WTO prohibits the spilling of domestic programs effects into international markets

While it is common to talk about policies and subsidies that either protect domestic industries from imports or provide these industries with a trade advantage in terms of boxes that are based on the traffic light colors of green, amber, and red, for agriculture there is no red box (https://tinyurl.com/ybjvytrd). According to the World Trade Organization (WTO), the Agreement on Agriculture (AoA) "has no red box, although domestic support exceeding the reduction commitment levels in the amber box is prohibited."

In next week's column we will talk about the blue box. "There are also exemptions for developing countries (sometimes called an 'S&D box' or 'development box', including provisions in Article 6.2 of the [AoA])." Further discussion of the domestic support boxes by the WTO can be found at https://tinyurl.com/y9ehzjpt.

This week we want to focus on the Agreement on Subsidies and Countervailing Measures (SCM) which was a part of the General Agreement on Trade and Tariffs (the predecessor trade regimen to the WTO) and made a part of the WTO trading rules (a pdf of these rules can be found at https://tinyurl.com/ychk34oj). For this discussion we are using the concise summary provided by Randy Schnepf in the Congressional Research Service report, "2014 Farm Bill Provisions and WTO Compliance" (https://tinyurl.com/y78dhuqz).

One might think that if a domestic agricultural support program is within the subsidy limits of the amber box, it would be home free. But as the US learned in the Brazil Cotton Case, things are not that simple because a program can be challenged under SCM rules if "the program's effect spills over into international markets—that is, if it can be established that a subsidy causes adverse market effects" (Schnepf).

The determination that a program is actionable under SCM is a two-step process. For the first step, the domestic support program must meet three criteria: a) "the subsidy constitutes a substantial share of farmer returns or of production costs for a commodity;" b) "the subsidized commodity is important to world markets (i.e., it represents a significant global share in terms of either production or trade); and" c) "a causal relationship exists between the subsidy and adverse effects in the relevant commodity market."

Once it was determined that portions of the US cotton program met all three of these criteria, the discussion moved to the second step. Under the second step only one of the potential negative effects of the challenged support program needed to be proved. One criterion is if the "subsidy displaces or impedes the import of a like product into the domestic market." So, if a country provides a subsidy to an agricultural product that makes that product cheaper for its domestic consumers, thereby discouraging imports, the subsidy can be found to be in violation of the SCM.

The second criterion is that "the subsidy displaces or impedes the export of a like product by another WTO member country."

Taken together these two criteria prohibit subsidies that reduce the level of exports by another WTO member country apart from any negative impact on world prices. That takes us to the third criterion: "significant price suppression, price undercutting or lost sales."

The last criterion is that the subsidy allows a country to increase its share of the world market.

Again, this is apart from any price impact of the subsidy though it is hard to envision a scenario in which price suppression, export levels, and market share are not interrelated. What the four criteria do is allow the challenging country to choose the impact that is easiest to prove or allow the challenger to make all four arguments and hope that just one of them will satisfy the dispute settlement panel.

The rationale is one that we have identified in an earlier column in this series: the subsidy "encourage[s] greater production or output than the market is prepared to absorb and, as a result, tends to lower market prices. Given the United States' prominent role in international agricultural markets, such potential market distortions, should they emerge, can be quickly transmitted from domestic to global markets."

We will want to return to this rationale and, in particular, that last sentence in next week's discussion of domestic policies that fall within the blue box.

Policy Pennings Column 918

Originally published in MidAmerica Farmer Grower, Vol. 37, No. 164, April 6, 2018

Dr. Harwood D. Schaffer: Adjunct Research Assistant Professor, Sociology Department, University of Tennessee and Director, Agricultural Policy Analysis Center. Dr. Daryll E. Ray: Emeritus Professor, Institute of Agriculture, University of Tennessee and Retired Director, Agricultural Policy Analysis Center.
Email: hdschaffer@utk.edu and dray@utk.edu; http://www.agpolicy.org.

Reproduction Permission Granted with:
1) Full attribution to Harwood D. Schaffer and Daryll E. Ray, Agricultural Policy Analysis Center, Knoxville, TN;
2) An email sent to hdschaffer@utk.edu indicating how often you intend on running the column and your total circulation. Also, please send one copy of the first issue with the column in it to Harwood Schaffer, Agricultural Policy Analysis Center, 1708 Capistrano Dr. Knoxville, TN 37922.