Domestic subsidies in the Doha Round agricultural negotiations: Restriction to support or consolidation of distortions?

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Abstract

According to the latest notifications to the WTO, the cuts proposed for major economies in Overall Trade-Distorting Domestic Support (OTDS) would not substantially reduce the domestic support applied. However, the disciplines on OTDS that are under negotiation are aimed at providing all WTO Members with greater predictability as regards the maximum level of distorting support that farmers can receive in developed countries. In this sense, these disciplines will enable the farmers of those countries to better perceive market signals so that they gradually become less dependent on production subsidies.

However, the modifications concerning permitted or Green Box policies, included in paragraphs 6 and 11 of Annex 2 to the Agreement on Agriculture in the last draft Modalities, entail some flexibility, since income support is linked to yield, planted areas and livestock numbers which are determined by reference to base periods that may be updated. Therefore, these modifications can potentially undermine the advantages resulting from the commitment assumed to restrict and reduce trade-distorting domestic support programmes.

In view of the foregoing, it is crucial to ensure that the new disciplines on OTDS which will be finally agreed upon cannot be eluded by transferring said programmes—which guarantee prices and/or income linked to production—to the Green Box.

The Doha Round constitutes an incomparable opportunity to substantially restrict domestic support policies that distort trade and production, but at the same time it actually constitutes a threat of continuing with the current system of border protection and production incentives, thus consolidating the influence developed countries' treasuries have on farmers' decisions.

1. Introduction

The members that are parties to the General Agreement on Tariffs and Trade 1947 (GATT 1947) promoted the liberalization of international trade through periodic rounds of multilateral negotiations aimed, almost exclusively, at reducing import duties.

Traditionally, GATT regulated trade measures without interfering in purely domestic production policies, except for the duty to notify and the possibility of consulting when those measures had certain trade effects under Article XVI.[1]

From the beginning of the General Agreement, the agricultural sector was seen as a "special" sector of the economy due to various and different reasons, and thus it was not included in the negotiation mandates until the Uruguay Round (1986–1994). With the creation of the World Trade Organization and the entry into force of the Agreement on Agriculture in 1995, the situation changed considerably. For the first time disciplines were established to regulate and/or reduce market access restrictions, export subsidies and domestic support.

The specific provisions under the Agreement on Agriculture (AoA) concerning domestic support are aimed at limiting the policies that led to an exponential output growth in OECD countries. The Agreement intends to regulate and reduce domestic support, while providing governments with a certain margin for the establishment of domestic agricultural policies so that they can cope with the great variety of specific circumstances arising in each country. Moreover, the new rules on domestic support are also aimed at ensuring that the binding commitments assumed in the area of market access and export competition are not offset.

The Uruguay Round Agreement on Agriculture was a significant step towards disciplining international trade in agricultural products. In terms of domestic support, the main virtue of this Agreement was to define and to "put on the table" the different types of subsidies prevailing in developed country Members, and it was also agreed that those subsidies which are more likely to distort trade and production should be bound and reduced (FAO, 1999). However, that agreement should be considered as transitional. This is so because the disciplines contained therein—which are more flexible than those regulating international trade in industrial goods—have proved to be insufficient to considerably regulate, restrict and reduce distortions in agricultural trade.

The main flaws observed in the Agreement's provisions include (Desta, 2002): the consolidation of domestic support based on the period 1986–1988, when the international prices of agricultural products were very low, and therefore the level of distorting domestic support was very high; the lack of specific commitments by product for Amber Box or AMS subsidies, which would enable the discretional allocation of subsidies to different products according to prevailing market conditions; the lack of a cap or ceiling for *de minimis* and Blue Box payments; and finally the drafting of Annex 2, which eventually proved to be so permeable as to label trade-distorting programmes as "green".

