Australian Cases before International Courts and Tribunals Involving Questions of Public International Law 2008

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Australia as Complainant or Third Party in World Trade Organization law dispute settlement 2008

United States – Cotton (Recourse to Article 21.5 by Brazil)
WT/DS267/RW Panel Report and WT/DS267/AB/RW
Report of the Appellate Body adopted by the WTO DSB on 20 June 2008

Australia participated as a third party in the recourse to Article 21.5 to consider the purported implementation by the United States of the ruling of the DSB in the earlier complaint by Brazil against the United States' various subsidies programmes relating to cotton.[1]

In the original dispute, the principal findings adopted by the DSB were:

(1) The US Step 2 payments were a violation of the Subsidies and Countervailing Measures Agreement ('SCM agreement') Article 3.1(b) and 3.1(a) and also of Article 3.3 and 8 of the Agreement on Agriculture ('AoA');

(2) The US export credit guarantees actually paid were a violation of AoA Article 10.2 because they were export subsidies not covered by Article 9.1 which circumvented the US export subsidy commitment on unscheduled products (including cotton) and one scheduled product (rice) and as a consequence of not complying with the AOA were not exempt from actions under Article 3 of the SCM agreement which they were held to violate;

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1 The original complaint was *US – Subsidies on Upland Cotton* WT/DS276/R Report of the Panel & WT/DS276/AB/R Report of the Appellate Body adopted 21 March 2005. A casenote appeared in (2007) 26 *Australian Yearbook of International Law* 275–87. The Article 21.5 proceedings noted here are *US – Subsidies on Upland Cotton, Recourse to Article 21.5 of the DSU by Brazil*, Panel Report WT/DS267/RW (herein referred to as the Art 21.5 Panel Report) and Appellate Body Report WT/DS267/AB/RW (herein referred to as the Article 21.5 Appellate Body Report) adopted together by the WTO DSB on 20 June 2008.

(3) That the combined effect of a number of payments (the Step 2 payments and various other subsidies that operated in a price contingent manner, including marketing loan and loan deficiency payments and counter cyclical payments) had caused serious prejudice within SCM Agreement Article 5 because they had caused price suppression within Article 6(3)(c) in the world cotton market (but that Brazil had failed to establish that the payments had also caused serious prejudice under Article 6(3)(d) because they had caused the US to increase its share of the world market for upland cotton).

The United States repealed the Step 2 payments to remove the first violation. To comply with the findings regarding the export credit guarantee programmes, the US ceased issuing guarantees under two of the programmes (GSM103 and the SCGP) and continued the GSM 102 programme but changed the costs of the programme.[2] It argued that the guarantees would no longer constitute export subsidies because the programme no longer had premiums inadequate to cover its long term operating costs. In respect of the serious prejudice finding, the US removed the Step 2 payments but left the other price contingent subsidy programmes in place without modification.

Brazil requested an implementation panel under DSU Article 21.5 arguing that the GSM 102 export credits were still in violation of both the AoA and the SCM Agreement and that the remaining non-prohibited subsidies continued to cause serious prejudice in violation of SCM Agreement Article 5. Australia contributed arguments on both of the principal claims and also responded to some matters relating to the appropriate scope of the Article 21.5 proceedings which were raised by the US.

The export subsidy claim – scope of article 21.5 proceedings

Part of Brazil's claim in relation to the operation of the revised GSM 102 export credit programme related to export guarantees given in respect of sales of three unscheduled products, rice, pig meat and poultry meat.[3] The ruling from the original dispute did include a ruling that guarantees under GSM 102 in respect of rice were violations of Article 10.1 of the AoA but did not include a ruling that guarantees under GSM 102 in respect of pig meat and poultry meat were violations. This was because the legal basis for the original Panel finding that no violation had been established in relation to pig meat and poultry meat was reversed by the Appellate Body but the Appellate Body (AB) did not complete the analysis to decide the question of conformity with Article 10.1.[4] In the Article 21.5 proceedings, the US argued that the panel should not consider the GSM 102 guarantees on pig and poultry meat since they were not "measures taken to comply" (within DSU Article 21.5) with the original ruling since there was no ruling with respect to GSM 102 guarantees with respect to those products. Brazil

