

# CRS Report for Congress

## U.S.-Canada WTO Corn Trade Dispute

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Prepared for Members and  
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# U.S.-Canada WTO Corn Trade Dispute

## Summary

On January 8, 2007, Canada initiated a World Trade Organization (WTO) dispute settlement case (DS357) against certain aspects of U.S. commodity programs in general, and the U.S. corn program in particular, by requesting consultations with the United States under the auspices of the WTO dispute settlement process. Canada's WTO case represents the present manifestation of long-simmering concerns that previously surfaced in 2005 in the form of an anti-dumping (AD) and countervailing (CV) duty case brought by Canadian corn producers who sought legal action for alleged unfair subsidization and dumping of U.S. corn in Canadian markets. Canada's International Trade Tribunal (CITT) ultimately ruled in favor of the United States on the 2005 AD/CV duty case. However, Canadian corn producers continued to press their concerns with the Canadian government about perceived unfair subsidization of U.S. corn. This pressure, and other supporting factors, likely contributed to the Canadian government's decision to request WTO consultations with the United States, thereby setting in motion the WTO dispute settlement process with its explicit rules and timetables for resolving a trade dispute.

In making its charges, Canada clearly seeks to build on Brazil's successful challenge of various provisions of the U.S. cotton program (WTO dispute settlement case DS267). Canada raises three explicit charges against U.S. farm programs. First, Canada contends that U.S. corn subsidies have caused serious prejudice to Canadian corn producers in the form of market price suppression in Canadian corn markets during the 1996 to 2006 period. Second, Canada argues that the U.S. export credit guarantee program operates as a WTO-illegal export subsidy. Third, Canada claims that U.S. fixed direct payments are not green-box compliant and should therefore be included with U.S. amber box payments, in which case the United States would be in violation of its \$19.1 billion amber box spending limit for 1999, 2000, 2001, 2004, and 2005.

Since Canada's initial request for WTO consultations, several other WTO members — including Argentina, Australia, Brazil, the European Communities (EC), Guatemala, Nicaragua, Thailand, and Uruguay — have requested to join the consultations as interested third parties.

If successfully litigated, this case could affect all U.S. agricultural policy since the charges against the U.S. export credit guarantee and direct payment programs extend beyond corn to all major program crops. Should any eventual changes in U.S. farm policy be needed to comply with a WTO ruling in Canada's favor, such changes would likely involve action by Congress to produce new legislation. Congress will be revisiting U.S. farm legislation this year and could potentially address some of the issues raised by Canada's WTO challenge. U.S. Secretary of Agriculture, Mike Johanns, who has been advocating that a new Farm Act should be designed to make U.S. farm policy be "beyond challenge," has recently proposed changes to U.S. commodity programs that, if accepted in a new Farm Act, potentially could alleviate many of Canada's concerns while minimizing the likelihood of future WTO challenges. This report will be updated as events warrant.

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# U.S.-Canada WTO Corn Trade Dispute

## Introduction

The United States and Canada conduct the world's largest bilateral trade relationship, with total merchandise trade (exports and imports) reaching almost \$500 billion in 2005.<sup>1</sup> However, this economic trade success story is not without its disagreements.<sup>2</sup> For example, the two countries engaged in a dispute over wheat trade for several decades that included both an anti-dumping (AD) and countervailing (CV) duty case and a World Trade Organization (WTO) case brought against various aspects of Canada's wheat trading practices by U.S. wheat interests.<sup>3</sup>

In 2005, the two countries extended their agricultural disagreement to the corn sector when Canadian corn producers sought legal action for alleged unfair subsidization and dumping of U.S. corn in Canadian markets. Canada's International Trade Tribunal (CITT) ultimately ruled on the 2005 AD/CV duty case in favor of the United States. However, Canadian corn producers continued to press their concerns upon the Canadian government about perceived unfair subsidization of U.S. corn. On January 8, 2007, the Canadian government requested consultations under the official WTO dispute settlement process with the United States concerning U.S. corn subsidies and their alleged affect upon Canadian corn markets. Canada's request initiated an official WTO dispute settlement case (number DS357) and set in motion the explicit rules and timetables of the WTO dispute settlement process. This report provides background on both the U.S. and Canadian corn sectors and the historical development of their corn trade dispute. In addition, it provides a discussion of the potential implications of the case for U.S. farm policy.

## Background on the U.S. and Canadian Corn Sectors

The United States is the world's leading producer and exporter of corn. Since 1980 U.S. corn production has accounted for over 40% of world production, while U.S. corn exports have represented over two-thirds of world corn trade. Canada is also an important producer and consumer of corn. However, Canada's average

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<sup>1</sup> For more information, see CRS Report RL33087, *United States-Canada Trade and Economic Relationship: Prospects and Challenges*, by Ian F. Fergusson.

<sup>2</sup> For a discussion of U.S.-Canada trade issues, see CRS Report 96-397, *Canada-U.S. Relations*, Carl Ek, Coordinator.

<sup>3</sup> For more information, see CRS Report RL32426, *U.S.-Canada Wheat Trade Dispute*, by Randy Schnepf.

annual production of 8.7 million metric tons (MMT) since 2000 is markedly smaller than U.S. average annual production of nearly 262 MMT.<sup>4</sup>

Although it is grown widely throughout the world, corn grows best in temperate conditions with deep, fertile soils such as exist in the U.S. Corn Belt. Corn's agroclimatic requirements, coupled with Canada's northerly latitudes, limit the extent of Canadian corn planting to the more southerly regions of Ontario and Quebec. As a result, growth in Canada's corn production has been limited almost entirely to yield (i.e., bushels per acre) enhancement. In contrast, strong and steady domestic demand for corn — driven by the livestock (dairy, swine, and poultry) and ethanol sectors — has outpaced domestic production and made Canada a net importer of corn, primarily from the United States, since the early 1990s (**Figure 1**).

