

**Consistency of the 2013 Farm Bills with US Obligations  
Under the World Trade Organization Agreements**  
(August 20, 2013)

We analyze in this paper the consistency of Title I of the House and Senate versions of the 2013 Farm Bill (“Farm Bills”) with US obligations under the World Trade Organization (“WTO”) agreements. Specifically, we discuss the WTO-consistency of the suggested counter-cyclical price programs, *i.e.*, Price Loss Coverage (“PLC”) in H.R. 1947 (“House Bill”) and Adverse Market Payments (“AMP”) in S. 954 (“Senate Bill”), which would trigger payments to farmers when market prices for covered crops decline below certain guaranteed levels. We also consider the vulnerability under WTO law of the proposed revenue-based programs, *i.e.*, Revenue Loss Coverage (“RLC”) in the House Bill and Agriculture Risk Coverage (“ARC”) in the Senate Bill, which would operate as revenue insurance to protect farmers against income losses.

**I. SUMMARY**

- The Farm Bills would repeal a number of farm support programs, namely direct payments, the counter-cyclical program (“CCP”), and Average Crop Revenue Election (“ACRE”).
- The direct payment and CCP programs would be replaced by the PLC program under the House Bill or the AMP program under the Senate Bill. Under these programs, payments would be made to farmers if current prices fell below a guaranteed reference (target) price.
  - The PLC program differs fundamentally from the AMP program. Payments under the PLC program would be **“coupled”** to the **actual** number of acres a farmer plants. In contrast, payments under the AMP program would be based on an historic measure of the acres planted. Economists widely view coupled payments, such as those under the proposed PLC program, to be **highly trade distorting** because farmers are incented to plant additional acres of a crop simply to receive the subsidy, rather than in response to market demand for the crop. As a result, crop sizes are artificially inflated, which reduces market prices and injures non-subsidized producers. Coupling payments to production would mark a significant step backwards in US agricultural policy.
  - Because the PLC program likely would be highly trade distorting, adoption of that program would more likely cause a WTO Member to initiate a dispute against the United States. If a dispute were initiated, it is **highly likely** that a WTO panel would find payments under the PLC program were actionable subsidies that cause “adverse effects” to the interests of other WTO Members, contrary to US obligations under the WTO *Agreement on Subsidies and Countervailing Duties* (“SCM Agreement”). We reach this conclusion because coupled payments under the PLC program likely would cause more direct and significant “adverse effects” to the interests of other WTO Members than those

caused under the CCP program, which was successfully challenged by Brazil in relation to its impact on cotton producers in the *US – Upland Cotton* case.<sup>1</sup>

- Because decoupled payments under the AMP program would be far less trade distortive, a WTO Member would be less likely to initiate a dispute against the US in response to that program. If a dispute were initiated, there is a risk that a WTO panel would find that payments under the AMP program were inconsistent with US obligations under the SCM Agreement based on the analysis by the panel in the *US – Upland Cotton* case.
- The current ACRE program would be replaced by the RLC program under the House Bill or the ARC program under the Senate Bill. ACRE was not challenged in the *US – Upland Cotton* case. Therefore, it is more difficult to assess the likelihood that a panel would find that the RLC or ARC programs were inconsistent with the SCM Agreement. That said, we believe the findings of the panel in *US – Upland Cotton* with respect to the CCP program would apply to the ARC and RLC programs because of similarities with respect to their structure, design, and potential impacts on other WTO Members. Payments under both the RLC and ARC programs would be coupled to actual planted acres, which may increase both the risk that a WTO Member would challenge the programs and the risk that a panel would find them to be inconsistent with US obligations under the SCM Agreement.
- If programs in the Farm Bills were successfully challenged at the WTO, the United States would be required to withdraw the subsidies or remove the “adverse effects” caused by them. If the United States failed to do so within the allotted time, it could face retaliation from the complaining country, as in the *US – Upland Cotton* case. Depending on the retaliation authorized by the WTO, **both US agricultural and non-agricultural sectors could be targeted**. Potential complainants include Brazil, China, and Argentina.

