

THE CUMULATIVE APPLICATION OF THE  
AGREEMENT ON AGRICULTURE AND THE  
SUBSIDIES AND COUNTERVAILING MEASURES  
AGREEMENT: AN APPROACH TO AGRICULTURAL  
SUBSIDIES BASED ON ITS EFFECTS

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ABSTRACT

Agricultural Trade Liberalization is one of the most complex issues in International Trade. Regarding the aforesaid, the World Trade Organization (WTO) legal framework has developed the Agreement on Agriculture (AoA) as the specific treaty that governs agricultural subsidies. This agreement specifically addresses the structure of an agricultural subsidy, but it does not develop any kind of rule that would allow Member States to challenge a specific agricultural subsidy depending on its trade distortion effects. This paper will focus on the fact that agricultural subsidies may be challengeable and controlled depending on its trade-distorting effects through the application of the Subsidies and Countervailing Measures

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Agreement (SCM) to agricultural subsidies. Accordingly, WTO judicial bodies –Panels and the Appellate Body– have the instruments to examine and review agricultural subsidies through its trade-distorting effects by the cumulative application of both the SCM and the AoA.

*Key words:* Agreement on Agriculture; Subsidies and Countervailing Measures Agreement; Prohibited Subsidies; Actionable Subsidies; Export Subsidies; Domestic Support Measures; Peace Clause; Green Box Subsidies; Blue Box Subsidies.

## LA APLICACIÓN SISTEMÁTICA DEL ACUERDO SOBRE LA AGRICULTURA Y EL ACUERDO SOBRE SUBVENCIONES Y MEDIDAS COMPENSATORIAS: UNA APROXIMACIÓN A LOS SUBSIDIOS AGRÍCOLAS CON BASE EN SUS EFECTOS

### RESUMEN

*La liberalización del mercado agrícola es uno de los temas más complejos en el comercio internacional. Teniendo en cuenta lo anterior, el marco legal de la Organización Mundial del Comercio (OMC) ha desarrollado el Acuerdo sobre la Agricultura (ASA) sobre el Tratado específico aplicable a los subsidios agrícolas. Dicho Acuerdo trata específicamente la estructura de un subsidio agrícola, pero no desarrolla alguna norma que les permita a los Estados Miembros demandar un determinado subsidio sobre la base de que sus efectos distorsionan el comercio internacional. El siguiente documento establecerá que los subsidios agrícolas pueden ser recurribles con base en sus efectos a través de la aplicación del Acuerdo sobre Subvenciones y Medidas Compensatorias (ASMC) a dichos subsidios. En consecuencia, los órganos judiciales de la OMC –Panel*

*y órgano de Apelaciones– tienen los instrumentos para examinar y revisar las subvenciones agrícolas a través de la aplicación sistemática del ASA y el ASMC.*

*Palabras clave: Acuerdo sobre la Agricultura; Acuerdo sobre Subvenciones y Medidas Compensatorias; cláusula de paz; Medidas de Apoyo Interno; subvención a la exportación; subvenciones de Caja Azul; Subvenciones de Caja Verde; subvenciones prohibidas; subvenciones recurribles.*

## INTRODUCTION

Agricultural Trade Liberalization is one of the most complex issues in International Trade<sup>1</sup>. Public policy objectives like national security<sup>2</sup>, environmental protection, and rural employment influence WTO Members and prevent countries from opening agricultural markets. These objectives and other political reasons have led WTO Members to sustain conducts that cause trade distorting effects in agricultural commerce. The present analysis is aimed at establishing the mechanisms that free-trade regulation has in order to control the distorting effects caused by agricultural subsidies (one of the mechanisms to sustain agricultural protection).

Regarding the aforesaid, the WTO legal framework has developed the Agreement on Agriculture (AoA) as the specific treaty that governs agricultural subsidies. In such treaty WTO Member States have agreed to undertake substantial reductions in agricultural support to establish a fair and market-oriented agricultural trading system. This agreement specifically addresses the structure of an agricultural subsidy, but it does not develop any kind of rule that would allow Member States to challenge a specific agricultural subsidy depending on its trade distortion effects.

- 1 Melaku G. Desta, *The Bumpy Ride Towards the Establishment of a Fair and Market Oriented Agricultural Trading System at the WTO: Reflections Following the Cancun Setback*, 8 Drake J. Agric. Law, 489, p. 493.
- 2 Jeffrey J. Steinle, *The problem Child of World Trade: Reform School for Agriculture*, 4 Minn. J. Global Trade, 333, p. 336 (1995).

This paper will focus on the fact that agricultural subsidies can be challengeable and controlled depending on its trade-distorting effects through the application of the Subsidies and Countervailing Measures Agreement (SCM) to agricultural subsidies. Accordingly, WTO judicial bodies –Panels and the AB– have the instruments to examine and review agricultural subsidies through its trade-distorting effects by the cumulative application of the SCM and the AoA.

The following paper will be structured on 3 basic sections. The first section will address the legal nature of a subsidy within the context and provisions of both the SCM and the AoA. The second section will lay out the rationale that governs such cumulative application. The third section will emphasize on the need to establish such cumulative application by developing two examples of how WTO-consistent domestic support may have trade-distorting effects.

## I. AN OVERVIEW: AGRICULTURAL SUBSIDIES WITHIN THE WTO

After seven years of negotiations, the Uruguay Round finished on April 15, 1994, with the most significant reform to the world's trading system: the creation of a new Multilateral Trade Organization called the World Trade Organization (hereinafter WTO). The WTO includes a remarkable list of legal texts enclosing about 60 agreements, annexes, decisions and understandings signed by 123 countries<sup>3</sup>. The WTO was created as an organization for liberalizing trade; a forum for governments to negotiate trade agreements and a place for them to settle disputes, everything under a system of trade rules<sup>4</sup>.

The legal instruments composing the WTO can be synthesized in five groups: i) the Marrakech Agreement establishing the WTO; ii) General agreements addressing goods (GATT 1994),

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3 Mitsuo Matsushita, Thomas J. Schoenbaum & Petros C. Mavroids, *The World Trade Organization: Law, Practice and Policy*, Oxford University Press, 2003, p. 6; World Trade Organization, *Understanding the WTO*, 3 ed., WTO Information and Media Relations Division, 2005, pp. 18 and 23.

4 WTO, *Understanding the WTO*, p. 9.

services (GATS) and Intellectual Property (TRIPS); iii) additional agreements and annexes dealing with specific sectors<sup>5</sup> or issues<sup>6</sup>; iv) the Dispute Settlement Understanding (DSU) and, v) Plurilateral Trade Agreements (PTA's).

This paper will focus on a specific issue of a specific sector: agricultural subsidies within the WTO. In this vein, it is pertinent to explain the general regime on subsidies under both the SCM and the AoA.

## A. SUBSIDIES UNDER THE SCM

### 1. DEFINITION AND ELEMENTS OF A SUBSIDY UNDER THE SCM

According to the SCM, a subsidy is a financial contribution by a government or any public body that confers a benefit to the recipient<sup>7</sup>. This definition is composed by two elements: (a) a financial contribution by a government or any public body and (b) a benefit.

#### *a. Financial contribution by a government or any public body*

The SCM establishes in Article 1.1 (a) that a financial contribution can be granted by six means, mainly: i) direct transfer of funds (e.g. grants or loans) or as potential transfers of funds or liabilities (e.g. loan guarantees); ii) revenue foregone (e.g. fiscal incentives); iii) government provision of goods or services other than infrastructure; iv) government purchase of goods; v) government payments to a funding mechanism, or entrusts or directs a private body to carry

5 On goods the *Agreement on Agriculture* and regarding services the Financial Services, Telecommunications and Maritime Transport Annexes to the GATS.

6 In relation to goods: Agreement on Sanitary and Phytosanitary Measures, Agreement on Technical Barriers to Trade, Agreement on Trade-Related Investment Measures, Anti-dumping Agreement, Agreement on Customs Valuation, Agreement on Import Licensing, Agreement on Preshipment inspection, Agreement on Rules of Origin, Agreement on Safeguards, and *Agreement on Subsidies and Countervailing Measures Agreement*.

7 *Agreement on Subsidies and Countervailing Measures*, art. 1.1 (April 15, 1994), LT/UR/A-1A/9.

out functions of the first two financial contributions described; vi) income or price support<sup>8</sup>.

b. *Benefit*

The SCM does not develop any criteria to set out when a benefit is conferred. However, the Appellate Body (AB) has addressed this issue by establishing that a benefit is bestowed when “the financial contribution makes the recipient better off than it would otherwise have been, absent that contribution”. Furthermore, the AB asserted that “the marketplace provides an appropriate basis for comparison in determining whether a benefit has been conferred...”, such that the core issue is to determine “whether the recipient has received a financial contribution on terms more favourable than those available to the recipient in the market”<sup>9</sup>.

Also, the AB has stated that the guidelines of Article 14 of the SCM -although related to countervailing measures- are relevant when interpreting the word “benefit” under Article 1.1 (b), as they provide benchmarks to determine when government provision of funds, loans, loan guarantees, and good or services shall be considered as conferring a benefit<sup>10</sup>.

Finally, it is important to remark that the term *benefit* always implies a beneficiary and/or a recipient<sup>11</sup>. In some cases, the recipient of the subsidy is not the exclusive beneficiary of it. This situation is known as the “pass through effect”, which takes place when a payment is granted to a purchaser but the producer of the commodity also receives the benefit<sup>12</sup>.

8 In this kind of subsidies, governments “fix a minimum guaranteed support price or a target price for a product, which is sustained by tied policy measures such as quantitative restrictions on production, custom duties, export subsidies or public stockholding”. 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 J. World Trade 305, 2002, p. 339.

9 Report of the AB, *Canada - Measures Affecting the Export of Civilian Aircraft*, para. 157 (August 2, 1999), WT/DS70/AB/R.

10 Id., paras. 155 and 158.

11 Id., para. 154.

12 For example, an amount of money granted to producers of bread, upon proof of

## 2. SPECIFICITY TEST

Article 1.2 of the SCM states that a subsidy shall be granted to a specific enterprise or industry or group of enterprises or industries, in order to be actionable because of its trade–distorting effects.

Article 2 of the SCM stipulates that a subsidy may be specific either *de iure* or *de facto*. A subsidy is specific *de iure* if the legal provision surrounding the granting of it limits expressly the access to the subsidy to certain enterprises<sup>13</sup> or if the granting of the subsidy is limited to certain enterprises located within a designated geographical region<sup>14</sup>. On the other hand, a subsidy may be specific *de facto* when, notwithstanding the objective criteria governing the eligibility for its access<sup>15</sup>, it is only used by certain enterprises; or it is granted disproportionately to certain enterprises; or it is bestowed under a discretionary power exercised by the granting authority<sup>16</sup>.

## 3. TYPES OF SUBSIDIES UNDER THE SCM

### a. PROHIBITED SUBSIDIES

These subsidies are considered to have trade distorting effects *per se*, reason why complainants must only demonstrate its existence in order to prevail in a dispute conducted before the WTO<sup>17</sup>. Moreover, the SCM establishes that all prohibited subsidies “shall be deemed

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purchase of bales of wheat flour. In this case, the purchaser is the direct recipient of the subsidy, but the benefit is extended to wheat flour producers, as demand for their products will increase. Report of the AB, *Final Countervailing Duty Determination with respect to certain Softwood Lumber from Canada*, para. 14 (January 19, 2004), WT/DS257/AB/R.