This paper analyses the treatment of the last two previously mentioned flaws of the AoA which is currently under negotiation in the Doha Round, in view of their importance for the consolidation of effective disciplines on domestic support. It is divided into 5 sections. After this introduction, section 2 discusses domestic support under the Uruguay Round Agreement on Agriculture, briefly describing the measures taken so far as well as the use and

[1] GATT 1994. Article XVI.1. If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify the CONTRACTING PARTIES in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization.

composition of support in major developed countries during the implementation period 1995–2000. Section 3 assesses the disciplines that are under negotiation in the Doha Round to limit and reduce Overall Trade-Distorting Domestic Support (OTDS) and its impact on major developed economies. Section 4 comments on certain types of direct payments included in Annex 2 to the AoA in the last draft Modalities (TN/AG/W/4/Rev.4) and on the potential those payments have to circumvent the commitments to limit and reduce the amount of OTDS. Finally, section 5 presents some conclusions.

2. Domestic support in the Uruguay Round Agreement on Agriculture

2.1. Description of domestic support under the Agreement on Agriculture

Under the AoA, any domestic support for producers is subject to rules. In this Agreement there are two types of commitment in terms of domestic support: i) a qualitative commitment, which provides a definition of domestic support policies which are exempt or not from reduction commitments, and ii) a quantitative commitment, which limits—through the Schedules of Commitments—domestic subsidies subject to reduction commitments.

The measures which are not subject to reduction commitments include, in the first place, those measures with minimal trade-distorting effects such as, for example, the permitted policies making up the so-called Green Box[2] and the measures for developing countries set forth in Article 6.2 of the AoA; and, in the second place, those measures that may distort trade, but only moderately. The latter category includes production limiting programmes which entail payments to producers based on fixed area, yields or level of production (Blue Box) as well as the *de minimis* levels set forth in Article 6.4 of the AoA.

The measures potentially posing the greatest risks of trade and production distortions are those which are subject to reduction commitments. They are usually channelled through price support programmes, subsidies for inputs and/or investment, thus isolating producers from market signals and interfering significantly in their production decisions. These measures enable certain countries and sectors to produce, or produce in excess beyond the levels of self-sufficiency, thus leading to strong distortions in both the domestic and the international market.

— Domestic Support Measures not subject to reduction commitments

Green Box

Green Box measures are listed in Annex 2 to the Agreement on Agriculture. The essential requirement for these measures to be exempt from reduction commitments is that they are non- or only minimally trade-distorting. Likewise, this support must be provided through government programmes financed by public funds (including government revenue foregone) which shall neither involve transfers from consumers nor have the effect of providing price support to producers.

Annex 2 to the Agreement lists the following measures:

- research and training services, pest and disease control, extension and advisory services, inspection services, marketing and promotion services, and infrastructural services (paragraph 2);
- domestic food aid and public stockholding for food security purposes (paragraphs 3 and 4 respectively); and

[2] For the historical context of the Green Box introduced in the Uruguay Round, see Stancanelli (2009).

- direct payments to producers such as decoupled income support (paragraph 6), income insurance and income safety-net programmes (paragraph 7), payments for relief from natural disasters (paragraph 8), producer retirement programmes and resource retirement programmes (paragraphs 9 and 10), structural adjustment assistance provided through investment aids (paragraph 11), environmental programmes (paragraph 12), and regional assistance programmes (paragraph 13).

Development Measures

Article 6.2 of the Agreement excludes from the reduction commitment certain domestic support measures, whether direct or indirect, which are aimed at encouraging agricultural and rural development and which are an integral part of developing countries' programmes. These include: investment subsidies which are generally available to agriculture in developing country Members; agricultural input subsidies generally available to low-income or resource-poor producers in developing country Members; and domestic support to producers in developing country Members to encourage diversification from growing illicit narcotic crops.

Blue Box

Although trade- and production-distorting, those direct payments under production-limiting programmes shall not be subject to the commitment to reduce domestic support if:

- such payments are based on fixed area and yields; or
- such payments are made on 85 per cent or less of the base level of production; or
- livestock payments are made on a fixed number of heads.