The elimination of tariffs on corn trade between the United States and Canada, first under the U.S.-Canada Free Trade Agreement (FTA) and later under the North American Free Trade Agreement (NAFTA), have facilitated corn imports into Canada from the United States and strengthened the integration of the North American livestock feeding industry. Since 1989, over 99% of Canada's corn imports have come from the United States. During the 1990s, U.S. corn exports to Canada averaged less than 1 MMT per year; since 2000, they have averaged almost 2.8 MMT per year.<sup>5</sup>

The surge in imports of U.S. corn occurred at a time when U.S. government program payments to the corn sector were also growing (**Figure 2**). During the 1990s, U.S. corn program payments averaged \$2.8 billion per year; since 2000 they have essentially doubled in size to an average of \$5.5 billion per year. The increases in both U.S. corn program payments and imports of U.S. corn drew the attention and ire of Canada's corn-producing sector, which claimed that U.S. corn exports were being facilitated by large U.S. government payments and being sold into Canada at less than the cost of production.

## Previous Action by Canadian Corn Growers

In August 2005, the Canadian Corn Producers — a coalition composed of the Ontario Corn Producer's Association, the Fédération des producteurs de cultures commerciales du Québec, and the Manitoba Corn Growers Association — announced that they would pursue action on three separate fronts against what they perceived as “unfairly traded U.S. grain corn imports.”<sup>6</sup>

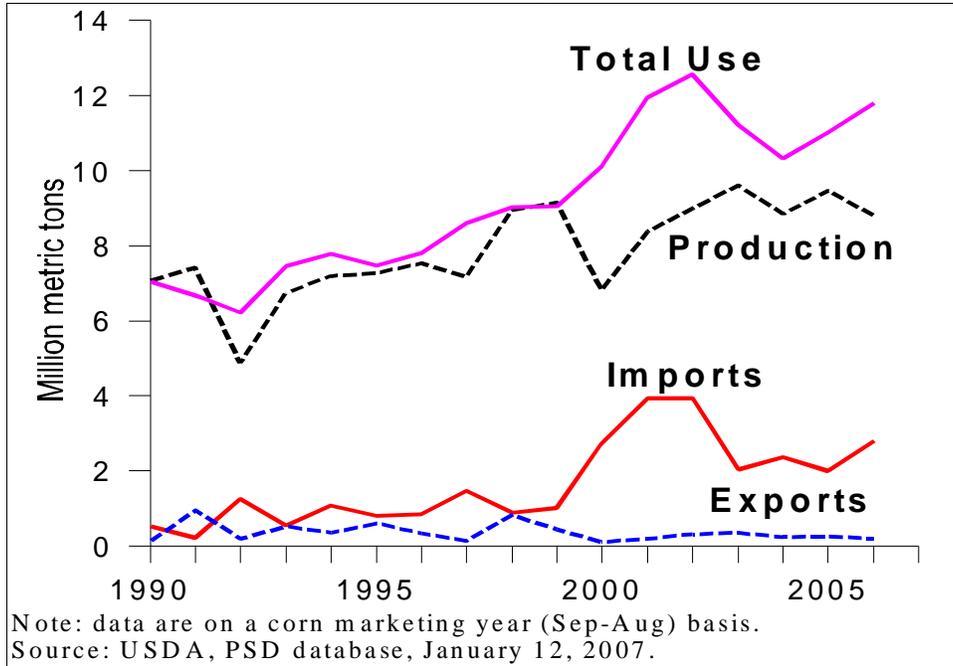
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<sup>4</sup> USDA, Production, Supply and Distribution (PSD) Online database, January 12, 2007, at [<http://www.fas.usda.gov/psdonline/psdHome.aspx>].

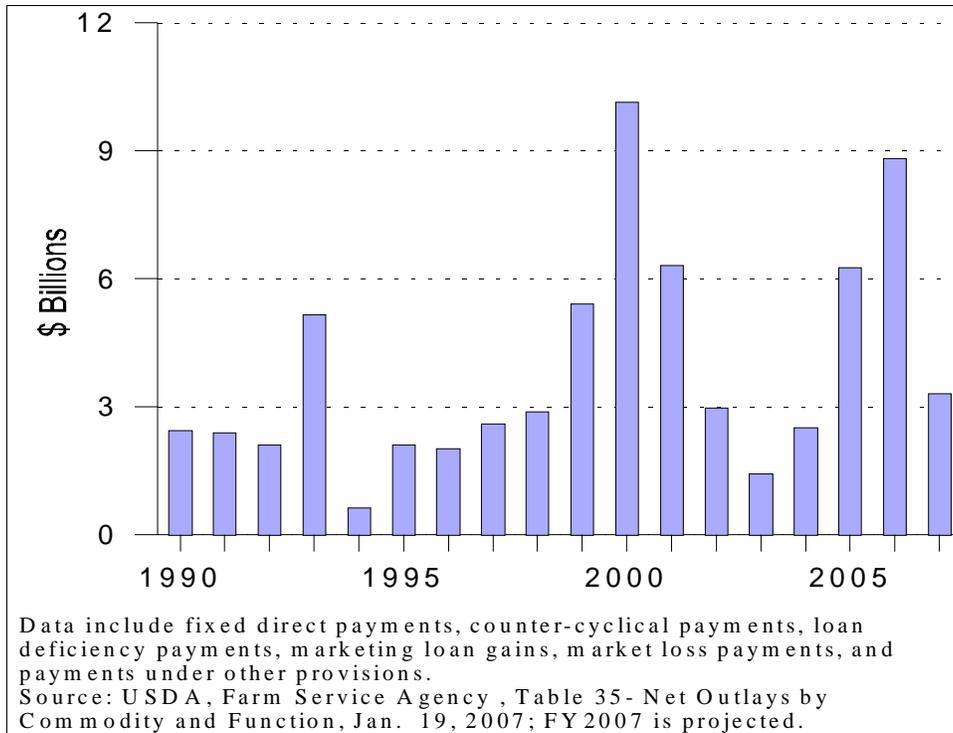
<sup>5</sup> USDA, FAS Online, U.S. Trade Internet System, January 12, 2007, at [<http://www.fas.usda.gov/ustrade/USTExFatus.asp?QI=>].

