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OBSERVATIONS ON THE PROPOSAL FOR A NEW PEACE CLAUSE

SYNOPSIS

This T.R.A.D.E. Analysis seeks to assist developing countries in discussions on the proposal to re-introduce a Peace Clause. It examines WTO dispute settlement developments after the expiry of the old Peace Clause and suggests possible trade-offs if developing countries decide to accept a new Peace Clause.

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OBSERVATIONS ON THE PROPOSAL FOR A NEW PEACE CLAUSE

I. Introduction

1. The United States has proposed re-introducing a Peace Clause. At the moment, it is not clear what the new Peace Clause would cover and what its duration would be. Some developing countries have already distanced themselves from the proposal.¹

2. Although it is not in the interest of developing countries to discuss any proposal for a Peace Clause, they might have to confront the issue in the run-up to the 6th WTO Ministerial Conference in Hong Kong. It is therefore important for developing countries to prepare for discussions on whether to re-introduce the Peace Clause and to look at the trade-offs or commitments that they can obtain in exchange for accepting the Peace Clause. But these trade-offs should only be resorted to if developing countries fail to reject the Peace Clause proposal.

3. The purpose of this paper is to assist developing countries in preparing for discussions on any proposals for a new Peace Clause. The first part explains the old Peace Clause provision. The second discusses developments in WTO case law after the expiry of the Peace Clause and the implications for the agriculture negotiations. The final part provides some elements to be considered by developing countries if the re-introduction of the Peace Clause is presented for discussion.²

II. Article 13 of the Agreement on Agriculture: the "Peace Clause"

4. 'Peace Clause' is the term used to refer to the due restraint provision in Article 13 of the Agreement on Agriculture. Article 13 reflected the political understanding that any multilateral agreement on agriculture would have to temporarily shield support measures (subsidies) from challenge in the WTO. The provision was intended to avoid a recurrence of a multitude of complaints over agricultural trade issues brought before GATT in the 1980s.³

5. The Peace Clause shielded three main remedies or actions, namely:

¹"Agriculture Week: Members Focus on Lagging Market Access Talks" in BRIDGES Weekly Trade News Digest - Vol. 9, Number 35 (19 October 2005).

²This paper partly draws from a South Centre Analytical Note titled "Note on the Expiry of the Peace Clause: Some Elements for Consideration by Developing Countries"

(SC/TADP/AN/AG/7, October 2003), available at http://www.southcentre.org/tadp_webpage/researchpapers_listag_webpage.htm.

³Chambovey, D., "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", *Journal of World Trade*, 36(2), 2002, pp. 305 - 352, at p. 306.

- a) recourse to countervailing measures based on Article VI of GATT 1994 (anti-dumping and countervailing duties) and Part V of the Subsidies and Countervailing Measures Agreement (SCM);
- b) dispute settlement actions based on Article XVI of GATT 1994 (subsidies) and provisions of the SCM agreement related to actionable subsidies (Part III of the SCM agreement); and
- c) dispute settlement actions based on non-violation nullification or impairment of the benefits of tariff concessions in the sense of paragraph 1(b) of Article XXIII of GATT 1994 and the Understanding on the Settlement of Disputes.

6. The level of protection provided by the Peace Clause varied according to the category or type of subsidy as determined by the definitions in the Agreement on Agriculture. The Peace Clause was designed to have a limited duration in order to put pressure on countries that heavily subsidize their agricultural sectors to seek negotiating compromises for a continued reduction of support as part of further negotiations in the WTO.

III. WTO case law after the expiry of the Peace Clause

7. Since the Uruguay Round, there has been little dispute settlement activity in the mainstream agricultural areas.⁴ And the expiry of the Peace Clause in December 2003 has not resulted in the floodgate of litigation that some had feared. But, there have been two major cases that have probably triggered the thoughts on re-introducing the Peace Clause.⁵ This part of the paper will briefly set out and discuss the most pertinent aspects of the rulings in the two cases.

A. US - Cotton⁶

8. Brazil invoked the WTO dispute settlement system to challenge subsidies provided by the US to producers, users and/or exporters of upland cotton. The measures at issue included marketing loan payments, user marketing (Step 2) payments, production flexibility contract payments, market loss assistance payments, direct payments, counter-cyclical payments, crop insurance payments,

⁴ Josling, T., "Domestic Farm Policies and the WTO Negotiations on Domestic Support" Invited paper presented at the International Conference on Agricultural Policy reform and the WTO: where are we heading? Capri, Italy, 23-26 June 2003, p. 14.

⁵ Note that the cases commenced before the expiry of the Peace Clause.

