

# **‘Treatment’ of Subsidies in Times of Crisis: Reviving the Economy through Trade Agreements**

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## EXECUTIVE SUMMARY

As part of measures taken to support the recovery efforts from the economic downturn caused by the pandemic, countries are providing large subsidies in various forms to their agricultural sector. Such support may have potentially lasting trade-distorting impacts. The applicable WTO norms on agriculture provide ample policy space for Members who have the resources to provide such support. On the other hand, developing countries lack both the policy space and the resources to support their agricultural sector. Failure of the Doha Round of negotiations and the current stalemate concerning the Appellate Body of the WTO have affected and impaired the progress of agriculture negotiations between Members.

Consequently, reliance may have to be placed on Free Trade Agreements (FTAs) to develop deeper disciplines on agricultural trade, particularly in the context of addressing the large subsidies provided during and in the immediate aftermath of the pandemic. At present, the treatment of agriculture differs substantially across FTAs. Significant progress has been made to improve market access and eliminate export subsidies on agricultural products. Domestic support disciplines, however, are usually in the nature of best endeavour clauses or an agreement to negotiate further at the WTO. In light of the above, this paper offers a possible solution to tackling domestic support disciplines for agricultural products under FTAs.

The domestic support disciplines under the Agreement on Agriculture (AoA) classify support into ‘boxes’ based on their presumed effects on trade-distortion. Such an approach may not be suitable under FTAs due to their limited membership and the resulting multilateral effects of such obligations. This paper proposes utilising the concept of cross-subsidization, as identified by the panel and the Appellate Body in its interpretation of Article 9.1(c) of the AoA in EC-Export Subsidies on Sugar. Cross-subsidization in principle means that the above-normal profits from the sale of one product subsidizes the export of another. The emphasis in this concept is on the effects of the measure.

The principle of cross-subsidization may be crystallised through suitable provisions under the FTA for the regulation of domestic support. The framework proposed in this paper first involves the identification of products which countries deem necessary to protect in times of crisis or a pandemic. Pursuant to this, countries are eligible to provide domestic support to such agricultural products to achieve their policy objectives. Domestic support may be provided until the economic effects of such support does not “spill over” to the export of such products between the parties to the FTA. While the spill-over effects may occur in all countries in which a party has an exporting interest, only the FTA parties would be able to take suitable corrective measures to nullify such effects. Suitable corrective action such as the imposition of a tool akin to a special safeguard may be imposed, as negotiated by the parties concerned. This entails the possibility of imposing a tariff based on price triggers. This approach takes into account the food security concerns of Members and attempts to regulate domestic support of products based on their effects on trade-distortion. This approach may therefore be introduced in FTAs to tackle agricultural domestic support measures taken as a response to a crisis or pandemic.

## I. INTRODUCTION

One of the most notable achievements of the Uruguay Round was the inclusion of agriculture in the system of multilateral rules, through the conclusion of the WTO Agreement on Agriculture (AoA).<sup>1</sup> Agriculture is very important for countries with a comparative advantage in the sector, many of which are developing countries.<sup>2</sup> Agriculture is also vital to livelihoods, employment and food security in most developing countries.

The ‘three pillars’ of the AoA include market access, domestic support and export subsidies. Domestic subsidies are considered to be the most challenging from a regulatory perspective, since they subsume a variety and range of government intervention, a majority of which can be considered as legitimate exercise of sovereign activity.<sup>3</sup> For instance, the pursuit of food security is accepted as a legitimate policy under the WTO agricultural regime.<sup>4</sup>

The domestic support disciplines under the AoA are categorized based on their presumed effects on market distortion. ‘Green Box’ subsidies are considered to be the least or minimally trade distorting agricultural policies.<sup>5</sup> ‘Blue Box’ subsidies may have some distortive effects, but are subject to certain limitations on production.<sup>6</sup> Agricultural policies which are considered to be most trade distorting and measured through the concept of ‘Aggregate Measurement of Support’ (AMS) are considered ‘Amber Box’ support.<sup>7</sup>

Domestic support programmes result in an expansion of the output of the subsidised agricultural product, potentially impacting world prices through an artificially increased global supply. Production support has to consequently be complemented by export subsidies to allow the surpluses to be sold.<sup>8</sup> WTO Members are not to provide export subsidies otherwise than in conformity with Articles 9 and 10 of the AoA.<sup>9</sup> Recognising the significant distortive effects of such export subsidies, WTO Members pledged to eliminate their export subsidies during the 2015 Nairobi Ministerial Conference.<sup>10</sup>

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<sup>1</sup> P. McMahon, ‘*The Agreement on Agriculture*’, in Macrory, Appleton and Plummer (eds.), ‘*World Trade Organisation: Legal, Economic and Political Analysis*’. (Springer, 2005), Vol. I.

<sup>2</sup> B.M. Hoekman & M. M. Kostecki, ‘*The Political Economy of the World Trading System: The WTO and Beyond*’. (Oxford University Press, 2001), p. 302 [hereinafter “Political Economy of the World Trading System”].

<sup>3</sup> J. H. Jackson, ‘*The World Trading System: Law and Policy of International Economic Relations*’. (2<sup>nd</sup> Ed., London: The MIT Press, 1997), p. 280.

<sup>4</sup> See Recital 6, Preamble, AoA; Paragraph 3, footnote 5, Annex 2, AoA.