## II. FACTUAL BACKGROUND

The Farm Bills would repeal a number of farm support programs, namely direct payments, CCP, and ACRE. The price-based CCP program would be replaced by the PLC program under the House Bill or the AMP program under the Senate bill. These programs would trigger payments when the mid-season national average market price (under the PLC program) or the national average marketing price (under the AMP program) for covered commodities fell below a guaranteed reference (target) price.<sup>2</sup> The final amount a farmer would receive under the price-support programs would be determined by multiplying the price difference (target price minus market price) times the producer’s payment acres times the payment yield.

While the AMP and PLC programs are similar to the existing CCP program in many respects, there are two noteworthy differences:

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<sup>1</sup> DS267 - United States — Subsidies on Upland Cotton (Complainant: Brazil).

<sup>2</sup> Covered commodities include: wheat, corn, soybeans, rice, barley, oats, and peanuts.

First, the PLC program would **couple payments** to a percentage of a farmer's **actual** planted acreage. Thus, a farmer that plants more acres of a crop in a particular year would receive a larger payment than a farmer that plants fewer acres of the crop in the same year. In contrast, the AMP program would continue the current CCP approach of decoupling payments from a farmer's production decision by calculating payments using an **historic number of acres** (base acres). Thus, the payment a farmer would receive would not vary based on annual planting decisions. This is a fundamental distinction between the PLC and AMP programs because coupled payments are widely considered by economists to be highly trade distorting because they create incentives for farmers to plant acres simply to obtain a large support payment, and without regard to market demand for the crop being planted or other crops that might be planted instead. For this reason, agricultural policy has focused for years on eliminating coupled payments. The PLC program under the House Bill would mark a **significant step backwards** in this respect.<sup>3</sup>

Second, reference prices under the PLC and AMP programs generally would be set at a higher level than under the CCP program, increasing the likelihood that payments would be made to farmers because actual market prices were below the reference prices.<sup>4</sup> It is expected that the PLC program, and to a lesser extent the AMP program, would trigger large government spending in times of low prices, particularly in the case of the PLC program which, as discussed above, would cause farmers to base planting decisions on the level of support, rather than market returns.<sup>5</sup>

Under the Farm Bills, the revenue-based programs, RLC and ARC, would replace the current ACRE program. Under the RLC program of the House Bill, a farmer would be required to choose between price-based or revenue-based payments; whereas, under the ARC program of the Senate Bill, the AMP and ARC programs would apply cumulatively. The RLC and ARC programs would operate like insurance against revenue losses. They would be provided on top of government subsidized insurance coverage to cover a farmer's crop insurance deductible (so-called "shallow" loss).<sup>6</sup> Payments under both the RLC and ARC would be calculated based on actual planted acreage, which as noted above affects farmers' planting decisions, distorting trade flows and world prices.<sup>7</sup>

For the sake of completeness, we note that a special program would apply to cotton to address the WTO's findings in the *US – Upland Cotton* case. Exempting cotton from the PLC/AMP and RLC/ARC programs does not affect our analysis of these programs with respect to the other covered commodities.

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<sup>3</sup> International Center for Trade and Sustainable Development, *Potential Impact of Proposed 2012 Farm Bill Commodity Programs on Developing Countries*, pp. 5 and 6.

<sup>4</sup> This applies to all commodities under the PLC program and to some (rice and peanuts) under the AMP program.

<sup>5</sup> Environmental Working Group, *Raising Price Supports Could Drive Up Government Spending and Distort Planting Decisions*, June 2013, p. 8.

<sup>6</sup> International Center for Trade and Sustainable Development, *Potential Impact of Proposed 2012 Farm Bill Commodity Programs on Developing Countries*, pp. 1, 9 and 10.

<sup>7</sup> International Center for Trade and Sustainable Development, *Potential Impact of Proposed 2012 Farm Bill Commodity Programs on Developing Countries*, p. 1.

### III. LEGAL ANALYSIS

#### A. The PLC and AMP Programs

In this section we analyze whether the PLC and AMP programs would provide actionable subsidies, contrary to the disciplines of the SCM Agreement. Part III of the SCM Agreement sets out the disciplines applicable to actionable subsidies. Article 5 provides that “[n]o Member should cause, through the use of any subsidy... adverse effects to the interests of other Members ...” Article 5(c) lists, as one such adverse effect, “**serious prejudice** to the interests of another Member”.<sup>8</sup> Emphasis added. Article 6.3 in turn, lists a number of cases where “serious prejudice” arises,<sup>9</sup> namely where “the effect of the subsidy” is:

- “to displace or impede... imports... into the market of the subsidizing Member”;
- “to displace or impede... exports... from a third country market”;
- “significant price suppression, price depression... in the same market”; or
- “an increase in the world market share”.