2 Article 21.5 Panel Report, [3.16].

3 Article 21.5 Panel Report, [14.141].

4 US – Cotton WT/DS276/AB/R, as above fn 1, [692].

took the broad position that the measure at issue was the whole of the amended GSM 102 programme. Australia supported Brazil's position stressing that this was not a situation of Brazil pressing a claim raised before the original panel that had not been fully resolved. Australia submitted that this was a new claim in respect of a new measure that had been introduced by the Respondent in response to the DSB rulings and the Art 21.5 panel should be able to examine the new measure in its totality.[5] The panel and the AB said that the whole of the new GSM 102 programme was within the scope of its task under Article 21.5. The AB modified the reasoning of the Panel. Whereas the Panel had emphasized that the claim with respect to the guarantees on exports of pig and poultry meat has a sufficiently close nexus to the measures taken to comply with the original ruling, the AB emphasized that in response to the original ruling, the US had made changes to the whole programme as it applied to any product and that it was appropriate for the 21.5 panel to consider the whole measure.[6]

The export subsidy claim – substantive claim

In deciding whether the US changes to the GSM 102 programme had removed the violation, the Panel assessed whether the provision of export guarantees under the GSM 102 programme after the end of the implementation period still constituted export subsidies. In line with the original US Cotton decision, in order to find that there was a violation of AoA Article 10.1, it was necessary to find that the US was providing export subsidies not covered by Article 9. Export credits are not included in the list of export subsidies in Article 9 of the AoA. Also in line with the original report, the Panel took the view that the payments would be export subsidies for the purposes of AoA Article 10.1 if they were within the meaning of export subsidy in the SCM Agreement.[7]

An area of ambiguity in the definition of export subsidy in the SCM agreement is the relationship between the criteria in Article 3.1(a) which in part depends upon the definition of subsidy in Article 1 and the illustrative list of export subsidies ('Illustrative List'). In this case, Brazil argued two alternative claims, first, that the continued provision of guarantees under the GSM 102 programme fell within the definition of subsidy in Article I and within the terms of Article 3.1(a) (essentially that of being contingent upon export performance) and second, that the payments fell within item (j) of the Illustrative List. The United States contended that the matter should be decided under item (j) and that if the payments fell outside of the Illustrative List then they should not be regarded as being export subsidies.[8] Australia made a third party submission that the complaining party should be able to argue either that a measure is an export subsidy within the definitions in Article 1.1 and 3.1(a) or that a measure is an export subsidy because it falls within one of

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5 Third party submission of Australia, annex a-4 to the Art 21.5 Panel Report, [10].

6 Article 21.5 Appellate Body Report, [202–05].

7 Article 21.5 Panel Report, Article 14.48.

8 Article 21.5 Panel Report, see footnote 642.

the items in the Illustrative List.[9] A number of other third parties made submissions similar to Australia's on this point. The Panel expressed its view that a finding on either approach would constitute a finding that the measures were export subsidies within Article 3.1(a). Since the parties were agreed that a finding that the measures fell within item (j) would mean that they would constitute export subsidies, then the Panel considered item (j) first and, as it turned out, found the measure did fall within item (j) so the Panel did not need to consider whether the measures fell within the terms of Article 1.1 and 3.1(a).

To find that the grant of guarantees under the programme fell within item (j) it was necessary for the Panel to find that the programme operated with premium rates "inadequate to cover the long-term operating cost of the programmes". The Panel found that the guarantees did fall within item (j). On appeal the AB found errors with the panel's quantitative analysis. However, the AB completed the analysis on the basis of the Panel record. Based on its assessment of the structure, design and operation of the programme as set out in the Panel report, the AB found that the programme was likely to operate at a loss.[10]

Having found that the guarantees made after the date for implementation were export subsidies, the Panel found that the volumes of subsidized exports did exceed the bound export subsidy volume and therefore the payments did circumvent the commitments in violation of Article 10.1. As in the original panel, the Panel found that since the grant of the guarantees did not conform to the disciplines in the AoA then they were not exempt from Article 3.1 of the SCM Agreement and they were found to breach Article 3.1(a).

The serious prejudice claim – scope of Article 21.5 proceedings

In relation to the serious prejudice claim, the US also made challenges to the scope of the matter before the Panel which, rather than being merely procedural, go to the heart of significant policy issues as to how best to formulate and apply rules for regulating subsidies. The challenges related to Brazil's claim that the US had failed to "take appropriate steps to remove the adverse effects" of the subsidy as required by Article 7.8 of the SCM Agreement, that is, to remove the serious prejudice caused by the collection of price contingent subsidies. Notably the original finding was not that the laws providing for the subsidy programmes caused serious prejudice but that the actual payments made pursuant to those laws over the marketing years from 1999 to 2002 (ending 31 July 2003) caused serious prejudice. The time for the US to comply with the ruling expired on 21 September 2005. By that date, the US had removed the Step 2 Payments but had not made any changes to any of the other subsidy programmes. Soon after 31 July 2006, Brazil requested the Article 21.5 panel. Brazil argued that the operation of the subsisting package of measures (comprising the marketing loan and countercyclical payment programmes) during the period between 21 September 2005 and 31 July 2006 caused adverse effects and that, therefore, the US had failed to remove the adverse

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9 Third Party submission of Australia, Annex A-4 to Art 21.5 Panel Report [23–24].