13 *Agreement on Subsidies* at art. 2.1 (a).

14 *Id.*, art. 2.2.

15 *Id.*, art. 2.1 (b).

16 *Id.*, art. 2.1 (c).

17 Uruguay Round Trade Agreement, *Statement of Administrative Action - Agreement on Subsidies and Countervailing Measures*, pp. 911-923 (Cong., 2D Sess., Vol. 1, September 27, 1994), H.R. DOC. No. 316, 103D. Quoted by Raj Bhala, *Internal Trade Law: Theory and Practice*, 2nd. Ed., Lexis Publishing, 2001, p. 972.

to be specific”<sup>18</sup>. There are two kind of prohibited subsidies: export subsidies and import substitution subsidies.

### *Export subsidies*

Article 3.1 (a) of the SCM prohibits those “subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance”. Accordingly, the key element to identify the existence of a prohibited subsidy under Article 3.1 (a) is the word “contingent”, which means conditional or dependent for its existence on something else<sup>19</sup>.

There are two types of export contingency: contingency *de iure* and contingency *de facto*. The first one has been approached by the AB, which has stated that a subsidy is contingent in law upon export performance, when the existence of that condition is explicitly or implicitly derived from the words of the legislation constituting the measure<sup>20</sup>. On the other hand, footnote 4 of the SCM sets out that a subsidy is contingent in fact upon export performance when its granting “is in fact tied to actual or anticipated exportation or export earnings”.

The AB has recognized that proving *de facto* export contingency is a difficult task that must be inferred, on a case-by-case basis<sup>21</sup> from the total configuration of the facts constituting and surrounding the granting of the subsidy<sup>22</sup>. Despite the casuistic background enclosing this issue, both Panels and the AB have established some objective guidelines that work as circumstantial evidence to disclose a contingency in fact upon export performance. The most significant guidelines to these Bodies are the export-orientation of the recipient<sup>23</sup>,

18 *Agreement on Subsidies*, art. 2.3.

19 Report of the AB, *Canada-Aircraft*, para. 166.

20 Report of the AB, *Canada - Certain Measures Affecting the Automotive Industry*, para. 100 (May 31, 2000), WT/DS139/AB/R and WT/DS142/AB/R.

21 Report of the Panel, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*, paras. 9.56-9.57 (May 25, 1999), WT/DS126/R.

22 Report of the AB, *Canada - Aircraft*, paras. 166-167.

23 In the own words of the AB, “the export orientation of a recipient may be taken into account as a relevant fact, provided that it is one of several facts which are considered and is not the only fact supporting a finding”. Reports of the AB, *Canada - Aircraft*, para. 173. However, on this point it is important to remark that footnote 4 of the SCM clearly specifies that “the mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy”.

the size of the domestic market<sup>24</sup> and the nearness-to-the-export-market of the projects funded<sup>25</sup>.

### *Import substitution subsidies*

A second type of red light subsidies are those “contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods” (Article 3.1 (b) of the SCM). Similar to Article 3.1 (a), the keyword in this Article is *contingent*, which has the same definition used when addressing export subsidies<sup>26</sup>. In the Canada-Autos case, the AB established that the word *contingent* in Article 3.1 (b) encompasses contingency *de iure* and contingency *de facto*, although the latter is not explicitly mentioned within the terms of this Article<sup>27</sup>.

## b. ACTIONABLE SUBSIDIES

Under this category the SCM refers to subsidies that are permitted by the WTO unless they cause adverse effects to the interest of another Member<sup>28</sup>. According to Article 5 of the SCM, adverse effects are caused through: (a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits accruing under GATT 1994 and, (c) serious prejudice to the interests of another Member.

24 “[A] Member’s awareness that its domestic market is too small to absorb domestic production of a subsidised product may indicate that the subsidy is granted on the condition that it be exported”. Report of the Panel, *Canada - Export Credits and Loan Guarantees for Regional Aircraft*, para. 7.370 (January 28, 2002), WT/DS222/R.

25 According to the Canada-Aircraft Panel, “the closer a subsidy brings a product to sale on the export market, the greater the possibility that the facts may demonstrate that the subsidy would not have been granted but for anticipated exportation or export earnings”. Para. 9.337.

26 Report of the AB, *Canada-Autos*, para. 123.

27 *Id.*, paras. 137-138. An example of an import substitution subsidy could be a payment granted to bakers contingent upon incorporation of wheat flour produced domestically. Also, an example of a import substitution subsidy can be found in the *US-Cotton* Case under the measure called “User Marketing (Step 2) Payments”. Report of the Panel, *United States Subsidies on Upland Cotton*, para. 7.1074 (September 8, 2004), WT/DS267/R.

28 WTO, *Understanding the WTO*, p. 46.

*Injury to the domestic industry of another Member*

Under the SCM, injury to the domestic industry encompasses material injury or threat of material injury to a domestic industry, or material retardation of the establishment of such an industry<sup>29</sup>. Article 15.1 of the SCM establishes that two issues shall be assessed when determining the injury to the domestic industry: i) the volume of subsidized imports and its effects on prices within the domestic market and ii) the impact of such imports on domestic producers. Furthermore, Article 15.4 establishes some other factors that should be considered, such as: i) the nature of the subsidy in question and the trade effects that may arise, ii) the rate of increase of the subsidized imports into the domestic market and, iii) the prices at which imports are entering to the internal market<sup>30</sup>.

*Nullification or impairment of benefits accruing under GATT 1994*

According to Article 5 (b) of the SCM, a second way to cause adverse effects to the interests of another Members is through “nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article 2 of GATT 1994”.

Footnote 12 of the same agreement stipulates that the determination of nullification or impairment follows the rules of GATT’s Article 23, in the sense that a benefit accruing by a Member can be nullified directly or indirectly as a result of: i) the failure of another contracting party to carry out its obligations under this Agreement or; ii) the application by another contracting party of any measure.

When applying Article 23 of the GATT 1994 to the provision of Article 5 (b) of the SCM, a Member that wishes to demonstrate adverse effects through nullification or impairment, should demonstrate three points: i) a concession negotiated under GATT 1994 that resulted in a tariff binding; ii) the introduction of a subsidy

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29 *Agreement on Subsidies*, footnote 45.

30 Chambovey, *How the Expiry of the Peace Clause Might Alter Disciplines on Agricultural Subsidies in the WTO Framework*, p. 322.

after the entry into force of the binding; iii) the introduction of the subsidy resulted in nullifying or impairing the benefits accrued by the country to which the tariff concessions were addressed<sup>31</sup>.

*Serious prejudice*

Article 6.3 of the SCM establishes that serious prejudice may arise when the effect of the subsidy is the following: a) to displace or impede the imports of a like product of another Member into the market of the subsidizing Member; b) to displace or impede the exports of a like product of another Member from a third country market; c) a significant price undercutting, price suppression, price depression or lost sales in the same market; d) an increase in the world market share of the subsidizing Member in a particular subsidized commodity when this increase follows a consistent trend over a period when subsidies have been granted.

Nowadays, there is a debate concerning the interpretation of this Article regarding whether the proof of one of the situations described instantly creates serious prejudice, or if it constitutes merely one step for serious prejudice to arise.

The latter approach relies on the fact that Article 6.3 provides that serious prejudice “may arise” when one of the four situations described therein is fulfilled. As the word “may” means “possibility” or “permission”, Article 6.3 stands for the possibility for serious prejudice to arise whenever one of the listed situations is proven. This interpretation is consistent with Article 31.1 of the Vienna Convention –that applies to WTO proceedings according to Article 3.2 of the DSU–<sup>32</sup>, which states that “[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”<sup>33</sup>.

31 Matsushita, Schoenbaum & Mavroids, *The World Trade Organization*, p. 279.

32 “The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law” (emphasis added). *Understanding on Rules and Procedures Governing the Settlement of Disputes*, art. 3.2 (April, 15 1994), LT/UR/A-2/DS/U/1.

33 *Vienna Convention on the Law of Treaties*, Article 31.1 (May 23, 1969), I.L.M 8.

However, despite the arguments regarding the interpretation of Article 6.3, the US-Cotton Panel stated that when a Member proves that the effect of a subsidy fits into one of the situations described in this provision, serious prejudice shall be deemed to exist<sup>34</sup>.

Two main arguments were stressed by the Panel. First, it interpreted the word “may” in the sense that the list of four situations was illustrative but not exhaustive, and therefore, a Member could prove serious prejudice by evidencing that the effect of a subsidy was other one that the listed in Article 6.3 of the SCM<sup>35</sup>. Second, the Panel regarded how Articles 5 and 6 have no additional criteria that would guide the interpreter in its examination as to when serious prejudice would arise<sup>36</sup>. This situation would make “serious prejudice” very difficult to prove, reducing its application to redundancy or inutility, since the term “serious prejudice” is broad and undetermined. Hence, “serious prejudice” needs defined requirements in order to arise.

The arguments expressed by the Panel show that the logical interpretation of this Article must be that serious prejudice arises *per se* when a Member proves that the effect of the challenged subsidy fits into one of the situations described in Article 6.3. The latter is consistent with the fact that before the SCM there were no express requirements in order to consider that serious prejudice existed. This made it almost impossible for Members to prove serious prejudice within the frame of the GATT 1947. Accordingly, the establishment of additional requirements besides those of Article 6.3, in order to prove that serious prejudice arises is a return to the past<sup>37</sup>.

Once the regulation of subsidies under the SCM has been described, it is pertinent to review the particular provisions of the AoA in connection with agricultural subsidies. This topic must be addressed since the AoA –which provides specific rules related to the agricultural sector– provides a special system for agricultural subsidies that is different from the one included in the SCM.

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34 Report of the Panel, *US-Cotton*, para 7.1389.

35 *Id.*, para. 7.1387.

36 *Id.*, para 7.1373.

37 Bhala, *International Trade Law*, p. 973.

## B. SUBSIDIES ACCORDING TO THE AoA

The following section will address the definition of the word *subsidy* under the AoA; subsequently, the types of agricultural subsidies brought under the AoA will be explained; finally, the types of domestic support measures under the AoA, and the special regulation that the AoA brings for agricultural export subsidies will be reviewed.

### 1. DEFINITION OF “SUBSIDY” UNDER THE AoA

Unlike the SCM Agreement, the AoA does not define the term *subsidy* or its elements. However, the AoA states that *export subsidies* are those “contingent upon export performance”<sup>38</sup>. Accordingly, the first task is to determine whether the AoA and the SCM understand the term *subsidy* in the same sense, and whether there is any difference between the definitions that both Agreements provide for the term *export subsidy*. The issue may be answered by applying the *rationale* that guides the application of Agreements adopted within the WTO framework<sup>39</sup>.

Within the WTO Agreements apply cumulatively. Both Panels and the AB have considered that WTO Agreements apply as a single understanding. Only in the case of a conflict between the rules of the Agreements, the more specific Agreement shall prevail<sup>40</sup>. Since there is no definition of the term *subsidy* in the AoA, there could be no such conflict with the definition of such term provided by the SCM. Hence, the definition of *subsidy* included in the SCM is applied to understand the definition of *subsidy* in the AoA, which means that a *subsidy* within the AoA is a “financial

38 *Agreement on Agriculture*, art. 1 (e) (15 April 1994), LT/UR/A-1A/2.