<sup>5</sup> See Annex 2, AoA.

<sup>6</sup> Article 6.5, AoA.

<sup>7</sup> See Articles 6 and 7; Annex 3, AoA; R. Bhala, ‘*International Trade Law: Theory and Practice*’. (2<sup>nd</sup> Ed., Lexis Publishing, 2001), p. 687.

<sup>8</sup> *Supra*, Political Economy of the World Trading System, p. 273.

<sup>9</sup> See Article 8, AoA.

<sup>10</sup> See Ministerial Decision of 19 December 2015 on Export Competition, Ministerial Conference, Tenth Session, Nairobi, WTO Doc. WT/MIN(15)/45, WT/L/980 dated 21 December 2015.

WTO Members have determined a maximum level of support per year in their respective schedules, which is termed as the ‘annual and final bound commitment level’.<sup>11</sup> In this regard, OECD estimates that the total support to agriculture provided in OECD countries represented USD 319 billion per year on average in 2017-19, of which 72% was provided as support to producers individually.<sup>12</sup> Many of the agricultural policies continue to distort farm production and trade decisions, and fail to effectively target stated government objectives.

### ***Agricultural support measures during the pandemic***

During the 2007-08 food price crisis, panic-driven policy responses, such as export bans and rapid escalation in food stock procurement through imports exacerbated market disruptions.<sup>13</sup> The COVID-19 crisis is likely to have significant impact on food and agriculture. Many countries have announced relief packages aimed at reviving the agricultural sector. Such temporary measures which include increased domestic support to agricultural products and producers may have a lasting impact.

For instance, the United States has enacted programs valued at \$19 billion to provide immediate financial relief to farmers, ranchers and consumers in response to the COVID-19 national emergency, majority of which includes direct payment to farmers coupled to actual production.<sup>14</sup> The European Union also has a number of pandemic-related measures directly supporting the farmers and rural areas, such as private storage aid, loans and guarantees at favourable conditions to cover operational costs, and crisis support for farmers that have been affected severely.<sup>15</sup> Developing countries such as India have offered fiscal support to farmers through measures such as working capital for farmers worth INR 30,000 crore, and PM KISAN fund transfer (direct transfer) of INR 18,700 crore, among others.<sup>16</sup>

As countries take measures to address the pandemic, it is imperative that these measures do not adversely affect trade in agriculture. In this regard, certain WTO Members have expressed their commitment to ensure that “emergency measures related to agriculture must be targeted, *proportionate*, transparent, and *temporary*” and “updated and accurate information on levels of

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<sup>11</sup> Article 6.1, AoA.

<sup>12</sup> OECD Agricultural Policy Monitoring and Evaluation 2019, ‘Overall Trends in Agricultural Support’, available at <<https://www.oecd-ilibrary.org/sites/928181a8-en/1/3/2/1/index.html?itemId=/content/publication/928181a8-en&csp=2101acf3044857a6975685747086cf09&itemIGO=oecd&itemContentType=book#endnotea2z2>>.

<sup>13</sup> Joint Statement on COVID-19 Impacts on Food Security and Nutrition, FAO, IFAD, WFP and the World Bank on the occasion of the Extraordinary G20 Agriculture Minister’s Meeting, dated April 21, 2020.

<sup>14</sup> USDA, ‘USDA Announces Coronavirus Food Assistance Program’, Release No. 0222.20, April 17, 2020.

<sup>15</sup> See ‘Supporting the Agriculture and Food Sectors amid Coronavirus’, available at <[https://ec.europa.eu/info/food-farming-fisheries/farming/coronavirus-response\\_en#measures](https://ec.europa.eu/info/food-farming-fisheries/farming/coronavirus-response_en#measures)>; The European Union has earmarked €15 billion for the European Agricultural Fund for Rural Development as part of the recently negotiated recovery plan for Europe, available at <[https://ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/recovery-plan-europe\\_en](https://ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/recovery-plan-europe_en)>.

<sup>16</sup> See COVID-19 in India – GOI’s Economic Package for Self-Reliant India – Food and Agriculture Items, available at <[https://apps.fas.usda.gov/newgainapi/api/Report/DownloadReportByFileName?fileName=COVID-19%20in%20India%20-%20GOI%27s%20Economic%20Package%20for%20Self-Reliant%20India%20-%20Food%20and%20Agriculture%20Items\\_New%20Delhi\\_India\\_05-23-2020](https://apps.fas.usda.gov/newgainapi/api/Report/DownloadReportByFileName?fileName=COVID-19%20in%20India%20-%20GOI%27s%20Economic%20Package%20for%20Self-Reliant%20India%20-%20Food%20and%20Agriculture%20Items_New%20Delhi_India_05-23-2020)>.

food production, consumption and stocks, as well as on food prices is widely available, including through existing international mechanisms.”<sup>17</sup>

### ***Need to utilise FTAs to address domestic support***

The domestic support commitment levels specified in Section I Part IV of Member’s schedules of certain countries provide them with ample policy space to provide trade-distorting support, while certain other countries, majority of which are developing, are limited to providing the *de minimis* level of support.<sup>18</sup> There is thus a need to examine the ability of Free Trade Agreements (FTA) to provide a forum to rebalance this inequity in policy space between developed and developing countries.