These effects may either occur singly or concurrently. We consider each of these requirements below.

#### 1. Are the PLC and AMP programs “specific subsidies” for the purposes of an actionable subsidies analysis?

In order to qualify as “actionable subsidies” for the purposes of Part III of the SCM Agreement, the AMP and PLC programs must be “specific subsidies” within the meaning of Articles 1.1, 1.2, and 2 of the SCM Agreement.

##### a) “Subsidy”

Under the SCM Agreement, a “subsidy” will be deemed to exist if a government provides a “financial contribution” and a “benefit” is thereby conferred.<sup>10</sup> The definition of “financial

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<sup>8</sup> The subsidies under the PLC and AMP programs would also be WTO-inconsistent if they caused “adverse effects to the interests of other Members” in the form of “injury to the domestic industry of another Member”, contrary to Article 5(a); or nullified certain GATT benefits of a Member, contrary to Article 5(b). We have not analyzed these provisions in this memorandum because there is no factual evidence to suggest they would apply and to support such an analysis.

<sup>9</sup> In *US – Upland Cotton*, the compliance panel clarified that the phrase “may arise” must be interpreted “to mean that ‘the situations listed in Article 6.3(a)-(d) in themselves constitute serious prejudice’”. As a consequence, “a finding of significant price suppression under Article 6.3(c) of the SCM Agreement”, for example, “is a sufficient basis for a finding of serious prejudice within the meaning of Article 5(c) of the SCM Agreement”. Panel Report, *US – Upland Cotton* (21.5), para. 10.255.

<sup>10</sup> Article 1 of the SCM Agreement provides, in part, that:

“1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:

- (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as “government”), i.e. where:

contribution” includes “direct transfer of funds”, including “grants”. The PLC and AMP programs would provide a financial contribution to farmers in the form of grants. They also would confer a “benefit” as they would place the recipients in a better position than they otherwise would have been in the marketplace.<sup>11</sup>

b) “Specific”

If a subsidy exists, it is subject to the rules of the SCM Agreement only if it is “specific to an enterprise or industry or group of enterprises or industries”.<sup>12</sup> Such specificity may exist in law (“*de jure*” specificity), in fact (“*de facto*” specificity), or by geographical limitation (regional specificity). In *US – Upland Cotton*, the panel stated that an industry or group of industries “may be generally referred to by the type of products they produce”.<sup>13</sup> The payments under the PLC and AMP programs would be available for a restricted number of agricultural products,<sup>14</sup> but would not be “widely or generally available in respect of all agricultural production, let alone the entire universe of US produced goods”.<sup>15</sup> The subsidies at issue therefore would be “specific”.<sup>16</sup> Because the limited availability is explicitly provided for in the Farm Bills, the subsidies would be considered *de jure* specific.<sup>17</sup>

**2. Do the subsidies cause “adverse effects” to the interests of other Members in the form of “serious prejudice”?**

The subsidies under the PLC and AMP programs would be WTO-inconsistent if they caused “adverse effects” to other Members in the form of “serious prejudice”, either present or a threat

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- (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);...

and

- (b) a benefit is thereby conferred.”

<sup>11</sup> Under WTO case law, a “benefit” is conferred when a financial contribution is provided on terms more favourable than those available in the market. As the Appellate Body has stated:

“We also believe that the word “benefit”, as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no “benefit” to the recipient unless the “financial contribution” makes the recipient “better off” than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a “benefit” has been “conferred”, because the trade-distorting potential of a “financial contribution” can be identified by determining whether the recipient has received a “financial contribution” on terms more favourable than those available to the recipient in the market.”

Appellate Body Report, *Canada – Aircraft*, para. 157.

In *US – Upland Cotton*, the panel concluded that the CCP payments constitute “subsidies” within the meaning of Articles 1.1(a) and (b) of the SCM Agreement. Panel Report, *US – Upland Cotton*, para. 7.1120.

<sup>12</sup> Article 2 of the SCM Agreement.

<sup>13</sup> Panel Report, *US – Upland Cotton*, para. 7.1142.

<sup>14</sup> These are wheat, corn, grain sorghum, barley, oats, rice, pulse crops, soybeans, other oilseeds, and peanuts.

