peace Clause opens up the possibility for two categories of potential suits: (1) those alleging pre-Peace Clause violations (such as Brazil’s argument in Upland Cotton that U.S. Amber Box subsidies exceeded agreed-upon 1992

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65 Another example of the specifically negotiated terms of the Peace Clause is its nine-year implementation period, whereas all other provisions of the Agreement on Agriculture have a six year implementation period. See Agreement on Agriculture, supra note 6, 1 (f), 13.

66 See Desta, supra note 56, 211, 440.

67 See accord, Porterfield, supra note 21, 1010.

68 See discussion infra, section II.
levels in the Agreement on Agriculture) and (2) those alleging post-Peace Clause violations (such as claims of “serious prejudice”\(^{69}\) or “adverse effects”\(^{70}\) under the SCM Agreement).

D. **U.S. Subsidies Regimes: The 1996, 2002 and 2007 Farm Bills**

(1) **Pre-1996 Farm Bills**

While it is beyond the scope of this article to describe in detail the various U.S. Farm Bills,\(^{71}\) it is important to have a basic understanding of their structure in order to understand both the U.S. - Upland Cotton case and the current debate in the Doha Rounds about the draft 2007 Farm Bill. From the 1930s to the 1990s, U.S. farm policy developed autonomously with little reference to world trade rules. In broad terms, the object of U.S. Farm Bills\(^{72}\) during this period was to maintain the stability of commodity crop prices\(^{73}\) through a system of production restrictions and price-

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\(^{69}\) Agreement on Agriculture, *supra* note 5, art. 5.

\(^{70}\) SCM Agreement, *supra* note 5, art. 6.


\(^{72}\) The U.S. Congress passes a new farm bill generally every five years. If a new farm bill is not passed prior to the expiration of the prior one, Congress generally extends the prior one. For example, until the 2007 Farm Bill was finalized in June 2008 the 2002 Farm Bill governed. The farm bill is a huge omnibus legislation with a budget of approximately $16.5 billion and covers not only farm subsidies, but also programs for environmental conservation, nutrition programs and loans for farm ownership as well as funding for research related to these programs.

\(^{73}\) A consistent feature of U.S. farm policy that has held true even today is that a small number of crops (corn, upland cotton, rice, wheat and soybeans) receive the lion’s share of all subsidies. These five commodities receive about 93% of all subsidies. See U.S. DeP’T OF AGRIC., 2007 FARM BILL THEME PAPERS, RISK MANAGEMENT 20 (2006), [http://www.usda.gov/documents/Farmbill07riskmgmtrev.doc](http://www.usda.gov/documents/Farmbill07riskmgmtrev.doc) (“The 2002 Farm Bill was developed under a budget that permitted spending to increase by about $8 billion per year above the levels projected under a continuation of the 1996 Farm Bill.”) [hereinafter U.S DeP’T OF AGRIC., RISK MANAGEMENT PAPER]. There are also subsidy
contingent loan and payment programs. For example, production restrictions in the form of paying farmers to leave land fallow, supported prices by limiting supply. Price guarantees were also provided through non-recourse loans, in which the government would provide loans using crops as collateral and allow farmers to forfeit the crops to the government’s Commodity Credit Corporation should the price of those crops fall below a set floor. Similarly, the deficiency payment program in the 1990 Farm Bill paid farmers when commodity prices fell below a fixed target, contingent upon farmers’ compliance with planting restrictions by acreage for that commodity.

(2) The 1996 Farm Bill

The 1996 Farm Bill was the first to integrate WTO rules, including the commitment the U.S. made in the 1994 Agreement on Agriculture to cap Amber Box spending at $19.1 billion. As such, the 1996 Farm Bill made drastic changes to U.S. farm policy. More than any other previous Farm Bills, the 1996 Farm Bill was an experiment with a free-market approach. Subsidies under the 1996 Farm Bill for the same five commodity crops (wheat, corn, upland cotton, rice and soybeans) decreased over a seven year implementation period in order to keep Amber Box spending under the programs that benefit other commodities—most significantly the sugar and dairy programs. Both programs function primarily by supporting the market price of the commodity rather than by providing direct payments to farmers. The sugar program functions through a system of price-support loans to sugar processors and tariff rate quotas that limit the access of foreign producers to U.S. sugar market. See Farm Security and Rural Investment Act of 2002, Pub. L. No. 107-171, 116 Stat. 134, § 1401 (2002) [hereinafter 2002 Farm Bill]. Milk prices are supported through a system of government purchases of “cheese, butter, and nonfat dry milk produced from the milk.” See 2002 Farm Bill § 1501.

74 See Lauck, supra note 71, 13.

75 See Lauck, supra note 71, 13.


$19.1 billion limit. However, the 1996 Farm Bill did retain the non-recourse loan program of previous bills.

The gradual reduction in subsidies payments was politically acceptable because most believe that the increased revenues from agricultural exports under the Agreement on Agriculture's reduced tariffs would more than offset the loss of the subsidies. However, these hopes were not realized. Commodities prices collapsed in the late 1990s. As a result, Congress passed a series of emergency bills providing supplemental market loss assistance (“MLA”) payments to American commodity crop farmers.

(3) The 2002 Farm Bill

The 2002 Farm Bill reversed the course of reducing farm subsidies undertaken in the 1996 Farm Bill. Compliance with WTO rules did not

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79 See 1996 Farm Bill, supra note 77, §113(a) (imposing a gradual reduction in production flexibility contract payments, which replaced deficiency payments under the prior Farm Bill for the same commodity crops, ending in fiscal year 2002.) Payments under the production flexibility contracts were based upon 85% of the contract acreage and not tied to the production of any particular commodity, so long as recipients did not produce any fruits or vegetables on the contract acreage. Id. at §118.


81 See Lauck supra note 71, 24-31.

82 See ECON. RES. SERV., U.S. DEP'T OF AGRIC., FARM AND COMMODITY POLICY: 1996-2001 COMMODITY PROVISIONS--EMERGENCY AND SUPPLEMENTAL ASSISTANCE, http://www.ers.usda.gov/briefing/FarmPolicy/1996emerge.htm (last updated Oct. 18, 2006); see also Upland Cotton Panel Report, supra note 2, ¶7.1301 (“The United States has acknowledged that MLA payments were paid in light of low commodity prices.”) The emergency MLA payments were not popular, criticized by farmers as too unpredictable, and were replaced by counter-cyclical payments in the 2002 Farm Bill. See discussion infra II.D (3).


84 U.S. DEP'T OF AGRIC., 2007 FARM BILL THEME PAPERS, RISK MANAGEMENT 20 (2006), http://www.usda.gov/documents/FarmBill07/riskmgmtrev.doc (“The 2002 Farm Bill was developed under a budget that permitted spending to increase by about $8 billion per year above the levels projected under a continuation of the 1996 Farm Bill.”) [hereinafter U.S DEP'T OF AGRIC., RISK MANAGEMENT PAPER]; see also Daniel A. Sumner, Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations, in TRADE POL'Y ANALYSIS No. 32, 4 (CATO Institute 2005) (noting that farm subsidies were increased in the 2002 Farm Bill).
seem to be a large motivating factor behind the 2002 Farm Bill.\textsuperscript{85} Once again, the bulk of subsidies went to the five commodity crops under the auspices of three programs: (1) marketing loan payments, (2) direct payments, and (3) counter-cyclical programs.\textsuperscript{86} The marketing loan programs were again retained in the same non-recourse loan form as under previous Farm Bills.\textsuperscript{87}

Direct payments were available to commodity crop farmers\textsuperscript{88} as well as certain other crops.\textsuperscript{89} Direct payments are calculated based on a formula of three values: (1) the rate set by statute (for example, $0.28 per bushel for corn, $0.0667 per pound for upland cotton), (2) the base-acres of the farmer for a commodity crop (the average number of acres planted by that farmer in years 1998-2001) and (3) the statutory payment yield for each commodity.\textsuperscript{90} Direct payments are calculated by multiplying the rate, 85\% of the base acres, and the payment yield.\textsuperscript{91} Farmers have some planting flexibility and are not required to plant a given number of acres with a certain crop. However, planting restrictions against fruits, vegetables, and wild rice still apply.\textsuperscript{92} To clarify, a farmer receiving direct payments may plant no crop at all, and is not required to plant a set acreage of any

\textsuperscript{85} Rather than decreasing subsidies support, the 2002 Farm Bill increased subsidies by $73 billion dollars in spending, of which $51 billion was spent on subsidies. \textit{see} Nick J. Scuillo, \textit{“This Woman’s Work” in a Man’s World: A Feminist Analysis of the Farm Security and Rural Investment Act of 2002}, 28 \textit{Whittier L. Rev.} 709, 715 (2006). However, the 2002 Farm Bill did contain a provision that requires the U.S. Secretary of Agriculture to modify or restrict commodity payments to avoid exceeding WTO domestic subsidies ceilings as the U.S. committed to in the Agreement on Agriculture. \textit{See} STEVEN ZAHNISER, ED YOUNG & JOHN WAINIO, \textit{RECENT AGRICULTURAL POLICY REFORMS IN NORTH AMERICA}, 8 (2005), http://www.ers.usda.gov/publications/WRS0503/wrs0503.pdf/.

\textsuperscript{86} \textit{See} U.S DEPT OF AGRIC., RISK MANAGEMENT PAPER, \textit{supra} note 84, 19.

\textsuperscript{87} \textit{See} 2002 Farm Bill, \textit{supra} note 83, §§ 1201-09; \textit{See also} U.S DEPT OF AGRIC., TITLE I COMMODITY PROGRAM, \textit{supra} note 80; \textit{see also} JIM MONKE, CONG. RESEARCH SERV., CRS REPORT RS21604, MARKETING LOANS, LOAN DEFICIENCY PAYMENTS, AND COMMODITY CERTIFICATES 2-3 (2004) (explaining the marketing loan program).

\textsuperscript{88} Corn, wheat, upland cotton, rice and soybeans are, of course, covered. \textit{See} 2002 Farm Bill, \textit{supra} note 83, §§1001(4) & 1103.

\textsuperscript{89} Producer of grain sorghum, barley, oats, and “other oilseeds” are also eligible for direct payments. \textit{Id.} Other “oilseeds” include “sunflower seed, rapeseed, canola, safflower, flaxseed, [and] mustard seed….“ \textit{Id.} at §1001(9).