39 See *supra*, I.B.1.

40 Report of the Panel, US-Cotton, para 71.071. Other cases analysing the relationship between the GATT and the other Annex 1A Agreements, see Report of the Panel, Brazil-Measures Affecting Desiccated Coconut, para. 227 (October, 17 1996), WT/DS22/R. Report of the AB, Argentina-Safeguards Measures on Imports of Footwear, paras. 79-81 (December 14, 1999), WT/DS121/AB/R.

contribution, made by a government or any public body, which confers a benefit<sup>741</sup>.

It is now relevant to determine whether the definition of *export subsidy* included in the AoA is the same one included in the SCM. The AoA states that *export subsidies* are those “contingent upon export performance”<sup>742</sup>. On the other hand, the SCM, states that those subsidies “contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance...<sup>743</sup>, are prohibited. As it can be seen, both Agreements understand *export subsidies* in the same way, as the element *contingent upon export performance* is present in both the SCM and the AoA. Accordingly, the SCM and the AoA understand the term *export subsidy* in the same manner.

This conclusion is supported by the fact that both Agreements make cross- references to each other every time these regulate subsidies. For example, Article 3 of the SCM –that states which subsidies are prohibited within the WTO–, provides that this regulation applies “except as provided in the Agreement on Agriculture”<sup>744</sup>. Therefore, if both agreements had understood *export subsidy* in a different way, they would not have made cross-references with the rules provided in both Agreements for export subsidies<sup>745</sup>.

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41 *Agreement on Subsidies*, art. 1.

42 *Id.*, art. 1.

43 *Id.*, art. 3.1.

44 Also, Article 13 of the AoA, which excepts certain agricultural export subsidies from being challenged under part III of the SCM provided that they comply with certain conditions, refers to the regulation of actionable subsidies included in Articles 5 and 6 of the SCM.

45 The *Canada-Dairy Panel* stated in this regard that “[o]n the issue of the relationship between Article 1€ of the Agreement on Agriculture (which provided guidance for what constituted an export subsidy under that agreement) and Article 3.1 (a) of the SCM Agreement, the ordinary meaning of these terms in the context off Annex 1A of the WTO Agreement would imply that the definitions were the same. If there were measures that fell under Article 3.1 (a) of the SCM Agreement but not the definition of export subsidy under Article 1(e) of the Agreement on Agriculture, they World not be covered by Article 13 (c) of the Agreement on Agriculture. That World appear to lead to a result other than the intention of Article 13 of the Agreement on Agriculture and so be ruled under Article 31.1 and 32 (b) of the Vienna Convention. Report of the

## 2. TYPES OF SUBSIDIES

The AoA divides subsidies directed to the agricultural sector in *export subsidies* and *domestic support* measures. Domestic support measures are sub-classified in *boxes*, depending on the nature of the subsidy and on its effects. The following section will explain the regulation for export subsidies; the regime provided by the AoA for domestic support measures –including all its boxes– and finally; reference will be made to the Article 13 of the AoA. This Article is the so-called “Peace Clause”, which protected certain agricultural subsidies from being challenged under the SCM<sup>46</sup>.

### a. EXPORT SUBSIDIES

The AoA brings a very different regime from the SCM regarding export subsidies. While the SCM prohibits export subsidies, the AoA allows them under certain conditions. Two provisions are relevant to see how the AoA permits subsidies *contingent upon export performance*. First, Article 8 of that Agreement which establishes that “[e]ach Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member’s Schedule”<sup>47</sup>. Second, Article 3.3 of the AoA provides that “[s]ubject to the provisions of paragraphs 2(b) and 4 of Article 9, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule *in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule*”<sup>48</sup> (emphasis added).

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Panel, *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, para. 5.5 (May 17, 1999), WT/DS103/R, WT/DS113/R.

46 See *supra* I.B.2.

47 *Agreement on Agriculture*, art. 8.

48 *Id.*, article 3.3.

As it can be noted, the AoA allows Members to grant export subsidies under the condition that they do not grant support to agricultural products *in excess* of the *export subsidy commitments* assumed by the country granting the subsidy. The concept of *export subsidy commitments* refers, firstly, to the limits –expressed in budgetary terms, quantity terms, or both– under which a Member may grant export subsidies directed to agricultural products<sup>49</sup>. These have been understood as *commitments for schedule products or schedule commitments*<sup>50</sup>. Under the second type of *export subsidy commitments*, Members have undertaken “*not to provide any export subsidy, listed in Article 9.1, with respect to uncheduled agricultural products*”<sup>51</sup>. These are the *commitments for uncheduled products*.

Accordingly, if the Member grants export subsidies in excess of its budgetary outlays and/or quantity commitment levels, the subsidy would be prohibited under the AoA. Also, if the Member has not made commitments in respect to an agricultural product, that Member cannot grant export subsidies to that commodity as listed in Article 9.1. Any amount granted to that product would be prohibited under the AoA<sup>52</sup>.

It shall be noted that Members make budgetary outlays and quantity commitments only with respect to those subsidies listed in Article 9.1 of the AoA<sup>53</sup>. For example, one of the subsidies listed

49 For example, a Member can make a budgetary commitment of one hundred dollars for the granting of export subsidies directed to the cotton industry, case in which the Member may only grant that amount of export subsidies to cotton producers. Also, a Member can make a quantity commitment of three hundred bales of cotton for the granting of export subsidies, which means that the Member may only subsidize three hundred bales of cotton. Finally, the Member can make budgetary and quantity commitments with respect to an agricultural product.

50 Report of the AB, *United States - Tax Treatment for “Foreign Sales Corporations”*, paras. 145-146 (February 24, 2000), WT/DS108/AB/R.

51 *Id.*

52 “With respect to *uncheduled* agricultural products, Members are *prohibited* under Article 3.3 from providing *any* export subsidies as listed in Article 9.1”, AB, *US-FSC*, paras. 150-152.

53 *Agreement on Agriculture*, art. 9.1. 1. The following export subsidies are subject to reduction commitments under this Agreement: (a) the provision by governments or

in Article 9.1 are “*subsidies on agricultural products contingent on their incorporation in exported products*”<sup>54</sup>. When a Member grants money to producers if they incorporate national raw material in the goods that are going to be exported, that Member cannot pay its producers an amount of money that exceeds its budgetary outlays (if any)<sup>55</sup>.

However, what happens if a Member grants an agricultural export payment using a different subsidy from the ones listed in Article 9.1? How is it possible to control these subsidies if Members only make

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their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance; (b) the sale or disposal for export by governments or their agencies of non-commercial stocks of agricultural products at a price lower than the comparable price charged for the like product to buyers in the domestic market; (c) payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived; (d) the provision of subsidies to reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services) including handling, upgrading and other processing costs, and the costs of international transport and freight; (e) internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments; (f) subsidies on agricultural products contingent on their incorporation in exported products.

54 *Id.*, Article 9.1 (f).

55 “Under Article 3, Members have undertaken two different types of “export subsidy commitments”. Under the first clause of Article 3.3, Members have made a commitment that they will “not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or group of product specified in Section II of part IV of its Schedule in excess of the budgetary outlay and quantity commitments levels specified therein”. This is the commitment for Schedule agricultural products. (...) Under the second clause of Article 3.3, Members have committed not to provide any export subsidies, *listed in Article 9.1*, with respect to *unscheduled* agricultural products. This clause clearly also involves “export subsidy commitments” within the meaning of Article 10.1. Our interpretation of this term is confirmed by the title of Article 9, which is “*export subsidy commitments*”. Consistently with our regarding of that term, Article 9.1 relates both to (1) the commitments made for *scheduled* agricultural products, under the first clause of Article 3.3, and to (2) the general prohibition, in the second clause of Article 3.3, against providing export subsidies listed in Article 9.1 to *unscheduled* agricultural products. Report of the AB, *US-FSC* at paras. 148-152.

budgetary and quantity limits in respect with the measures listed in Article 9.1? The answer to these questions is provided in Article 10.1 of the AoA. This Article states that a Member cannot grant export subsidies different from the ones included in Article 9.1 if those subsidies result in or may lead to circumvention of the export subsidy commitments made in respect of subsidies listed in Article 9.1<sup>56</sup>. This is a very important provision because, as stated in the *US-FSC* case, “Members would certainly have ‘found a way round’, a way to ‘evade’, this prohibition if they could transfer, through tax exemptions, the very same economic resources that they are prohibited from providing in other forms under Articles 3.3 and 9.1”<sup>57</sup>.

It is important to mention that in this case the *phrase export subsidy commitments*, included in Article 10.1 was interpreted to include not only commitments in respect to scheduled products in connection with the list of subsidies in Article 9.1 (reduction commitments), but also commitments in respect to unscheduled products<sup>58</sup>.

The conclusion from this interpretation held by the AB is that within the frame of the AoA, export subsidies are permitted if they are in accordance with the export subsidy commitments. There are two types of export subsidy commitments: the commitment for scheduled products and the commitment for unscheduled products. Members have to comply with both of these types of commitments

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56 *Agreement on Agriculture*, art. 10.1.

57 Report of the AB, *US-FSC*, para. 150.

58 “We also find support for this interpretation of the term “export subsidy commitments” in Article 10 itself, which draws a distinction, in subparagraphs 1 and 3, between “export subsidy commitments and “reduction commitment levels”. In our view, the terms “export subsidy commitments” and reduction commitments have different meanings. “Reduction commitments” is a narrower term than “export subsidy commitments” and refers only to commitments made, under the first clause of Article 3.3, with respect to scheduled agricultural products. It is only with respect to scheduled products that Members have undertaken, under Article 9.2 (b) (iv) of the Agreement on Agriculture, to reduce the level of export subsidies, as listed in Article 9.1, during the implementation period of the Agreement on Agriculture. The term “export subsidy commitments” has a wider reach that covers commitments and obligations relating to both scheduled and unscheduled agricultural products. *Id.*, paras. 144-147.

in order to comply with the AoA. Additionally, if the Member grants an export subsidy different from the ones included in Article 9.1 of the AoA, the subsidy shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments (including in “export subsidy commitments” those for Schedule products and those for unscheduled products).

#### b. DOMESTIC SUPPORT MEASURES

The AoA divides domestic support measures in coloured “boxes”: amber box, green box and blue box, depending on the structure or the effects of the subsidy. Before addressing the explanation of each one of the boxes included in the AoA, it is necessary to make a reference to the relevant rules that regulate domestic support measures.

The first provision that must be quoted is Article 3.2. of the AoA. This provision states that “[s]ubject to the provisions of Article 6, a Member shall not provide support in favour of domestic producers in excess of the commitment levels specified in Section I of Part IV of its Schedule”<sup>59</sup>. According to this provision, Members make budgetary and/or quantity commitments not only in respect of export subsidies, but also in respect of domestic support measures.

Article 6 of the AoA is the second relevant provision. The Article states that:

“1. The domestic support reduction commitments of each Member contained in Part IV of its Schedule shall apply to all of its domestic support measures in favour of agricultural producers with the exception of domestic measures which are not subject to reduction in terms of the criteria set out in this Article and in Annex 2 to this Agreement. The commitments are expressed in terms of Total Aggregate Measurement of Support and “Annual and Final Bound Commitment Levels. (...) and, 3. A Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual

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59 *Agreement on Agriculture*, art. 3.

or final bound commitment level specified in Part IV of the Member's Schedule"<sup>60</sup>.