⁶ *United States - Subsidies on Upland Cotton* (WT/DS267/AB/R). No previous panel or Appellate Body had ever made findings on the Peace Clause. The Peace Clause was raised in *Brazil - Desiccated Coconut* but the Panel found that the Agreement on Agriculture was not applicable because the investigations which led to the imposition of the countervailing measures at issue commenced before the WTO Agreement entered into force: *Brazil - Measures Affecting Desiccated Coconut* (WT/DS22/R).

cottonseed payments and export credit guarantee programs. Brazil contended that the measures were inconsistent with the provisions of the Subsidies and Countervailing Measures (SCM) Agreement, the Agreement on Agriculture, and GATT 1994. Both the Panel and the Appellate Body decided in favour of Brazil. There are four points worth noting.

9. First, the green box was interpreted narrowly. Payments will only be considered as decoupled, and thus within the green box, if the payments are not related to, or based upon, either a positive requirement to produce certain crops or a negative requirement not to produce certain crops or a combination of both the positive and negative requirements on production of crops. The Appellate Body found that the US's production flexibility contract payments and direct payments are not decoupled income support. These payments could not be shielded by the Peace Clause because they do not qualify for the WTO's green box category of domestic support. Instead, they are domestic subsidies directly affecting cotton production and they should be notified as amber box payments. This finding put pressure on the US because shifting those subsidies to the amber box might cause the US to provide support in excess of its amber box commitments, thereby making it vulnerable to more challenges.

10. Secondly, non-green box domestic support measures that do not grant support to a specific commodity in excess to that decided during the 1992 marketing year are sheltered by the Peace Clause. The US argued that although some of its measures grant support to upland cotton, producers are free to grow other crops or not to plant any crop at all. It claimed that a proper construction of the phrase "support to a specific commodity" means "product specific support" and therefore excludes payments under its "non-product-specific" base acre dependent measures. Neither the Panel nor the Appellate Body accepted this argument. They said that the phrase transcends "product-specific" support. As long as there is a discernible link between the support-conferring measure and a commodity, it is immaterial that the measure also gives support to other crops or that producers are free not to plant any crop at all. This effectively broadens the scope of non-green box measures that do not qualify for Peace Clause protection and shows the limits of the protection that the Peace Clause offered.

11. Thirdly, although the Peace Clause shielded export subsidies partially, its expiry may cause problems for the US. In this dispute, the US argued that the Step 2 payments to exporters and domestic mill users are part of its domestic program since they are targeted to domestic users as well as exporters. It said Step 2 payments are notified to the WTO as "amber" box domestic support payments and not as export subsidies. The Appellate Body ruled that the fact that subsidies granted to domestic users are not export contingent could not dissolve the export contingency for the exporters. The domestic and export aspects of the measure were viewed distinctly. Thus "export subsidy" has a broader meaning than that proffered by the US.

12. The fourth major point is the finding that Article 10.2 of the Agreement on Agriculture does not exempt export credit guarantees from the export subsidy disciplines. WTO members' agreement to negotiate international disciplines governing the provision of export credit guarantees does not mean that the disciplines in the Agriculture Agreement are not applicable. The Appellate Body held that the Agriculture Agreement covers an export credit guarantee that meets the definition of an export subsidy.⁷

B. EC - Sugar⁸

13. Australia, Brazil, and Thailand brought a challenge against the European Communities' sugar regime. The complainants claimed that since 1995 the EC has been exporting quantities of subsidized sugar in excess of its annual commitment levels. They alleged that the EC violates the Agreement on Agriculture by providing some sugar with an export subsidy and exporting it in excess of commitment levels; and also by granting direct subsidies on exports of "ACP/India equivalent" sugar in excess of the EC's commitment levels. The complainants further claimed that the EC sugar regime violates the Subsidies and Countervailing Measures Agreement. Both the Panel and the Appellate Body ruled that the sugar subsidies are inconsistent with the EC's obligations under the Agreement on Agriculture.

14. In determining whether there is a subsidy, the Appellate Body affirmed the broad definitions of the concepts of "payments" and "governmental action". "Payment" means a transfer of economic resources and includes payments-in-kind, revenue foregone, and a transfer of economic resources within one economic unit. "Governmental action" was defined to embrace a full range of activities by which governments regulate, control or supervise individuals. It may be a single act or omission, or a series of acts or omissions.

15. Similarly, the phrase "export subsidies" was interpreted widely. The Appellate Body said that the economic effects of WTO-consistent domestic supply can spill over to benefit export production. This can constitute an export subsidy, but should not be seen as eroding the boundary between domestic support and export subsidies.

16. The legal status of agricultural support after 2003 was one of the contentious issues regarding the expiry of the Peace Clause. Some argued that all agricultural subsidies would be subject to the SCM Agreement - which would make Members providing subsidies vulnerable to more challenges. Others

⁷ For a critique of this finding, see Benitah, M., "US Agricultural Export Credits after the WTO Cotton Ruling: The Law of Unintended Consequences" *Estey Centre Journal of International Law and Trade Policy*, Volume 6 Number 2 2005, pp. 107 -114.