<sup>6</sup> Ontario Corn Producers' Association, News Release, August 31, 2005, at [<http://www.ontariocorn.org/newsrel/newsrelease8.31.05.pdf>].

**Figure 1. Canada's Corn Supply and Use, 1990 to 2006**



**Figure 2. U.S. Government Payments in Support of Corn Production, FY1990 to FY2006**



First, they asked the Canadian government to include U.S. grain corn imports on the list of products targeted for retaliation by Canada against the United States for the U.S. refusal to repeal the Byrd Amendment.<sup>7</sup> The Byrd Amendment had been ruled to violate WTO obligations in a dispute proceeding filed by Canada and other WTO members. Congress eventually repealed the Byrd Amendment in February 2006 with a several-month transition period, and a U.S. federal court ruled in July 2006 that the Byrd Amendment did not apply to imports from Canada. However, in mid-2005, Canada was particularly concerned about the economic effects of the Byrd Amendment because, at that time, it appeared that as much as \$4 billion in anti-dumping (AD) and countervailing (CV) duty deposits on Canadian softwood lumber could eventually become available for distribution to U.S. lumber producers under this law.<sup>8</sup>

Second, the Canadian Corn Producers asked the Canadian government to commence WTO dispute settlement proceedings by requesting consultations with the United States regarding the alleged “illegality of U.S. grain corn subsidies.” Third, Canadian corn producers filed a domestic trade remedy complaint under Canada’s Special Import Measures Act (SIMA) for the alleged “injurious subsidization and dumping of imports of U.S. corn.”

Dumping occurs when goods are sold to importers at prices that are less than their selling prices in the exporter’s domestic market or at unprofitable prices. If proven, dumping is addressed by the imposition of AD duties. Subsidizing occurs when imported goods benefit from government financial assistance in the exporting country. If proven, subsidizing is addressed by the imposition of CV duties. Canada’s SIMA protects Canadian producers from the damaging effects of both of these unfair trade practices.

**Canadian AD/CV Duty Investigation of U.S. Corn.** On September 16, 2005, the Canadian Border Services Agency (CBSA) announced that, in response to the trade remedy complaint filed by the Canadian Corn Producers, it was beginning an investigation into the alleged dumping and subsidizing of grain corn from the United States. (Unprocessed grain corn includes whole-kernel grain corn and grain corn that has been milled to a limited degree, i.e., milled grain corn, regardless of its physical form, that preserves all the constituent parts of whole kernel grain corn and is chemically identical to whole kernel grain corn. The investigation excluded seed corn, sweet corn, and popping corn.)

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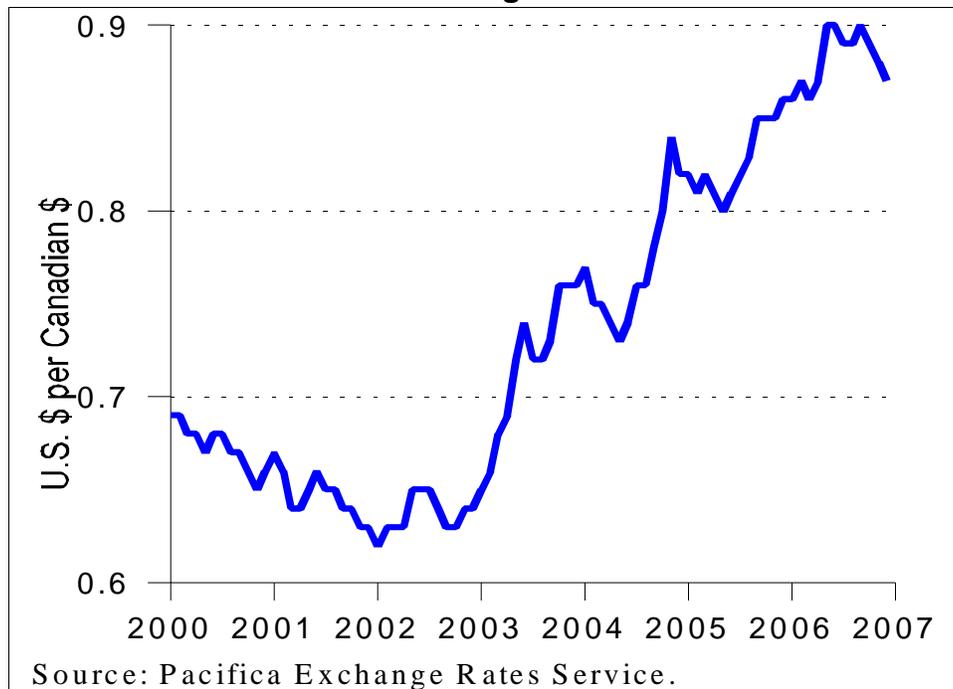
<sup>7</sup> The “Byrd Amendment,” or the Continued Dumping and Subsidy Offset Act (CDSOA), was a U.S. law providing for the distribution of import duties collected as a result of antidumping or countervailing duty orders to petitioners and other interested parties in the investigations that resulted in the orders. For more information on the Byrd Amendment, see CRS Report RL33045, *The Continued Dumping and Subsidy Offset Act (“Byrd Amendment”)*, by Jeanne Grimmett and Vivian Jones.