These provisions bring an important rule that must be analyzed. Article 6.1 refers to two types of subsidies: those that are subject to reduction commitments, and those that are not subject to reduction commitments by complying with the criteria set out in Annex 2 of the SCM. The first ones are known as "Amber Box subsidies" and the second ones are known as "Green Box subsidies". Therefore, Amber box subsidies shall comply with the reduction commitments made by the country granting the subsidy.

#### *Amber Box subsidies*

Amber Box subsidies are domestic payments considered to cause trade-distorting effects. Hence, these subsidies are subject to reduction commitments<sup>61</sup>. The Member granting the subsidies shall not exceed its commitments (the total AMS) and if it does, the subsidy is prohibited<sup>62</sup>.

#### *Green Box subsidies*

Article 6.1 of the AoA states that domestic support measures granted in terms of the criteria set out in Annex 2 of the AoA shall be exempted from reduction commitments. Subsidies shall comply with the fundamental requirement: *that they have no, or at most minimal, trade-distorting effects or effects on production*<sup>63</sup> in order to be within the Green Box. Additionally, Green Box subsidies shall fulfil two requirements: (i) they must be "provided through a publicly-funded government programme not involving transfers from consumers" –which means that consumers will not assume higher prices for the products, and, (ii) the support

60 Id., arts. 6.1 and 6.3.

61 WTO, *Domestic Support Boxes*, [http://www.wto.org/english/tratop\\_e/agric\\_e/agboxes\\_e.htm](http://www.wto.org/english/tratop_e/agric_e/agboxes_e.htm) (accessed October 1, 2006). Reduction commitments in connection with domestic support are expressed in terms of a "total aggregate measurement of support" (AMS), which "includes all supports for specified products together with supports that are not for specific products, in one single figure".

62 *Agreement on Agriculture*, art. 6.3

63 Id., Annex 2, art. 1.

in question shall not have the effect of providing price support to producers<sup>64</sup>.

Besides these three requirements, Annex 2 establishes some specific conditions depending on the structure of the subsidy being granted for the payment to qualify as a Green Box measure. Usually, green box subsidies are programmes that are “not targeted at particular products, and include direct income supports that are not related to (are “decoupled” from) current production levels or prices. They also include environmental protection and regional development programmes. “Green Box” subsidies therefore have no limits, to the extent they comply with the policy-specific criteria set out in Annex 2”<sup>65</sup>.

#### *Blue Box subsidies*

These subsidies are regulated in Article 6.5 of the AoA, which states that direct payments under production-limiting programmes shall not be subject to the commitment to reduce domestic support if: (i) such payments are based on fixed area and yields; or (ii) such payments are made on 85 per cent or less of the base level of production; or (iii) livestock payments are made on a fixed number of heads.

At first sight, Blue Box subsidies are those payments granted when the recipient limits production. However, there is a debate concerning the conditions for granting the subsidy. Indeed, from a literal interpretation regarding Article 6.5, the condition for granting the subsidy is not an effective product-limitation, but only the fact of being part of a production-limiting programme. This discussion and others, involving this type of payments will be analyzed in part IV-2 of this paper.

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64 Id.

65 WTO, *Domestic Support Boxes*, [http://www.wto.org/english/tratop\\_e/agric\\_e/agboxes\\_e.htm](http://www.wto.org/english/tratop_e/agric_e/agboxes_e.htm)

### 3. THE ROLE OF THE PEACE CLAUSE (ARTICLE 13 OF THE AoA)

Before the year 2004, the AoA brought a provision that, amongst other things, exempted some agricultural subsidies from being challenged because of their trade-distorting effects (Part III of the SCM Agreement). Although this provision has already expired, it is important to explain how it worked in the past.

Article 13 of the AoA established that all Green Box measures were exempt from actions based on Article 16 of GATT 1994 and Part III of the SCM<sup>66</sup>. This meant that if a Green Box subsidy caused adverse effects to the interests of another Member, it could not be challenged under the SCM. The same protection was given to Amber Box subsidies that complied with the Schedule of Commitments, and with all Blue Box subsidies, provided that they complied with certain requirements<sup>67</sup>.

Additionally, export subsidies that complied with export subsidy commitments included in each Member's Schedule, were protected from claims under Articles 5 and 6 of the SCM if they caused adverse effects to the interests of another Member. Since the Peace Clause has now expired, there are relevant debates in connection with the application of the SCM to agricultural subsidies. These debates will be analyzed below, and will serve to clarify the possibility of challenging agricultural subsidies through SCM provisions.

## II. APPLYING THE SCM TO AGRICULTURAL SUBSIDIES

This chapter will emphasize on two issues: first, the importance regarding the cumulative application of the SCM and the AoA; second, the legal basis under which such cumulative application is possible.

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66 *Agreement on Agriculture*, art. 13.

67 *Id.*, art. 13 (b) (iii).

## A. THE IMPORTANCE OF A CUMULATIVE APPLICATION

The main importance of a cumulative application rests on the fact that agricultural subsidies that are under compliance with the AoA, may be challenged if these cause *adverse effects to the interests of another Member* according to the SCM<sup>68</sup>. The application of the rules included in the SCM to agricultural subsidies is a very important issue when analyzing whether a WTO Member that grants agricultural subsidies is acting inconsistently with WTO provisions or not. Generally, WTO rulings<sup>69</sup> and Scholars<sup>70</sup> have accepted the application of SCM provisions to agricultural subsidies.

## B. LEGAL BASIS FOR CUMULATIVE APPLICATION

### 1. PROVISIONS OF THE SCM AND THE AoA REGARDING SUBSIDIES

The SCM sets forth a general regime applicable to subsidies directed to all industries. As explained before, it provides rules in connection with subsidies that are prohibited and subsidies that are actionable regarding their trade distorting effects<sup>71</sup>. Also, the SCM states that rules included in that Agreement for prohibited subsidies apply except as provided in the AoA. Additionally, within that Agreement, rules in connection with actionable subsidies apply except as provided in the Peace Clause, which expired on January 2004.

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68 Richard H. Steimber & Timothy E. Fosling, *When the Peace ends: The Vulnerability of EC and US Agricultural Subsidies to WTO Legal Challenges*, 6 (2) J. Int. Econ. Law 369, Oxford University Press 2003, pp. 374-375.

69 Report of the Panel, *US-Cotton*, para. 71.071. See supra, note 40.

70 Chambovey, *How the Expiry of the Peace Clause Might Alter Disciplines on Agricultural Subsidies in the WTO Framework*, pp. 308-309. Steimberg & Fosling, *When the Peace Ends*, pp. 374-375.

71 See supra, I.B.2.

On the other hand, the AoA brings a more permissive subsidy regime<sup>72</sup>. It allows Members to grant export subsidies<sup>73</sup> if they are in compliance with their scheduled commitments –quantity commitments and budgetary outlays–<sup>74</sup>. With regards to domestic support, the AoA also subjects part of these payments to reduction commitments, and divides them in three types: Green Box, Blue Box and Amber Box. Most importantly, the AoA had a provision that protected agricultural subsidies from being challenged because of their trade-distorting effects (Article 13 of the AoA, the so-called Peace Clause)<sup>75</sup>.

## 2. THE APPLICATION OF SCM PROVISIONS TO THE AOA

It is now necessary to analyze the application of the SCM to agricultural payments. Article 21.1 of the AoA establishes: “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”<sup>76</sup>. This indicates that the AoA provides for the application of other WTO Multilateral Trade Agreements. As the SCM is part of that group of Agreements, it must be understood that it applies to agricultural subsidies even though the AoA Agriculture brings specific provisions in connection with this matter.

WTO Panels and the AB have stated that WTO Agreements generally apply cumulatively as a single body of rules<sup>77</sup>. This means that an agricultural payment has to comply with both the

72 Karen Halverson, *King Cotton, Developing Countries, and The Peace Clause: The WTO's Cotton Subsidies Decision*, 9 J. Int. Econ. L. 149, 2006, p. 164.

73 *Agreement on Agriculture*, art. 3.3 and 8.

74 In the Uruguay Round, Members agreed to allow the granting of export subsidies directed to agricultural goods. However, this permission has a limit. Accordingly, each Member granting agricultural subsidies had to schedule budgetary commitments and a quantity commitments as the limit to which they could grant Agricultural export subsidies and domestic support payments.

75 *Id.*, art. 13.

76 *Id.*, art. 21.1.

77 Report of the Panel, *US-Cotton*, para. 71.071. See *supra*, note 40.

AoA and the SCM, but how does the SCM apply to agricultural goods? Article 21.1 of the AoA resolves this issue by stating that Multilateral Trade Agreements apply “*subject to the provisions of [the Agreement on Agriculture]*”<sup>78</sup>. This provision has been interpreted in the way that the SCM applies to the AoA unless the latter brings specific provisions that contradict those from the SCM<sup>79</sup>, case in which the provisions of the AoA shall prevail. This means that when analyzing the compliance of agricultural subsidies with WTO provisions, the AoA takes precedence over the SCM, even though both Agreements apply cumulatively, *i.e.* agricultural subsidies have to be analyzed first under the AoA, and only if necessary under the SCM.

Nevertheless, the question of how agricultural subsidies may be challenged under SCM provisions has not had uniform answers. Didier Chambovey has shed some lights on the argument that the SCM does not apply at all to agricultural subsidies because the AoA is *lex specialis*, and brings specific provisions dealing with this matter<sup>80</sup>. The theory is supported by the interpretation made by the AB when analyzing the *EC Bananas* case. In that case, the AB held that the SCM applies to agricultural subsidies “except to the extent that the AoA contained specific provisions dealing specifically with the same matter”<sup>81</sup>. Hence, if the AoA has specific provisions regulating agricultural subsidies, the SCM should not apply to agricultural subsidies. Furthermore, the fact that the AoA was negotiated separately, with a different purpose<sup>82</sup> and under a different set of rules, supports the opinion that the SCM does not apply to agricultural subsidies<sup>83</sup>. Finally, accepting that the SCM

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78 Agreement on Agriculture, art. 21.1.

79 Steimberg & Fosling, *When the Peace Ends*, pp. 374-375.

80 Chambovey, *How the Expiry of the Peace Clause Might Alter Disciplines on Agricultural Subsidies in the WTO Framework*, p. 309.

81 Report of the AB, *European Communities - Regime for the importation, Sale and Distribution of Bananas*, paras. 155-158 (September 1997), WT/DS27/AB/R.

82 The long term objective is to establish a fair and market-oriented agricultural trading system. *Agreement on Agriculture* at Preamble.

83 Chambovey, *How the Expiry of the Peace Clause Might Alter Disciplines on Agricultural Subsidies in the WTO Framework*, p. 309.

applies to the AoA and therefore applies to agricultural subsidies would be in contravention of the Principle *in dubio mitius*<sup>84</sup>.

On the other hand, WTO Panels, the AB and most Scholars have agreed that the SCM does apply to the AoA and to agricultural subsidies. Regarding this interpretation, Article 21.1 of the AoA is clear in accepting the application of other WTO Agreements to agricultural goods. This correct interpretation is consistent with the cross-references made by both Agreements in connection with the application of some SCM provisions to the AoA. Articles 5 and 6 of the SCM provide that they do not apply to subsidies maintained on agricultural products as provided in Article 13 of the AoA. As Article 13 of the AoA –the “Peace Clause”–, expired in January 2004, it shall be understood that there is no current protection for agricultural subsidies from claims made under the SCM based on their effects.

a. DOES THE SCM APPLY TO AGRICULTURAL DOMESTIC SUPPORTS?