<sup>15</sup> Panel Report, *US – Upland Cotton*, para. 7.1148.

<sup>16</sup> In *US – Upland Cotton*, the panel concluded that the CCP payments are “specific” within the meaning of Article 2. Panel Report, *US – Upland Cotton*, para. 7.1154.

<sup>17</sup> Article 2.1(a).

thereof.<sup>18</sup> As noted above, “serious prejudice” arises in a number of specific cases set out in Article 6.3. Our analysis focuses on whether “the effect of the subsidy” is “significant price suppression ... in the same market”, pursuant to Article 6.3 (c), which was the main claim in *US – Upland Cotton*. However, we also briefly consider other scenarios enumerated in Article 6.3, *i.e.*, an increase in the world market share and the displacement or impedance of imports or exports, because they could also be relevant with respect to certain crops covered by the Farm Bills.

Whether any of these market phenomena has occurred can only be determined on the basis of the specific facts before a panel and would require specific data in relation to the crops and markets concerned.<sup>19</sup> Nevertheless, we discuss below arguments that could be advanced by a WTO complainant with respect to the PLC and AMP programs.

a) *Significant price suppression as the effect of the subsidies, Article 6.3(c)*

The Farm Bills would cause serious prejudice to other WTO Members, contrary to the SCM Agreement, if “the effect” of the PLC and AMP payments provided to US farmers was “significant price suppression... in the same market”.<sup>20</sup>

i) *Legal test*

WTO jurisprudence has established that in disputes involving claims under Part III of the SCM Agreement, “a complainant must demonstrate not only the existence of the relevant subsidies and the adverse effects to its interests, but also that the subsidies at issue have *caused* such effects”.<sup>21</sup>

The existence of a causal link requires “a genuine and substantial relationship of cause and effect”.<sup>22</sup> In other words, “the subsidies must contribute, in a ‘genuine’ and ‘substantial’ way, to producing or bringing about one or more of the effects or market phenomena, enumerated in Article 6.3”.<sup>23</sup> A panel does not need to determine that a subsidy is “the *sole* cause of that effect, or even that it is the *only* substantial cause of that effect”.<sup>24</sup> That said, a panel must “ensure that it does not attribute the effects of ... other causal factors to the subsidies at issue”.<sup>25</sup>

The SCM Agreement does not prescribe the manner in which a panel must conduct its analysis of causation. In previous cases, panels have conducted a “counterfactual analysis” under which the requirement of a causal link is satisfied if, “but for” the subsidy, the world market price for the

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<sup>18</sup> Footnote 13 to Article 5(c) clarifies that “the term ‘serious prejudice to the interests of another Member’... includes threat of serious prejudice”.

<sup>19</sup> For example, in its ruling in *US - Large Civil Aircraft (2nd complaint)*, the Appellate Body noted that “a demonstration that subsidies are a genuine and substantial cause of the alleged serious prejudice is a fact-intensive exercise, and one that inevitably involves extensive, case-specific evidence”.

<sup>20</sup> Article 6.3(c).

<sup>21</sup> Appellate Body Report, *US - Large Civil Aircraft (2nd complaint)*, para. 913. Original emphasis. This conclusion follows from Article 6.3 (“the *effect* of the subsidy”) and Article 5 (“No Member should *cause*, through the use of any [specific subsidy]... c) serious prejudice to the interests of another Member).

<sup>22</sup> Appellate Body Report, *US - Large Civil Aircraft (2nd complaint)*, para. 913.

<sup>23</sup> Appellate Body Report, *US - Large Civil Aircraft (2nd complaint)*, para. 913. Footnotes omitted.

<sup>24</sup> Appellate Body Report, *US - Large Civil Aircraft (2nd complaint)*, para. 914.

<sup>25</sup> Appellate Body Report, *US - Large Civil Aircraft (2nd complaint)*, para. 914. Footnotes omitted.

commodity at issue would have increased significantly, or would have increased by significantly more than was, in fact, the case.<sup>26</sup> The analysis may be highly quantitative or predominantly qualitative in nature, or may involve both quantitative and qualitative elements”.<sup>27</sup>

ii) *Whether “the effect” of the PLC and AMP programs is “significant price suppression”*

In *US – Upland Cotton*, in examining whether the world market price for cotton would have increased significantly, but for the subsidies, the compliance panel relied on a number of factors. A panel established to rule on the WTO-consistency of the PLC or AMP programs likely would rely on the same or similar factors, and find that the effect of payments provided to US farmers under the programs is “significant price suppression” within the meaning of Article 6.3(c).

