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U.S. Agricultural Export Credits after the WTO Cotton Ruling: The Law of Unintended Consequences

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The recent WTO cotton ruling has led to a paradoxical result for the United States, a result that seems a textbook illustration of the "law of unintended consequences". Indeed, during the Uruguay Round negotiations of the present WTO agreements, the United States refused to put agricultural export credits in the category of agricultural export subsidies, where they would then have been subject only to reduction commitments. Paradoxically, the United States finds itself now in a position where these same agricultural export credits that it did not condescend to reduce during the Uruguay Round are openly considered as prohibited export subsidies. This article analyses and criticizes the tortuous legal path followed by the cotton panel before arriving at such a radical conclusion.

Keywords: Agreement on Agriculture, Brazil, cotton, Doha Round, export credits, export subsidies, SCM, United States, WTO

With regard to U.S. agricultural export credits,[2] the recent WTO cotton ruling[3] has led to a paradoxical result for the United States, a result that seems a textbook illustration of the "law of unintended consequences". This law, often cited but rarely defined, expresses the idea that actions of people – and especially of government – always have effects that are unanticipated or "unintended". Economists and other social scientists have heeded its power for centuries; for just as long, politicians and popular opinion have largely ignored it.[4]

Indeed, during the Uruguay Round negotiations of the present WTO agreements, the United States refused to put agricultural export credits (which guarantee the commercial financing of U.S. agricultural commodities) in the category of agricultural export subsidies, which arise, for example, when a U.S. wheat producer receives an explicit payment for every ton of wheat exported.[5] If it had done so, the United States would have been obliged to reduce its agricultural export credits, by virtue of the reduction commitments of agricultural export subsidies included in Article 9.1 of the Agreement on Agriculture (AoA),[6] which is precisely entitled "Export Subsidy Commitments"; however, the United States would have been allowed in such a case to continue to grant the credits to a certain extent through the portion conforming to reduction commitments.[7] Paradoxically, the United States finds itself now in a position where these same agricultural export credits that it did not condescend to reduce during the Uruguay Round are openly considered as prohibited export subsidies. After a tortuous legal path, the WTO cotton panel (in a ruling upheld by the Appellate Body) has actually concluded that the United States export credit guarantee programs "constitute a per se export subsidy within the meaning of item (j) of the Illustrative List of Export Subsidies" of the SCM Agreement, "and these export credit guarantee programs are [thus prohibited] export subsidies for purposes of Article 3.1(a) of the SCM Agreement …."[8]

In spite of the numerous pages devoted by the Cotton Panel Report to the issue, it is possible to detect two decisive steps that made it possible for the panel to arrive at this conclusion. These two steps are so interconnected legally that their *chronological order of appearance in the Cotton Panel Report is not to be taken too seriously,* since it is likely that the panel had a good idea of how a given finding would thereafter fit in its global puzzle. Note also from the outset that the first step was unsuccessfully appealed by the United States. However, surprisingly, the second step was not appealed by the United States, although it was potentially an Achilles heel of the panel's reasoning.

Step one: Rejecting that the Agreement on Agriculture reflects the deferral of disciplines on agricultural export credits

Article 10.2 of the AoA seems to reflect at least implicitly that WTO members "agreed not to agree" on the issue of agricultural export credits and that they committed themselves only to negotiate future disciplines on this topic:

> Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits … and, after agreement on such disciplines, to provide export credits … only in conformity therewith.

The United States argued that the plain words of Article 10.2 indicate that export credit guarantee programs are not subject in any way to export subsidy disciplines included in the Agreement on Agriculture. As underlined in the introduction to this article, one of the strongest arguments advanced by the United States was that the panel's interpretation leads to a result that is "manifestly absurd or unreasonable". According to the United States, it "defies logic ... to take the view of the Panel in which [agricultural export credits] would be treated as ... [prohibited] export subsidies yet not … included within the applicable reduction commitments expressly contemplated by [Article 9.1 of the AoA]".[9]

The panel, however, keeping in mind that it had *previously* found, with the help, *as context*, of item (j) of the Illustrative List of Export Subsidies of the SCM Agreement, that U.S. agricultural export credits were export subsidies for AoA purposes,[10] decided to place the bar very high before accepting the U.S. view.