The ability of Members to provide excessive distortive domestic support within their applicable WTO obligations has become more evident in times of this pandemic. It is pertinent to note WTO Members have raised nearly 60 questions seeking clarifications on major economies’ large farm support packages in response to the crisis, among others. Multiple questions have been raised on the United States’ Coronavirus Food Assistance Program and Canada’s CAD\$ 50 million Surplus Food Purchase Program.<sup>19</sup> This is indicative of the deep concerns over the size of domestic support measures provided by certain developed countries.

Developed countries in particular have the resources to provide large agricultural subsidies to their farmers, as seen above. On the other hand, developing countries lack the resources to support their agricultural sector, prioritising the expenditure on health during times of a pandemic. While this practice of developed countries may not fall foul of their WTO commitments, it may have adverse impacts on the livelihood and food security of developing countries in the longer run. Consequently, there arises a need to address the practice and rules applicable to developed countries in the context of domestic support. Such provisions may particularly be useful in the case of FTAs which are between developed and developing countries.<sup>20</sup>

In this regard, while the WTO has achieved considerable multilateral liberalisation of the sector, FTAs have been increasingly used as a tool to deliver greater openness in agricultural markets. Majority of recent FTAs are “full” trade agreements, i.e., they liberalise substantially all trade and cover a much broader scope of issues.<sup>21</sup>

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<sup>17</sup> *Responding to the COVID-19 pandemic with open and predictable trade in Agricultural and Food Products*, WTO Doc. No. WT/GC/208, dated 22 April 2020.

<sup>18</sup> *De minimis* is the minimal amount of domestic support allowed under the AoA even though it could distort trade; See Article 6.4, AoA.

<sup>19</sup> Committee on Agriculture, Compilation of Questions for the Special Meeting of 18 June 2020, WTO Doc. No. G/AG/W/206, dated 8 June 2020.

<sup>20</sup> For instance, the Regional Comprehensive Economic Partnership (RCEP) is an example of a mega-regional FTA with both developed and developing country participants. Such provisions may also be incorporated in bilateral FTAs between countries such as the United States and European Union with emerging economies such as India, China, South Africa etc.

<sup>21</sup> See A. Dür & M. Elsig, ‘Introduction: The purpose, design and effects of preferential trade agreements’, in ‘Trade Cooperation: The Purpose, Design and Effects of Preferential Trade Agreements’. (Cambridge University Press, 2015).

As per a recent report of the OECD, agriculture appears to be increasingly treated in a similar manner to other goods trade, with agreements delivering reduced tariffs among members across the majority of agricultural commodities.<sup>22</sup> However, FTAs usually do not include provisions for domestic support to agriculture.<sup>23</sup> There is little incentive for FTA parties to make concessions on domestic support since such a provision would benefit all trading partners and not just FTA parties. Regulation of domestic support is considered better suited to be addressed in the multilateral forum. Most agreements therefore do not go beyond the WTO AoA. Where provisions exist to limit the use of producer support, they are based on best endeavours<sup>24</sup> or an agreement to take the matter forward in multilateral negotiations.<sup>25</sup> This outlook may have to be revisited to make room for innovative solutions within FTAs to tackle domestic support measures.

Unfortunately, the dispute settlement arm of the WTO has been under siege and has resulted in the ‘asphyxiation’ of the Appellate Body.<sup>26</sup> There is a growing debate over the role and future direction of the WTO. To tackle some of the new trade issues and the outstanding issues relating to agriculture in the wake of the Doha Round impasse, countries are turning to FTAs as an alternate forum. The need for FTAs to act an alternate forum is exacerbated in times of crisis or pandemic, in order to ensure a mechanism to avoid trade-distortive agricultural measures.

With this background, the objective of this paper is to propose a framework for the regulation of domestic support under FTAs. In the longer run, such disciplines in FTAs may positively influence future multilateral trade negotiations in this area. Following this Introduction, Part II recalls the jurisprudence on the concept of ‘cross-subsidization’ in the *EC-Export Subsidies on Sugar* dispute. Utilising this concept, a proposal of a possible framework for the regulation of domestic support disciplines under FTAs is explored in Part III. Part IV concludes.

## II. EC-EXPORT SUBSIDIES ON SUGAR DISPUTE AND THE CONCEPT OF CROSS-SUBSIDIZATION

In *EC-Export Subsidies on Sugar*, Australia, Brazil and Thailand argued that the European Communities (EC) provided export subsidies in excess of its WTO export-subsidy commitment levels for sugar. The complainants argued that this was in part the result of *de facto* cross-subsidization of exports as a consequence of guaranteeing high annual intervention (support) prices for a given quantity of EC sugar.<sup>27</sup>

The factual matrix of the dispute was as follows. The EC sugar regime had two categories of production quotas, namely, ‘A sugar’ and ‘B sugar’, which constituted the maximum quantities

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<sup>22</sup> OCED Joint Working Party on Agriculture and Trade, ‘*The evolution of the treatment of agriculture in preferential and regional trade agreements*’, TAD/TC/CA/WP(2018)5/FINAL, 7 February 2019, available at <[http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/TC/CA/WP\(2018\)5/FINAL&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/TC/CA/WP(2018)5/FINAL&docLanguage=En)>, Key Findings, p. 6 [hereinafter “OECD, 2019”].

<sup>23</sup> *Ibid.*; See L. Fulponi, M. Shearer & J. Almeida, ‘*Regional Trade Agreements - Treatment of Agriculture*’. OECD Food, Agriculture and Fisheries Papers No. 44, (OECD Publishing, Paris, 2011).