<sup>8</sup> For more information, see CRS Report RL33752, *Softwood Lumber Imports from Canada: Issues and Events*, by Ross Gorte and Jeanne Grimmett.

At the same time that CBSA was conducting its investigation, Canada's International Trade Tribunal (CITT) also began a parallel investigation to determine whether imports of U.S. corn were harming Canadian producers.

U.S. Secretary of Agriculture Mike Johanns and then-U.S. Trade Representative Rob Portman issued a joint statement (September 16, 2005) expressing their disappointment that Canada was proceeding with a formal AD/CV duty investigation, and said that the United States believes that Canada's petition calling for the investigation lacked "sufficient evidence of injury" to justify initiating such an investigation.<sup>9</sup> In addition, they pointed out that U.S. corn exports to Canada had actually declined during the two preceding years (2003/04 and 2004/05), while Canadian corn production had increased (see **Figure 1**).

**Figure 3. The Canadian Dollar Strengthened Against the U.S. Dollar during 2002 to 2006**



U.S. officials argue that a 46% decline in Canadian imports of U.S. corn from 2002/03 to 2003/04, coupled with a steadily strengthening Canadian dollar (**Figure 3**) which makes imports cheaper *ceteris paribus*, suggested that economic forces other than U.S. dumping or subsidies may have accounted for increased Canadian imports of U.S. corn and weakened Canada's case.<sup>10</sup> In addition, 20 Canadian corn users from the livestock, food processors, and ethanol sectors voiced their disagreement with the Canadian Corn Producers' accusation that imports of

<sup>9</sup> USDA News Release No. 0382.05, Sept. 16, 2005.

<sup>10</sup> World Perspectives, Inc., "Canada Moves to Investigate U.S. Corn," by Dave Juday, Sept. 19, 2005.

U.S. corn were either dumped or subsidized and expressed their opposition to this case moving forward.<sup>11</sup>

On November 15, 2005, the CITT announced its determination that there was reasonable evidence that the dumping and subsidizing of unprocessed U.S. grain corn caused injury to Canada's domestic industry.<sup>12</sup> On December 15, 2005, the CBSA announced its preliminary determination of dumping and subsidizing of U.S. grain corn. As a result, provisional duties of \$1.65 per bushel were imposed payable on imports of U.S. corn at any time on or after December 15, 2005, including a provisional AD duty of \$0.58 per bushel and a provisional CV duty of \$1.07 per bushel. (All amounts are in U.S. dollars.)

### **Canadian Government Proposes AD/CV Duty Rebate Program.**

Following numerous complaints by Canadian corn users, the Canadian government (mid-December 2005) announced a duty-relief program and a duty-drawback program designed to help the livestock and other Canadian corn user groups obtain at least a partial rebate of the \$1.65 per bushel punitive duty.<sup>13</sup> The duty rebate programs gave an exemption to the tariff for Canadian corn users who imported corn from the United States for use as an input, then sent the finished product back outside the country. A corn user would apply for the duty rebate as the imported corn was re-exported in the form of a value-added product. Exports were not restricted to the United States, but exports had to be made within four years of the release date of the imported corn.

Some market analysts expressed initial concerns that the duty rebate program would contribute to increased U.S. imports of Canadian agricultural products, particularly live hogs and processed pork products, since Canada's pig industry was a major user of imported U.S. corn.<sup>14</sup> U.S. trade officials voiced an additional concern. They suggested that the duty-drawback program could result in U.S. trade action against Canada based on how such a duty-rebate program was implemented.

**CITT Removes AD/CV Duties on U.S. Corn.** On March 15, 2006, the CBSA announced a final determination of dumping and subsidizing, and stated that it would continue to impose the \$1.65 per bushel tariff on imports of U.S. corn until the CITT concluded its investigation of injury to Canadian producers. Shortly thereafter, on March 17, 2006, the United States requested WTO dispute settlement consultations with Canada concerning Canada's imposition of provisional AD/CV duties on unprocessed U.S. grain corn. In its WTO request, the United States' arguments included an accusation that Canada's CITT had relied on weak causality between imports and injury, while ignoring other candidates more likely causing

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<sup>11</sup> Statement of the U.S. Trade Representative, Dec. 16, 2005.

<sup>12</sup> CITT, *Dumping and Subsidizing: Determination*, Preliminary Injury Inquiry No. PL-2005-001, Grain Corn, Nov. 15, 2005; [[http://www.citt-tcce.gc.ca/dumping/preinq/determin/pi2f001\\_e.asp](http://www.citt-tcce.gc.ca/dumping/preinq/determin/pi2f001_e.asp)].

<sup>13</sup> Cattlenetwork.com; "Farmers to Get Rebates On U.S. Corn Tariff," Dec. 23, 2005.

<sup>14</sup> *ProFarmer*, Vol. 34, No. 4, "So... did you know they could get the \$1.65 back?" Jan. 28, 2006.

injury, such as exchange rate movements and unusually large world corn harvests leading to weak international corn prices.

On April 18, 2006, the CITT announced its final determination, reversing its earlier position, by issuing a finding of no injury regarding the importation of U.S. grain corn.<sup>15</sup> Pursuant to this final finding, the preliminary AD/CV duties of \$1.65 per bushel were removed and all duties already assessed were to be returned. Similarly, the United States' motivation for pursuing its WTO case against Canadian AD/CV duties was ended.