Before the year 2004, Article 13 of the AoA provided that Green Box, Blue Box and Amber Box subsidies could not be challenged because of their trade effects provided that they were in compliance with the conditions set out for this protection in the AoA. Now that the Peace Clause has expired, there is no provision within the WTO framework protecting agricultural domestic supports from being challenged under Part III of the SCM if they cause adverse effects. Consequently, even if the domestic support is consistent with the AoA, including full compliance with the schedule of concessions, it can be challenged under the SCM if it causes adverse effects.

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84 This principle states that “if the meaning of a term is ambiguous, that meaning is to be preferred which or less onerous to the party assuming an obligation, or which it interferes less with the territorial and personal supremacy of a party, or involves less general restrictions upon the parties”. R. Jennings & A. Watts (eds), *Oppenheim’s International Law*, 9th ed. vol. 1. Longman, London, 1992, p. 1278. Quoted by, Chambovey, *How the Expiry of the Peace Clause Might Alter Disciplines on Agricultural Subsidies in the WTO Framework*, p. 310.

b. DOES THE SCM APPLY TO AGRICULTURAL EXPORT SUBSIDIES THAT ARE IN COMPLIANCE WITH THE AoA?

The question of the application of SCM rules to agricultural goods rises because the SCM prohibits Members from granting export subsidies and, on the contrary, the AoA allows Members to grant agricultural export subsidies under certain conditions specified in Article 3.3. and 8. Apparently, this contradiction would lead to conclude that there is a conflict between the AoA and the SCM and hence, that an agricultural export subsidy could not be challenged under SCM provisions in regard to their trade-distorting effects. Are these two provisions in conflict? Do they contradict each other?

Before answering these questions, the meaning of contradiction must be reviewed. The Panel on *Indonesia-Autos* considered that “[i]n international law for a conflict to exist between two treaties, three conditions have to be satisfied. First, the treaties concerned must have the same parties. Second, the treaties have to cover the same subject matter [...] Third, the provision must conflict, in this sense, the provision must impose mutually exclusive obligations”<sup>85</sup>. Also, in *Guatemala-antidumping Investigation*, the AB defined “conflict” in the following way: “a special or additional provision should only be found to prevail over a provision of the DSU in a situation where adherence to the one provision will lead to a violation of the other provision”<sup>86</sup>.

In this specific case, two of the three conditions are satisfied, as both treaties concern all WTO Members and both provisions cover subsidies directed to agricultural goods. However, the provisions do not impose mutually exclusive obligations or, adherence to one provision does not lead to a violation of the other provision.

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85 Report of the Panel, *Indonesia - Certain Measures Affecting the Automobile Industry*, para. 14.28, (July 2, 1998), WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R. Quoted by Chambovey, *How the Expiry of the Peace Clause Might Alter Disciplines on Agricultural Subsidies in the WTO Framework*, p. 314.

86 Report of the AB, *Guatemala-Antidumping Investigation Regarding Portland Cement from Mexico*, para. 65 (November 2, 1998), WT/DS60/AB/R.

It could not be held that these two provisions contradict each other because although the SCM prohibits export subsidies, it makes an exception by using the phrase “except as provided in the AoA”. Accordingly, the SCM does not punish Agricultural export subsidies per se provided that they are in conformity with the AoA, it only punishes those export subsidies that cause adverse effects to the interests of another. Hence, a WTO Member may grant export subsidies to agricultural goods –Article 3.3 and 8 of the AoA– and not be challenged under Article 5 if its subsidies do not cause adverse effects. However, if the Member granting Agricultural export subsidies within its schedule of commitments causes adverse effects to the interests of another Member, it would be acting inconsistently with WTO provisions.

To have a better understanding of this point, the difference between a legal and an actionable subsidy must be outlined. Legal subsidies may be defined as those granted within the Schedule of commitments. Actionable subsidies are those legal subsidies –granted within the Schedule of commitments–, that cause adverse effects to the interests of another WTO Member. Therefore, the fact that a subsidy is legal does not mean that is not actionable. Articles 3.3 and 8 of the AoA only exempt agricultural export subsidies from being illegal –prohibited under the SCM–, however, these provisions do not exempt these subsidies from being actionable under Article 5 of the SCM.

Moreover, Article 13 of the AoA provides guidance to support the interpretation of the Application of Article 5 of the SCM to agricultural subsidies. Indeed, that provision exempted agricultural export subsidies from claims under Article 5 of the SCM. Now that this provision has expired it shall be understood that if a legal subsidy causes adverse effects to the interests of another Member it may be challenged under Article 5 of the SCM. Certainly, if members included this exception in the AoA is because they believed that in its absence Members would be allowed to bring claims under Article 5 of the SCM<sup>87</sup>.

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87 David Morgan & Goh Gavin, “Peace in Our Time, An Analysis of Article 13 of the Agreement on Agriculture”, 37(5) *J. World Trade*, 986, 2003, pp. 996-997.

This study has analyzed how after the expiration of the Peace Clause domestic supports and export subsidies that are in full compliance with the AoA may be challenged under Part III of the SCM, if they cause adverse effects to the interests of another Member. Accordingly, Part III of the SCM becomes the relevant legal provision in order to challenge agricultural subsidies based on its effects and not on its structure.

### III. TWO EXAMPLES OF HOW WTO-CONSISTENT DOMESTIC SUPPORTS SHOULD BE ASSESSED BASED ON ITS EFFECTS

This chapter will address two examples of how domestic support measures, that are consistent with the AoA, may be challenged within the WTO legal framework by analyzing its trade distorting effects at the light of the SCM. The first example is the so called “spill over” effect, which refers to the case where consistent domestic supports finance export production. Secondly, it will be addressed the trade distortions caused by domestic support payments under the Blue Box.

#### A. EXAMPLE NUMBER ONE: WTO-CONSISTENT DOMESTIC SUPPORTS THAT FINANCE EXPORT PRODUCTION

This section will explain the reason why WTO-consistent domestic supports with economic effects in the export market are a problem within the AoA and will elaborate on the special situation where this problem arises. Afterwards, the solutions provided by the WTO judicial bodies will be addressed by focusing on the contributions made to the WTO legal framework and on the deficiencies that remain today. Finally, it will be concluded that a possible solution to this problem is through a based-on-effects analysis under the SCM.

##### 1. WHY THE FINANCING OF EXPORT PRODUCTION THROUGH DOMESTIC SUBSIDIES CONSTITUTES A PROBLEM TO THE AoA?

The “*spill over*” effect is a problem within the WTO since it negatively affects the reasonable expectations of Members created

by the consolidated reduction commitments both on domestic and on export agricultural subsidies<sup>88</sup>.

The AoA classifies the agricultural supports as export subsidies or domestic support depending on the export contingency of a measure. This Agreement demands from Members more restrictive commitments in export subsidies than in domestic supports, since commitments to reduce Amber Box subsidies apply at sector level rather than at product level as it occurs with export subsidies reduction commitments<sup>89</sup>. Also, the AoA establishes higher reduction levels on export subsidies than on domestic support payments<sup>90</sup>. Consequently, when a domestic subsidy finances export production, the distinction established by the AoA between domestic supports and export subsidies is blurred, undermining the effectiveness of the specific reduction commitments in export subsidies.

Even though this problem is not new within the WTO<sup>91</sup>, the AoA did not include any provision with a solution to this matter. The

88 Report of the AB, *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products - Recourse to Article 21.5 of the DSU*, paras. 89-91 (December 3, 2011), WT/DS103/AB/RW and WT/DS113/AB/RW.

89 This situation allows countries to increase product-specific domestic support at any level if they do not exceed the corresponding annual or final bound commitment level specified in its Schedule, contrary to what occurs in export subsidies reduction commitments where such a flexibility is not possible. See, Melaku G. Desta, *The Bumpy Ride Towards the Establishment of a Fair and Market Oriented Agricultural Trading System at the WTO: Reflections Following the Cancun Setback*, 2003, p. 525.

90 The AoA demands from the Member a 36% reduction on budgetary outlays (24% for developing countries) and of 21% on quantities of subsidized exports (14% for developing countries), as compared with the reduction commitments required to domestic support: 20% for developed countries and 13% for developing countries. Felipe Serrano P., José Plata P. & Rafael Rincón O., *The Never Ending Agricultural Trade Liberalization: Three Substantial Problems*, 7 *Int. Law Rev. Colomb. Derecho Int.* 359, 2006, p. 366.

91 “One of the main issues here is whether payments to producers as opposed to exporters, such as deficiency payments and comparable practices, which are not specifically export performance related but which can in practice operate to maintain or increase exports and to insulate producers from world price movements, should be treated as export subsidies for the purpose of reduction commitments. A consideration to be taken into account is that such payments would, in principle, be subject to reduction commitments in the context of internal support”. *Negotiating Group on Agriculture, Options in the Agriculture Negotiations – Note by Chairman–*, point 47 (1991), MTN.GNG/AG/W/1.

problem rose afterwards in the *Canada-Dairy* case were the concept of the “*spill-over*” effect was addressed by the AB<sup>92</sup>. Nowadays, the lack of regulation of this problem is a structural deficiency within the AoA. However, this deficiency has been subject to further developments since the Panels and the AB started to analyse claims under the Agreement.

## 2. SPECIAL SITUATIONS WHERE WTO-CONSISTENT DOMESTIC SUPPORT HAS ECONOMIC EFFECTS IN THE EXPORT MARKET AND THE PARTIAL SOLUTIONS PROVIDED FOR BY WTO BODIES

The above-mentioned problem takes place mainly through: a) payments granted to a universe of eligible users and b) inter-market cross-subsidization. Each of these situations have been subject to analysis by WTO bodies, like the *US-Cotton* case where a scheme like the former example was analyzed, or the *Canada-Dairy* and *EC-Sugar* cases, which constitute examples of cross-subsidization.

### a. PAYMENTS GRANTED TO A UNIVERSE OF ELIGIBLE PRODUCERS AND/OR PROCESSORS

When the beneficiaries of a subsidy are all producers of an agricultural product disregarding its final destination, subsidies might support the total production to be exported although being considered a domestic support<sup>93</sup>.

92 “It is possible that the economic effects of WTO-consistent domestic support in favour of producers may ‘spill over’ to provide certain benefits to export production, especially as many agricultural products result from a single line of production that does not distinguish whether the production is destined for consumption in the domestic or export market... Consequently, if domestic support could be used, without limit, to provide support for exports, it would undermine the benefits intended to accrue through a WTO Member’s export subsidy commitments”. AB, *Canada-Dairy, Recourse to Article 21.5*, paras. 89-91.

93 Report of the Panel, *US-Cotton*, paras. 7.731 and 7.735.

In order to illustrate this idea, imagine a case where a government decides to subsidize the total production of domestic wheat and in this country 60% of the final production is exported. In this case, the subsidy would support the 100% of the wheat production to be exported, which is bigger than the production for domestic consumption, but the bounty would be a domestic support under the AoA because its granting is not contingent upon export performance.

*The US-Cotton case: A useful guidance to disclose disguised Export Subsidies hidden behind Domestic Support Schemes*

In the *US-Cotton* case, WTO bodies analyzed a single subsidy scheme granted to cotton users and found that there was an export subsidy hidden behind a domestic support scheme. This approach shed some lights to the problem of *payments granted to a universe of eligible producers and/or processors* but remains insufficient to provide a definitive solution to this practice.