⁸ *European Communities - Export Subsidies on Sugar (WT/DS265/AB/R)*.

asserted that other provisions that make exceptions for agricultural subsidies will continue to apply, thereby maintaining some protection for subsidizing Members.⁹ The latter view is correct. The other provisions continue to apply and continue to provide exceptions for agricultural subsidies. Where there is conflict between the Agriculture Agreement and other agreements, the Agriculture Agreement prevails as *lex specialis* in relation to agricultural subsidies.¹⁰ But, where the Agreement on Agriculture is silent, the other agreements apply. These propositions are supported by WTO case law, although the cases did not discuss the Peace Clause.¹¹ In relation to the SCM Agreement, the matter should not have been contentious at all because Article 3 of the SCM Agreement defers to the Agriculture Agreement by providing that “except as provided for in the Agreement on Agriculture” export subsidies are prohibited.

17. Nevertheless, the Appellate Body report in *EC – Sugar* shows that some aspects of the SCM and Agriculture Agreements apply cumulatively. It said that after finding a violation of Articles 3 and 8 of the Agriculture Agreement, there was still need to address claims under Article 3 of the SCM Agreement because Article 4.7 of the SCM Agreement, which requires prohibited subsidies to be withdrawn without delay, provides an additional remedy to a successful complainant.

18. The rulings in *US – Cotton* and *EC – Sugar* interpreted the subsidies disciplines strictly, thereby making it very difficult for developed countries to justify subsidies that do not comply with the WTO Agreements. Developed countries have seen that they cannot easily continue to provide subsidies within the boxes as presently defined. The narrow interpretation of the green box is notable because that box is the one that was offered the strongest protection by the Peace Clause. Furthermore, the broad definitions of domestic support and export subsidies increase the array of subsidies that might be open to challenge. In addition, the finding that the Agriculture Agreement applies to export subsidy components of export credit guarantees has certainly caught developed countries by surprise. The two cases have also shown that developing countries are determined to challenge developed country subsidies; and they have opened the door to other developing countries to explore possibilities of further challenges.¹²

⁹ These provisions are: Article 3.1 of the SCM Agreement; Article 21 of the Agreement on Agriculture; and the schedules of commitments. See Delcros, F., “The Legal Status of Agriculture in the World Trade Organization” *Journal of World Trade*, 36(2), 2002, pp. 219 – 253, at p. 250.

¹⁰ Chambovey, supra, at pp. 308 - 313. “*lex specialis*” is short form for the Latin maxim “*lex specialis derogat generali*” meaning “specific law prevails over general law”.

¹¹ *Canada – Measures Affecting the Exportation of Dairy Products and the Importation of Milk; Recourse to Article 21 of the DSU by New Zealand and the United States (WT/DS103/RW)* (for the statement that the Agriculture Agreement allows Members to provide agricultural subsidies despite the prohibitions in the SCM Agreement) and *EC – Regime for the Importation, Sale and Distribution of Bananas (WT/DS27/AB/R)* (for the proposition that in the absence of specific provisions in the Agriculture Agreement, other agreements apply to agricultural products).

¹² Josling, T., notes that the *US – Cotton* Panel Report gives encouragement to countries that have refrained from making challenges because they felt that panels would have difficulties in finding

19. To some extent, the outcomes in the two cases have probably affected US and EC positions in the agriculture negotiations. The US and the EC consider the blue box as a sensitive issue. The *US - Cotton* ruling has strengthened the US resolve to continue fighting for an expansion of the blue box criteria. The key objective is to lock-in countercyclical payments within the blue box. These payments were found to be WTO-inconsistent in the case. As for the green box, the US and the EC would like the status quo to remain but are also willing to clarify and review the green box. In reality, neither has engaged in any clarification of the provisions.¹³

20. At the same time, fearing that it might still fall foul of the new disciplines, the US is proposing a new Peace Clause. As stated in the introduction, the nature and duration of the new Peace Clause is not clear yet. One of the main worries is that since the dispute settlement reports have clarified the limits of the protection offered by the old Peace Clause, the US or any future proponent of a new Peace Clause might seek a more extensive due restraint provision. In addition, the Panel and Appellate Body stressed the need for clear language in exception provisions when addressing the applicability of the Agreement on Agriculture to export credit guarantees. The proponents of a new Peace Clause will certainly take note of the need for legal clarity.