\textsuperscript{90} \textit{See} 2002 Farm Bill, \textit{supra} note 83, §§1101-1103.

\textsuperscript{91} \textit{Id.} at § 1103(c).

\textsuperscript{92} \textit{Id.} at §1106.
particular crop, so long as she plants no fruits, vegetables or wild rice on her land.

Counter-cyclical payments formalized and replaced the emergency MLA payments Congress appropriated under the 1996 Farm Bill.93 They are calculated using the same base acreage as for direct payments, but are tied to the difference between a target price for each commodity and the “effective price” for that commodity.94 The “effective price” is defined as the higher of the average market price or the marketing loan rate added to the direct payment rate for the commodity.95 In essence, counter-cyclical payments function as price guarantees that shield U.S. farmers from market fluctuations. If the market price is high, counter-cyclical payments would be low or de minimus. If the market price is low, payments will be high. As with direct payments, the same planting restrictions for fruits, vegetables and wild rice apply.96

(4) The 2007 Farm Bill

The 2002 Farm Bill expired in September 2007, but was extended until the draft 2007 Farm Bill97 was enacted in June 2008.98 The Senate version of the 2007 Farm Bill passed on the Senate floor in December 2007.99 A similar version also passed in the House of Representatives.100 The Senate’s

93 Id. at §1104.
94 Id. at §1104.
95 Id. at §1104.
96 Id. at §1106.
$286 billion farm bill authorized significant new spending for food stamps and conservation programs but made very modest changes to the existing subsidy system. Overall, the Senate bill decreased spending by $10 billion in total, but increased direct payments to farmers. The Senate version also did not include an amendment that would have ended subsidies to farmers earning more than $750,000 after expenses. The current limit is $2.5 million. Senate and House negotiators reached agreement on the 2007 Farm Bill on May 8, 2008, but the administration immediately threatened to veto it. President Bush favors more drastic reforms and subsidy cuts and opposes the funding mechanisms of the draft bill. President Bush’s veto was overridden by the House and the Farm Bill enacted.

On May 15, 2008, Congress sent the negotiated version of the 2007 Farm Bill to President Bush. Due to a clerical error, the draft arrived at the White House missing 34 pages of title III of the original bill passed by both the House and the Senate. Therefore, the version for signature had to be resent to the White House, rather embarrassingly. As vowed, President Bush vetoed the incomplete version of the bill on May 21, 2008.

101 Id.
102 See Morgan, supra note 99.
103 See Dan Morgan, Negotiators Agree on Farm Bill, but Bush Vows to Veto It, THE WASHINGTON POST, May 9, 2008, A10, also available at http://www.washingtonpost.com/wp-dyn/content/article/2008/05/08/AR2008050803320.html?sub=new (last visited May 9, 2008) (“This bill increases subsidies to farmers at a time of record farm income,” Agriculture Secretary Ed Schafer said. The negotiators “have done a disservice to taxpayers.”).


The White House press release stated that the reason for President Bush's veto was the bills failed to achieve the fiscal policies put forth by his administration.\(^{108}\) Initially, the missing pages caused some uncertainty as to whether Congress could effectively turn the bill into law by overturning President's veto of the incomplete bill.\(^{109}\) Congress once again however, sent the complete version of the original bill to the White House.\(^{110}\) After another Presidential veto of the complete draft,\(^{111}\) both houses overturned President's veto by more than two thirds of votes, turning the 2007 Farm Bill into law on June 17, 2008.\(^{112}\)

The 2007 Farm Bill as enacted runs afoul of WTO rules in several ways. Initially, both draft Senate and House versions of the bill contained provisions to bring the export credit program into compliance, so one can deduce that at least some legislators were sensitive to WTO compliance issues. However, neither bill addressed the problem of counter-cyclical payments and their price-contingent nature. The 2007 Farm Bill gives producers the option of remaining in the 2002 counter-cyclical payments program or selecting “a new counter-cyclical program that is triggered when the actual national revenue per acre for each program crop falls below a national revenue target.”\(^{113}\) The new program is called the Average Crop Revenue Election Program, or ACRE, and will come into effect in 2009. It allows for counter-cyclical payments when the state’s revenue for a particular crop is below the guaranteed revenue for that crop. Guaranteed revenue is “based on the 5-year state average yield and the 2-year national average price.”\(^{114}\) ACRE is the United States’ attempt to bring counter-cyclical payments into WTO compliance by basing them on yields as opposed to prices. However, it is likely that WTO members will try to have the payments categorized as Amber Box such that they must be factored

\(^{108}\) See id.

\(^{109}\) See Problems with Congress override of farm Bill, supra note 106.


\(^{111}\) See id.

\(^{112}\) Id.

\(^{113}\) See University of Kentucky, College of Agriculture, Summary of H.R. 2419 (2007 Farm Bill), available at http://www.uky.edu/Ag/AgEcon/farmbill/pubs/hr2419Aug07.html.

into AMS calculations. The rationale would be that even though the main consideration is historical yields, payments are still tied to triggering events tied to price and total revenue. Thus, the new ACRE still has price-contingent aspects that are problematic.

The WTO had found that certain of the price-contingent subsidies (direct payments and counter-cyclical payments) of the 2002 Farm Bill caused serious prejudice in the form of both market loss and price suppression to the upland cotton market. The final 2007 Farm Bill also failed to change the problematic aspects of these price-contingent subsidies.

For Congress to be serious about WTO compliance, which is an important goal for at least some legislators, it needs to engage in a meaningful restructuring of the subsidies programs. It is questionable if the political will is present for such deep reforms. Some members of Congress are openly hostile to the idea of WTO compliance. However, the Bush administration is committed to reforming the farm bill both to avoid further WTO challenge and to ensure the 2007 Farm Bill is compatible with Doha Round agricultural reforms.

The international community has been watching the progress of the 2007 Farm Bill closely. Developing nations negotiating at Doha justifiably feel that they have a great stake in the outcome. Why should they bother to negotiate new agricultural subsidies terms if the U.S. will ignore them for another five years, until the 2012 Farm Bill? Many countries view the 2002


116 See infra discussion in section __.


118 House Agriculture Chairman Colin Peterson even went as far as to say “I want a bill that is good for agriculture. If somebody wants to sue us (at the WTO), we’ve got a lot of lawyers in Washington.” See Institute for Agriculture and Trade Policy, A Fair Farm Bill for the World. Available at: http://www.agobservatory.org/library.cfm?refid=97624 (last visited May 9, 2008); see also Institute for Agriculture and Trade Policy, Understanding the US Farm Bill: US WTO Commitments and the Farm Bill. Available at: http://www.iatp.org/iatp/publications.cfm?accountID=258&refID=99970 (last visited May 9, 2008) (stating that some members of Congress have claimed they will disregard WTO commitments in drafting the farm bill).

Farm Bill as an abdication of WTO responsibilities. A 2007 Farm Bill that is not WTO compliant would be extremely unwelcome to many. Brazil, for example, has been relatively patient in pursuing retaliatory trade sanctions for the U.S.’s failure to fully implement the U.S. – Upland Cotton decision in part because the 2007 Farm Bill was pending. Once it became clear that the 2007 Farm Bill would not make the requisite changes to U.S. farm subsidies, Brazil has all the incentives it needs to move forward on WTO authorization for $4 billion in retaliatory trade sanctions.

C. Why the U.S. and the WTO are on an Inevitable Collision Course

The complexity of the WTO regulatory regime and the existence of the Peace Clause both help explain the dearth of challenges to agricultural subsidies in the period from 1995-2004. However, we can expect to see an up-swing in future litigation in the area for four reasons. First, the Peace Clause expired in January of 2004, thereby bringing an end to the negotiated freeze on litigation for most agricultural subsidies. Second, the suspension of negotiations in the Doha Round in July 2006 and the

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123 Id.

124 See Agreement on Agriculture, supra note 6 Art. 13; see also Porterfield, supra note 21.

125 See Doha Round Suspended Indefinitely after G-6 Talks Collapse, BRIDGES-WEEKLY TRADE NEWS DIGEST, July 26, 2006, available at http://www.ictsd.org/weekly/06-07-26/story1.htm (“The Doha Round of trade negotiations was put into deep freeze on 24 July, after a meeting of ministers from six key trading nations collapsed over divisions on how to cut farm subsidies and tariffs.”); see also In the Twilight of Doha, THE ECONOMIST, July 29, 2006, 63. Pascal Lamy, the Director General of the WTO commented on the suspension, “Today there are only
subsequent lack of an agreement on some key agricultural issues,\textsuperscript{126} and the subsequent disappointing breakdown of negotiations in the revived Doha Round talks of July 20 to July 30, 2008 means that frustrated parties may turn to litigation in the face of stymied negotiations. Third, the 2007 Farm Bill is not fully compliant with WTO rules\textsuperscript{127}, and will therefore be vulnerable to WTO challenge. Moreover, subsidy programs under the 2002 Farm Bill remain subject to WTO challenge, which does not impose statutes of limitations on suits. Lastly, Brazil successfully mounted a challenge to numerous U.S. subsidies programs for cotton in the U.S. - Upland Cotton case in a 2004 panel decision\textsuperscript{128} that was upheld by the Appellate Body in March 2005.\textsuperscript{129} In doing so, Brazil blazed a trail for other countries to follow in attacking U.S. subsidies for other commodity crops, including corn. Let’s now turn to a detailed examination of that case.

losers….The feeling of frustration, regret and impatience was unanimously expressed by developing countries this afternoon.” Pascal Lamy’s statements are available at http://www.wto.org/english/news_e/news06_e/mod06_summary_24july_e.htm (last visited June __, 2008). Little progress was made in 2007, but Pascal Lamy, the Director General of the WTO, believes that the round may be concluded in 2008 following the issuance of new draft framework deals from the chairs of the WTO negotiating committees on agriculture and industrial goods trade expected in late January of 2008. These reports should contain proposals, called modalities, for expanding market access for agricultural and industrial products by developing nations. On December 5, 2007 Pascal Lamy told reporters that “[I]f we agree on modalities early next year, I believe we could be able to conclude the round before 2008.” Available at http://www.ictsd.org/weekly/07-12-05/story1.htm (last visited June __, 2008). Negotiators did agree on a draft framework of modalities for subsidies reduction on February 8, 2008. See World Trade Org., Draft Blueprints Issued for Final Deal on Agricultural and non-Agricultural Trade, (Feb. 8, 2008) http://www.wto.org/english/tratop_e/agric_e/chair_texts08_e.htm (last visited May 8, 2008). The initial response to the draft framework has not been very promising, however. See Press Release, Institute for Agriculture and Trade Policy, New WTO Agriculture Text Falls Short-Again (Feb. 8, 2008), http://www.iatp.org/iatp/press.cfm?refid=101542 (last visited May 8, 2008). See also David Blandford et al., Implications of the WTO February 2008 Draft Agricultural Modalities for the United States, available at www.ifpri.org/events/seminars/2008/20080501/20080501USLabordeetal.pdf (last visited May 8, 2008).