**Canadian Corn Producers Review Their Options.** Shortly after the CITT's final decision, the Canadian Corn Producers announced that they were reviewing their options for pursuing further legal action against imports of U.S. corn. At that time, such options included requesting a NAFTA binational panel review or possibly encouraging the Canadian government to pursue a WTO dispute settlement case. A NAFTA panel review would involve a review of whether Canadian trade authorities (in this case, the CITT) had correctly interpreted and applied existing Canadian law in reaching their negative injury determination. In contrast, a WTO case — which can only be brought by the Canadian government, not a private party such as the Canadian Corn Producers — would likely be pursued under the Agreement on Subsidies and Countervailing Measures (SCM Agreement) and would involve an investigation of whether “serious prejudice” occurred in the marketplace as a result of U.S. domestic corn program payments.

## Canadian Request for WTO Consultations

On January 8, 2007, the delegation of Canada to the WTO requested consultations with the delegation of the United States under Article 4.4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU)* concerning three separate allegations involving certain aspects of U.S. commodity programs in general, and the U.S. corn program in particular.<sup>16</sup> This action by Canada initiated a WTO dispute settlement case (DS357) which is expected to proceed in accordance with the explicit rules and timetables of the DSU.<sup>17</sup>

In making its charges, Canada clearly seeks to build on Brazil's successful WTO challenge of various provisions of the U.S. cotton program (dispute settlement case DS267).<sup>18</sup> Other potential motivating factors include domestic political concerns

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<sup>15</sup> CITT, *Dumping and Subsidizing: Finding*, Inquiry No. NQ-2005-001, Unprocessed Grain Corn, Apr. 18, 2006, at [[http://www.citt-tcce.gc.ca/dumping/inquiries/findings/nq2f001\\_e.asp](http://www.citt-tcce.gc.ca/dumping/inquiries/findings/nq2f001_e.asp)].

<sup>16</sup> Request for Consultations by Canada, *UNITED STATES - SUBSIDIES AND OTHER DOMESTIC SUPPORT FOR CORN AND OTHER AGRICULTURAL PRODUCTS*, WT/DS357/1 (Jan. 11, 2007).

<sup>17</sup> For more information, see CRS Report RS20088, *Dispute Settlement in the World Trade Organization: An Overview*, by Jeanne Grimmett.

<sup>18</sup> For more information, see CRS Report RL32571, *Background on the U.S.-Brazil WTO* (continued...)

emanating from a weak coalition government responding to pressure from corn producing interests following the unfavorable CITT AD/CV corn duty ruling, as well as Canada's general interest in influencing the U.S. farm bill debate in favor of lower amber-box-type support.<sup>19</sup> In a government news release that coincided with the Canadian government's request for WTO consultations, Canadian Trade Minister, David Emerson, said, "We hope to see the U.S. live up to its WTO obligations, particularly given that it has the opportunity to do so when it rewrites its Farm Bill this year."<sup>20</sup> A news report suggests that two additional factors motivating Canada's case against U.S. corn programs include the current suspension of Doha Round negotiations (where the U.S. had already offered to reform its export credit guarantee program) and the settlement of a softwood lumber dispute between Canada and the United States which freed up government trade attorneys to refocus on the WTO litigation.<sup>21</sup>

Since Canada's initial request for consultations, several other WTO members — Argentina, Australia, Brazil, the European Communities (EC), Guatemala, Nicaragua, Thailand, and Uruguay — have officially requested to join the consultations as interested third parties.<sup>22</sup> A news report suggests that Mexico is also contemplating whether or not to join as a third party.<sup>23</sup> News reports speculate that this growing alliance of interested third parties could add to pressure for the United States to further expand its agricultural subsidy reduction proposal in the current Doha Round of WTO trade negotiations, especially in the corn sector.

In its official request for consultations, Canada raises three explicit charges against U.S. farm programs. Each of these is discussed below.

**First Allegation: U.S. Corn Subsidies Cause Serious Prejudice.**

Canada contends that the subsidies and domestic support provided to the U.S. corn sector have caused adverse effects to Canadian corn producers in the form of serious prejudice and the threat of serious prejudice to the interests of Canada during the

<sup>18</sup> (...continued)

*Cotton Subsidy Dispute*, and CRS Report RS22187, *U.S. Agricultural Policy Response to WTO Cotton Decision*, both by Randy Schnepf.

<sup>19</sup> The amber box includes those policies that result in market and trade distorting support. For a discussion of proposed reductions in WTO domestic support commitments, see CRS Report RL33144, *WTO Doha Round: The Agricultural Negotiations*, by Charles Hanrahan and Randy Schnepf.

<sup>20</sup> Government of Canada, News Release, Jan. 8, 2007, No. 2 at [<http://www.international.gc.ca/tna-nac/wto-ds-en.asp>].

<sup>21</sup> *Inside U.S. Trade*, "Johanns Says U.S. Will Defend Farm Programs from Canadian Challenge," Jan. 12, 2007.

<sup>22</sup> Official WTO documents are: (Jan. 22, 2007) Australia, WT/DS357/2; (Jan. 23, 2007) Guatemala, WT/DS357/3; and Brazil, WT/DS357/4; (Jan. 24, 2007) Argentina, WT/DS357/5; the EC, WT/DS357/6; Uruguay, WT/DS357/7; Nicaragua, WT/DS357/8; and Thailand, WT/DS357/9.

<sup>23</sup> *Washington Trade Daily*, "Brazil, Argentina and U.S. Corn Subsidies," Vol. 16, No. 16, Jan. 22, 2007.