***De minimis* exemptions**

In principle, all domestic support measures which cannot be included under the Green Box, Art. 6.2 or the Blue Box are subject to reduction commitments. *De minimis* exemptions allow domestic support which would otherwise be subject to reduction commitments to be exempt where such support does not exceed 5 per cent of the total value of production of a specific agricultural product. Moreover, non-product-specific support is exempt from reduction commitments where such support is less than 5 per cent of the total value of agricultural production. It is worth noting that the 5 per cent threshold applies to developed countries, while for developing countries, the ceiling is 10 per cent.

— Measures subject to reduction commitments: Aggregate Measurement of Support or Amber Box

Support provided under non-exempt measures is included in the Aggregate Measurement of Support (AMS) or Amber Box, which is the sum of expenditures on non-exempt domestic support corresponding to all products and policies.

Both budgetary outlays and revenue foregone are taken into consideration to calculate the AMS. Annex 3 to the Agreement lists the categories of production subsidies that should be included in the AMS or Amber Box:

- market price support;
- non-exempt direct payments which are dependent on a price gap or based on factors other than price; and
- other non-exempt measures, including input subsidies.

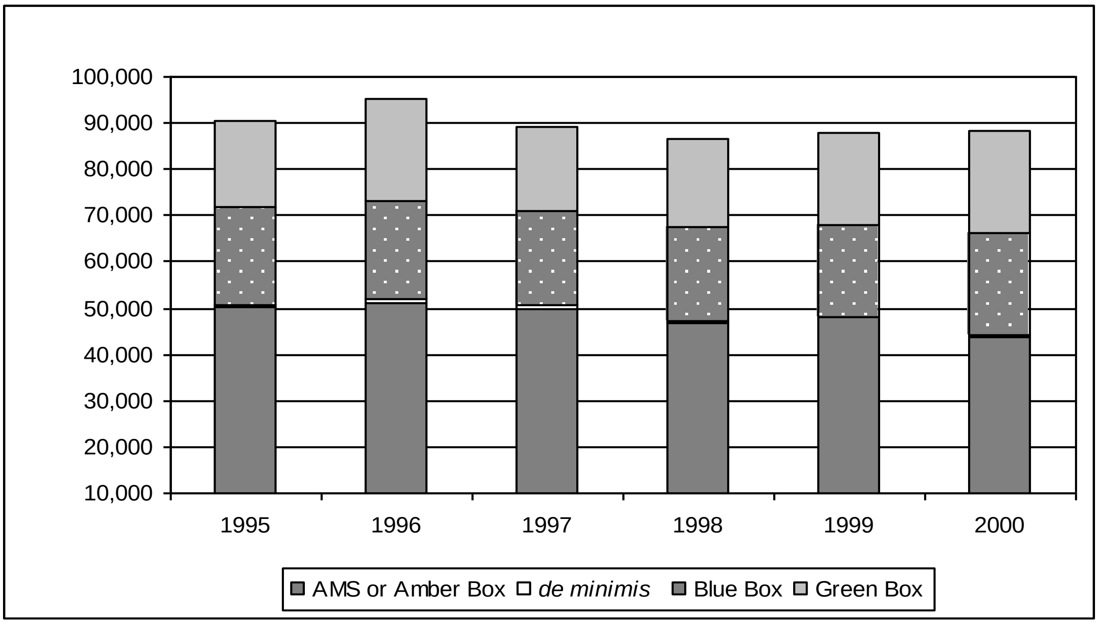
The amount of subsidies aimed at market price support is calculated using the gap between a fixed external reference price—which should be based on the period 1986–1988—and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price. The amount of direct payments and other non-exempt measures is calculated using budgetary outlays.