\textsuperscript{126} See generally Cho, supra note 28.

\textsuperscript{127} See supra section I.4.

\textsuperscript{128} See Panel Report Upland Cotton, supra note 2, ¶1.77

\textsuperscript{129} See Appellate Body Report Upland Cotton, supra note 2, 777.
DI. TACKLING A GIANT: BRAZIL’S UPLAND COTTON VICTORY AGAINST THE U.S.

A. The Subsidies Challenged


In summary, Brazil made five distinct principal arguments against the U.S. subsidies regime. This article will discuss each of the five arguments, and their ultimate disposition by the Appellate Body in its final decision, in turn.

1) The Peace Clause Does Not Bar the Suit

As a threshold matter, Brazil had to show that the Peace Clause of the Agreement on Agriculture did not bar its challenge even though the dispute involved subsidies that were provided from 1999 to 2002, prior to the expiration of the Peace Clause. Brazil argued that the Peace Clause no longer applied because the U.S.’s domestic support and export subsidies exceeded its reduction commitments under the Agreement on Agriculture. The Peace Clause only protects exempt subsidies, those that fall within the set commitments. Brazil also argued that U.S. cotton subsidies for the 2001 marketing year were greater than they were in the baseline marketing year of 1992. Recall that the Agreement on Agriculture set floors on subsidies support based on 1992 levels. The U.S. defended on the basis that the Peace Clause still “exempt[ed] from actions” and that Brazil was barred from bringing any actions based on the 1992 marketing year. The WTO panel concluded that Brazil had successfully proven that current U.S.

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132 See Appellate Body Report Upland Cotton, supra note 2.
133 See Agreement on Agriculture, supra note 6, art. 13. See also supra notes 61-70 and accompanying text.
134 See Panel Report Upland Cotton, supra note 2, 2-3.
135 See Agreement on Agriculture, supra note 6, art. 13(b)(ii).
137 See Agreement on Agriculture, supra note 6, arts. 6.1, 6.3.
subsidies exceeded 1992 levels, and thus were no longer shielded by the Peace Clause. The Appellate Body affirmed.

The decision on the Peace Clause, which accords with the interpretation offered in this article, is not surprising when one considers the relevant precedent. A previous panel decision in Canada – Milk explored the relationship between the Agreement on Agriculture’s Peace Clause and the SCM Agreement. The panel ruled that “[t]he use of export subsidies beyond such scheduled limits is, in principle, also actionable under the prohibition of Article 3 of the SCM Agreement.” Although Canada – Milk dealt specifically with export subsidies, the principle that any subsidy that exceeds the commitment levels of the Agreement on Agriculture are subject to, and actionable under, the SCM Agreement.

The panel and Appellate Body reports in U.S. – Upland Cotton affirm this interpretation and apply it beyond export subsidies to all agricultural subsidies generally. The interpretation makes clear that the remedies of the SCM Agreement, in particular the unilateral imposition of countervailing duties, are available for actionable agricultural remedies. As discussed below in section ___, the SCM Agreement remedies enable developing nations, in particular, to protect against harmful subsidies without bringing an action in the WTO dispute settlement process. Thus, this aspect of the U.S. – Upland Cotton case, while not doctrinally surprising, is of particular importance to developing nations.

2) Direct Payments are not Green Box subsidies

139 See Panel Report Upland Cotton, supra note 2, ¶ 3.1(i).

140 See Appellate Body Report Upland Cotton, supra note 2, ¶ 363.

141 See infra discussion, section II.A (1).


143 Id. (Canada –Milk) ¶7.20.

144 The panel in Canada – Milk also went on to note ““However, by virtue of Article 13(c)(i) [the Peace Clause], of the Agreement on Agriculture, export subsidies that conform fully to Part V of the Agreement on Agriculture are exempt from actions based on Article 3 of the SCM Agreement for the duration of the ‘implementation period.’” This confirms the interpretation that the protected afforded by the Peace Clause lasts only for the implementation period, which expired in January 2004. Id. (Canada –Milk) ¶7.20. See accord MATSUSHITA ET AL., supra note 31, at 297.

145 See infra section IV and accompanying footnotes.
The U.S. and Brazil disputed the classification of direct payments under the 2002 Farm Bill.\textsuperscript{146} The U.S. believed that direct payments qualified as Green Box\textsuperscript{147} subsidies and as such are unlimited by the Agreement on Agriculture.\textsuperscript{148} Brazil contended that direct payments should be classified as Amber Box\textsuperscript{149} subsidies subject to the reduction and \textit{de minimis} limits of the Agreement on Agriculture.\textsuperscript{150} The critical WTO text for settling this dispute is Annex 2 of the Agreement on Agriculture, which sets forth the requirements for Green Box classification and gives a non-exhaustive list of examples that qualify.\textsuperscript{151} The most important of the Annex 2 requirements is that Green Box subsidies must be decoupled, or not linked to production.\textsuperscript{152} One scholar has succinctly explained that decoupling generally requires:

that the amount of income support payments should not be related to the type or volume of production, the domestic or international price of products, or the factors of production employed in any year after the base period. Furthermore, no production should be required in order for the producer to receive such payments.\textsuperscript{153}

In order to be Green Box, payments must be de-coupled not only from price but also production. They can not, in other words, be crop-based or production volume based. The U.S. government can not say you get these payments only if you either you grow cotton or grow a certain acreage of cotton.

\textsuperscript{146} See infra section II.3 for a description of the direct payments program under the 2002 Farm Bill.

\textsuperscript{147} See infra section I.2(c) for a description of Green Box subsidies.

\textsuperscript{148} See The Boxes, supra note 32.

\textsuperscript{149} See infra section I.2(a) and accompanying notes for a description of Amber Box subsidies.

\textsuperscript{150} Id.

\textsuperscript{151} See Agreement on Agriculture, supra note 6, Annex 2; see also Desta, supra note 56, 416.

\textsuperscript{152} See Desta, supra note 56, 416 (“Whether included in the list or not . . ., each has to satisfy additional policy-specific criteria,” the most significant of which is the requirement that the support be decoupled).

\textsuperscript{153} Id. (Desta at 416).
It is important to recall that if a subsidy does not qualify as a Green Box one, then it is an Amber Box subsidy by default.\textsuperscript{154} This means that any subsidy that does not satisfy the classification requirements of Annex 2 is an Amber Box subsidy that counts against a country’s reduction commitments and \textit{de minimus} limits. Moreover, Amber Box subsidies are fixed at 1992 levels, while Green Box subsidies may increase over time. Thus, proper classification is critical.

Brazil argued that direct payments could not be classified as decoupled because they were reduced or even eliminated if fruits, vegetables and wild rice were planted on the covered acreage. Thus, Brazil argued, “the effect of the [planting] restriction is to funnel production on base acreage into particular types of crops.”\textsuperscript{155} The U.S. made two arguments in its defense. First, it pointed out that under the direct payments program, “there was no requirement that the farmer engage in any production to receive payment or that the base acreage be used for production.”\textsuperscript{156} Second, it argued that by calculated direct payments on the basis of past acreage,\textsuperscript{157} it had satisfied Annex 2 by completely decoupling payments from either current production or market price.\textsuperscript{158}

The WTO panel ruled in Brazil’s favor.\textsuperscript{159} The panel found that because direct payments were contingent on farmers not producing certain crops (fruits, vegetables and wild rice), they were production contingent and thus could not qualify as Green Box subsidies.\textsuperscript{160} In its decision, the panel focused on both the plain language of the direct payments program in the 2002 Farm Bill\textsuperscript{161} and its actual effect on production, which was to


\textsuperscript{155} See Panel Report Upland Cotton, \textit{supra} note 2, ¶ 7.358.

\textsuperscript{156} See Panel Report Upland Cotton, \textit{supra} note 2, ¶ 7.360.

\textsuperscript{157} See \textit{supra} section II.2 for a description of direct payments.

\textsuperscript{158} See Panel Report Upland Cotton, \textit{supra} note 2, ¶ 7.360.

\textsuperscript{159} See Panel Report Upland Cotton, \textit{supra} note 2, ¶ 8.1(c).

\textsuperscript{160} See Panel Report Upland Cotton, \textit{supra} note 2, ¶ 8.1(c).

\textsuperscript{161} The panel asserted that “[i]t is clear that the planting flexibility limitations at issue provide for the ‘amount’ of […] ‘payments’ to be reduced or eliminated by reference to the planting of fruit and vegetables (and wild rice) on base acres… Therefore, on a plain reading, the amount of all …. payments were and are related to the type of production undertaken by the producer after the base period ….. These limitations therefore significantly constrain production choices available to […]
encourage the production of cotton by “the overwhelming majority” of recipients.\textsuperscript{162} The Appellate Body affirmed on essentially the same grounds.\textsuperscript{163}

3) The Step-2 Program is an Illegal Export Subsidy

The Step-2 Program is the only subsidy at issue in U.S. – Upland Cotton that applies solely to cotton, and not any other commodity crops.\textsuperscript{164} The Step-2 Program provided price supports to ensure that U.S. cotton remained competitive even when the price of U.S. cotton exceeded world market prices.\textsuperscript{165} It gave payments to exporters and domestic mill users when U.S. upland cotton prices are high, thereby giving an economic incentive for both export and domestic consumption of U.S. upland cotton that would not otherwise exist.\textsuperscript{166} When prices are high domestically, one would expect U.S. cotton millers to buy cheaper non-US cotton if it is available. These payments removed the incentive to do that by giving direct payments to make up the higher cost of buying domestic cotton. When U.S. cotton prices are higher than the world market price, one would also expect to see a decrease in U.S. exports. The Step-2 program inoculated against either outcome. The net effect chills the market on non-US cotton.