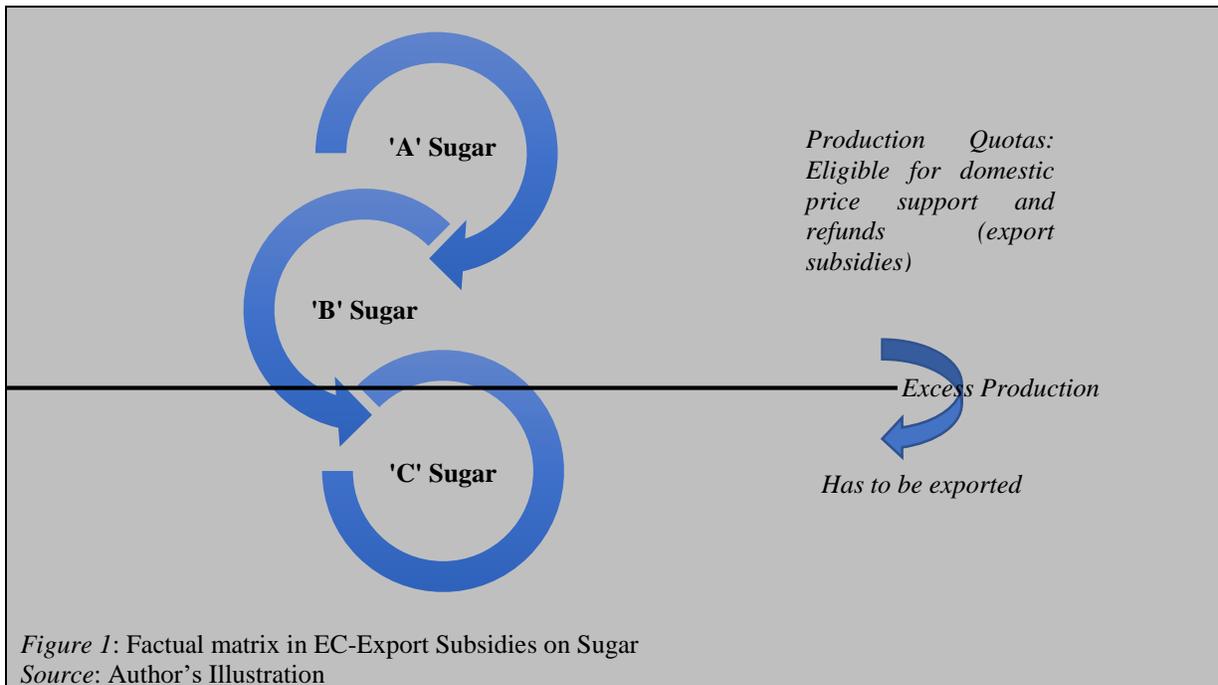
<sup>24</sup> See Article 704, North American Free Trade Agreement, 1994.

<sup>25</sup> See Article 7.4, Comprehensive and Economic Trade Agreement, 2017; Supra, OECD 2019, p. 40.

<sup>26</sup> Farewell speech of Appellate Body Member Ramírez-Hernández, 28 May 2018, available <[https://www.wto.org/english/tratop\\_e/dispu\\_e/ricardoramirezfarwellspeech\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/ricardoramirezfarwellspeech_e.htm)>.

<sup>27</sup> Panel Report, *European Communities–Export Subsidies on Sugar*, WT/DS265/R, paras 241 and 295 [hereinafter “Panel Report, *EC-Sugar*”].

eligible for domestic price support and direct export subsidies.<sup>28</sup> Domestic prices for A and B sugar were supported by a combination of minimum prices, supply management, import restrictions, intervention in the market to purchase A and B sugar at prices that ensured a “fair income” for producers. Sugar produced in excess of these quantities was called ‘C sugar’. While C sugar was not subject to any quotas or subsidies, it had to be exported.<sup>29</sup>



One of the fundamental questions before the Panel was whether EC had demonstrated that its exports of C sugar were not subsidized. The Complainants’ main contention in this regard was that the legal framework created by the EC resulted in sugar producers receiving a payment. This was evidenced by the fact that C sugar was being exported at prices that did not reflect its proper value because the price received did not cover its average total cost of production.<sup>30</sup> The relevant provision under consideration was Article 9.1(c) of the AoA which requires reduction of commitments for “payments on the export of an agricultural product that are financed by virtue of governmental action”.<sup>31</sup>

The Panel began its analysis by noting that producers of A, B and C sugar are the same companies and that all three classifications of sugar was made in a continuous line of production. Recalling that the quantities of sugar that may be sold in the domestic market was tightly regulated, the Panel determined that cross-subsidization constituted a “payment” within the meaning of Article

<sup>28</sup> *Ibid.*, para 3.4.

<sup>29</sup> *Ibid.*, para 3.7.

<sup>30</sup> *Ibid.*, para 7.241.

<sup>31</sup> Article 9.1(c), AoA states “(c) payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived”.