IV. Considerations on re-introducing the Peace Clause¹⁴

21. Any proposal to re-introduce the Peace Clause should be viewed skeptically. The expiry of the Peace Clause was meant to put pressure on subsidizing countries to continue the reform process through negotiations of substantial and additional reduction commitments in production and export subsidies that would reduce their vulnerability to challenge in the WTO dispute settlement system. The expiry was seen as a means of leverage for obtaining concessions from WTO Members who give substantial support to their farmers.¹⁵ It also allows for dispute settlement to be used in tandem with negotiations as a means of effectively eliminating the distortions that subsidies cause in world markets.

evidence of serious prejudice: "Unraveling the Cotton Case" ICTSD "Bridges" Year 9 No. 4, April 2005, pp. 3 – 5 at p.4.

¹³ "State of Play in Agriculture Negotiations: Country Groupings' Positions", *South Centre Analytical Note*, (SC/TADP/AN/AG/10, July 2005), available at http://www.southcentre.org/tadp_webpage/researchpapers_listag_webpage.htm.

¹⁴ This section should not be read as implying that developing countries should favour the re-introduction of the Peace Clause. Similarly, the suggestions for possible trade-offs do not mean that such trade-offs are the most desirable or that trade-offs should be limited to agriculture only. The objective here is to clarify the relevant issues so that developing countries take an informed decision in pursuance of their negotiating objectives.

¹⁵ Chambovey, *supra*, at p. 306.

22. Thus a new Peace Clause would be a step back and could encourage developed countries to maintain their subsidies or to propose a long period for withdrawal of subsidies. It would also deprive developing countries of an important bargaining chip in the negotiations since they would not have the option of resorting to dispute settlement. Therefore, developing countries should reject any proposals for a Peace Clause.

23. Given that developing countries do not provide production and export subsidies in any significant way, a Peace Clause would represent a concession by developing countries in favour of countries that heavily subsidize their agricultural sectors, particularly the US and the EC.¹⁶ If for any reason developing countries decide to consider proposals for re-introducing the Peace Clause, they must secure developed country support on issues that they have a particular interest in. Although every developing country has its own priorities in the negotiations, certain proposals backed by a large number of developing countries could be used as possible trade-offs for a Peace Clause. These proposals include:

- i. **Special Safeguard Mechanism (SSM):** the Framework agreement states that a Special Safeguard Mechanism will be established for use by developing country Members. Recent consultations on the basis of a detailed legal draft on SSM submitted by the G33 indicate that there is resistance from other WTO Members to incorporate a price-based trigger in the SSM. They argue that developing countries lack capacity to implement such measures and that it will affect predictability. Both the EC and the US have put forth these arguments and advocated for a volume-based only SSM. The price trigger is probably the most effective and useful of the two to be incorporated in the SSM. The experience in the use of the SSG shows that it is the price trigger that is most widely used by both developed and developing countries. Whether the SSM should contemplate a volume and a price trigger may be an important political issue to be put to Members for decision at Hong Kong.
- ii. **Special Products (SPs):** important issues remain open with respect to the designation and treatment of special products by developing countries. Regarding the selection of SPs, some Members insist on a very strict approach based on specific indicators and a numerical ceiling thus doubly constraining developing countries' flexibilities.

¹⁶ The expiry of the Peace Clause does not represent a threat to subsidies provided by developing countries because of the low level of subsidization that they provide and also the non-specific character of their subsidies. See "Note on the Expiry of the Peace Clause: Some Elements for Consideration by Developing Countries", *supra*, at pp. 13 - 15, on the vulnerability of developing country subsidies to the expiry of the Peace Clause.

Regarding treatment, some Members, notably the US, insist on substantial improvement in market access being provided on all products including SPs. Developing countries may consider a very ambitious approach with respect to special products covering both designation and treatment issues, assessing the conditions negotiated on sensitive products for developed and developing countries and the re-introduction of the Peace Clause, if this is in fact on the table for Hong Kong.

- iii. **Facilitated countervailing measures:** countervailing measures were not widely used during the implementation period of the Agriculture Agreement even though the due restraint discipline enshrined in the Peace Clause is rather weak. One of the reasons to explain this may be the difficulties imposed by the substantive and procedural requirements of the SCM Agreement as applicable to the agriculture sector (i.e. the requirement to prove causal relationship between subsidized imports and the alleged injury to the domestic industry), especially in developing countries. One way to go around this difficulty could be to waive the requirement of proving injury for the purposes of imposing countervailing duties on subsidized imports from developed countries. Such a waiver would last for the duration of the Peace Clause. Again, this approach would only address the defensive concerns of developing countries in the negotiations but it could be important for putting a halt to a flood of subsidized imports, at least in key sectors.

Finally, a new Peace Clause should not apply indefinitely or for the duration of the 'reform process' which could take several additional rounds of trade talks. There should be a specific deadline for the expiry of the Peace Clause. A clear and short deadline would maintain the pressure on the subsidizing countries to negotiate substantial and timely reduction commitments in agriculture support.

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