The panel reasoned that "in order to carve out or exempt particular categories of measures from general obligations [of the AoA], ... it would be reasonable to expect an explicit indication revealing such an intention in the text of the Agreement".[11] In other words, the panel adopted the position that Article 10.2 of the AoA does not include express language suggesting that it is intended as an exception, nor does it expressly state that the application of any AoA export subsidy disciplines to export credits is "deferred" as the United States suggests. In the words of the Appellate Body, "Given that the drafters were aware that subsidized export credit(s) ... could fall within the export subsidy disciplines in the Agreement on Agriculture … it would be expected that an exception would have been clearly provided had this been the drafters' intention".[12]

In a rare dissenting opinion on this point, an anonymous member of the Appellate Body Division (which consists of three members) underlined that in Article 10.2 of the AoA, WTO members did exactly what the panel required, namely, carve out

agricultural export credits and "spell out in Article 10.2 their commitments with respect to those ... areas".[13] The anonymous member specified:

> I recognize that the language of this provision is not free from ambiguity. As noted by my colleagues on the Division, the drafters could have – dare I say, should have – made their intentions even more plain. If there were no Article 10.2, then I might concur with my colleagues .... However, Article 10.2 does exist and the meaning of the words as I read them is entirely prospective, at least with respect to the existence of applicable disciplines.[14]

Of course, had the panel found the existence of a deferral of disciplines through Article 10.2 of the AoA, the issue of agricultural export credits would have become virtually moot.

Step two: Using the SCM Agreement both as context for the AoA and as a source for a radical prohibition obligation

Once it had "settled" the issue of deferral of AoA disciplines, the panel confronted several obstacles before it could arrive at the radical conclusion that agricultural export credits were prohibited export subsidies under the SCM Agreement. It had to establish that, first, agricultural export credits were export subsidies for AoA purposes and, second, that they were not sheltered by the agricultural "peace clause" from an action under the SCM. The first obstacle was not negligible, since the AoA does not contain a general definition of an agricultural export subsidy and since, in the Appellate Body's own words, "agricultural export credits do not necessarily constitute export subsidies for purposes of the Agreement on Agriculture".[15] In other words, agricultural export credits are subject to the export subsidy disciplines in the AoA only to the extent that such measures include an export subsidy component under the form of a benefit not available in the free market for U.S. producers/exporters of, for example, wheat.[16] One could thus have expected long developments by the panel intended to demonstrate the "benefit" or "subsidy component" of U.S. agricultural export credits. However, as we shall see, this expectation would have been in vain.

Even supposing the first obstacle were overcome, there remained the second obstacle in the form of the agricultural peace clause, since any application of Article 3 of the SCM Agreement to U.S. agricultural credits was potentially hindered by the peace clause (Article 13/AoA). This clause provided during the implementation period (1995–2003) a shelter from action under the SCM Agreement to "fully conform"[17] agricultural export subsidies.

The panel overcame *simultaneously* all these obstacles by using item (j) of the SCM in order to kill two birds with one stone. First, item (j) was used, *as context*, in order to interpret the meaning of the expression "export subsidies" in the AoA. On this basis, the panel concluded that U.S. agricultural export credits were export subsidies for AoA purposes,[18] since they were provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes".[19] The panel then found that with respect to upland cotton and other products, the United States applies export credits constituting export subsidies in a manner that results in circumvention of its export subsidy commitments inconsistently with Article 10.1 of the AoA. Concretely, this meant they did not "fully conform" to Part V of the AoA and thus were not sheltered by the peace clause from actions under Article 3 of the SCM Agreement. Finally, the panel added that it saw no "reason ... why this [contextual] analysis may not also be applied directly in an examination of the merits of Brazil's claims ... under the SCM Agreement".[20] All the necessary elements were then met for concluding that

> To the extent that the United States export credit guarantee programmes .... do not conform fully to ... Part V of the Agreement on Agriculture and do not benefit from the exemption from actions provided by [the peace clause] ..., they are also *export subsidies prohibited by Article 3.1(a)/SCM* (emphasis added).[21]

Why did the panel, before using item (j), not place the bar as high as it did in its interpretation of Article 10.2 of the AoA?