9.1(c):<sup>32</sup>

“[T]he relatively high EC administered domestic market (above-intervention) prices for A and B quota sugar allow the sugar producers to recover fixed costs and to sell exported C sugar over average variable costs but below the average total cost of production. Sugar is sugar whether or not produced under an EC created designation of A, B or C sugar. *A, B or C sugar are part of the same line of production and thus to the extent that the fixed costs of A, B and C are largely paid for by the profits made on sales of A and B sugar, the EC sugar regime provides the advantage which allows EC sugar producers to produce and export C sugar at below total cost of production.* For the Panel this cross-subsidisation constitutes payment in the form of a transfer of financial resources.”

(Emphasis Added)

In other words, when EC consumers pay the regulated high price for domestic sugar, this generates substantial financial resources and constitutes an “advantage” to the same producers in their production of C sugar. The Appellate Body (AB), observing that Article 9.1(c) does not qualify the term “payments” by reference to the entity making or receiving the payment,<sup>33</sup> concurred with the findings of the Panel.

Second, the Panel opined that a payment “on export” does not need to be contingent upon export,<sup>34</sup> but rather should be in connection with exports.<sup>35</sup> Since C sugar had to be exported, this condition was held to be satisfied.<sup>36</sup> Third, relying on the AB’s ruling in *Canada-Dairy* on the understanding of “by virtue of governmental action”, the Panel was of the view that the broad EC governmental action of regulating the domestic market satisfied this requirement.<sup>37</sup> Finally, the Panel held that the EC’s “governmental action regulating the domestic sugar market cross-subsidizes sales of C sugar that otherwise would not be made, or would be made at a loss”.<sup>38</sup>

The concept here is one of cross-subsidization, i.e., the above-normal profits from the sale of one product subsidize the export of another.<sup>39</sup> The economic rationale is that the total output is likely to exceed what would have been observed under free trade since there are producers in the market because of the domestic subsidy. The importance of the *EC-Sugar* Panel’s interpretation is that it addressed the problem by having regard to the effects, rather than by the structure of a measure.<sup>40</sup>

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<sup>32</sup> Supra, Panel Report, *EC-Sugar*, para 7.310.

<sup>33</sup> Appellate Body Report, *European Communities–Export Subsidies on Sugar*, WT/DS265/AB/R, para 262 [hereinafter “AB Report, *EC-Sugar*”].

<sup>34</sup> Supra, Panel Report, *EC-Sugar*, para 7.273.

<sup>35</sup> *Ibid.*, para 7.275.

<sup>36</sup> *Ibid.*, para 7.321.

<sup>37</sup> *Ibid.*, para 7.326; Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, WT/DS103/AB/RW, para. 113 [hereinafter “AB Report, *Canada-Dairy*”]; Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, WT/DS103/AB/RW2, para. 130 [hereinafter “AB Report, *Canada-Dairy II*”].

<sup>38</sup> Supra, Panel Report, *EC-Sugar*, para 7.326.

<sup>39</sup> B. Hoekman & R. Howse, ‘*EC-Sugar*’. World Trade Review, Vol. 7, Issue 1, (2008), p. 153 [hereinafter “Hoekman & Howse, *EC-Sugar*”].

<sup>40</sup> J. F. Puyana, F. S. Pinilla & R. J. N. Ordonez, ‘*The Cumulative Application of the Agreement on Agriculture and the Subsidies and Countervailing Measures Agreement: An Approach to Agricultural Subsidies based on its Effects*’.

Utilising this principle of addressing the trade-distorting effects of domestic support measures, the following part attempts to propose a basic framework of incorporating such disciplines in FTAs.

### **III. FRAMEWORK FOR REGULATING DOMESTIC SUPPORT UNDER FTAs**

As observed in Part I, FTAs do not usually include provisions regulating domestic support to the agricultural sector. For instance, the Eurasian Economic Union (2015) (a) permits, without limitations, non-distorting support such as research and development, general services etc.; and (c) limits the amount of all forms of support which do not fall into the above categories to 10% of the gross value of production of the agricultural product. This is largely a reiteration of the applicable WTO commitments.