1996 to 2006 period in violation of Articles 5(c) and 6.3(c) of the WTO's Agreement on Subsidies and Countervailing Measures (SCM Agreement).<sup>24</sup> Article 5(c) defines adverse effects as including serious prejudice to the interests of another WTO member. Article 6.3(c) states that serious prejudice applies when the effect of a subsidy is a serious price undercutting by the subsidized product, price suppression, price depression or lost sales for a like product in the same market.

In its consultation request, Canada lists the subsidies and domestic support programs that it contends supported the U.S. corn sector during the 1996 to 2006 period. These include commodity programs from both the 1996 and 2002 Farm Acts — marketing loan payments (i.e., marketing assistance loans, market loan gains, loan deficiency payments, commodity certificates, commodity certificate exchange gains, and commodity loan interest subsidies), the production flexibility contract (PFC) payments of the 1996 Farm Act, and the fixed direct payments (DP) and counter-cyclical payments (CCP) of the 2002 Farm Act.<sup>25</sup> In addition, U.S. Market Loss Assistance (MLA) payments provided under six different emergency supplemental acts authorized by Congress between 1998 and 2001,<sup>26</sup> and benefits received under the agricultural export credit guarantee programs<sup>27</sup> were included in the list of support programs contributing to serious prejudice.

The Canadian government included an Annex with its official consultation request.<sup>28</sup> The Annex, entitled “Statement of Available Evidence,” included a lengthy list of websites providing information on U.S. commodity programs, but provided no discussion of the specific program outlays other than the general discussion included in the consultation request.<sup>29</sup> However, in a related news release, Canada contends that in 2005/06, the United States accounted for 41% of global corn production and 68% of global corn exports, while U.S. support to corn producers has averaged nearly \$9 billion in each of the previous two (Sep/Aug) marketing years — 2004/05 and 2005/06 — resulting in what Canada claims is a significant distortion of its domestic corn prices.<sup>30</sup>

**Second Allegation: U.S. Export Credit Guarantees Act as Illegal Export Subsidies.** Canada argues that the U.S. export credit guarantee program

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<sup>24</sup> For a description and interpretation of Articles 5(c) and 6.3(c) of the SCM Agreement, see CRS Report RL33697, *Potential Challenges to U.S. Farm Subsidies in the WTO*, by Randy Schnepf and Jasper Womach.

<sup>25</sup> For more information on commodity programs see CRS Report RS21999, *Farm Commodity Policy: Programs and Issues for Congress*, by Jim Monke.

<sup>26</sup> For more information on Market Loss Assistance payments (or “market loss” payments), see CRS Report RL31095, *Emergency Funding for Agriculture: A Brief History of Supplemental Appropriations, FY1989-FY200*, by Ralph M. Chite.

<sup>27</sup> For more information on U.S. export credit guarantees, see CRS Report RL33553, *Agricultural Export and Food Aid Programs*, by Charles Hanrahan.

<sup>28</sup> Annex: Statement of Available Evidence, WT/DS357/1, pp. 5-8 (Jan. 11, 2007).

<sup>29</sup> Such a statement is required under Article 7.2 of the SCM Agreement.

<sup>30</sup> Government of Canada, News Release, Jan. 8, 2007, No. 2.

operates as a WTO-illegal export subsidy. This charge stems from a previous WTO case — the U.S.-Brazil Cotton case (DS267) — where a WTO panel found (and was upheld by an Appellate Board (AB) on appeal) that U.S. export credit guarantees effectively function as export subsidies because the financial benefits returned by these programs failed to cover their long-run operating cost.<sup>31</sup> Furthermore, the panel found that this applies not just to cotton, but to all commodities that benefit from U.S. commodity support programs and receive export credit guarantees. As a result, export credit guarantees for any recipient commodity are subject to previously scheduled WTO spending limits.

**Third Allegation: U.S. Total Domestic Support Exceeds Its WTO Limit.** Canada contends that the United States has provided support to its agricultural sector in excess of its scheduled WTO commitment levels. As with the second allegation above, this allegation hinges directly on a WTO panel finding from the U.S.-Brazil Cotton case (DS267) as described below.

For the United States, its total spending limit for “amber box” programs (i.e., programs that are trade and market distorting), as listed in its WTO country schedule of commitments was \$19.9 billion in 1999 and \$19.1 billion in all subsequent years. Each WTO member has agreed to notify its annual domestic support outlays to the WTO for verification that it is adhering to its spending commitments. The United States has notified to the WTO its annual program spending through 2001. In these notifications, U.S. domestic support outlays remain well within U.S. WTO spending commitments. Also in its WTO notifications, the United States has notified its Production Flexibility Contract (PFC) payments as fully decoupled and green box compliant.<sup>32</sup> This is an important distinction because the green box contains only non-distorting program payments and is not subject to any limit.

Canada’s claim that the United States has exceeded its total spending limits hinges on a previous WTO panel ruling from the U.S.-Brazil Cotton case (DS267). In that case, the WTO panel found (and was upheld by the Appellate Body) that U.S. payments made under the PFC and Direct Payment (DP) programs do not qualify for the WTO’s green box category of domestic spending, because of their prohibition on planting fruits, vegetables, and wild rice on covered program acreage.<sup>33</sup> Instead, the panel ruled that payments under these programs should be counted as domestic subsidies directly affecting crop production (i.e., distorting) and should therefore be

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<sup>31</sup> Found to violate Annex I(j) of the SCM Agreement, *WTO Legal Texts*, p. 267, which identifies as an export subsidy, “The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programs, of insurance or guarantee programs against increases in the cost of exported products or of exchange risk programs, at premium rates which are inadequate to cover the long-term operating costs and losses of the programs.”

<sup>32</sup> Decoupled means it has no influence on producer’s decision-making process; green box compliant means it adheres to the terms and conditions of Annex 2 of the Agreement on Agriculture.