- **“Substantial proportionate influence” of U.S. production and export**

In *US – Upland Cotton*, the compliance panel found that the United States exerts a “substantial proportionate influence” on the world market for upland cotton because of the magnitude of the US shares of world production and exports.<sup>28</sup> These would also be valid considerations with respect to the PLC and AMP programs. For example, the United States has been the largest exporter (based on average of exports from 2008 through 2012) of corn, soybeans, and wheat.<sup>29</sup> It is therefore possible that a WTO panel would conclude that the United States exerts a “substantial proportionate influence” on the relevant market for several of the commodities covered by the PLC and AMP programs. Because payments under the PLC program would be coupled to production, it likely would result in greater production of covered commodities than the AMP program. As a result, the PLC program would more likely result in a finding by a WTO panel that the United States exerts a “substantial proportionate influence” on the relevant market.

- **“Structure, design and operation” of the PLC and AMP programs**

In *US – Upland Cotton*, the compliance panel concluded that “the structure, design and operation” of CCP payments provided by the United States support a finding that the effect of these subsidies “significant price suppression” in the world market for upland cotton. More precisely, the panel stated that the CCP payments “affect the level of US upland cotton acreage and production as a result of their mandatory and price-contingent nature and their revenue-stabilizing effect”.<sup>30</sup> Thus, “these subsidies protect or ‘insulate’ revenues of US upland cotton producers when prices are low”.<sup>31</sup> Viewed together with other evidence, the panel said, “it is reasonable to conclude that

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<sup>26</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.49. This approach was endorsed by the Appellate Body. See Appellate Body Report, *US – Upland Cotton (Article 21.5)*, para. 369, 370.

<sup>27</sup> Appellate Body Report, *US - Large Civil Aircraft (2nd complaint)*, para. 1019.

<sup>28</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.58.

<sup>29</sup> National Grain and Feed Association, *Comparison of Target Price Concepts in Senate and House Farm Bills*, July 10, 2013, p. 11. Environmental Working Group, *Raising Price Supports Could Drive Up Government Spending and Distort Planting Decisions*, June 2013, p. 6.

<sup>30</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.104.

<sup>31</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.104.

without these subsidies the level of US upland cotton acreage and production would likely be significantly lower”.<sup>32</sup>

These findings would also apply directly to the PLC and AMP programs. Due to their market-price contingency, the payments “may influence production decisions indirectly, by reducing total and per unit revenue risk associated with price variability in some situations”.<sup>33</sup> Furthermore, payments under the PLC and AMP programs would be directly linked to reference prices, “thereby insulating United States producers’ from low prices”.<sup>34</sup>

The fact that the current CCP payments are not coupled to actual production did not change the panel’s conclusion in the *US – Upland Cotton* case. To the contrary, the panel stated that the relationship between upland cotton base acre holders and upland cotton production “is significant in that it suggests that cotton counter-cyclical payments play a role in maintaining the level of acreage and production at a higher level than would otherwise be the case”.<sup>35</sup> Thus, despite the fact that the AMP program would decouple payment amounts from the actual acreage planted, a panel could still find that the program suppresses prices. That said, and as discussed elsewhere, the PLC program would be highly vulnerable to a WTO challenge because payments would be coupled to a farmer’s actual planted acreage, clearly distorting planting decisions and, thus, market prices. Also, **because the PLC program likely would cause more damage to the producers of other WTO Members, it would be more likely to result in a WTO dispute** against the United States.

- **“Magnitude” of PLC and AMP programs**

In *US – Upland Cotton*, the compliance panel found that “when considered in conjunction with other factors, the order of magnitude of the marketing loan payments and the counter-cyclical payments supports a finding of significant price suppression”.<sup>36</sup> Importantly, in analyzing whether the effect of a subsidy is significant price suppression, a panel is not required “to quantify precisely the amount of a subsidy benefiting the product at issue in every case.”