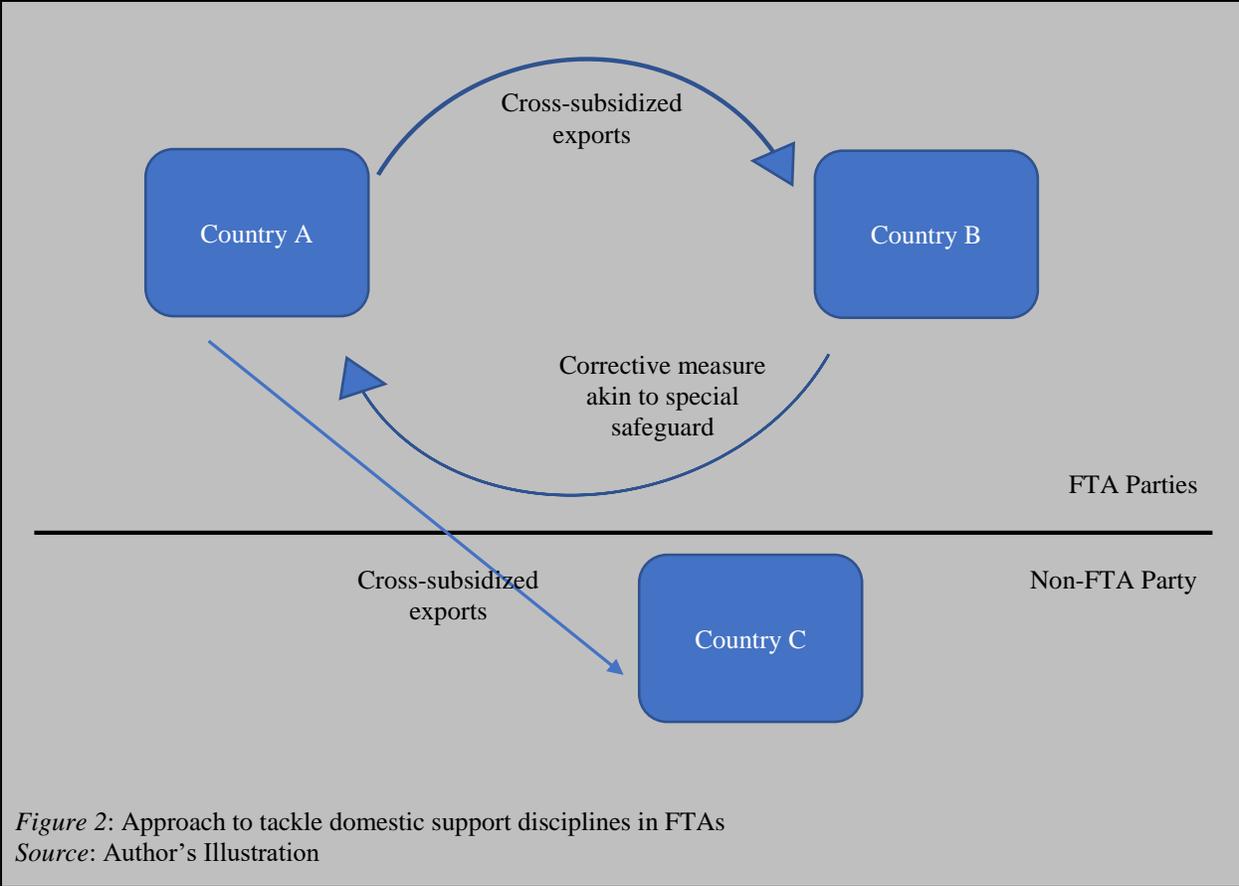
In order to achieve deeper liberalisation in the agricultural sector, while maintain certain flexibility to pursue legitimate policy goals, countries should aim at negotiating relevant disciplines under FTAs. In this regard, a potential provision regulating domestic support in an FTA may initially be utilised in the event of a crisis or a pandemic in order to ensure that domestic support to agricultural producers do not have adverse lasting trade impacts. Consequently, such a provision may be made more permanent in an FTA, and may influence future negotiations at the WTO in this context.

#### ***Proposal for a framework to regulate domestic support***

Countries may consider negotiating provisions that crystallise the concept of cross-subsidisation within the FTAs. Such a provision would primarily be for the regulation of domestic support. Parties to an FTA may identify agricultural products that are ‘sensitive’ for their domestic market, i.e., those that require government intervention to either achieve food security or to ensure guaranteed income for such farmers. Pursuant to this, countries are eligible to provide domestic support to such agricultural products to achieve their policy objectives. Domestic support may be provided until the economic effects of such support does not “spill over” to the export of such products between the parties to the FTA. While the spill-over effects may occur in all countries in which a party has an exporting interest, only the FTA parties would be able to take suitable corrective measures to nullify such effects. In other words, if the domestic support has the effect of cross-subsidizing the sales of the product in the export market, the affected party may adopt a measure akin to a special safeguard in order to counter the effects of cross-subsidization. This has been explained in detail below.

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Int. Law: Rev. Colomb. Derecho Int. Bogotá (Colombia) N° 10: 209-264, 2007, p. 246 [hereinafter “Puyana et. al., *Cumulative Application of AoA and SCM*”].



On determination of a suitable way to include cross-subsidization within FTAs, countries may consider incorporating suitable trade remedy provisions to counter-act the effect of such subsidies. In order to ensure the balance between the benefits of the negotiated agreement accruing only to the FTA parties, while at the same time limiting the spill-over effect of domestic support measures, resort may be made to tools akin to special safeguard measures. In the traditional sense, Article 5 of the AoA provides for Special Safeguard which provides for tariff increases under certain conditions. It can be triggered by import surges or price falls, without any need to test injury or to negotiate compensation.<sup>41</sup>

In the proposed approach, the conditions under which such tools under FTAs may be invoked can be negotiated between the parties. For example, parties may provide that such tools address the low export prices indirectly being caused by the alleged domestic support of the concerned FTA party provided during a crisis or pandemic.

Terrance Stewart opines that cross-subsidization occurs when sales revenue from one market finances a portion of the costs associated with sales made in another market.<sup>42</sup> Building on this, domestic support may be said to have an effect of cross-subsidizing sales in the export market if the whole scheme surrounding the allocation of funds leave the producer with no choice other than

<sup>41</sup> See Article 5, AoA.  
<sup>42</sup> T. Stewart, 'U.S. - Japan Economic Disputes: The Role of Antidumping and <sup>[1]</sup><sup>[1]</sup>Countervailing Duty Laws'. Arizona Journal of International and Comparative Law, Vol. 16 (1999), p. 702. <sup>[1]</sup><sup>[1]</sup>

using it for export production. In the case of a crisis or pandemic, such effect of cross-subsidizing the sales in the export market may perhaps be noticeable at the stage of recovery or stabilisation of the particular commodity market.