Members assumed a commitment to reduce 20 per cent (13.3%, in the case of developing countries) of the base AMS on equal annual instalments over the implementation period 1995–2000 (1995–2004, in the case of developing countries). It is worth mentioning that reduction commitments refer to total AMS, which means that there are no reduction commitments related to specific products or policies.

2.2. Use and composition of aid in the main developed countries during the implementation period 1995–2000

The EU average domestic support was at EUR 90 billion a year over the period 1995–2000, and showed almost no variation in terms of its composition (Graph 1). Green Box expenditures and Blue Box payments were at around EUR 20 billion annually, representing in each case 22 per cent of total domestic support. Amber Box or AMS expenditures were at around EUR 50 billion annually, that is, 55 per cent of total domestic support.

Graph 1
EU domestic support: 1995–2000
in millions of EUR



Source: CEI based on notifications submitted by the EU to the WTO.

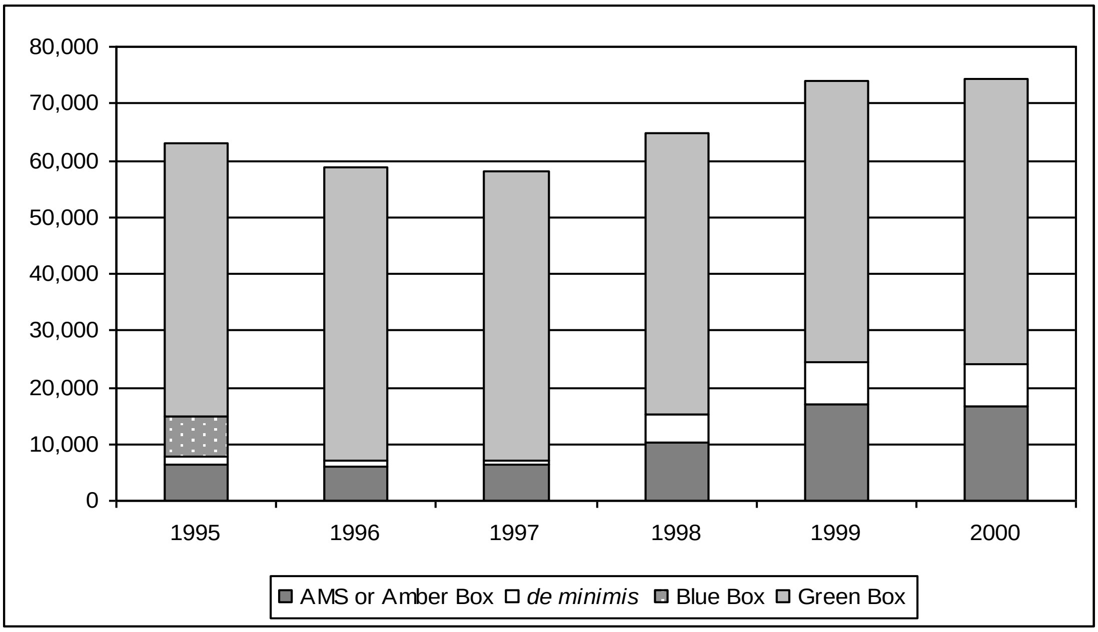
As for Green Box policies, 75 per cent of the support granted by the EU was in the form of direct payments. It is worth pointing out that, within this category, 80 per cent of said support was destined to the structural adjustment assistance provided through investment aids, payments under environmental programmes and regional assistance programmes (Paragraphs 11, 12 and 13 of Annex 2 to the AoA).

Payments for cereals—and, to a lesser extent, for oilseeds—based on fixed area and yields accounted on average for 75 per cent of Blue Box payments during the period 1995–2000.

During the implementation period, the EU Amber Box or AMS included market price support (MPS) policies and non-exempt direct payments (NDPs). Between 1995 and 2000 the products that received on average the highest level of subsidies through MPS were: beef (30% of total AMS or Amber Box), white sugar, butter, wheat, barley, maize, olive oil, wine, and cotton. The system of NDPs was generally used for fruit and vegetables, among which tomatoes, apples, pears and peaches stood out.