Supporters of the Farm Bills claim they would reduce government spending in the agricultural sector by eliminating the existing system of price and revenue supports.<sup>37</sup> However, economic experts have pointed out that the new price-based payments (PLC and AMP) and the revenue-based payments (RLC and ARC) “would increase costs by just over \$35 billion” and “the expected costs associated with these programs offset most of the savings achieved by eliminating current programs”.<sup>38</sup> In addition, the reference prices under PLC and AMP programs generally would be higher than those under the current CCP. Therefore, the proposed programs “create the potential for far larger

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<sup>32</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.104.

<sup>33</sup> Panel Report, *US – Upland Cotton*, para. 7.1302.

<sup>34</sup> Panel Report, *US – Upland Cotton*, para. 7.1349.

<sup>35</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.102.

<sup>36</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.111.

<sup>37</sup> Environmental Working Group, *Raising Price Supports Could Drive Up Government Spending and Distort Planting Decisions*, June 2013, p. 7.

<sup>38</sup> Environmental Working Group, *Raising Price Supports Could Drive Up Government Spending and Distort Planting Decisions*, June 2013, p. 7.

outlays if commodity prices fall below the levels guaranteed in the bills”.<sup>39</sup> All of this strongly indicates that the magnitude of the subsidies under the PLC program, and to a lesser extent the AMP program, would continue to be “very large”,<sup>40</sup> which would support a finding that their effect is “significant price suppression”.

- **Significant gap between the total costs of production of producers and their market revenue**

In *US – Upland Cotton*, the compliance panel concluded that “there exists a significant gap between the total costs of production of US upland cotton producers and their market revenue”.<sup>41</sup> The panel considered that this gap, when considered in conjunction with the magnitude of subsidies and the significance of US market participation, “supports the proposition that the marketing loan and counter-cyclical payments are an important factor affecting the economic viability of US upland cotton farming”.<sup>42</sup> The panel therefore concluded that “without these subsidies the level of US upland cotton acreage and production would be considerably lower”.<sup>43</sup>

Similarly to the CCP payments, the PLC and AMP payments would be an important factor affecting the economic viability of producers of covered crops. It is therefore reasonable to believe that without these payments, the level of crop acreage and production would be considerably lower. The situation would be even worse with respect to PLC payments than with respect to the CCP payments considered in the *US – Upland Cotton* case because the PLC payments would be tied to planted acres, creating a clear and direct incentive for farmers to plant crops based on the level of government support, rather than market returns.

- **Link between significant price suppression and subsidies, despite other factors affecting the world market price**

In *US – Upland Cotton*, the compliance panel rejected arguments of the United States that other factors (in particular, China’s role in trade in cotton) drove world market prices and, therefore, there was no causal link between US subsidies and market suppressed prices.<sup>44</sup> The panel recognized that it was necessary “to ensure that the effects of other factors on prices are not improperly attributed to the challenged subsidies”.<sup>45</sup> However, it said that “it is not necessary in this respect to undertake a comprehensive evaluation of factors affecting the world market price for upland cotton”.<sup>46</sup> Rather, “the question is whether the evidence before the Panel supports the conclusion that in the absence of the US marketing loan payments and counter-cyclical subsidies the world market price would increase significantly”.<sup>47</sup> Based on the evidence, the panel concluded that “while China may play a

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<sup>39</sup> Environmental Working Group, *Raising Price Supports Could Drive Up Government Spending and Distort Planting Decisions*, June 2013, p. 7.

<sup>40</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.108 (quoting Panel Report, *US – Upland Cotton*, paras. 7.1297 and 7.1308).

<sup>41</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.196.

<sup>42</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.196.

<sup>43</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.196.

<sup>44</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.240.

<sup>45</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.242.

<sup>46</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.243.

<sup>47</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.243.

significant role in the market for upland cotton, this does not diminish the significance of the impact of US subsidies on the world price for upland cotton as a result of their effect on US supply to the world market”.<sup>48</sup>

The panel’s reasoning in the *US – Upland Cotton* case suggests that even if other factors may influence the markets for crops covered under the PLC and AMP programs, they would only be of limited relevance in a panel’s analysis of price suppression. A panel likely would focus on the significant impact of US subsidies on world prices and US production (particularly with respect to coupled payments under the PLC program), and find that the causation requirement is satisfied.