Brazil argued that Step-2 payments should be characterized as export subsidies, which are per se illegal under the SCM Agreement.\textsuperscript{167} Brazil bolstered its argument by pointing out that exporters are eligible to receive payment recipients and effectively eliminate a significant proportion of them. Whilst these programmes permit recipients to produce nothing, this alone does not remove the significant constraint that the planting flexibility limitations have in certain regions on the choices of those […] payment recipients who produce something, which the evidence shows is the overwhelming majority.” \textit{See} Panel Report Upland Cotton, \textit{supra} note 2, ¶¶ 7.384-7.387.

\textsuperscript{162} \textit{See} Panel Report Upland Cotton, \textit{supra} note 2, ¶¶ 7.384-7.387.

\textsuperscript{163} \textit{See} Appellate Body Report Upland Cotton, \textit{supra} note 2, ¶¶ 341-342.

\textsuperscript{164} \textit{See} 2002 Farm Bill, \textit{supra} note 73, § 1207.


\textsuperscript{166} Schnepf, \textit{supra} note 166, \textit{See also} Panel Report Upland Cotton, \textit{supra} note 2, ¶ 7.732.

\textsuperscript{167} \textit{See infra} section I.B (1).
Step-2 payments only if they provide documentary evidence that they have exported upland cotton. As such, the payments are clearly export contingent. The U.S. asserted that because Step-2 payments are available to both domestic mill users as well as exporters, they should be classified as Amber Box subsidies.

Once again, the WTO panel and the Appellate Body sided with Brazil. The panel found that Step-2 payments were in effect given to exporters based on proof of export, and as such were export contingent. The panel also decided that the payments to domestic users constituted an import substitution subsidy, also prohibited under the SCM Agreement because it explicitly requires the use of domestically produced upland cotton as a pre-condition for receipt of the payments. The Appellate Body affirmed and took the opportunity to expound on how export contingency would be analyzed, in light of past precedent, such as the U.S. – Foreign Sales Corporations case.

The Appellate Body also elaborated on the relationship between the Agreement on Agriculture and the SCM Agreement in its analysis of the Step-2 program. The Appellate Body applied the international law treaty interpretation principle of “effective interpretation,” which holds that treaties are to be interpreted to give effect, whenever possible, to all the provisions of the treaty. In its defense of the Step-2 subsidies, the U.S. alleged that because those subsidies complied with the Agreement on Agriculture’s terms on domestic support, they were exempt from the SCM

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\(^{168}\) See Panel Report Upland Cotton, supra note 2, ¶¶ 7.679-82.

\(^{169}\) See Panel Report Upland Cotton, supra note 2, ¶ 3.5; See also Appellate Body Report Upland Cotton, supra note 2, ¶¶ 47-55.

\(^{170}\) See Panel Report Upland Cotton, supra note 2, ¶ 7.749.


\(^{173}\) See Appellate Body Report Upland Cotton, supra note 2, ¶¶ 578-81.

\(^{174}\) See Appellate Body Report Upland Cotton, supra note 2, ¶¶ 529-52.

\(^{175}\) See supra note ___ and accompanying text. See also Steinberg & Josling, supra note 22, 375; Chambovey, supra note 61, 309.
Agreement’s Article 3.1(b) prohibition on import substitution subsidies. The Appellate Body rejected the argument, noting that:

[A] treaty interpreter must read all applicable provisions of a treaty in a way that gives meaning to all of them, harmoniously. . . . Article 3.1(b) of the SCM Agreement can be read together with the Agreement on Agriculture provisions relating to domestic support in a coherent and consistent manner which gives full and effective meaning to all of their terms.

The only interpretation that gives “full and effective meaning” to the Peace Clause takes into account its time-limited implementation period, after which the terms of the SCM Agreement apply. Any other interpretation would render its specific and differentiated nine year implementation period redundant and ineffective.

4) Export Guarantee Programs are not WTO Compliant

The 2002 Farm Bill contains a number of programs designed to finance exports of U.S. agricultural products, including cotton and corn. The programs increase the demand for U.S. agricultural exports by providing offsets to tariffs levied on the exports by the importing country. As we have seen, the WTO regime scrutinizes export subsidies more closely than domestic subsidies because of the greater trade-distorting potential.

The U.S. – Upland Cotton examined two groups of export subsidies: (1) the Export Credit Guarantee Programs, also known as

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176 See SCM Agreement, supra note 5, art. 3.1(b); see also infra section ___ (export subsidies of SCM Agreement).

177 Appellate Body Report Upland Cotton, supra note 2, ¶ 549 (internal quotation marks omitted).

178 Id. (¶ 549 of AB report)

179 See Agreement on Agriculture, supra note 6, art. 1(f) (the “implementation period” means the six-year period commencing in the year 1995, except that, for the purposes of Article 13, it means the nine-year period commencing in 1995.”).

180 See MATSUSHITA ET AL., supra note 31, 261.

181 Id. (MATSUSHITA, 261)

182 See infra section ___.

GSM-102 and GSM-103, and (2) the Supplier Credit Guarantee Program, or SCGP. Each of the GSM 102, GSM 103, and the SCGP are designed to “ensure that credit is available to finance commercial exports of U.S. agricultural products” and the programs differ primarily in the duration of the credit guarantee. Because payment is guaranteed by the U.S. government, financial institutions can offer a much lower interest rate to importers who applied for the credit guarantees, which considerably lowers the costs of export. The program is particularly helpful to importers of U.S. agricultural products in developing countries, where credit would be scarce or too costly without such guarantees.

The panel in U.S. – Upland Cotton found the funding mechanisms and risk allocation of the export guarantee programs most troubling. First, the panel concluded that the programs were subsidies because they were backed “by the full faith and credit of the United States government” and “are not designed to avoid a net cost to the government.” Second, the

184 The GSM-102 and GSM-103 Programs are designed to ensure that “ensure that credit is available to finance commercial exports of U.S. agricultural products, while providing competitive credit terms to buyers. By reducing financial risk to lenders, credit guarantees encourage exports to buyers in countries—mainly developing countries—where credit is necessary to maintain or increase U.S. sales, but where financing may not be available without such guarantees.” Id. Both programs are administered by the USDA and funded by the Commodity Credit Corporation (“CCC”). Id. The CCC in turns borrows money to fund the program from U.S. Treasury, a fact which helped to convince the panel in U.S. – Upland Cotton that the programs are subsidies. See Panel Report Upland Cotton, supra note 2, ¶ 7.857. The GSM-102 extended credit guarantees for one to three years while the GSM-103 guarantees were for the three to ten year range. Both programs generally covered 98% of the principal and a portion of the interest at an adjustable rate. See EXPORT CREDIT GUARANTEE PROGRAM, supra note 183.

185 The SCGP program functioned in a similar way to the GSM-102 and GSM-103 programs except that it offered credit guarantees only in the short term (usually 180 days) and it also guaranteed a smaller percentage (usually 65%) of the credit provided. It also had a similar funding structure. USDA, Foreign Agricultural Service, Fact Sheet, Supplier Credit Guarantee Program, http://www.fas.usda.gov/info/factsheets/scgp.asp.

186 Id. (Supplier Credit Guarantee Program)

187 The U.S. did not defend its export guarantee programs on substantive grounds. Rather, it relied on a procedural defense which neither the panel nor the Appellate Body found persuasive. The U.S. argued that as Brazil had not adequately raised the issue during the consultation phrase, it should be barred from raising it before the panel. Both the panel and the Appellate Body rejected the procedural defense. See Panel Report Upland Cotton, supra note 2, ¶ 3.5; Appellate Body Report Upland Cotton, supra note 2, ¶¶ 56-57, 62-69.

188 See Panel Report Upland Cotton, supra note 2, ¶ 7.858.

189 See Panel Report Upland Cotton, supra note 2, ¶ 7.857.
The panel was disturbed by the lack of risk-based premiums and the lack of loan criteria setting an appropriate risk level to qualify for a credit guarantee. The effect was that the Commodity Credit Corporation was “able to provide large amounts of guarantees to high-risk countries with a resulting high rate of default,” which was compensated by the United States government. Thus, both the panel and the Appellate Body characterized the programs as prohibited export subsidies within the meaning of the SCM Agreement unless the programs were modified to include a risk-based premium structure, one in which the operating costs of the programs would be covered by the premiums, as well as risk assessment criteria.

5) *Cotton Subsidies Caused Brazil Serious Prejudice*

Lastly, Brazil argued that U.S. actionable cotton subsidies “suppressed upland cotton prices in the U.S., world[,] and Brazilian markets” during the 1999-2002 marketing years. The effect of the price suppression was that U.S. upland cotton garnered a share of the world cotton market “beyond its equitable share.” The U.S. claimed that the increase in U.S. cotton exports was not due to an increase in subsidies, but rather to a decrease in U.S. domestic textile consumption and manufacturing.

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190 “[T]he premiums are not risk based, either with respect to country risk or the creditworthiness of the borrower in an individual transaction.” See Panel Report Upland Cotton, *supra* note 2, ¶ 7.861.
195 The price suppression argument applies to all actionable or yellow-light subsidies, which excludes the prohibited export subsidies and import subsidies discussed *infra* in sections ____ and ____. See also SCM Agreement, *supra* note 5, art. 5.
197 See *infra* section ____ for a description of how a price suppression analysis generally proceeds; see also SCM Agreement, *supra* note 5, art. 5.
198 *Id.*
The panel’s price suppression analysis can be divided into three distinct strands.\textsuperscript{200} Substantively, the panel seemed\textsuperscript{201} to focus on the magnitude of the subsidies, the price contingency nature of the subsidies and the effect in terms of limiting production. Each of these elements contributed to the ruling that significant price suppression did occur,\textsuperscript{202} which was affirmed by the Appellate Body.\textsuperscript{203} Overall, four price contingent subsidy programs, counter-cyclical payments, Step-2 payments, marketing loan program payments,\textsuperscript{204} and market loss assistance payments,\textsuperscript{205} were found to cause significant price suppression.\textsuperscript{206}

\textsuperscript{200} The Panel describes the “significant price suppression” analysis as being comprised of three separate inquiries: (1) whether price suppression exists; if so, (2) whether it is significant; and (3) whether the price suppression is the effect of the subsidies. Panel Report Upland Cotton, \textit{supra} note 2, ¶ 7.1275-7.1315 (“price suppression”); ¶ 7.1316-7.1333 (“significant”); ¶ 7.1334-7.1363 (“effect of the subsidy”).