When a domestic subsidy finances export production, the distinction established by the AoA between domestic support and export subsidies is blurred, undermining the effectiveness of the specific commitments.<sup>43</sup> Though this problem was recognised during the Uruguay Round negotiations,<sup>44</sup> the AoA does not include a provision addressing this matter. In this regard, the observations of the AB in *Canada-Dairy* are apposite:<sup>45</sup>

“However, we consider that the distinction between the domestic support and export subsidies disciplines in the *Agreement on Agriculture* would also be eroded if a WTO Member were entitled to use domestic support, without limit, to provide support for exports of agricultural products. Broadly stated, domestic support provisions of that Agreement, coupled with high levels of tariff protection, allow extensive support to producers, as compared with the limitations imposed through the export subsidies disciplines. *Consequently, if domestic support could be used, without limit, to provide support for exports, it would undermine the benefits intended to accrue through a WTO Member's export subsidy commitments.*”

(Emphasis Added)

When the beneficiaries of a subsidy are all producers of an agricultural product, irrespective of the final destination of the product, subsidies might support the total production to be exported although being considered a domestic support.<sup>46</sup> In the *US-Cotton* dispute, WTO adjudicatory bodies analyzed a single subsidy scheme granted to cotton users and found that there was an export subsidy hidden behind a domestic support scheme.<sup>47</sup> In effect, such measures or policies have inherent hidden export subsidies; or, viewed differently, have hidden excessive domestic support.

### ***Highlights and challenges of this approach***

It is pertinent to note that the language of Article 9.1(c) of the AoA played a pivotal role in the findings of the Panel and the AB on the concept of cross-subsidization.<sup>48</sup> The AB found in Article 9.1(c) the way to bring the economic effects on the export scenario, produced by a domestic support, within the framework of the export reduction commitments.<sup>49</sup> While the language of Article 9.1(c) may be used as starting point for developing similar provisions which may be

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<sup>43</sup> Supra, Puyana et. al., *Cumulative Application of AoA and SCM*, p. 238.

<sup>44</sup> “One of the main issues here is whether payments to producers as opposed to exporters, such as deficiency payments and comparable practices, which are not specifically export performance related but which can in practice operate to maintain or increase exports and to insulate producers from world price movements, should be treated as export subsidies for the purpose of reduction commitments. A consideration to be taken into account is that such payments would, in principle, be subject to reduction commitments in the context of internal support” See Negotiating Group on Agriculture, ‘*Options in the Agriculture Negotiations*’, Note by Chairman, point 47 (1991), MTN. GNG/AG/W/1.

<sup>45</sup> Supra, AB Report, *Canada- Dairy*, para. 91.

<sup>46</sup> Panel Report, *United States–Subsidies on Upland Cotton*, WT/DS267/R, paras 7.731 and 7.735.

<sup>47</sup> Appellate Body Report, *United States–Subsidies on Upland Cotton*, WT/DS267/AB/R, para 542.

<sup>48</sup> Supra, Hoekman & Howse, *EC-Sugar*, p. 158, wherein they opine that there will be limited scope for claims of cross-subsidization outside the context of Article 9.1(c) of the AoA.

<sup>49</sup> Supra, AB Report, *Canada-Dairy II*, para. 148.

incorporated into an FTA, suitable modifications may have to be made to expand its ambit and provide certain flexibility.

Concerns have been raised on the high level of intervention required for proving the nexus between the governmental action and the financing of the payments. The *Canada-Dairy* and *EC-Sugar* disputes had a high level of intervention through the establishment of fixed prices, production quotas and tariffs. Consequently, problems may arise in the case of other types of domestic support, which are capable of assuring high profits to producers, but which do not involve direct government intervention.<sup>50</sup> For example, income support programs tied to neutral non-price criteria that possibly increase production to levels that growers could not have sustained without the subsidy are unlikely to have easily discernible effects on prices.<sup>51</sup> Therefore, the effect of all “boxes” of subsidies on the export of a product would have to be captured in determining the resultant cross-subsidization, for which the language of Article 9.1(c) may have to be modified. In addition, the payment in the form of internal allocation of funds was considered to be “on the export” because the EC sugar regime established that C sugar shall be exported.<sup>52</sup> Resultantly, the circumstances under which “spill over” may exist is not definitive, given that export contingency is not a strict requirement.<sup>53</sup> Therefore, the language of Article 9.1(c) may have to be modified to capture the activity of export being a consequence of the payment financed by virtue of the governmental action.

In the WTO context, agricultural subsidies that are in compliance with the AoA may be challenged if they cause adverse effects to the interests of another Member, according to the Agreement on Subsidies and Countervailing Measures (SCM Agreement).<sup>54</sup> However, the determination of cross-subsidization as a result of domestic support under the AoA has certain advantages over an analysis of the domestic support under the SCM Agreement. Preliminarily, these include:

- (a) *the nature of government intervention*: The ambit of ‘payments’ that are ‘financed by virtue of governmental action’ under Article 9.1(c) of the AoA appears to be broader than the requirement of financial contribution being made by the government or any public body under Article 1 of the SCM Agreement;
- (b) *demonstration of benefit*: The Panel in *EC-Sugar* noted that, unlike as under the SCM Agreement, a demonstration of “benefit” was not required to constitute a “payment” under Article 9.1(c) of the AoA; and
- (c) *evidence of adverse effects*: Article 5 of the SCM Agreement delineates how “adverse effects” may be demonstrated, and usually involves an elaborate data-intensive investigation. On the other hand, an analysis under Article 9.1(c) only envisages a comparison of the price of the exported product with its proper value.