*b) Increase in world market share as the effect of the subsidies, Article 6.3(d)*

Article 6.3(d) provides that “serious prejudice” also arises where “the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted”. WTO jurisprudence has established that this requires “*first*, a showing that there has been an increase in the world market share of the subsidizing Member in a particular primary product or commodity as compared to the average market share of that Member in the previous period of three years”.<sup>49</sup> And, “[*s*]econd, it must be shown that this increase follows a consistent trend over a period when subsidies have been granted”.<sup>50</sup> The term “world market share” has been interpreted to mean “share of the world market supplied by the subsidizing Member”.<sup>51</sup>

In *US – Upland Cotton*, the panel found that Brazil “has not been able to demonstrate that the small increase in the US world market share is the effect of marketing loan and counter-cyclical payments”.<sup>52</sup> It further stated that “[i]t was not unreasonable to interpret such a small increase to be part of the ordinary fluctuations on the US market share”.<sup>53</sup> However, depending on the specific facts for a particular covered crop, it may well be possible to demonstrate to a WTO panel that any increase in US world market share is the effect of PLC or AMP payments, contrary to Article 6.3(d), particularly if the increase could be linked to coupled payments under the PLC program.

*c) Displacement or impedance of imports or exports as the effect of the subsidies, Articles 6.3(a) and (b)*

Depending on the specific facts, it may also be possible to demonstrate to a panel that the effect of the PLC or AMP payments is displacement or impedance of imports or exports, contrary to Article 6.3(a) and (b). The Appellate Body has found that “displacement arises under subparagraph (a) of Article 6.3 where the effect of the subsidy is that imports of a like product of the complaining

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<sup>48</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.243.

<sup>49</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.261.

<sup>50</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.261.

<sup>51</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.262 (quoting Panel Report, *US – Upland Cotton*, para. 7.1454). Brazil raised this issue in its appeal, but the Appellate Body found that an interpretation of the phrase “world market share” in Article 6.3(d) was not necessary to resolve the dispute. Appellate Body Report, *US – Upland Cotton*, para. 511.

<sup>52</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.264.

<sup>53</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.264.

Member are substituted by the subsidized product in the market of the subsidizing Member”.<sup>54</sup> Similarly, the Appellate Body has concluded that “under subparagraph (b) displacement arises where exports of the like product of the complaining Member are substituted in a third country market by exports of the subsidized product”.<sup>55</sup> With respect to the term “impede”, the Appellate Body found that it “connotes a broader array of situations than the term ‘displace’”.<sup>56</sup> It “refers to situations where the exports or imports of the like product of the complaining Member would have expanded had they not been ‘obstructed’ or ‘hindered’ by the subsidized product”.<sup>57</sup> The Appellate Body added that “[i]t could also refer to a situation where the exports or imports of the like product of the complaining Member did not materialize at all because production was held back by the subsidized product”.<sup>58</sup>

If it could be demonstrated that the PLC or AMP payments have the effect that subsidized US crops are substituted for imports in the US market, or subsidized US crop exports are substituted in a third country for exports from other WTO Members, a panel likely would find a situation of “serious prejudice” under Articles 6.3(a) or (b). The same would apply if there was sufficient evidence to show that exports of a WTO Member to the United States or a third country would have expanded had they not been hindered or obstructed by subsidized US crops. As with virtually all of the other factors discussed above, such a finding would be far more likely with respect to coupled payments under the PLC program because of the clear incentive they would create for farmers to overproduce.

## **B. The RLC and ARC Programs**

As noted, Brazil did not challenge the current ACRE program, which would be replaced by the RLC and ARC programs, in the *US – Upland Cotton* case. However, based on the findings of the WTO adjudicatory bodies in the cotton case, good arguments could be made that payments under the proposed RLC and ARC programs would be vulnerable under the SCM Agreement. The reasoning, discussed above, that led to a finding of “serious prejudice” in the form of “significant price suppression” with respect to the CCP program could, in most cases, could be similarly applied to the RLC and ARC programs:

- The United States is the largest exporter of several subsidized crops<sup>59</sup> covered by the RLC and ARC programs. With respect to these crops, a WTO panel would probably find a “substantial proportionate influence” of US production and exports on the relevant market.
- Arguably, the RLC and ARC payments “protect or insulate”<sup>60</sup> revenues of US farmers when prices are low. Thus, “the structure, design and operation”<sup>61</sup> of

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<sup>54</sup> Appellate Body Report, *EC and certain member States — Large Civil Aircraft*, para. 1160.