The challenged measure “User Marketing (Step 2) payments” was a loan for upland cotton users<sup>94</sup>, which was categorized by the United States as a domestic support because it was granted to all cotton users disregarding the final destination of the product<sup>95</sup>. However, The AB asserted that the Step 2 payment was a domestic support and an export subsidy since the proof required to qualify for the subsidy was different regarding the recipient. Indeed, under the Step 2 payment scheme, if the recipient was a cotton exporter it had to submit proof of exportation but if the recipient was a cotton domestic user it had to provide documentation indicating the number

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94 The Step 2 payment is an example of deficiency payments. In this type of subsidies, the government sets a price called the “target price” at a level considered fair and remunerative to producers for a particular agricultural product. When the market price, at which producers sell their product, goes below the target price, the government makes a deficiency payment that consists in the difference between the target price and the market price. Melaku Geboye Desta, *The Law of International Trade in Agricultural Products*, 2002, p. 331. Quoted by, William Petit, *The Free Trade Area of the Americas: Is it Setting the Stage for Significant Change in U.S. Agricultural Subsidy Use?*, 37 Tex. Tech L. Rev. 127, p. 140-141.

95 Report of the Panel, *US-Cotton*, para. 7.685.

of bales opened<sup>96</sup>. Taking this into account, WTO bodies agreed on the fact that the measure had a two-fold nature.

This ruling contributes to the WTO law since it enforces the possibility to “examine separately the conditions pertaining the granting of a subsidy”<sup>97</sup> within a single scheme, when assessing the consistency of a subsidy with a covered agreement<sup>98</sup>. Given the fact that in this particular case the conditions for the granting of subsidy were different<sup>99</sup>, then the finding of this case would be insufficient to provide a general solution to the problem of *payments granted to a universe of eligible producers and/or processors*.

#### b. INTER-MARKET CROSS-SUBSIDIZATION

The term inter-market cross-subsidization occurs when sales revenues from one market finance a portion of the costs associated with sales made in another market<sup>100</sup>. As explained by Terrence Stewart, cross-subsidization of any form is only sustainable with the ability to shield above-average profits on other market or product<sup>101</sup>.

96 Report of the Panel, *Us-Cotton*, para. 7.727 and AB, *US-Cotton*, para. 577.

97 Report of the AB, *US - FSC (Article 21.5 - EC)*, para. 115.

98 In this paragraph we use the word “enforces” since such a kind of approach had been previously used by the AB in the case *United States - Tax Treatment for Foreign Sales Corporations - Recourse to Article 21.5 of the DSU* (January 14, 2000), WT/DS108/AB/RW. In that case, the United States argued that the tax exclusion at issue was not an export-contingent subsidy because it was available for both (i) property produced within the United States and held for use outside the United States and (ii) property produced outside the United States and held for use outside the United States. According to the United States, the Panel’s separate examination of each situation in which the tax exemption was available “artificially bifurcat[ed]” the measure. The AB rejected the United States’ contention and confirmed the Panel’s finding that the tax exemption in the first situation, namely for property produced within the United States and held for use outside the United States, was an export-contingent subsidy. See, Report of the AB, *US-Cotton*, paras. 578-579. Quoting, Report of the AB, *US - FSC, Recourse to Article 21.5*, paras. 110-119.

99 Report of the AB, *US-Cotton*, para. 542.

100 Terrence Stewart, *U.S. - Japan Economic Disputes: The Role of Antidumping and Countervailing Duty Laws*, 16 *Ariz. J. Int’l & Comp. L.* 689, 1999, pp. 702 and 744.

101 *Id.*, p. 702.

In agriculture, the cross-subsidization effect commonly takes place when domestic supports are granted to producers that sell the product both in the domestic and export markets manufacturing their commodity within a single line of production<sup>102</sup>. When a producer stays within that single line of production, the costs of production are shared between the revenues received from selling the commodity in these two markets. Although, when a domestic support ensures high revenues in the domestic market, the fixed costs of production would be covered by revenues obtained in just one market, allowing the producer to sale the same product for the export at just the marginal costs of production<sup>103</sup>. Thus, inter-market cross subsidization raises as a form how domestic subsidies subsidize export production.

*The Canada Dairy and EC-Sugar Cases: A partial solution to the problem of Inter-market Cross-subsidization through a broad Interpretation of Article 9.1 (c) of the AoA*

In the *Canada Dairy* and the *EC-Sugar* cases, the AB provided a solution to this problem by finding that the inter market cross-subsidization effects of consistent minimum price support systems<sup>104</sup> were export subsidies in the sense of Article 9.1(c). However, this solution is not definitive since the rationale that lies behind it only applies to minimum price support schemes and not to other domestic subsidies that confer an advantage to export. Also, this finding disregards the “benefit” as an essential element of a subsidy.

In the above-mentioned cases, the WTO judicial bodies analyzed the Canadian milk Scheme and the EC-Sugar Regime, which

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102 “It is not contested that these producers use the same production facilities to produce domestic and export milk—that is, the same land, cattle, buildings, machinery, milking facilities, and so on. Indeed, in some provinces, even after production, both regulatory classes of milk have common storage and transportation facilities. There is, in other words, a single line of production for all milk, whatever its destination market”. Report of the AB, *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products—Second Recourse to Article 21.5 of the DSU—*, December 20, 2002, WT/DS103/AB/RW2 and WT/DS113/AB/RW2, paras. 138-139.

103 *Id.*, paras. 138-139.

104 For a definition of this type of domestic support, see *supra*, note 6.

followed a similar pattern. First, both regimes share the origin of the problem: producers were selling its products for the export markets at prices below costs of production. Furthermore, both cases had the same cause: producers were cross-subsidizing the sales for the export market with the high revenues obtained from selling the same product in the domestic market. Finally, both schemes had a similar background: a domestic subsidy in the form of market price support that assured high revenues to producers.

The AB found in Article 9.1 (c) the way to bring the economic effects on the export scenario, produced by a domestic support, within the framework of the export reduction commitments<sup>105</sup>. According to Article 9.1 (c) of the AoA, “payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved...” are subject to reduction commitments. This article is composed of three main elements: (a) payments, (b) financed by virtue of governmental action and (c) on the export. All these elements were analyzed by the *Canada-Dairy* and *EC-Sugar* Panels as well as by the AB.

#### *a. Payments*

Regarding the meaning of the word payments under Article 9.1 (c), the AB set out two important rulings by establishing that: i) a payment exists when raw material is sold to manufacturers at a price below market rates, and ii) internal allocations of funds within an entity are payments as well. However the latter finding is inconsistent since it disregards one of the elements that must be present in any subsidy: the benefit.

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105 “Subsidies may be granted in both the domestic and export markets, provided that the disciplines imposed by the Agreement on the levels of subsidization are respected. If governmental action in support of the domestic market could be applied to subsidize export sales, without respecting the commitments Members made to limit the level of export subsidies, the value of these commitments would be undermined. Article 9.1(c) addresses this possibility by bringing, in some circumstances, governmental action in the domestic market within the scope of the ‘export subsidies’ disciplines of Article 3.3”. Report of the AB, *Canada-Dairy*, *Second Recourse to Article 21.5*, para. 148.

*(i) Payments in the form of input sales below market rates*

According to the AB, when goods are supplied at prices below market rates, payments are made to the purchaser in the form of revenue foregone since a portion of the price is not charged<sup>106</sup>. Thus, the issue is to identify when a product was provided at a price below market rates, for which it took into consideration three benchmarks: the domestic price, the world market price<sup>107</sup> and the average cost of production (COP) benchmarks<sup>108</sup>. The AB asserted that the appropriate benchmark should be determined on a case-by-case basis<sup>109</sup>, although, it stated that the COP was the right standard to be applied when dealing with minimum price support schemes<sup>110</sup>.

*(ii) Payments in the form of internal allocation of funds*

According to the WTO judicial bodies, when the transfer of economic resources within a single entity is an effect of a domestic support it might be a payment, although the granter and the recipient of the subsidy are the same person<sup>111</sup>. This controversial finding was appealed by the European Communities by arguing mainly that a payment must confer a benefit<sup>112</sup>, however, the AB asserted that when a measure complies with the specific elements of the export subsidies described in Article 9.1 of the AoA, it is not necessary to demonstrate the general requirements of a subsidy described in the SCM (e.g. benefit)<sup>113</sup>.

106 *Id.*, para. 113.

107 The first two benchmarks confront the price charged to a purchaser with the regular price charged for the same product in the domestic market or in the world market, respectively. Report of the Panel, *Canada-Dairy*, paras. 7.47 and 7.48.

108 The third benchmark compares the price charged by the producer with the fixed and variable costs of production divided by the total number of units produced in an industry-wide basis. Report of the AB, *Canada-Dairy, Recourse to Article 21.5* at para. 94 and Report of the AB, *Canada-Dairy, Second Recourse to Article 21.5*, paras. 94-96.

109 Report of the AB, *Canada-Dairy, Recourse to Article 21.5*, para. 76.

110 Report of the AB, *Canada-Dairy, Second Recourse to Article 21.5*, paras. 87-88.

111 Report of the Panel, *EC-Sugar*, para. 7.310; Report of the AB, *EC-Sugar*, para. 264.

112 Report of the AB, *EC-Sugar*, para. 268.

113 *Id.*, para. 269.

This interpretation is inconsistent with the general approach made by WTO law to the subsidies issue. As it was explained before, the essence of a subsidy is that it is always composed of a grantor of a financial contribution and of a recipient of a benefit. Accordingly, when a subsidy is being conferred in the form of internal allocation of funds within a single entity there are not two entities since the qualities of grantor and recipient are confused in a single person. Additionally the entity that makes an internal allocation of funds is not receiving something that would place it in a better position where otherwise it would not have been. In this sense the entity is not receiving a benefit.

*b. Financed by virtue of governmental action*

Regarding this, the AB ruled that private parties might grant export subsidies if there exists a tighter nexus between the governmental action and the financing of these payments. However, this tighter nexus might be difficult to prove in domestic subsidies other than in minimum price support schemes. With regards to the interpretation of the term *financed by virtue of governmental action*, the AB established that export subsidies under Article 9.1 (c) might not be funded by the public account<sup>114</sup>. Thus, the issue in this Article is the proof of a tighter nexus between the governmental action and the financing of payments by private parties<sup>115</sup>.

Considering that in the *Canada-Dairy* and the *EC-Sugar* cases the government had a high level of intervention through the establishment of fixed prices, production quotas and tariffs, the AB did not have problems in proving the tighter nexus between the governmental action and the financing of the payments by private parties<sup>116</sup>. However, the problem arises in other types of domestic subsidies, which are capable of assuring high profits to producers, but where the governmental action is only performed through the granting of a subsidy without including intervention on the market.

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114 Report of the AB, *Canada-Dairy, Recourse to Article 21.5*, para. 114.

115 *Id.*, para. 113.

116 Report of the AB, *Canada-Dairy, Second Recourse to Article 21.5*, para. 145; Report of the AB, *EC-Sugar*, paras. 239 and 257.

*a. Payments on the export*

The last reason why the solution provided by the AB to the “*spill over*” effect is not definitive, is because it abstain from making a broad interpretation of an export subsidy when a payment, with effects in the export market, lacks of export contingency.