<sup>33</sup> For more information on these restrictions see USDA, Farm Service Agency, Fact Sheet, *Direct and Counter-Cyclical Payment Program Wild Rice, Fruit, and Vegetable Provisions*, February 2003, at [<http://www.fsa.usda.gov/pas/publications/facts/html/fav03.htm>].

included with other commodity program outlays to evaluate whether the United States has met or exceeded its “peace clause” limits. Such “peace clause” limits were established under Article 13 of the Agreement on Agriculture (AA) which states that domestic support measures that comply with the AA’s commitments are exempt from being challenged as illegal subsidies under dispute settlement proceedings as long as the level of support for the commodity in question remains at or below the outlays of the 1992 marketing year.<sup>34</sup>

Canada argues that, because PFC and DP payments do not conform with paragraph 6(b) of Annex 2 of the AA (which states that such payments should not be related to producer behavior such as compliance with a planting restriction), they should be included in U.S. amber box payments. Furthermore, Canada argues that U.S. CCP payments made under the 2002 Farm Act should similarly be counted against the U.S. amber box spending limit of \$19.1 billion. In addition, Canada claims that PFC, DP, and CCP payments for all covered crops — wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, and other oilseeds — should be counted against the amber box limit. Because the United States has only notified through the year 2001, no program spending under the 2002 Farm Act — including both the DP and CCP programs — has yet been notified. However, Canada charges that, when PFC, DP, and CCP payments are included in the U.S.’s amber box, then the total outlays exceeds the spending commitment in each of 1999, 2000, 2001, 2004, and 2005. In contrast, the United States, as part of its Doha policy reform proposal, recommends that CCP payments be eligible for notification as blue box payments where they would be subject to a different limit than the amber box.<sup>35</sup>

## U.S. Response to Canadian Allegations

In response to Canada’s recent request for consultations on U.S. subsidies, U.S. Secretary of Agriculture, Mike Johanns, declared that the United States would vigorously defend U.S. farm programs against any possible WTO challenge by Canada.<sup>36</sup> A spokesman for the U.S. Trade Representative (USTR) was critical of Canada’s action, particularly in light of the significant increase in international corn prices since September 2006. The USTR spokesman said, “Given the dramatic improvement in the market over the past year, we’re surprised that Canada believes that our corn programs are now causing harm in breach of WTO rules.”<sup>37</sup> However, current market conditions are unlikely to influence any WTO investigation (should the case reach that point) since Canada is specifically challenging U.S. subsidies for the period 1996 through 2006 when corn prices were substantially lower (**Figure 3**).

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<sup>34</sup> For more detail, see CRS Report RL32571, *Background on the U.S.-Brazil WTO Cotton Subsidy Dispute*, by Randy Schnepf.

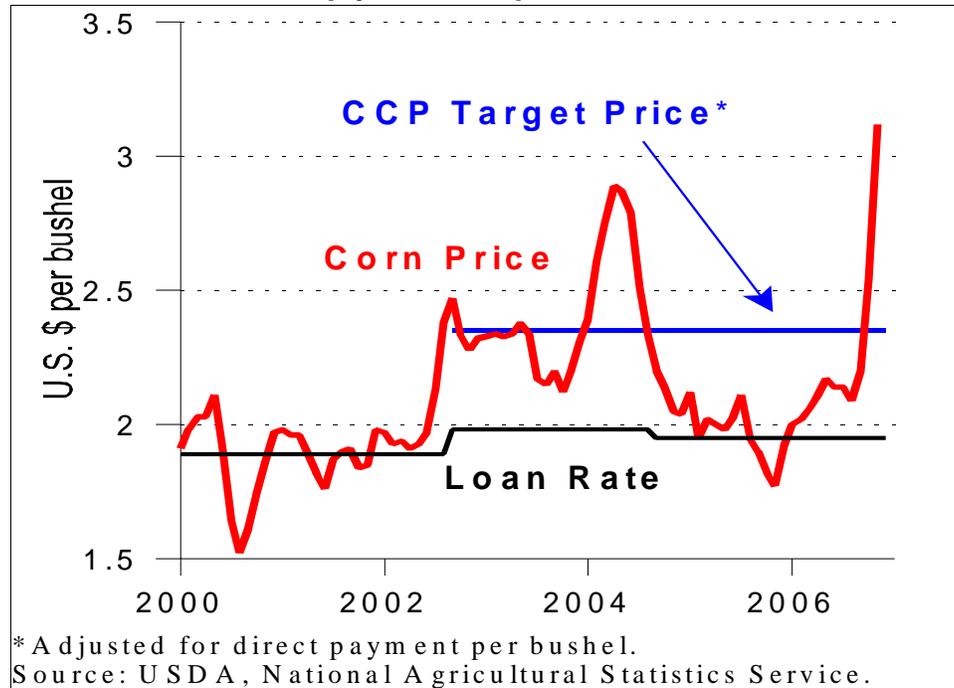
<sup>35</sup> Blue box payments are defined as “production-limiting” types of payments. For more information see CRS Report RL33144, *WTO Doha Round: The Agricultural Negotiations*, by Charles Hanrahan and Randy Schnepf.

<sup>36</sup> *Inside U.S. Trade*, “Johanns Says U.S. Will Defend Farm Programs from Canadian Challenge,” January 12, 2007.

<sup>37</sup> *International Herald Tribune*, “Argentina, Brazil join WTO complaint against U.S. corn subsidies,” Jan. 22, 2007.