10 Article 21.5 Appellate Body Report [321].

effects of the measures. The US made a number of related challenges to the scope of the matter before the panel, including the following (but omitting some US arguments which appear to have been nothing more than deliberate time wasters[11]):

- That since the US obligation to remove the adverse effects related to the DSB rulings of serious prejudice caused by the payments during the marketing years 1999–2002, then the obligation did not apply to payments made after the end of the 2002 marketing year so payments made after the end of the 2002 marketing year were not within the scope of the Article 21.5 proceedings;[12]
- That Brazil's claim as to the continuing serious prejudice caused by the marketing loan and countercyclical programmes could not be within the scope of the Article 21.5 proceeding because the original DSB rulings had related to the actual payment made not to the programmes as such.

If the US position had been accepted, then the only way that Brazil could have challenged the payments between 21 September 2005 and 31 July 20006 would have been to initiate a new complaint. Australia was supportive of Brazil's request that the Article 21.5 Panel undertake a new assessment of whether the payments actually made under the remaining package of price contingent subsidy programmes between 21 September 2005 and 31 July 2006 were causing serious prejudice, whether under Article 6(2)(c) or (d). Australia submitted that Brazil's claim did not amount to a challenge of the programmes as such but rather related to "the continuing effects of the unamended programmes".[13]

The Panel did not agree with the US that its obligation to take appropriate steps to remove the adverse effects as found to have occurred in the 1999–2002 marketing years only applied to removing adverse effects from the subsidies paid in those years. The Panel found that the US obligation to remove adverse effects of the subsidies included an obligation to remove adverse effects of those subsidies after that period and in particular after the expiration of the date for implementation of the rulings. ([9.75]–[81]) The US appealed that finding. Before the Appellate Body, Brazil argued that acceptance of the US position would "mean that the grant of annually recurring subsidies becomes "a moving target that escape[s] from [the WTO subsidy] disciplines" [14] and Australia submitted it would "lead to a complaining Member becoming involved in a permanent litigation loop of annual

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11 For example, the argument that Art 21.5 proceedings could only apply to measures taken to comply with recommendations or rulings and that since an unmodified measure was not one taken to comply with the rulings then an unmodified measure was not within the scope of Article 21.5 proceedings. (See art 21.5 Panel Report [9.28]).

12 Art 21.5 Panel Report, [9.73].

13 Third party submission of Australia, annex A-r to the Art 21.5 Panel Report [12–15] (the quotation is from [15]).

14 Article 21.5 Appellate Body Report [231] quoting from Brazil's appellee submission which in turn quoted from *US – Softwood Lumber IV (Recourse to Article 21.5 by Canada)*, Panel Report, WT/DS257/RW, adopted 20 December 2005, [4.30].

challenges concurrent with the expiry of each marketing year" defeating the purpose of Article 21.5 proceedings.[15] The AB rejected the US position, saying that the obligation under SCM Article 7.8 on "the Member granting or maintaining [the subsidy causing adverse effects]" to "take appropriate steps to remove the adverse effects ..." was:

> not limited to subsidies granted in the past. .. the obligation set forth in Article 7.8 is of a continuous nature, extending beyond subsidies granted in the past. This means that, in the case of recurring annual payments, the obligation in Article 7.8 would extent to payments "maintained" by the respondent member beyond the time period examined by the panel for purposes of determining the existence of serious prejudice, as long as those payments continue to have adverse effects. Otherwise, the adverse effects of subsequent payments would simply remove the adverse effects that the implementing member was under an obligation to remove."[16]

On that basis, it was found that it was within the scope of the Article 21.5 proceedings for the Panel to examine the continuing effect of the remaining package of price contingent subsidy programmes in assessing whether the serious prejudice had been removed.