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<sup>50</sup> Supra, Puyana et. al., *Cumulative Application of AoA and SCM*, p. 245.

<sup>51</sup> See D. A. Sumner, ‘Farm Programs and Related Policy in the United States’, available < <https://pdfs.semanticscholar.org/603a/4033fb0f924a8485e9f7e1e8648b2f3a563d.pdf>>.

<sup>52</sup> Supra, AB Report, *EC-Sugar*, para 275.

<sup>53</sup> Supra, Puyana et. al., *Cumulative Application of AoA and SCM*, p. 247.

<sup>54</sup> R. H. Steinber & T. E. Josling, ‘When the Peace ends: The Vulnerability of EC and US Agricultural Subsidies to WTO Legal Challenges’. *Journal of International Economic Law*, Vol. 6 (2) (Oxford University Press, 2003), pp. 374-375.

Based on the above, FTA parties may benefit significantly from developing disciplines on cross-subsidisation to tackle domestic support measures. Perhaps the most significant advantage of crystallising cross-subsidization under FTAs would be its impact on a Member's WTO scheduled domestic support commitment. As observed in Part I, certain WTO Members have undertaken specific domestic support commitments, calculated on the basis of subsidies granted in the past, and enshrined in Part IV of their Schedule of Concessions.<sup>55</sup> Accordingly, those Members are eligible to provide domestic support which is to be included in the calculation of AMS upto the extent of such commitments, without being considered to be in violation of the AoA. Incorporating principles of cross-subsidisation would have the effect of a WTO-plus commitment on this aspect, since domestic support would no longer be able to be provided to the extent of the erstwhile commitments.

The potential economic impact of the domestic support on the export of the product would act as an inherent check and balance against the quantum of the support that may be provided. In other words, the approach proposed in this paper would result in an indirect limitation to the trade-distortive domestic support that may be provided by a country based on their economic effects, as compared to the limits established under their WTO schedule of commitments. It further ensures that the negotiated commitments benefit only the parties to the FTA.

#### IV. CONCLUSION

This COVID-19 pandemic and previous worldwide crises have seen WTO Members ramp up their domestic agricultural support measures to aid their agricultural sector. While such support is essential, there are concerns over its quantum and potential lasting adverse economic impacts. The current WTO rules of agriculture are insufficient to address these concerns due to the vast policy space available to certain developed Members. With the current impasse on the appointment of judges to the AB taking centre-stage, and the stalled negotiations on agricultural issues, reform of the AoA may not be possible in the near future. Further, a situation of crisis or pandemic provides unique challenges for which suitable action may have to be taken by countries in a swift manner. There is therefore a need to utilise the FTAs as a basic driver of reform in this sector.

The AoA deals with the pervasive distortion of trade in agriculture through the combined and interactive effects of a wide variety of government policies such as levies, export subsidies, quotas and price support mechanisms. Such a concerted approach is essential under FTAs as well.

One of the deficiencies of the AoA is perhaps the lack of a definition of what a domestic support is, but it is generally understood as payment provided to agricultural producers regardless of whether the product is exported or not.<sup>56</sup> While the AoA attempts to regulate domestic support based on its trade-distortive effects, FTAs do not discipline such measures. This paper suggests a possible framework for the regulation of domestic support in FTAs. Such a provision is perhaps

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<sup>55</sup> See Article 3.1, AoA; Also see Supporting Tables for commitments on agricultural subsidization, available at < [https://www.wto.org/english/tratop\\_e/agric\\_e/supporting\\_tables\\_e.htm](https://www.wto.org/english/tratop_e/agric_e/supporting_tables_e.htm)>.

<sup>56</sup> M. G. Desta, 'The Bumpy Ride Towards the Establishment of "a Fair and Market Oriented Agricultural Trading System" at the WTO: Reflections Following the Cancun Setback'. Drake Journal of Agricultural Law, (2003), p. 521.

most vital in ensuring that large subsidies provided by countries during and in the immediate aftermath of a crisis or pandemic, do not have lasting adverse trade impacts.

In this regard, it is recommended that FTAs consider the incorporation of the principle of cross-subsidization, as recognised by the Panel and AB in its analysis under Article 9.1(c) of the AoA in *EC-Sugar*. The incorporation of such a provision would be intended for the regulation of domestic support. In other words, the enquiry into whether a *de facto* policy measure generates incentives to cross-subsidize exports, could form the basis for regulating domestic support under FTAs.

On identification of a ‘sensitive’ list of products, domestic support may be provided in order to achieve policy objectives such as ensuring food security. However, if such support has a ‘spill over’ effects on the price of such commodities in the export market, the affected FTA party may raise a concern. Consequently, such affected FTA party may wish to apply a tool akin to a special safeguard negotiated between the parties, on such imports in order to counteract the effect of the alleged domestic support. Such a mechanism ensures an in-built limitation on the domestic support that may be provided by FTA parties. This approach takes into account the food security concerns of Members and attempts to regulate domestic support for products based on their effects on trade-distortion. While there are limits to the capacity of an FTA to deliver greater disciplines on domestic support, this proposal may be considered to be a positive step in that direction.

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