The US average domestic support was at USD 64 billion a year over the period 1995–2000, and since 1998 there has been a substantial increase in support as a result of the escalation recorded in *de minimis* payments and in the Amber Box (Graph 2). Green Box expenditures remained constant at around USD 50 billion a year and, except in 1995, there were no Blue Box payments[3].

Graph 2
US domestic support: 1995–2000
in millions of USD



Source: CEI based on notifications submitted by the United States to the WTO.

As for Green Box policies, 85 per cent of the support granted by the United States was destined to domestic food aid programmes and general research, inspection, marketing and advisory services. Since the enactment of the 1996 Farm Bill, the United States also

[3] Amended by the Federal Agriculture Improvement and Reform Act of 1996.

included decoupled income support payments, whose annual average was approximately of USD 5 billion.[4]

Since 1998, the sudden increase in *de minimis* payments has been accounted for by the inclusion of the "market loss" assistance programme. This mechanism allowed those producers who received production flexibility contracts (PFCs) payments—that is, decoupled Green Box direct payments during the tax year 1998–1999 and 2000—to also receive market loss assistance payments proportional to PFC payments as set out in the Agricultural Risk Protection Act of 2000 (Public Law 106–224).[5]

During the implementation period, the US Amber Box or AMS, as well as that of the EU, included market price support (MPS) policies and non-exempt direct payments (NDPs). During the period under analysis, the only products that received subsidies through MPS were sugar, dairy products and peanuts. The system of NDPs was used for other products, among which soybean, maize, cotton and rice received a high level of support.

Japan's average domestic support was at JPY 5 trillion over the period 1995–2000 (Graph 3). The sharp decrease in domestic support observed since 1998 was triggered by the 70 per cent reduction in Amber Box subsidies implemented since the reform introduced in the rice sector. Said year, non-exempt direct payments to rice were eliminated. Instead, a rice farming income stabilization programme was implemented—direct payments to producers within the production limiting programme (Blue Box)—and border protection increased to prohibitive levels, such as 700 per cent ad valorem duties. Green Box expenditures remained constant at around JPY 2.5 trillion a year. Ninety per cent of the Green Box in Japan was destined to programmes on general research, inspection, marketing and advisory services.

[4] In 2005, within the framework of Brazil's WTO case against US cotton subsidy and guarantee programmes, the WTO Appellate Body claimed that the direct payments introduced by the United States in the 1996 Farm Bill and included under the classification "Production Flexibility Contracts" could not be considered "green" since they prohibited the planting of fruit and vegetable on base acreage.
[5] For US agricultural policy programmes, see Monke (2006).

Graph 3
Japan domestic support: 1995–2000
in billions of JPY

Source: CEI based on notifications submitted by Japan to the WTO.

3. The disciplines that are currently being negotiated in the Doha Round to limit and reduce Overall Trade-Distorting Domestic Support (OTDS)

On the basis of the limitations of the Agreement on Agriculture to restrict the granting of domestic support, WTO Members undertook to negotiate new disciplines that substantially reduce trade-distorting domestic measures. With the launch of the Doha Round in 2001 and the adoption of the work programme in August 2004[6], WTO Members agreed on a comprehensive approach of this issue.

The main concepts on domestic support contained in the work programme that served as the basis for subsequent draft modalities to establish specific binding commitments in the Doha Round are:

- The Bound AMS or Amber Box and the permitted *de minimis* levels will be subject to substantial reductions and, in the case of the Blue Box, support will be capped.
- In addition to specific commitments, each such Member will make a substantial reduction in the overall level of its trade-distorting support from bound levels.
- The overall base level of all trade-distorting domestic support, as measured by the Final Bound Total AMS plus the permitted *de minimis* level and the level agreed for Blue Box payments, will be reduced according to a tiered formula. Under this formula, Members having higher levels of trade-distorting domestic support will make greater overall reductions in order to achieve a harmonizing result.
- This commitment will apply as a minimum overall commitment. However, it will not be applied as a ceiling on reductions of overall trade-distorting domestic support, should the separate and complementary formulae to be developed for Total AMS, *de*

[6] WT/L/579 - Decision adopted by the General Council on 1 August 2004.

minimis and Blue Box payments imply, when taken together, a deeper cut in overall trade-distorting domestic support for an individual Member.