In spite of all possible policy arguments against agricultural export credits and their possible distortional trade effects, the fact is that the legal reasoning of the cotton panel (upheld by the Appellate Body) on this issue is not totally convincing. The problem stems partly from using item (j) of the SCM Illustrative List both as context for interpreting the meaning of the expression "export subsidy" in the AoA and as a direct source of a radical prohibition obligation (under Article 3 of the SCM, which itself refers to the Illustrative List). There is nothing wrong with using the SCM Agreement as context for interpreting certain terms not defined in the Agreement on Agriculture. This has been done several times by previous panels.[22] In this case, however, the contextual analysis was transformed into a substantive analysis leading to a radical conclusion, without the panel taking the time (it saw "no reason") to reflect on the legitimacy of its approach. The panel underlined of course that Article 21 of the AoA indicates that the SCM applies to agricultural subsidies, but Article 21 indicates also that this application is "subject to the provisions [of the AoA]" which

contains, as we saw, also Article 10.2 relating to a potential deferral of agricultural export credits disciplines. One could thus ask why in such a controversial and uncertain legal issue, the panel did not place the bar as high for itself as it did while interpreting Article 10.2 of the AoA. In other words, why did the panel not seek to find in item (j) of the SCM Illustrative List "an explicit indication revealing ... an intention" that item (j) applies to agricultural export credits? It is useful to note here that such an explicit indication would have been most welcome, since the legislative history of the Uruguay Round indicates that, at one point in the negotiations, there was a proposal for applying the SCM Illustrative List of Export Subsidies to agricultural products. This proposal was dropped in the Draft Final Act in favor of an "undertak[ing] not to provide export credits otherwise than in conformity with internationally agreed disciplines", which in turn was replaced by the current version of Article 10.2 of the AoA.[23] Of course, if the panel had sought to find such an explicit intention in item (j), it would not have found it.

Recently, in response to the WTO ruling, the U.S. Department of Agriculture announced a modification of the three export credit guarantee programs administered by USDA's Commodity Credit Corp. (CCC), namely the Export Credit Guarantee Program (GSM-102), the Intermediate Export Credit Guarantee Program (GSM-103), and the Supplier Credit Guarantee Program (SCGP).[24] Effective July 2005, the CCC will use a risk-based fee structure for the GSM-102 and SCGP programs. The idea is that that fee rates will be based on the country risk that CCC is undertaking, as well as the repayment term (tenor) and repayment frequency (annual or semi-annual) under the guarantee. Also as of July 1, the CCC will no longer accept applications for payment guarantees under GSM-103. Any remaining country and regional allocations for GSM-103 coverage under fiscal year 2005 program announcements will be reallocated to the existing GSM-102 program for that country or region.

Although these compliance measures seem to be accepted by Brazil, at least for the agricultural export credits portion of the cotton ruling, it remains to be seen if these measures will be enough in the context of the Doha Round negotiations. Recall that the European Union is insisting in this round on new disciplines for agricultural export credits as a condition for it agreeing to the eventual elimination of agricultural export subsidies. The European Union is the biggest spender on agricultural export subsidies, while the United States is the biggest user of agricultural export credits. Would the European Union find these compliance measures to be enough to satisfy its demand for new agricultural export credits disciplines, now that there is a WTO ruling declaring that these export credits are prohibited subsidies under the SCM agreement?