In the *Canada-Dairy Case*, the Panel interpreted the term “payment on the export as follows: “[i]n our view, the term ‘payment on the export of an agricultural product’ means, indeed, that the payment is conditional or contingent on the export of such product”<sup>117</sup>. In contrast, the *EC-Sugar* Panel interpreted the same term as follows: “[i]n the Panel’s view a payment ‘on export’ need not be ‘contingent’ on export but rather should be ‘in connection’ with exports”<sup>118</sup>.

The importance of the interpretation made by the *EC-Sugar* Panel is that it addressed the problem by the effects rather than by the structure of a measure. By doing it, the Panel asserted that the focus of the analysis under Article 9.1 (c) is on whether the payment granted is “on the export” or provides an advantage on the export not whether a whole scheme, or the cross-subsidization resulting from the scheme, is contingent upon the product being exported<sup>119</sup>. However, The AB eluded to support the Panel’s statement and ruled that in the particular case the payment in the form of internal allocation of funds was “on the export” because the *EC-Sugar* regime established that over quota sugar (or C sugar) shall be exported<sup>120</sup>.

The main problem of avoiding a broader definition of an export subsidy is that inter market cross-subsidization could only be regarded as an export subsidy when the scheme, in law or in fact, obliges that the production subsidized must be exported. Therefore, if a WTO-consistent domestic support is having the effect of cross-subsidizing sales in the export market, this sort of payment would only be an export subsidy if the claimants demonstrate that the

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117 Report of the Panel, *Canada-Dairy*, para. 7.90.

118 Report of the Panel, *EC-Sugar*, para. 7.275.

119 *Id.*, para. 7.317.

120 Report of the AB, *EC-Sugar*, para. 275.

whole scheme surrounding the allocation of funds did not give any other choice to the producer than placing its funds in the export production.

As a result, the solution provided by the AB to the “*spill-over*” is not definitive because the reduced interpretation of export contingency bars the possibility to treat as export subsidies measures that lack of export contingency but that have its effects on the export market.

Taking all the above-mentioned into account, it must be concluded that neither the findings of the *US-Cotton* Report provided a complete solution to the problem of *payments granted to a universe of eligible users*, nor the findings of the *Canada-Dairy* and *EC-Sugar* Reports provided a definitive and consistent solution to the problem of *inter-market cross-subsidization*.

### 3. THE SCM AS THE WTO-TOOL TO MAKE AN EFFECTS-BASED TEST

As it was explained before, the economic effects of a WTO-consistent domestic support are a problem when these “*spill-over*” to the export scenario. WTO judicial bodies have tried to provide a solution to this problem by stating that these economic effects on the export market can be considered as an export subsidy in the sense of Article 9.1 (c) of the AoA. However, this rationale is insufficient and inconsistent. First, the rationale is insufficient since the AoA does not include provisions dealing with the effects of agricultural subsidies, reason why the analysis under this agreement would not provide a definitive solution to the problem. Second, the rationale is inconsistent since the effect of a subsidy cannot constitute a new subsidy by itself, what is evident when trying to find the presence of a benefit in this sort of allocation of funds.

Accordingly, the best way to approach to the problem of effects on the export scenario of WTO-consistent domestic support schemes is through the tool that WTO has established for this matter. Thus, the SCM is the relevant provision that Members and WTO bodies should regard when dealing with adverse effects of agricultural domestic support that are consistent with the AoA.

## B. THE BLUE BOX SUBSIDIES PROBLEM AND ITS DISTORTING EFFECTS IN AGRICULTURAL TRADE LIBERALIZATION

The following section will address the nature and context surrounding Blue Box subsidies and submit some proposals regarding its reform within the WTO Negotiating framework. These proposals will emphasize on the need to consider the effects of the subsidy according to the provisions of the SCM. First, a brief description concerning the context and background of such payments is elaborated. Afterwards, an overview of Article 6.5 of the AoA –which governs the thresholds that Blue Box subsidies must meet – will be laid out. Finally, it is pertinent to analyze the trade distorting effects of such subsidies.

### 1. CONTEXT AND BACKGROUND

Blue Box subsidies are somewhat of a mystery within the context and nature of the AoA. First, these were created under the basis of a political agreement in order to save the Uruguay Round. The legal provisions that govern such payments are not clear to many, and are subject to interpretations that disregard the object and purpose of the AoA

Moreover, Panels have not addressed this specific kind of payments, and those cases that have addressed agricultural subsidies have not emphasized on the Blue Box. Additionally, scholars have not developed a consistent trend in order to analyze these payments.

### 2. STRUCTURE AND DESIGN OF THE BLUE BOX

Blue Box subsidies are rooted in the Blair House Agreement, which was settled both by the United States and the European Union to fulfill with the expectations of the Uruguay Round of 1992<sup>121</sup>. Article

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121 “The Blair House Agreement, struck between the U.S. and EU in 1992 in order that the Uruguay Round could be completed, essentially identified the two sorts of payments, categorising each element of EU and U.S. subsidies into amber (subject to reductions) and green (exempt from reductions). The most difficult element for the EU was to

6.5 of the AoA became the only legal provision which expressed the terms and conditions of such agreement regarding these subsidies. This Article is organized upon two general provisions; one that describes the structure of the payments –6.5 (a)– and the other one that establishes the main consequence regarding the blue box –6.5 (b)–. These provisions will be carefully explained below. Afterwards, a comparative analysis of the Blue Box with the green box and the amber box will be presented.

a. ARTICLE 6.5 (a)

The background and conditions are described in Article 6.5 (a) as follow:

Article 6.5.

- (a) Direct payments under production-limiting programmes shall not be subject to the commitment to reduce domestic support if:
- (i) such payments are based on fixed area and yields; or
  - (ii) such payments are made on 85 per cent or less of the base level of production; or
  - (iii) livestock payments are made on a fixed number of head.

The structure of this Article is analyzed on a two step basis. The first step will focus on establishing the meaning and content of the production-limiting program. The second step will emphasize on the thresholds that such payments within the program must meet.

*Step 1: The Production-Limiting Program*

Article 6.5 (a) governs the structure and design of the Blue Box Subsidy. When addressing this issue one question must be answered.

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defend its now substantial area-based compensations for price cuts. The EU argued that these were both de-coupled from production and that they were linked to supply controls because producers were required in return to set aside a proportion of their cultivated land. In the eventual agreement a special category, blue box, was established whereby the U.S. recognised that whilst these were trade-distorting, the EU had indeed made considerable efforts to de-couple them. Demanding a further reduction in the immediate future would be politically risky for the EU. These subsidies were, effectively, put to one side, but on the clear understanding that they would be subject to negotiation in future trade talks and so were neither amber nor green box". Jim Dixon, *Nature conservation and trade distortion: green box and blue box farming subsidies in Europe*, 29 Golden Gate U.L. Rev. 415, 1999, pp. 436-437.

What must be understood by a production-limiting program? Neither this Article nor any other provision within the AoA states a definition. The fact that the meaning of this Program is not defined within the terms and conditions of Article 6.5 (a) allows several interpretations.

*Step Two: Thresholds within Article 6.5 (a)*

The thresholds that every payment must alternatively meet would apparently be clear and emblematic rules subject to minimum disagreement. In fact, these rules would care about the content of the so called “Production-limiting program” and establish a legal framework by which Blue Box subsidies would be subject to WTO control. None of the conditions mentioned before are satisfied by Article 6.5 (a) of the AoA.

The thresholds establish that i) payments must be contingent upon a fixed area; ii) or made on 85 percent or less of the base level of production; iii) or –in the case of livestock payments– be made on a fixed number of heads.

*(i) Payments that are based on fixed area and yields*

This criterion establishes that the payment is contingent on the area of production. For instance, any manufacturer will receive the payment if it decides to produce on a limited space, and under no circumstance will increase such space<sup>122</sup>. The fact that payments are made upon a fixed area does not serve to the purpose of limiting production. These subsidies would not be conditioned to product limitation but to the area of production. For that matter, producers would be encouraged to increase their level of production within a smaller amount of acres. The area of production fails to qualify as a criterion that could actually limit production.

*(ii) Payments made on 85 per cent or less of the base level of production*

This second criterion covers exclusively the production percentage. For instance, if a farmer produces 1000 flowers, and

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122 Raj Bhala, *World Agricultural Trade in Purgatory: the Uruguay Round Agriculture Agreement and its implications for the Doha Round*, 79 N. Dak. L. Rev. 691, 2003, p. 795.

has decided to limit its production, every payment made within that production-limiting program must be calculated on 850 or less of the flower production. This threshold is exclusively elaborated so that if a farmer wishes to limit or cut production entirely –stop producing those 1.000 flowers and produce any other commodity– , the subsidy will not cover its entire production, but only 85% of it. As it can be concluded, this prong is aimed at addressing those major production-limiting programs that end up with the non-production of a particular commodity.

*(iii) Livestock payments made on a fixed number of heads*

Regarding livestock payments the question is what is understood by the premise “fixed number of heads”. A reasonable interpretation could be that for each head that is being limited or cut from production the farmer would receive a payment. Therefore the subsidy could be granted upon a “per head basis”. However this is not the only possible interpretation, since farmers could set to limit production on a long term basis. The main problem regarding the structure of these payments, is that these are overly generous and provide other sort of advantages to manufacturers or farmers in the market. These advantages might be reflected on the possibility of farmers to sell below market prices either on the domestic or export arena.

b. ARTICLE 6.5 (b)

Article 6.5 (b) of the AoA states:

- (a) The exemption from the reduction commitment for direct payments meeting the above criteria shall be reflected by the exclusion of the value of those direct payments in a Member’s calculation of its Current Total AMS.

The statement that Blue Box subsidies are not subject to WTO control is explained on the fact that these payments are not subject to domestic support reduction. Article 6.5 (b) establishes that such payments are excluded from the calculation of the current total

Aggregate Measure of Support –hereinafter the “AMS”<sup>123</sup>. The AMS is the sum of all domestic agricultural subsidies during the 1986-1988 period. This sum is the total amount of domestic support allowed for a WTO member. The current total AMS is the amount that will be used in order to determine compliance with the AoA. Consequently, this provision established that direct payments under production-limiting programmes are excluded from any Member’s calculation of its current total Aggregate Measure of Support<sup>124</sup>, and thus, from reduction requirements. Hence, Article 6.5 fails to meet an adequate standard that would illustrate the Member States on how to limit production effectively.

### C. COMPARATIVE ANALYSIS OF THE AMBER BOX AND GREEN BOX SUBSIDIES VS. ARTICLE 6.5 OF THE AOA

Both Green Box and Amber Box Measures are payments that are analyzed carefully within the AoA. In fact the provisions that govern such subsidies address not only the structure of the subsidy, but the nature of its effects. The following section will contrast the rules that govern such subsidies with Article 6.5 of the AoA.

#### a. *Green Box Subsidies*

Annex 2 is the relevant framework to determine the content of the so called Green Box subsidies<sup>125</sup>. Such provisions clearly determine that these subsidies must have not or at least minimal

123 Carmen Gonzalez. *Institutionalizing Inequality: the WTO Agreement on Agriculture, Food Security, and Developing Countries*, 27 Colum. J. Envtl. L. 433, 2002, p. 466.

124 See Article 1 of the Agreement on Agriculture.

125 *Agreement on Agriculture* on Annex II establishes “Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:

(a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,

(b) the support in question shall not have the effect of providing price support to producers”;

trade distorting effects. Green Box Subsidies group different kinds of payments that are decoupled from production in order to address other concerns besides trade. Annex II elaborates a list on such payments that include: (i) Government service programmes; (ii) public stockholding for food security purposes and domestic food aid; (iii) direct payments to producers as decoupled income support; (iv) government financial participation in income insurance and income safety-net programmes and, (v) payments under environmental programmes, and payments under regional assistance programmes.