In addition to the specific reduction commitments for the different components of domestic support, Members have introduced to the negotiations a key concept in the establishment of new disciplines: Overall Trade-Distorting Domestic Support or OTDS, which must be substantially bound and reduced.

3.1. Treatment of overall trade-distorting domestic support (OTDS) in the last draft Modalities for the Establishment of Specific Binding Commitments (TN/AG/W/4/Rev.4)

OTDS was one of the central issues of the different drafts Modalities[7] written as from July 2004. In general, Members had a common understanding of the construction of the Base OTDS on which the reductions as well as the tiers of the tiered formula would be applied. Nevertheless, Members could not reach an agreement on the reduction percentage that would correspond in each case, which is evident from the use of square brackets with different reduction options for each tier of the formula.

In the last draft Modalities, tabled by the Chairman of the Special Session of the Committee on Agriculture of 6 December 2008[8] the square brackets were eliminated and only one proposal was put forward to regulate OTDS. The main elements of this proposal which are applicable to developed countries are:

- The base level for reductions in Overall Trade-Distorting Domestic Support shall be the sum of: i) the Final Bound Total AMS; ii) 10 per cent of the average total value of agricultural production in the 1995–2000 base period (this being composed of 5 per cent of product-specific *de minimis* payments and 5 per cent of non-product-specific *de minimis* payments); and iii) the average of Blue Box payments as notified to the WTO Committee on Agriculture, or 5 per cent of the average total value of agricultural production—whichever is higher—in the 1995–2000 base period.
- The Base OTDS shall be reduced in accordance with the following tiered formula:

  a) where the Base OTDS is greater than USD 60 billion, or the equivalent in the monetary terms in which the binding is expressed, the reduction shall be 80 per cent;

  b) where the Base OTDS is greater than USD 10 billion and less than or equal to USD 60 billion, or the equivalents in the monetary terms in which the binding is expressed, the reduction shall be 70 per cent;

  c) where the Base OTDS is less than or equal to USD 10 billion, or the equivalent in the monetary terms in which the binding is expressed, the rate of reduction shall be 55 per cent.
- Developed country Members with high relative levels of Base OTDS in the second tier (at least 40 per cent of the average total value of agricultural production in the 1995–2000 period) shall undertake an additional reduction that shall be equal to one half of the difference between the reduction rates specified for tiers a) and b) above, that is, 5 percentage points.

[7] TN/AG/W/3 (12 July 2006), TN/AG/W/4 (1 August 2007), TN/AG/W/4/Rev.1 (8 February 2008), TN/AG/W/4/Rev.2 (19 May 2008), TN/AG/W/4/Rev.3 (10 July 2008).
[8] TN/AG/W/4/Rev.4.

- The reductions shall be implemented in six steps over five years.
- Base, Annual and Final Bound OTDS entitlements shall be scheduled in monetary terms in Part IV of the Schedules of Commitments. Such commitments will apply as a minimum overall commitment. Each Member shall ensure that the sum of the applied levels of trade-distorting support under each OTDS component does not exceed the Annual and Final Bound OTDS levels specified in Part IV of its Schedule.

The disciplines to limit and reduce OTDS are still under negotiation, without disregarding the principle of "single undertaking"—nothing is agreed until everything is agreed—that governs the Doha Round. Nevertheless, the reduction percentages included in TN/AG/W/4/Rev.4 are thought to give a very accurate idea of what will possibly be agreed in the end.