Endnotes

1. Professor Benitah is the author of *The Law of Subsidies under the GATT/WTO System*, Kluwer Law International, 2001.
2. The U.S. Department of Agriculture (USDA) administers export credit guarantees for commercial financing of U.S. agricultural commodities through the Commodity Programs Credit Corporation (CCC). The CCC operates three export credit guarantee programs: General Sales Manager 102 (GSM 102), General Sales Manager 103 (GSM 103) and the Supplier Credit Guarantee Program (SCGP). These programs were established by 7 USC 5622. Pursuant to this statute, the CCC may: guarantee the repayment of credit made available to finance commercial export sales of agricultural commodities on credit terms that do not exceed three years (under the GSM 102 program); issue guarantees for the repayment of credit made available for a period of not more than 180 days by a U.S. exporter to a buyer in another country (under the SCGP program); and guarantee the repayment of credit made available by financial institutions in the United States to finance commercial export sales of agricultural commodities on credit terms of between three and ten years (under the GSM 103 program) "in a manner that will directly benefit United States agricultural producers."
3. Report of the panel, United States – Subsidies on Upland Cotton, September 8, 2004, WT/DS267/R/Add.2 (hereafter, the Cotton Panel Report) and Report of the Appelate Body, United States – Subsidies on Upland Cotton, September 8, 2004, WT/DS267/AB/R (hereafter, the Cotton Appellate Body Report).
4. The Concise Encyclopedia of Economics (CEE), article by Rob Norton, available at http://www.econlib.org/library/Enc/UnintendedConsequences.html
5. For an analysis of the conceptual difference between export subsidies and export credits, see Rude, J. (2000), Reform of Agricultural Export Credit Programs. *The Estey Centre Journal of International Law and Trade Policy* 1(1), 66-82. Available at http://www.esteycentre.ca/journal/archives.htm
6. Available at http://www.wto.org/english/docs_e/legal_e/14-ag_01_e.htm
7. The portion conforming to reduction commitments would have been shielded from actions under the AoA (or the SCM by virtue of the "peace clause" included in Article 13 of the AoA, at least until December 31, 2003). At the moment, i.e., subsequent to the expiration of the peace clause, the issue of whether the SCM Agreement applies to the agricultural export subsidy as a whole, or whether it applies only to the extent that the subsidy exceeds a member's commitment levels as specified in its schedule, is still not resolved and has not been yet addressed by the Appellate Body. At first glance, for the portion conforming to reduction commitments, it seems that a recommendation to "withdraw" a subsidy under the SCM would be difficult to reconcile with the right to grant an export subsidy up to a certain point under the AoA. See on this issue footnote 537 of the Cotton Appellate Body Report.
8. Cotton Panel Report, para 7.869
9. Cotton Appellate Body Report, para 625
10. More precisely, the panel found that they were export subsidies not listed in paragraph 1 of Article 9 of the AoA.

11. Cotton Appellate Body Report, para 68
12. Idem, para 609
13. Idem, para 632
14. Idem, para 634
15. Idem, para 626
16. Recall the present WTO case law definition of a subsidy under the SCM Agreement: it is a governmental financial contribution (described in Article 1/SCM) granted selectively to specific enterprises and which confers a benefit to its recipient. A benefit exists when a governmental financial contribution

> places the recipient in a more advantageous position than would have been the case but for the financial contribution. In our view, the only logical basis for determining the position the recipient would have been in absent the financial contribution is the market. Accordingly, a financial contribution will only confer a "benefit", i.e., an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market. (Report of the Appellate Body, United States – Tax Treatment for "Foreign Sales Corporations", AB-1999-9, February 24, 2000,T/DS108/AB/R, para 136)

17. Namely, fully conform to Part V of the AoA, which deals principally with disciplines relating to agricultural export subsidies, including the requirement in Article 10.1 of the AoA that agricultural export subsidies not subjected to reduction commitments shall not be "applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments."
18. More precisely, it found that that they were export subsidies not listed in paragraph 1 of Article 9 of the AoA.
19. SCM Illustrative List of Export Subsidies, available at http://www.wto.org/english/docs_e/legal_e/24-scm_03_e.htm#annI
20. Cotton Panel Report, para 7.946
21. Idem, para 7.947
22. See for example, Report of the Appellate Body United States – Tax Treatment for "Foreign Sales Corporations", AB-1999-9, February 24, 2000, WT/DS108/AB/R, para 136.
23. Cotton Appellate Body Report, para 636
24. Agriculture: USDA Announces Steps to Bring U.S. into Compliance with WTO Cotton Ruling. *WTO Reporter Highlights* July 5, 2005 (BNA) (Bureau of National Affairs).