\textsuperscript{201} The panel decision was not very clear, and it was criticized by the Appellate Body on that front. “[W]e believe that, in its reasoning, the Panel could have provided a more detailed explanation of its analysis of the complex facts and economic arguments arising in this dispute. The Panel could have done so in order to demonstrate precisely how it evaluated the different factors bearing on the relationship between the price-contingent subsidies and significant price suppression.” See Appellate Body Report Upland Cotton, \textit{supra} note 2, ¶ 458. See also Richard H. Steinberg, \textit{United States--Subsidies on Upland Cotton}, 99 AM. J. INT'L L. 852, 860 (2005) (“[T]he Panel's causation analysis [....] lacked rigor and specificity, which may diminish the persuasiveness and effectiveness of the opinion.”). The Appellate Body also observed that the panel considered a variety of arguments raised by the parties and a “voluminous evidentiary record, including several economic studies and substantial data.” See Appellate Body Upland Cotton, \textit{supra} note 2, ¶ 458. Examples of the numerous factors considered by the panel include: (1) “substantial proportionate influence” that the United States had on the world market for upland cotton due to its high levels of production and export of cotton, Appellate Body Report Upland Cotton, \textit{supra} note 2, ¶¶ 419 & 449 (discussing the relevance of the magnitude of U.S. production and export of upland cotton in evaluating whether there has been “price suppression” and whether it has been “significant”); (2) the “temporal coincidence of suppressed world market prices and the price-contingent subsidies,” \textit{id.} ¶¶ 419 & 451 (quoting Panel Report Upland Cotton, \textit{supra} note 2, ¶ 7.1351); and (3) the “divergence between United States producers' costs of production and revenue from sales of upland cotton.” \textit{id.} ¶ 452. The lack of analytical clarity in the panel report makes it harder to tease out the most important considerations in the case. This section is an attempt to do so.

\textsuperscript{202} See Panel Report Upland Cotton, \textit{supra} note 2, ¶¶ 8.1(g)(ii).

\textsuperscript{203} See Appellate Body Upland Cotton, \textit{supra} note 2, ¶¶ 763(c)(1) – (2).

\textsuperscript{204} The Farm Service Agency, through the Commodity Credit Corporation, provides marketing assistance loans to producers of certain specified crops, including both upland cotton and corn. See 2002 Farm Bill, \textit{supra} note 73, § 1201; see also U.S. Dep’t of Agric., Economic Research Service, Farm Bill, MARKETING ASSISTANCE

The panel and the Appellate Body both mandated the immediate withdraw or revision of offending U.S. cotton subsidies and gave the U.S. a reasonable time to do so. Because WTO decisions are not self-executing, they require Congress to implement through legislation to eliminate, alter, or amend the programs to remove their adverse effects. Prohibited or per se illegal subsidies generally have to be withdrawn without delay. Alternatively, in the case of actionable subsidies, the U.S. could choose either withdrawal or the payment of negotiated compensatory damages to

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**Loans and Loan Deficiency Payments (LDPs),**


[hereinafter MARKETING ASSISTANCE AND LDPs]. Producers receive loans from the government at a commodity specific rate per unit of production (fixed by the 1996 and 2002 Farm Bills) and use expected harvests as collateral on the loan. The loan rate under the 2002 Farm Bill for corn is $1.98 per bushel and the loan rate for upland cotton is $0.52 per pound. See 2002 Farm Bill, supra note 73, § 1202. The producers may repay the loans through their choice of three options: (1) repaying the loan rate plus interest, (2) forfeiting the pledged crop to the Commodity Credit Corporation, or (3) repaying at the alternative loan rate under LDPs discussed below when actual market prices are lower than a commodity’s loan rate. See MARKETING ASSISTANCE AND LDPs.

Producers may choose to forgo a marketing assistance loan and instead obtain a loan deficiency payment (LDP) when market prices are lower than commodity loan rates. See 2002 Farm Bill, supra note 73, § 1205; see also MARKETING ASSISTANCE AND LDPs, supra note 204. The LDP is based on the amount that the loan rate exceeds the market price of a commodity. See MARKETING ASSISTANCE AND LDPs. LDPs essentially allow producers to receive the same support benefits afforded by marketing assistance loans without requiring them to take out and repay the loan. Id. The purpose of both the marketing loan assistance and LDPs programs is to supplement commodity receipts when market prices are low. The programs also reduce revenue risk associated with price variability. See also PAUL C. WESCOTT, C. EDWIN YOUNG, & MICHAEL PRICE, THE 2002 FARM ACT: PROVISIONS AND IMPLICATIONS FOR COMMODITY MARKETS 6 (U.S. Department of Agriculture, Economic Research Service 2002), available at http://www.ers.usda.gov/Publications/AIB778/ (last visited May 13, 2008).

See Appellate Body Report Upland Cotton, supra note 2, ¶ 496.

See Panel Report Upland Cotton, supra note 2, ¶ 7.1502; see also Appellate Body Report Upland Cotton, supra note 2, ¶ 384.


See SCM Agreement, supra note 5, art. 4.7.
Brazil to offset the injury suffered.\textsuperscript{210} If the U.S. chooses to do nothing or does not give full relief, Brazil may seek authorization to suspend concessions or impose retaliatory trade sanctions.\textsuperscript{211}

The U.S. has fully complied with only one aspect of the U.S. – Upland Cotton decision. It withdrew the Step 2 Program on August 1, 2006.\textsuperscript{212} With respect to the direct payments, counter-cyclical payments, export guarantees, and marketing loan provisions that were found to have caused serious prejudice to Brazil, the panel mandated that the U.S. take appropriate steps to remove the adverse effects of these subsidies or to withdraw them.\textsuperscript{213} On July 1, 2005, the USDA instituted a temporary fix to the export guarantee program by creating a risk-based fee structure for two of these programs and eliminating one of them.\textsuperscript{214} The risk-based fee structure is responsive to the problem identified by the panel in U.S. – Upland Cotton that the financial returns of these programs did not cover the operating costs, thereby making them more like subsidies than insurance programs.\textsuperscript{215} The WTO may be called upon to assess whether the 2007 Farm Bill has effected full compliance with the U.S. – Upland Cotton case.\textsuperscript{216}

One of the biggest compliance problem lies with the price and production contingency aspects of the counter-cyclical payments. The newly enacted 2007 Farm Bill does not address the issue in a satisfactory manner.\textsuperscript{217} Counter-cyclical payments are structured in much the same way as they were in the 2002 Farm Bill and are therefore non-compliant. The 2007 Farm Bill does not include ways to de-couple counter-cyclical payments from price and production, thereby making it vulnerable to WTO challenge on that front as well. One of the negotiating strategies the U.S. is

\begin{footnotes}
\item[210] See SCHNEPF & WOMACH, supra note 208; see also Tsai-yu Lin, Remedies for Export Subsidies in the Context of Article 4 of the SCM Agreement: Rethinking Some Persistent Issues, 3 ASIAN J. WTO & HEALTH L. & POL’y 21, (2008).
\item[211] See SCM Agreement, supra note 5, ¶7.9; see also SCHNEPF & WOMACH, supra note 208, 6.
\item[213] See Panel Report Upland Cotton, supra note 2, ¶ 7.1503.
\item[214] See SCHNEPF, supra note 165, 3.
\item[215] See Panel Report Upland Cotton, supra note 2, ¶ 7.861.
\item[216] See SCHNEPF, supra note 165, 3.
\item[217] See discussion infra on pages 23-4.
\end{footnotes}
pursuing in Doha is to lobby for the creation of a new Blue Box definition that would shield counter-cyclical payments. However, thus far, this effort has met with resistance, particularly from the most influential bloc of developing nations, the G-20, led by Brazil and India. As negotiations are deadlocked again as of July 31, 2008, the U.S. strategy has not succeeded. Thus, counter-cyclical payments remain vulnerable to WTO challenge. The 2007 Farm Bill also failed to address the disqualification of direct payments as Green Box subsidies.

Thus far, Brazil has been relatively patient in pursuing its legal remedies while the draft 2007 Farm Bill has been negotiated in Congress in the hope that the 2007 Farm Bill would have fixed or removed the problematic aspects of U.S. subsidies. However, Brazil’s patience has been running out. It has already initiated steps to seek $4 billion in retaliatory trade measures in compensation, consisting of $3 billion in suspended tariff concessions as well as obligations under TRIPS and GATS.

The WTO recently reviewed the Upland Cotton case to determine whether or not recent changes in United States agricultural policy were in compliance with the original rulings. The review was based upon 2006

\[\text{\textsuperscript{218}} \text{ Office of U.S. Trade Representative, Doha Development Agenda Policy Brief: Implications of the U.S. Agriculture Proposal on Trade-Distorting Domestic Support} \ 2 \ (2005), \text{http://www.ustr.gov/assets/Document_Library/Fact_Sheets/2005/asset_upload_file414_8527.pdf} \ [\text{hereinafter USTR, Implications}].\] Counter-cyclical payments, like direct payments, are based on historic production and do not require current production of any specific commodity for eligibility. See infra section I.3.

\[\text{\textsuperscript{219}} \text{ See Porterfield supra note 21, 1025; see also Group of 20, Draft Elements for Discussion--Blue Box} \ (2005), \text{http://www.sagpya.mecon.gov.ar/new/00/programas/negociaciones/Omc/g20_06.pdf, 1-2; see also generally Cho, Doha’s Development, supra note 28, 170-72 (describing the strong role played by the G-20 on agricultural negotiations at the Cancun Ministerial Conference).}\]

\[\text{\textsuperscript{220}} \text{ See SCHNEPF, supra note 165, 6.}\]

\[\text{\textsuperscript{221}} \text{ See SCHNEPF, supra note 165, 4.}\]


amendments to the 2002 Farm Bill. The panel concluded that the United States failed to remedy its non-compliance with Article 7.8 of the Agreement on Agriculture with its continued marketing loan provisions and counter-cyclical payments. The panel also found that the United States failed to comply with Articles 8 and 10.1 of the Agreement on Agriculture because of its continued use of export guarantees resulting in “the circumvention of United States' export subsidy commitments.”