In another response to Canada's recent request for consultations, the American Farm Bureau Federation (AFBF) stated that Canada's request for a WTO consultation should have "no bearing" on the U.S. farm policy debate.<sup>38</sup>

**Figure 4. U.S. Monthly Average Farm Price for Corn Has Risen Sharply Since September 2006**



## What Happens Next?

Under WTO rules, for subsidy complaints alleging adverse effects, a minimum 60-day consultation period is required before a country can ask for WTO to establish a panel.<sup>39</sup> If Canada and the United States are unable to reach some sort of agreement during the consultations, and Canada insists on establishing a WTO panel, this would likely not occur until the April meeting of the WTO's Dispute Settlement Body (DSB). This is because the United States could potentially block a Canadian panel request at the DSB's March meeting. While a WTO case can result in punitive sanctions being authorized, the proceedings of a formal case can take many months, and sometimes years, to reach a conclusion.<sup>40</sup>

For example, the U.S.-Brazil cotton case was initiated by Brazil's request for WTO consultations on September 27, 2002. A panel was established nearly six months later on March 18, 2003. The panel's final report was delivered to the WTO

<sup>38</sup> AFBF press release, "Statement by Bob Stallman, President, AFBF, Regarding Canadian Request for WTO Consultations on Subsidies," Jan. 8, 2007.

<sup>39</sup> Article 7.4, SCM Agreement.

<sup>40</sup> For more information, see CRS Report RS20088, *Dispute Settlement in the World Trade Organization: An Overview*, by Jeanne Grimmett.

Dispute Settlement Body (DSB) 18 months later on September 8, 2004. The case was appealed and the Appellate Body's final report was adopted by the DSB on March 21, 2005, nearly 30 months after the initial request for consultations.<sup>41</sup> However, the case is not yet finalized as a WTO compliance panel is currently reviewing (under request from Brazil) whether the United States has fully complied with the panel's rulings. The WTO compliance panel's chairman has said that the panel would not be able to make a determination before July 2007, thus extending the length of the U.S.-Brazil cotton case to nearly five years.

## Potential Implications of WTO Case

Many market analysts and news media suggest that the U.S.-Canada corn trade dispute is a harbinger of future challenges against U.S. commodity programs. If successfully litigated, this case could affect all U.S. agricultural policy by determining that both direct and counter-cyclical payments should be counted as trade-distorting amber box support and thereby making the \$19.1 billion amber-box spending limit a serious ceiling on U.S. program outlays in their current form. Furthermore, there is not a clear precedent for what constitutes successful compliance with a serious prejudice charge. Compliance through policy reform would likely require substantial reshaping of current U.S. commodity programs that use market price triggers for determining payments.

With respect to the ruling that PFC and DP payments do not fully comply with green box rules, compliance through policy reform would likely involve some type of adjustment, if not full removal, of the planting restriction on fruits, vegetables, and wild rice on acres receiving direct payments.

With respect to the ruling that export credit guarantees operate like illegal export subsidies, compliance through policy reform would likely involve incorporating user fees that reflect the market risk associated with each loan guarantee. For example, this could be achieved by removing the 1% cap on user fees charged under the export credit guarantee program. The 1% fee cap prevents charging market-based fees and contributes to the export credit guarantee program operating as a WTO-illegal export subsidy.

## Role of Congress

Should any eventual changes in U.S. farm policy be needed to comply with a WTO ruling in Canada's favor, such changes would likely involve action by Congress to produce new legislation. Congress will be revisiting U.S. farm legislation this year and could potentially address some of the issues raised by Canada's WTO challenge.

During the past year, Agriculture Secretary, Mike Johanns, has been advocating that a new Farm Act should be designed to make U.S. farm policy be "beyond challenge." The Administration recently released (January 31, 2007) a proposal for

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<sup>41</sup> This timeline is discussed in more detail in CRS Report RL32571, *Background on the U.S.-Brazil WTO Cotton Subsidy Dispute*, by Randy Schnepf.

U.S. farm policy reform that, if incorporated into a new Farm Act, potentially could alleviate many of Canada's concerns while minimizing the likelihood of future WTO challenges.<sup>42</sup> The proposal includes removal of the planting restriction on base acres receiving direct payments. It also includes adjustments to the export credit guarantee program to make them more compatible with WTO rules. Finally, the proposal includes adjustments to price-contingent commodity programs, i.e., the marketing loan program and the CCP, that would likely make them more WTO compliant.

Given the importance of corn in the U.S. agricultural economy, Congress will be closely monitoring developments in the WTO corn dispute. The House Committee on Agriculture regularly holds hearings on agricultural trade negotiations. For example, such hearings were held on April 28 and May 19, 2004.<sup>43</sup> Among the trade issues discussed during these hearings, both the U.S. Trade Representative and representatives of major program commodity groups provided testimony on U.S. participation in international trade negotiations.

In addition, the 110<sup>th</sup> Congress is likely to hold hearings and be in consultation with the Administration concerning the possible extension of fast track, or Trade Promotion Authority (TPA) legislation which is set to expire on July 1, 2007.<sup>44</sup> Such hearings and consultations would be a major vehicle for Members to express their views on the U.S.-Canada corn trade dispute, on the negotiating issues that it raises, and on the potential implications for U.S. farm policy.

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<sup>42</sup> USDA News Release No. 0020.07, "Johanns Unveils 2007 Farm Bill Proposals," Jan. 31, 2007.

<sup>43</sup> Hearings before the Committee on Agriculture, House of Representatives 108<sup>th</sup> Congress, Second Session, April 28 and May 19, 2004, Serial No. 108-29, at [<http://agriculture.house.gov/hearings/108/10829.pdf>].

<sup>44</sup> For more information, see CRS Report RL33743 *Trade Promotion Authority (TPA): Issues, Options, and Prospects for Renewal*, by J. F. Hornbeck and William H. Cooper.