<sup>55</sup> Appellate Body Report, *EC and certain member States — Large Civil Aircraft*, para. 1160.

<sup>56</sup> Appellate Body Report, *EC and certain member States — Large Civil Aircraft*, para. 1161.

<sup>57</sup> Appellate Body Report, *EC and certain member States — Large Civil Aircraft*, para. 1161.

<sup>58</sup> Appellate Body Report, *EC and certain member States — Large Civil Aircraft*, para. 1161.

<sup>59</sup> Environmental Working Group, *Raising Price Supports Could Drive Up Government Spending and Distort Planting Decisions*, June 2013, p. 6.

<sup>60</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.104.

the RLC and ARC payments would support a finding that the effect of these subsidies is “significant price suppression” in the relevant market.

- As noted above, experts have argued that the new subsidy programs, including RLC and ARC, would increase costs “by just over \$35 billion”<sup>62</sup>. A panel is therefore likely to conclude that the “magnitude” of the subsidies continue to be “very large”.<sup>63</sup>

In *US – Upland Cotton*, as noted above, the adjudicatory bodies found support for their finding that the effect of the subsidies was “significant price suppression” also in the fact that the payments were “an important factor affecting the economic viability of US farming”, as well as in the “significant gap between the total costs of production of producers and their market revenue”.<sup>64</sup> Certain economic models have revealed that the “expected payment levels for ARC are modest”<sup>65</sup> and that the “average RLC payments are quite a bit lower than ARC payments”.<sup>66</sup> This could indicate that the RLC and ARC payments play only a limited role “as a share of revenue”.<sup>67</sup> However, we note that this would not necessarily preclude a panel from finding a violation under the SCM Agreement. The criteria applied in *US – Upland Cotton* in order to support a finding of “serious prejudice” are not the only ones that a future panel might consider. The criteria were developed in the context of the specific case. As consistently noted by the Appellate Body, there must be a causal link, meaning a genuine and substantial relationship of cause and effect.<sup>68</sup> The RLC and ARC programs would be WTO-inconsistent if a panel had sufficient evidence that the world market price for a particular commodity would have increased significantly, “but for” the subsidies provided under the RLC and ARC programs. As explained above, there are a number of good arguments that could be made in this respect.

#### IV. CONCLUSION

The PLC program of the House Bill is highly problematic from a WTO perspective because payments would be coupled to actual production acres, which would create incentives for farmers to overproduce to receive support payments and likely cause “adverse effects” to the farmers of other WTO Members. As a result, we conclude that the PLC program would be more likely to result in a challenge by other WTO Members. And, if a WTO were initiated, it is **highly likely** that a WTO panel would find that the PLC program was inconsistent with US obligations under the SCM Agreement.

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<sup>61</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.104.

<sup>62</sup> Environmental Working Group, *Raising Price Supports Could Drive Up Government Spending and Distort Planting Decisions*, June 2013, p. 7.

<sup>63</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.108 (quoting Panel Report, *US – Upland Cotton*, paras. 7.1297 and 7.1308).

<sup>64</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.196.

<sup>65</sup> International Center for Trade and Sustainable Development, *Potential Impact of Proposed 2012 Farm Bill Commodity Programs on Developing Countries*, p. 13.

<sup>66</sup> International Center for Trade and Sustainable Development, *Potential Impact of Proposed 2012 Farm Bill Commodity Programs on Developing Countries*, p. 14.

<sup>67</sup> Panel Report, *US – Upland Cotton (Article 21.5)*, para. 10.196.

<sup>68</sup> Appellate Body Report, *US - Large Civil Aircraft (2nd complaint)*, para. 913.

Because payments under the AMP program of the Senate Bill would not be coupled to production acres, there is a smaller risk both that other WTO Members would challenge it and that a panel would conclude the program is inconsistent with US obligations under the SCM Agreement. That said, it is important to bear in mind that the AMP program would be similar to the current CCP program, which was successfully challenged by Brazil with respect to cotton.

Finally, although there is no precedent in WTO case law with respect to the revenue-based payments under the current ACRE program, the RLC and ARC programs have a number of features similar to the CCP program, which was successfully challenged by Brazil with respect to cotton, and payments under both programs would be coupled to actual production acres, which could support a successful challenge under the SCM Agreement.