Unsurprisingly, the National Cotton Council of America was disappointed in the decision, which did not take into account the new counter-cyclical payment program and the elimination of the long-term export credit program implemented in the 2008 Farm Bill to bring the United States into compliance with the Upland Cotton decision.

Even so, other organizations, such as the Institute for Agriculture Trade and Policy, find that the new 2007 bill undertakes only minor adjustments to the 2002 Farm Bill which will do little to remedy the issues which arose in the Upland Cotton case. While the new measures may change prospects in the short-term, the long-term impact remains uncertain. Brazil, Canada and Australia have also voiced concerns that the new 2007 Farm Bill continues to support illegal cotton subsidies as well as the continued use of trade-distorting subsidies in general. Overall, the bill increases support to cotton farmers and fails to address the concerns articulated in Upland Cotton and the recent report from the Appellate Body, reviewing that decision.

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224 Appellate Body Report, United States – Subsidies on Upland Cotton, Recourse to Article 21.5 of the DSU by Brazil, WT/DS267/AB/RW (June 2, 2008), ¶ 328.

225 Id. ¶ 448 (c) (i).

226 Id. ¶ 448 (b) (iv).


229 Id.

DII. THE IMPLICATIONS FOR U.S. CORN AND ETHANOL SUBSIDIES

A. U.S. Dominion of World Corn Markets

The U.S. is not only the largest producer of corn in the world, but also the largest exporter.\(^{231}\) Over 20% of all corn grown in the U.S. is exported.\(^{232}\) The U.S. accounts for an impressive share of the world corn market. For example, in the 2003-2004 marketing year, the U.S. was responsible for 65% of the world’s corn exports.\(^ {233}\) Corn receives generous subsidy support. In the 1995-2005 period, total U.S. support for corn was over $51 billion, compared to $19 billion for cotton.\(^ {234}\) In addition, ethanol subsidies, much of which is an indirect subsidy for corn, was between $5.1 and $7 billion in 2006.\(^ {235}\) This Part will assess the applicability of the U.S. – U.S. Upland Cotton case holdings to corn subsidies as well as discuss the likelihood of a challenge to corn subsidies.

A. Is Corn Next?

Each of the subsidy programs analyzed in the U.S. – U.S. Upland Cotton case apply to corn, except for the Step-2 program\(^ {236}\), which has already


\(^{232}\) U.S. Grains Council, supra note 231.

\(^{233}\) Id.

\(^{234}\) Environmental Working Group, Farm Subsidy Data Base, Top Programs in the United States, 1995-2005, http://farm.ewg.org/farm/region.php?fips=00000 [hereinafter Farm Subsidy Data Base]. However, cotton received more support than corn as a percentage of cash flow or actual receipts of farmer. For example, for years 1996-2005, subsidy payments accounted for 25% of cash receipts for corn and 58% of cash receipts for upland cotton. See SCHNEFF & WOMACK, supra note 208, 3.


been withdrawn.\textsuperscript{237} The support for corn in terms of direct payments, counter-cyclical payments, export credit guarantees, marketing loan assistance and LDP programs, are also substantially similar to the programs for cotton.\textsuperscript{238} Thus, all same objections to these programs raised in the U.S. – Upland Cotton case would presumably apply with equal force. Any challenger would, of course, need to meet the burden of proof with respect to establishing serious prejudice. That portion of the analysis would be a case-specific one, based on complex economic data on prices and market shares.

However, based on the three criteria discussed \textit{infra} as the most critical, a challenger should have little difficulty establishing serious prejudice. With respect to the magnitude of the subsidies, corn receives over two and half times as much in support than cotton in absolute terms.\textsuperscript{239} This, combined with the fact that the U.S. is responsible for a staggering 65% of corn exports worldwide,\textsuperscript{240} makes it relatively easy to show that U.S. corn subsidies had an effect on world prices.

Several obstacles to a corn challenges must be overcome. One potential problem is that corn is less subsidized as a percentage of cash receipts (25%) than cotton (58%).\textsuperscript{241} However, while this may have an effect on the magnitude of harm, it is not likely to be dispositive on the question of serious prejudice. Another possible pitfall arises in the timing of a challenge to corn subsidies. Recently, commodity prices have spiked due to shortages worldwide,\textsuperscript{242} unusual weather volatility in

\textsuperscript{237} See \textit{infra} section II.6


\textsuperscript{239} See \textit{supra} note 234 and accompanying text.

\textsuperscript{240} See \textit{supra} note 233 and accompanying text.

\textsuperscript{241} See SCHNEFP & WOMACK, \textit{supra} note 208, 3.

the American Midwest,\textsuperscript{243} and an increased demand, in the case of corn, for ethanol due to the unprecedented high cost of gasoline.\textsuperscript{244} Thus, it is possible that 2008 may not result in significant price suppression or serious prejudice to non-U.S. commodity crop growers.\textsuperscript{245} However, this does not necessarily mean that a challenge would not be bought. As we saw in U.S – Upland Cotton, one can challenge subsidies selectively by culling out the years in which significant price suppression did occur or can be most easily proven. If prices turn out to be high worldwide for corn in 2008, a challenger would simply exclude 2008 from the WTO dispute.

B. U.S. Ethanol Policies – Increasing Incentives for a Corn Challenge

In addition to subsidizing corn as a commodity crop, the U.S. also provides significant federal\textsuperscript{246} support for ethanol production. U.S. support of biofuels through tax incentives, initially motivated by volatile


\textsuperscript{245} This is by no means certain. Prices and projected yields for 2008 are still subject to great volatility. It is impossible to predict the outcome until the 2008 harvests are in.

\textsuperscript{246} Subsidies, tax credits and other support mechanisms for ethanol production exist at both the federal and state levels. Due to the focus of this article on the WTO regime, discussion shall center primarily on the federal support scheme. However, the concerns raised in this section apply with equal force to state schemes. It is just more likely that any potential challenge would target federal programs, in conjunction with an attack on corn subsidies.
Oil prices\(^{247}\) began in 1978.\(^{248}\) Ethanol leads other biofuels in terms of total support. Support is given both to blenders and producers. Currently, the American Jobs Creation Act of 2004 provides incentives, in the form of an excise tax credit, to ethanol blenders.\(^{249}\) Under the Volumetric Ethanol Excise Tax Credit (“VEETC”), ethanol blenders receive an excise tax credit of 51 cents per gallon of ethanol used.\(^{250}\) This provision is scheduled to expire in 2010,\(^{251}\) but is likely to be renewed, if not expanded, in the current political environment of high gasoline prices. The VEETC is unlimited, detached from gasoline prices, and applies to both domestic and imported ethanol.\(^{252}\)

Support is also given to ethanol producers. Established by the Omnibus Budget Reconciliation Act of 1990, the Small Ethanol Producer Credit program provides a tax credit of 10 cents per gallon of ethanol produced.\(^ {253}\) Each producer may receive the credit for the first 15 million gallons of ethanol produced.\(^ {254}\) The Energy Policy Act of 2005 expanded the standard for qualification as a small producer from production of 30 million gallons or less to production of 60 million gallons or less of ethanol.\(^ {255}\) The expiration date of the provision appears to have been extended from December 31, 2007 until December 31, 2008.\(^ {256}\)

\(^{247}\) Kaylan Lytle, Driving the Market: The Effects on the United States Ethanol Industry if the Foreign Ethanol Tariff is Lifted, 28 Energy L. J. 693, 698 (2007).


\(^{250}\) Id. at § 301.

\(^{251}\) Id.


\(^{254}\) Id.


The Omnibus Budget Reconciliation Act of 1980 established a 2.5% ad valorem tax and a 54 cent per gallon tariff on ethanol imports into the United States, with exceptions for most Caribbean Basin Initiative nations. Supporting the tariff assert that it is necessary for the survival of the domestic ethanol industry in the face of competition from the cheaper, sugar-based ethanol from Brazil. The tariff also prevents the tax credit provided by VEETC, which makes no distinction between domestic and foreign ethanol, from effectively subsidizing foreign ethanol producers at the expense of domestic tax payers. Opponents of the tariff assert that the tariff results in lower domestic supply by decreasing cheap imports, which increases fuel prices domestically.

The U.S. Treasury estimated that it would lose $2.6 billion in tax revenue because of the tax credits provided by the VEETC program during the years 2005-2009. During 2006, demand for ethanol exceeded the estimations and a 2007 report predicted actual losses to exceed estimates. Unless tax incentives are reduced, the goals set by the Energy Independence and Security Act of 2007 (“EISA”) will cause the amount of revenue lost from the incentives to continue increasing. The EISA increased the mandated Renewable Fuel Standard (RFS) established by the Energy Policy Act of 2005. The Energy Policy Act of 2005 created a RFS that mandated the use of 7.5 billion gallons of ethanol in 2012 and increasing to a level of 8.6 billion gallons in 2022. The new standard under EISA requires 9 billion gallons in 2008 and increases to 36 billion gallons by 2022, all of which will be subject to the VEETC tax credit under current legislation. In addition to federal

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258 John A. Sautter et al., Construction of a Fool’s Paradise: Ethanol Subsidies in America, 7 SUSTAINABLE DEV. L. & POL’Y 26 (Spring 2007).
259 See Lytle, supra note 247, at 703.
260 Id. at 705.
261 Koplow, supra note 252, 24.
262 Id.
support, many states subsidize their ethanol industries through various programs, including direct payments to producers and tax incentives.265  

1. Economic and Environmental Concerns

An economic analysis of ethanol support described the benefits of the ethanol support regime as “energy security” and “environmental benefits.”266 By providing a domestic substitute for foreign oil, the United States would be less susceptible to the fluctuations of world oil markets.267 A reduction in oil consumption by the United States, one of the world’s largest oil consumers, would decrease world demand for oil and lower world prices, allowing the United States to purchase the oil it used in addition to ethanol at lower prices.268 The economic costs associated with the regime are increased production and distribution costs, and dead weight loss associated with government regulation of the industry.269