As it can be noted, there is clarity regarding the kind of payments that can be considered as a Green Box. There are no such examples regarding the Blue Box. Additionally, the Green Box is meant to satisfy what many scholars have identified as multifunctionality payments. Multifunctionality is “any unpriced spillover benefits that are additional to the provision of food and fibre. Claimed benefits range from environmental values, rural amenities, cultural values, rural employment and rural development”<sup>126</sup>.

The fact that the Member States would design payments such as the Green Box indicates that trade is not the only concern within the Negotiations. Public Policy principles such as the environment and public health must be taken into account, in accordance with Article 20 of the AoA<sup>127</sup>. Hence, such payments are out of the Current total AMS. The question that arises then is why would Blue Box

126 Bhala, *International Trade Law*, p. 721.

127 *Agreement on Agriculture at art. 20*. Continuation of the Reform Process. Recognizing that the long-term objective of substantial progressive reductions in support and protection resulting in fundamental reform is an ongoing process, Members agree that negotiations for continuing the process will be initiated one year before the end of the implementation period, taking into account:

- (a) the experience to that date from implementing the reduction commitments;
- (b) the effects of the reduction commitments on world trade in agriculture;
- (c) non-trade concerns, special and differential treatment to developing country Members, and the objective to establish a fair and market-oriented agricultural trading system, and the other objectives and concerns mentioned in the preamble to this Agreement; and
- (d) what further commitments are necessary to achieve the above mentioned long-term objectives.

Subsidies, which are not decoupled from production, be subject to the same prerogatives that cover Green Box Subsidies?

*b. Amber Box subsidies*

Article 6.1 provides the relevant framework for the establishment of an Amber Box Subsidy.

Article 6. Domestic Support Measures. 1. The domestic support reduction commitments of each Member contained in Part IV of its Schedule shall apply to all of its domestic support measures in favour of agricultural producers with the exception of domestic measures which are not subject to reduction in terms of the criteria set out in this Article and in Annex 2 to this Agreement. The commitments are expressed in terms of Total Aggregate Measurement of Support and Annual and Final Bound Commitment Levels.

The schedule of commitments which every country must comply with is a treaty provision according to the AoA<sup>128</sup>. It is important to understand that those payments under commitments are considered to be trade-distorting, and therefore subject to WTO control. Commitments are the framework that govern Amber Box measures. It is clear that both Green Box and Amber Box subsidies are regulated both on its structure and effects within the terms of the AoA. On the contrary Blue Box subsidies are only governed on their structure.

*c. Conclusion*

As it can be established through the provisions of the AoA there is a vagueness when interpreting the terms and conditions of Article 6.5 of the AoA. This ambiguity however is not the main concern in order to establish a fair and market oriented agricultural trading system. The fact that there are no provisions regarding the effects of these subsidies creates an environment in which this sort of payments may distort trade without the control of WTO judicial bodies. The following section will address specifically the

128 Agreement on Agriculture, *Article 3. Incorporation of Concessions and Commitments*. 1. The domestic support and export subsidy commitments in Part IV of each Member's Schedule constitute commitments limiting subsidization and are hereby made an integral part of GATT 1994.

2. Subject to the provisions of Article 6, a Member shall not provide support in favour of domestic producers in excess of the commitment levels specified in Section I of Part IV of its Schedule.

possibility to control such payments based on the trade-distorting effects these may cause on the Agricultural market.

### 3. CONTROLLING BLUE BOX SUBSIDIES AND ITS TRADE DISTORTING EFFECTS

In the following section the nature of the trade distorting effects caused by the Blue Box will be reviewed. It will be held that the best way to control such subsidies and bring its effects into compliance with the establishment of a fair and market oriented agricultural trade policy would be through the application of Part III of the SCM.

#### a. THE NATURE OF THE TRADE DISTORTING EFFECTS CAUSED BY THE BLUE BOX

Customary rules of interpretation of international law state that treaties shall be interpreted “in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”<sup>129</sup>. As it was stated, since the objective expressed in the AoA is to establish a fair and market oriented agricultural trading system<sup>130</sup>, this Agreement incorporated reduction commitments on domestic support measures with trade distorting effects such as the ones included in the amber box<sup>131</sup>. Hence, in accordance with the fact that Blue Box measures were excluded from reduction commitments, these are not supposed to cause the same trade distorting effects such as the ones that are subject to reduction commitments (Amber Box)<sup>132</sup>.

129 Vienna Convention at art. 31.1; Report of the Panel, *Us-Cotton*, para. 7.965.

130 *Agreement on Agriculture* at Preamble.

131 According to Raj Bhala “To phrase the definition affirmatively, the Amber Box consists of support payments to farmers or processors that distort trade, production, or prices.” Bhala, *World Agricultural Trade in Purgatory*, p. 794.

132 According to scholar Jim Dixon . “Thus, one of the most complex areas for the future is the extent to which existing classification of subsidies will be legitimate. Can we continue to divide agriculture subsidies into amber box (deemed ‘trade-distorting’ and subject to reductions under the Uruguay Round Agreement on Agriculture), green box (deemed not trade-distorting and therefore not subject to reductions) and blue

However, this lack of rules regarding the content of the Blue Box serves as an excuse for many countries to use such a figure for different reasons beyond its purpose. It is now relevant to address what are the possible trade distorting effects that rise from the Blue Box.

b. POSSIBLE TRADE DISTORTING EFFECTS THAT ARE CAUSED  
BY BLUE BOX SUBSIDIES

In this section the different interpretations concerning the content and meaning of Article 6.5 of the AoA will be reviewed. First, the possible consequences that arise from the fact that the payment is not contingent on product-limitation will be addressed. Consequently, the possibility of controlling those trade distorting effects created by the Blue Box through the use of other sources of international law shall be analyzed.

*a. Contingency to a Production-Limiting Program: Is the Blue Box decoupled from production?*

The fact that the payment is only contingent to a production-limiting program concludes that the subsidy is not dependent on effective product-limitation. Accordingly, what could be the structure and design of a Blue Box subsidy under such programs?

The question is relevant since the AoA does not forbid that payments decoupled from production could be a part of this Production-limiting program. This would mean that the subsidies could be granted upon the consideration of factors such as the protection of the environment<sup>133</sup> or the supporting of welfare programs for farmers.

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box (trade-distorting but deemed acceptable under the Blair House agreement)?", Dixon, *Nature Conservation and Trade Distortion*, pp. 434-435.

133 Article 31.3 (c) of the Vienna Convention establishes that any relevant rules of international law applicable to the relationships between the parties shall be interpreted taking into account the context treaties.

Other instruments must be observed in order to understand the relationship between the AoA and the environment. The environment is protected by international law. *The Rio Declaration on Environment and Development* (August 12, 1992), A/CONF.151/26 (Vol. I), is a relevant standard in order to interpret the obligations that a country must comply with. This instrument establishes that States should reduce

The question may be solved by establishing whether Blue Box Subsidies have a flexible nature. In other words, whether the whole payment must be contingent on product limitation or not. WTO judicial bodies have decided upon the flexible nature of other domestic support measures. The US-Cotton Panel analyzed whether Production Flexibility Contract Payments could be Green Box Subsidies, although these were not entirely decoupled from production.

The Panel established that Green Box Subsidies may have a flexible nature<sup>134</sup>. Hence, why should Blue Box subsidies not be flexible as well? In fact, the United States intended to locate the Production Flexibility Contract Payments as a Blue Box subsidy due to the fact that the Panel never established that such payments were Amber Box measures<sup>135</sup>. Moreover, scholar Raj Bhala has established that Blue Box subsidies can be conditioned to non-production as well<sup>136</sup>.

Consequently, there is no provision within the AoA that states that Blue Box subsidies need to be contingent to effective production-limiting. Although these payments may be part of a production-limiting scheme, there is no provision that contradicts the fact that the granting of the payment may be decoupled from production. Ambiguity was enhanced when Blue Box subsidies were allowed to be considered as flexible payments.

The failure to address sensitive matters regarding the Blue Box has led to a series of interpretations that disregard the objective of such payments. State Members and WTO judicial bodies must establish specifically whether there is a possibility to address multifunctionality concerns through these subsidies. Under this last premise, both Green Box and Blue Box subsidies would overlap both

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or eliminate unsustainable patterns of production in order to achieve sustainable development. Therefore, a blue box measure is justified in this case in order to fulfil other kinds of international obligations.

134 Report of the Panel, *US-Cotton*, para 7.383.

135 Stephen J. Powell & Andrew Schmitz, *Domestic Support Measures within the Agreement on Agriculture*, 20. *Ariz. J. Int'l and Comp. Law* 143, p. 234.

136 Bhala, *World Agricultural Trade in Purgatory*, p. 797.

on its content and purpose. Clarity is requested in order to fulfill the premise that justifies the AoA: the establishment of a fair and market-oriented agricultural trading system.

Any trade distorting effect that might rise from the Blue Box is originated because such kind of domestic support is not controlled by the WTO. Producers or manufacturers may give a different destination to such payments, the only condition is that it's classified within a production-limiting program. Therefore there is a higher risk that such domestic support will become export subsidies through cross-subsidization. The fact that Blue Box subsidies are not subject to control expenditure, may be decoupled from production, and are not necessarily linked to effective production-limiting increases the risk that such payments will be used to improve export performance.

It is important to address how these payments may be subject to control by the WTO when trade-distorting effects are present.

*b. The Control of Blue Box subsidies based on its trade distorting effects*

The lack of rules that govern Blue Box Subsidies forces the need to use International Law as an instrument that will bring these payments into compliance with the purpose and objectives established in the preamble of the AoA. The law applicable to Blue Box subsidies is not limited to treaty provisions, according to Article 31.3 (c) of the Vienna Convention on the Law of Treaties. Professor Joost Pauwelyn emphasized on the fact that although claims to WTO judicial bodies have been structured regarding the Covered Agreements, these treaties are not the only relevant legal provisions that must be analyzed<sup>137</sup>. Hence, there are other sources of International Law that must be studied. The question is what other sources? The provisions of the SCM are rules that respect the object and purpose of the AoA by controlling the effects caused by Blue Box Subsidies.

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137 Joost Pauwelyn, *The Role of Public International Law in the WTO: How Far Can We Go?*, 95 A.J.I.L. 535, 2001, pp. 560-561.

### c. EFFECTIVENESS OF SCM PROVISIONS IN CONTROLLING BLUE BOX SUBSIDIES

As it has been established, the AoA has only provisions that govern the structure and design of those payments which are considered a Blue Box. Since the AoA stipulates nothing regarding the effects of such subsidies, it can be argued that those payments decoupled from production could create trade-distorting effects not subject to WTO control.

However, through the cumulative application of both the SCM and the AoA it can be stated that such subsidies should also be subject to control based on possible trade-distorting effects. The latter would definitely limit the capacity of WTO members when designing the structure of those payments within the Blue Box. It is important to mention that the SCM would not determine whether the production-limiting program is effective, it would only care to address the possibility that such payments within the program could be trade distorting.

Part III of the SCM would emerge as the benchmark in order to correct those holes left within the AoA when addressing Blue Box domestic support. Consequently, it would seem that the most effective path in order to reach the establishment of a fair and market oriented agricultural trading system is through the cumulative application of both legal texts.

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