The serious prejudice claim – substantive claim

Moving to the substantive issue, the Panel considered whether the US had removed the serious prejudice in the sense of price suppression within the meaning of Article 6(c). The Panel considered whether the marketing loan payments and counter-cyclical payments caused price suppression. The Panel finding which was upheld by the Appellate Body was that:

> "... the United States acts inconsistently with its obligations under Article 5(c) and 6.3(c) of the *SCM Agreement* in that the effect of marketing loan payments and counter-cyclical payments provided to US upland cotton producers pursuant to the FSRI Act of 2002 is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* in the world market for upland cotton constituting "present" serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*."[17]

and

> "... that by acting inconsistently with Articles 5(c) and 6.3(c) of the *SCM Agreement* the United States has failed to comply with the DSB recommendations and rulings. Specifically, the United States has failed to comply with its obligation under Article 7.8 of the *SCM Agreement* "to take appropriate steps to remove the adverse effects or ... withdraw the subsidy".[18]

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15 Article 21.5 Appellate Body Report [231].

16 Article 21.5 Appellate Body Report [237].

17 Article 21.5 Panel Report [10.256](italics in the original), upheld by the AB: see Article 21.5 Appellate Body Report [447].

18 Article 21.5 Panel Report [10.257](italics in the original), upheld by the AB: see Article 21.5 Appellate Body [447].

It is inappropriate to set out here all of the elements of the analysis of the Panel and the Appellate Body in reaching that finding on causation of price suppression. This author finds worth noting that the reasoning on causation in the original US Cotton dispute was rather more complicated than in the *Indonesian Autos Case* prior to the *US Cotton Case*, and the *Korea Commercial Vessels Case* after the *US Cotton Case*. In those two cases, the panels had assessed the causal effects of subsidies by using a 'but for' test: asking whether there would have been a difference between the factual with the subsidy and a counterfactual without the subsidy.[19] However, in the original *US Cotton Case*, the Panel and Appellate Body reports whilst arguably consistent with a 'but for' test, worked through a convoluted analysis of considering four major factors:

(a) the US substantial proportionate influence in the world upland cotton market;

(b) that the subsidies insulated US producers from low prices;

(c) the temporal coincidence of suppressed world market prices and the price-contingent US subsidies; and

(d) the divergence between US producers total costs and their sales revenues indicating that the subsidies enabled them to sell below cost.

In the Article 21.5 case, the Panel does consider a number of factors (see [10.247]–[10.253]) which support a finding of causation of present serious prejudice but they do say that the essential test is a 'but for' test and the Appellate Body endorses that approach.[20] It is also of note that the economic evidence plays a significant role in the deliberations of the Panel. The Panel considered economic literature and reports from both sides on the effects of the subsidies on the level of production. The Panel's evaluation of that evidence leads it to conclude that there is a positive correlation between the subsidies and farmers electing to continue to plant cotton.[21] Apart from accepting that part of Brazil's evidence, the Panel also accepts an economic model submitted by Brazil simulating the counterfactual scenario predicting what the world price would have been in the absence of the payments. It acknowledges the US criticisms of the model and of certain parameters utilized but still takes note of the fact that the simulations suggest price suppression.[22]

The adverse effects rules in Article 5 and 6 of the SCM agreement reflect a deliberate choice to regulate some subsidies not by reference to any category but by reference to their negative impact on other parties' interests. Regulating subsidies

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19 *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, adopted 11 April 2005, esp [7.537] and [7.612]; *Indonesian Autos Case* WT/DS54, 55,59 & 64/R, Panel Report adopted 23 July 1998, esp [14.215–14.219].

20 See Article 21.5 Panel Report, [10.49] and Appellate Body Report [375].

21 Article 21.5 panel, see the conclusions at [10.103]–[10.104] and the preceding paragraphs.

22 Article 21.5 Panel Report, see the conclusions at [10.219]–[2.222].

by reference to their effects rather than their classification has the advantage of leaving members with autonomy to use subsidies subject to the possibility of having to adjust the balance of obligations with other members through compensation or retaliation. The disadvantage of effects rules is that a challenge cannot be brought until after the end of a given time period when there is sufficient evidence available to evaluate the effects of the subsidy. The original *US Cotton Case* was the first AB decision to consider the application of the adverse effects rules in Article 5 and 6 of the SCM Agreement. It showed that it was possible to adjudicate on the somewhat imprecise issues of causation. This Article 21.5 report advances the jurisprudence on causation by using a clearer 'but for' approach. Finally, it is important that the approach to reviewing implementation of rulings under the adverse effects rules be done in a way that will ultimately facilitate the operation of the rules for rebalancing through compensation or retaliation to adjust for the adverse effects. This decision on implementation facilitates the achievement of that goal by clarifying that an Article 21.5 Panel should consider the way the measures remaining in place after the implementation date continue to cause adverse effects.