The environmental benefits are a reduction in greenhouse gases and improved air quality, resulting from the cleaner emissions of ethanol relative to gasoline.270 To realize the goal of reduced emissions, biofuel policies must consider the emissions and soil erosion and infertility associated with forest conversion.271 The Hahn and Cecot study estimated the benefits, in terms of average health and benefit value, of ethanol displacement of gasoline to range from $300 million to $600 million.272 The environmental costs of the support program stem from increased emissions required for ethanol production and distribution.273 The study concluded that costs of the ethanol subsidy programs

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265 Sautter et al., supra note 258, 26.  
267 Id. at 8.  
268 Id.  
269 Id. at 11.  
270 Id. at 6.  
272 Hahn & Cecot, supra note 266, 10.  
273 Id. at 11.
developed through US legislation exceed the benefits by $1 billion to $3 billion annually.\textsuperscript{274}

The primary reason that the costs of support exceed the benefits so dramatically is that ethanol, when made of corn or soy, has almost negligible environmental benefits.\textsuperscript{275} Soybeans and corn are both input-intensive row crops.\textsuperscript{276} They require heavy levels of fertilizer and pesticides, which are carried off, along with soil, with precipitation.\textsuperscript{277} Fertilizer and pesticides “are the major cause of nitrogen runoff—the harmful leakage of nitrogen from fields when it rains—of the type that has created the so-called dead zone in the Gulf of Mexico, an ocean area the size of New Jersey that has so little oxygen it can barely support life.”\textsuperscript{278} The billions of dollars in subsidies combined with the pollution associated with corn and soy-based ethanol seem to greatly outweigh the modest efficiency advantage it carries over fossil fuels.\textsuperscript{279}

There is a consensus that corn alone is not energy efficient enough to one day produce ethanol at levels to ensure energy independence for the United States.\textsuperscript{280} However, though corn is not the most efficient energy source, when oil prices are high enough, it becomes a competitive alternative to oil.\textsuperscript{281} The immediate effect of high oil prices and tax incentives for ethanol is to encourage the use of corn ethanol. Continued use of corn ethanol as fuel, which is only feasible through subsidization of the industry,\textsuperscript{282} will further commit the alternative energy industry to corn-based ethanol through the creation of infrastructure and market, likely at the expense of development of more

\textsuperscript{274} Id. at 13-14.\textsuperscript{275} C. Ford Runge & Benjamin Senauer, How Biofuels Could Starve the Poor, Foreign Affairs, May/June 2007, available at http://www.foreignaffairs.org/20070501faessay86305/c-ford-runge-benjamin-senauer/how-biofuels-could-starve-the-poor.html.\textsuperscript{276} Id.\textsuperscript{277} Id.\textsuperscript{278} Id.\textsuperscript{279} Id.\textsuperscript{280} Id.; see also Brent D. Yacobucci & Tom Capehart, Selected Issues Related to an Expansion of the Renewable Fuel Standard (RFS) 11 (March 31, 2008), available at http://www.nationalaglawcenter.org/assets/crs/RL34265.pdf.\textsuperscript{281} Runge & Senauer, supra note 275.\textsuperscript{282} Sautter et al., supra note 258.
efficient energy sources. If the current programs continue, it is predicted that the result will be one of two outcomes. Either the programs will create the infrastructure to allow the ethanol industry to function without government support, or the industry will require increasingly greater governmental support for survival.

2. Additional Policy and Equity Concerns

The use of commodities traditionally used for food, such as corn, for fuel creates a tighter link between fuel and food markets. As oil prices increase, alternative fuels become more competitive and demand for them increases. When oil prices reach US$60 levels, biofuels become competitive in some countries, even with existing technologies. As demand for alternative fuels increases, the prices of the input commodities also rise. Rises in commodity prices resulting from biofuel expansion “is also accompanied by a net decrease in the availability of and access to food, with calorie consumption estimated to decrease across all regions compared to baseline levels.”

“[S]ubsidies for biofuels that use agricultural production resources are extremely anti-poor because they implicitly act as a tax on basic food, which represents a large share of poor people’s consumption expenditures and becomes even more costly as prices increase.” An increase in a commodity such as corn is disposed to increase food prices generally. As the price of corn increases, more land will be used to produce corn at the expense of other commodities, which decreases the supply, and ultimately increases the price of the commodities whose production has been replaced by corn. The increased use of corn-based ethanol in the United States has been identified as a major

283 Runge & Senauer, supra note 275.
284 Sautter et al., supra note 258.
286 von Bruan, supra note 271, 7.
287 Meyers et al., supra note 285, 11.
288 von Bruan, supra note 271, 8.
289 Id. at 9. (von Bruan)
290 See Meyers et al., supra note 285, 13.
contributor to current global food crisis.\textsuperscript{291} The new close relationship between oil prices and corn demand created by the surge of corn-based ethanol has not only increased the global price of corn and food prices generally, but some predict that it has in effect transferred the volatility of the oil market to the corn and other commodity markets.\textsuperscript{292}

**B. Likelihood of a Corn/Ethanol Challenge**

Brazil has some special incentives to challenge U.S. ethanol subsidies. Brazil’s alternative energy program, focused on sugar-based ethanol, is considered to be the most successful in the world.\textsuperscript{293} Sparked by oil crises in the 1970s with the goal of energy independence, the United States and Brazil both initiated ethanol programs during the same time period.\textsuperscript{294} However, domestically produced ethanol currently accounts for much more of Brazilian energy than that of the United States and the Brazilian ethanol industry is much less dependent on governmental support.\textsuperscript{295} Currently, renewable energy comprises forty percent of Brazilian consumption.\textsuperscript{296}

Brazil’s success is often attributed to the ability of the dictatorial government to mandate minimum ethanol requirements, which provided a consistent demand.\textsuperscript{297} The government also invested in ethanol infrastructure, such as ethanol pumps at almost all filling stations, making distribution feasible and ethanol accessible throughout the

\textsuperscript{291} Runge & Senaur, supra note 275 (“The enormous volume of corn required by the ethanol industry is sending shock waves through the food system. (The United States accounts for some 40 percent of the world’s total corn production and over half of all corn exports.) In March 2007, corn futures rose to over $4.38 a bushel, the highest level in ten years. Wheat and rice prices have also surged to decade highs, because even as those grains are increasingly being used as substitutes for corn, farmers are planting more acres with corn and fewer acres with other crops.”).

\textsuperscript{292} See Meyers et al., supra note 285, 16.


\textsuperscript{294} Id. at 331. (Potter)

\textsuperscript{295} Id. at 334.

\textsuperscript{296} Id.

\textsuperscript{297} Id. at 336.
country. Another reason for Brazilian success is its focus on sugar, from which it produces ethanol today at about half of the cost of the corn-based ethanol produced in the United States. Brazil also used similar incentives to those currently used by the United States to make ethanol competitive with gasoline, subsidizing sugarcane producers and taxing ethanol at rates significantly lower than gasoline. During epochs of low gasoline prices during the 1980s and 1990s, subsidies that would have allowed ethanol to compete with gasoline became too expensive and were reduced. However, the government maintained minimum ethanol content requirements, which allowed Brazil to retain ethanol infrastructure. With infrastructure established, the ethanol industry experienced a resurgence with the recent rise in gasoline prices, currently producing enough ethanol to replace 460 million barrels of oil per year.

DIII. Assessing the Significance of U.S – Upland Cotton

Brazil’s successful challenge to U.S. upland cotton subsidies is extremely significant for a number of reasons. It is the first WTO decision to apply the WTO rules of the SCM Agreement to subsidies that cause serious prejudice to agricultural subsidies. As such, it stands for the proposition that a complainant can levy countervailing duties per the SCM Agreement against any subsidies that do not comply with the terms of the Agreement on Agriculture. The decision implies that developing nations may now avail themselves of a powerful new remedy against trade-distorting agricultural subsidies, by imposing countervailing duties to offset their effect. Moreover, an injured party may do so unilaterally under the SCM Agreement. Countervailing duties levied in response to trade-distorting subsidies are likely to be upheld by the WTO. Even if they are not, some short-term benefits may be gained by country imposing the countervailing duty as the remedy in case of a WTO challenge is usually timely withdrawal of the duty. The case makes it clear that the unilateral

298 Id.
299 Id.
300 Lytle, supra note 247, 696-97.
301 Id. at 697.
302 Id.
303 Id. at 698.
304 See supra note 13 and accompanying text.
remedy of the SCM Agreement is available to injured WTO members, without resort to the costly and time-consuming dispute settlement process.\textsuperscript{305} Such a remedy is particularly beneficial to developing nations who may not have the resources or expertise to pursue a dispute before the WTO.\textsuperscript{306} Prior to the U.S. – Upland Cotton case, it was not clear if the

\textsuperscript{305} See e.g., Phoenix Cai, Aid for Trade: A Roadmap for Success, 36 DENVER J. INT’L L. & POL’Y 100, __ (2008) (highlighting the resources currently lacking but required for developing nations to pursue suit at the WTO).

\textsuperscript{306} For a variety of reasons, many developing countries do not make use of the dispute settlement mechanism at all or do so infrequently. There are a number of explanations, from lack of experience, lack of familiarity with the system, lack of human resources to pursue lengthy litigation, to a sense that the system does not provide meaningful remedies to developing nations with small economies. However, there is no doubt that developing nations face a serious lack of financial resources and legal expertise that may inhibit their ability to make full use of the dispute settlement system. See e.g., Douglas Ierley, Defining the Factors that Influence Developing Country Compliance with and Participation in the WTO Dispute Settlement System: Another Look at the Dispute over Bananas, 33 LAW & POL’Y INT’L BUS. 615, 616 (2002) (presenting the five principal factors cited by diplomats as influencing developing country participation in and compliance with WTO panel and Appellate Body decisions as: (1) the dramatic influence of the political and economic strength of developed countries on the dispute settlement process; (2) the effectiveness, at least in principle, of the dispute settlement system in resolving disputes between countries of diverging political and economic power; (3) the non-compliance of developed countries with WTO decisions; (4) the lack of recourse to retaliation; and (5) the lack of financial resources and technical capacity available to developing countries in order to file and defend against complaints). Conventional wisdom holds that it is a waste of time for developing nations to pursue complaints against industrial nations because the remedies available to them are inadequate. Commentators who have weighed in on this question include Robert E. Hudec, The Adequacy of WTO Dispute Settlement Remedies for Developing Country Complainants, in DEVELOPMENT, TRADE AND THE WTO: A HANDBOOK 81, 81 (Bernard Hoekman et al. eds., 2002). While Hudec concedes that this conventional wisdom has “a great deal of truth to it,” his paper is devoted to showing the complexity of the issues involved. \textit{Id. See also} Marc L. Busch & Eric Reinhardt, Developing Countries and General Agreement on Tariffs and Trade/World Trade Organization Dispute Settlement, 37 J. WORLD TRADE 719 (2003) (arguing that developing countries are no better served under the WTO than they were under GATT); Gregory Shaffer, How to Make the WTO Dispute Settlement System Work for Developing Countries: Some Proactive Developing Country Strategies, International Centre for Trade and Sustainable Development, Resource Paper No. 5, Mar. 2003, \textit{available at} http://www.ictsd.org/pubs/ictsd_series/resource_papers/DSU_2003.pdf. \textit{See also} Phoenix X.F. Cai, Aid for Trade: A Roadmap for Success, 36 DENVER J. INT’L L. & POL’Y 101, ____ (2008) (discussing ways to use aid for trade to assist developing nations to participate more actively in the WTO, including accessing the dispute settlement mechanisms). The countries that make the most frequent use of the WTO’s dispute settlement system as complainants during the period of January 1, 1995 to September 30, 2004 are the United States, Canada, Mexico, European Union, Japan, Korea, India, Thailand, Brazil, Argentina and Chile. See WTO Secretariat, \textit{Statistical Information on Recourse to WTO Dispute Settlement Procedures, Background Note Prepared for the Special Session of the Dispute Settlement Body, JOB(03)/225/Rev.1} (Oct. 22, 2004). The list of the most frequent respondents in WTO cases is identical except for the exclusion of Thailand.
countervailing duty remedy of the SCM Agreement was applicable to all agricultural subsidies because of the Peace Clause.\textsuperscript{307} This point in itself makes the case a landmark one.

In addition, the case is a classic David versus Goliath\textsuperscript{308} tale - the first case in which a developing nation, albeit a middle-income agricultural giant, successfully challenged the agricultural subsidy programs of a powerful developed nation. It is the first dispute in WTO history to challenge domestic subsidies for the production of cotton. It is also the first WTO decision involving export subsidies for agricultural products. It is also the first WTO case to rule on the legality of agricultural export credit guarantees. Lastly, it is the first WTO case to clarify the meaning of Green Box subsidies.

The U.S. – Upland Cotton case is also a landmark case as a normative matter on two distinct levels. First, it suggests a number of criteria for WTO member nations to follow in structuring their farm subsidies programs. Factors that should be taken into account include the magnitude of the subsidies, price contingency, production contingency, and the actual effect and impact of the subsidies in influencing production. Each of these will be discussed in turn. Second, the U.S. – Upland Cotton case suggests important lessons to guide the Doha Round of negotiations on agricultural subsidies, and beyond. The next section will detail the international governance lessons that can be distilled from the case, lessons which transcend agricultural subsidies and indeed the WTO and apply to all fields of public international law.

VI. Normative lessons for international governance: the opportunity to reverse political capitulation

A. Balancing Judicial and Legislative Power

As previously stated, agricultural subsidies are the subject of heated debate in the current Doha Round of negotiations. Negotiators convened on July 21, 2008 to consider, among many other agenda items,

\textsuperscript{307} Canada- Milk had made it clear that this was the case for export subsidies, but did not consider agricultural subsidies in general. \textit{See supra} note 142 and accompanying text.

\textsuperscript{308} \textit{See 1 Samuel 17} (Old Testament).
a new set of draft modalities for cutting subsidies.\textsuperscript{309} Those talks failed to achieve a consensus agreement due in large part to an impasse on special safeguard mechanism for developing nations to impose higher tariffs in some special circumstances, such as a large import surge.\textsuperscript{310} Even though some significant gains were made, and no one seems prepared to throw in the towel on the Doha Round, this recent collapse represents a tremendous lost opportunity. Not only is more litigation guaranteed, but the very legitimacy of the WTO may be in jeopardy.\textsuperscript{311}

The failure to reach a final agreement during this summer’s reiteration of the Doha Round has several important ramifications. First, developing nations and least developed nations are likely to feel more acutely that the WTO has little to offer them if the so-called Doha Development Round is not brought successfully to a close. The fact that this round stalled over safeguard measures for developing nations is indicative of the mood of disillusionment by some powerful developing nations. Failure of Doha and the mood of recalcitrance, if continued, are virtually certain to lead to more litigation.

Increased litigation, particularly against developed nations like the U.S., comes with significant costs. The remedies given to victorious challengers include the imposition of higher tariffs and other import restrictions on the products of the losing nations. The remedies are limited to the subject of the original litigation. Thus a victory in a case against corn subsidies may well mean higher tariffs on U.S. cars and other manufactured goods. If the U.S. begins to lose more cases, the result may contract exports, thereby increasing our trade deficit. In a time of recession or economic contraction, this can hardly be a desirable outcome.

More litigation in the WTO will inevitably mean more litigation on agriculture. Brazil’s Upland Cotton victory will become a blueprint for

\textsuperscript{309} See Ministers begin final efforts to agree blueprints of deal, available at http://www.wto.org/english/news_e/news08_e/meet08_summary_21july_e.htm.


many developing nations to use in their individual or collective challenges to subsidies programs. While greater resort by developing nations to the WTO’s dispute settlement system is beneficial in many ways, it also comes at a cost to the system. It is beyond the scope of this Article to canvass all the costs and benefits of more litigation. However, one aspect of the trend, merits closer study because it goes to the very heart of the balance between judicial and political power. The question may be posed as “What effect would greater litigation in area of agricultural subsidies have on the power of the WTO dispute settlement body vis-à-vis the political branch, the General Council, consisting of all member nations?”

In his book, Tomer Broude advances a very useful theory of relative judicial power. He shows convincingly that the WTO’s dispute settlement mechanisms and the Appellate Body in particular, were designed to be relatively weak, as an institutional matter. Most of the power, including the power to adopt decisions by the dispute settlement bodies, vested in the political body, the general membership wearing the hat of the Dispute Settlement Body. Nonetheless, the Appellate Body is powerful relative to other supranational adjudicative bodies only because the General Council has failed to exhibit political leadership at critical times and have effectively ceded power to the Appellate Body to make decisions the General Council should have tackled. This type of political capitulation is exemplified most recently in the failure to reach a final agreement in the July 2008 round of negotiations. Failure, for example, to finalize clearer definitions of and caps on Blue Box and Green Box subsidies in July of 2008 means that the Appellate Body will eventually have to give such “clarifications” and “interpretations,” much in the same way it did in U.S. – Upland Cotton with respect to Green Box subsidies.

The resulting shift in the balance of power from the General Council or Ministerial Conferences, the political branch of the WTO, to the Appellate Body, the judicial branch, is problematic on a number of different levels. First, it was not the intended outcome. The WTO’s constitutive documents, the WTO Agreement and other documents reached in the Uruguay Rounds, contemplate a relatively weak judicial

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branch. Most of the important power vested in the General Council and the Ministerial Conference. Thus, trade ministers meeting at the Doha Round certainly have the power to make all the problems with agricultural subsidies discussed in this article go away by reaching agreement on new rules and limits on agricultural subsidies. However, they have thus far failed to do so. Negotiations stall due to deadlock. By their inaction and capitulation of their constitutional role, the political body leaves thorny questions for panels and, ultimately, the Appellate Body, to decide. For example, rather than agreeing on new definitions of Blue Box and Amber Box subsidies that would resolve some of the issues raised in U.S.-Upland Cotton, those questions remain for panels and the Appellate Body to address in subsequent cases.

Such a result is not optimal. First, it can take years for these issues to be resolved through litigation, as most cases take years to resolve. Some notoriously difficult issues have been pending before the WTO for twenty years or more, from the GATT era. Even as these issues are resolved in cases, the disposition is likely to be piecemeal as panels and the Appellate Body are always careful to address only questions directly before them. Moreover, the balance of power issues are even more intractable. Nations may well object to the piecemeal resolutions of these issues are judicial overreach. After all, they ought to be resolved through political agreement. Over-reliance on judicial determinations may also undermine transparency, democratic input and accountability. All of these goals are important to all branches of the WTO. It is indeed ironic that one branch may unwittingly be undermining it by an inability to bring albeit difficult negotiations to a successful closure. For these reasons, trade ministers must take the opportunity to reach agreement on at least agricultural subsidies and market access issues in Doha. It is simply too valuable of a chance to reverse the current trend of political capitulation to pass up.

VI. Conclusion

As the world becomes more and more integrated, the webs that link us become more and more intricate. Thus, rice shortages and rising prices in Asia lead to rationing in American Costco and Sam’s Club stores.\textsuperscript{314} Subsidized kerosene (similar to jet fuel) used for cooking fuel by the poor in

\textsuperscript{314} See 2 Major U.S. Retailer Ration Rice Amid Global Food Crisis, April 28, 2008 available at http://afp.google.com/article/ALeqM5jPhvZAJ7gmkUzDNsAmJmZP50l4wg
India and Indonesia contribute to the rising costs of plane tickets worldwide.\textsuperscript{315} In such a brave new world, an appreciation of complexity and inter-connectedness is indispensable. Equally indispensable is an understanding of the complex international regime that governs agriculture and subsidies. In a world of food shortages, high fuel costs and global warming, it is impossible to remain ignorant of the WTO’s impact on such issues through regulation of food and other subsidies. Cases like U.S. – Upland Cotton will have an impact well beyond the esoteric field of international agricultural trade law. This Article situates the U.S. Upland Cotton case in a broad global context, showing how it can extend to corn and ethanol subsidies, and framing as an important development in the debate regarding the balance of power between developed and developing nations, supranational and domestic regulation, and WTO judicial and political power.