3.2. Binding and composition of OTDS

With the binding of Base OTDS in monetary terms specified in Part IV of the Members' Schedules of Commitments, all potentially trade-distorting production subsidies are, for the fist time, subject to a cap or ceiling.

While the Agreement on Agriculture only established limits on Amber Box payments, in Doha—on the basis of the commitment to bind and reduce OTDS—Blue Box payments and *de minimis* levels shall not exceed a maximum amount in spite of the fact that their values are bound as a percentage of the average value of production (or as the average of expenditures incurred during a certain period in the past).

Taking into account that—except for the Bound AMS or Amber Box—Base OTDS is based on a percentage of the 1995–2000 average gross value of production, it is crucial that said information is available to all Members and cannot be modified. In this respect, Argentina has put forward[9] that, at the time of agreeing on the Modalities, the gross value of production of each Member must be annexed to the document so that no change can be introduced when preparing and verifying the Schedules of Commitments. It is worth noting that paragraph 12 of the draft Modalities text TN/AG/S/21/Rev.4 includes this concept, and the WTO Secretariat has updated the value of production of most Members.[10]

Table 1 shows the Base OTDS for major developed countries. As can be observed, the relevance of the AMS or Amber Box in the composition of the Base OTDS changes considerably among major developed countries: while the AMS accounts for 60 per cent of EU OTDS and for more than 70 per cent of Japan's OTDS, in the case of the United States, the AMS accounts for less than 40 per cent of OTDS.

[9] JOB(09)/65, 2 July 2009.
[10] TN/AG/S/21/Rev.4, 6 December 2008.

Table 1
Overall trade-distorting domestic support: base level

Member	Base OTDS	Bound Amber Box		Blue Box average or 5% GPV 95-00		maximum specific *de minimis*		maximum non-specific *de minimis*		Average Gross Production Value 1995–2000	Unit of measurement
		value	%	value	%	value	%	value	%		
EU–27	119,464	72,244	60	21,293	18	12,963	11	12,963	11	259,269	millions of euros
US	48,491	19,103	39	9,796	20	9,796	20	9,796	20	195,931	millions of USD
Japan	5,449	3,972	73	492	9	492	9	492	9	9,849	billions of JPY
Norway	21,206	11,449	54	7,493	35	1,132	5	1,132	5	22,643	millions of NOK
Switzerland	5,970	4,257	71	571	10	571	10	571	10	11,420	millions of CHF
Canada	8,918	4,301	48	1,539	17	1,539	17	1,539	17	30,765	millions of CAD

Source: CEI based on TN/AG/S/21, TN/AG/S/21/Rev.3, TN/AG/S/13, TN/AG/S/14 and notifications to the WTO submitted by Members subject to review.

This paper analyses the EU–27 AMS or Amber Box, but Section I Part IV of Schedule CXL corresponding to the EU–25 and the EU–27 has not as yet been submitted and certified by Members.[11] It is worth highlighting that while there is no procedure to certify the changes introduced to the subsidy schedules, there exists a procedure to introduce changes to market access schedules.[12] The bound AMS of Poland, the Czech Republic and Bulgaria taken together exceed USD 5 billion.

3.3. Reduction in the Base OTDS: impact on applied levels

OTDS reduction has different effects on the applied levels of trade-distorting domestic support in major industrialized countries (Table 2). The results shown in this table must be carefully analysed so as not to fall into the error of considering the ambition of the cuts proposed—and, in general, of the disciplines on OTDS—by only taking into account the impact on the applied levels[13] of trade-distorting domestic support.

[11] The value of the EU–27 AMS was calculated on the basis of the EU–15 AMS plus the AMS of New Members.
[12] L/4962 of 26 March 1980.
[13] The latest notification to the WTO submitted by the United States, Switzerland and Norway was in 2007; that submitted by the EU, in 2006/2007; that submitted by Japan, in 2006; and that submitted by Canada, in 2004.

Table 2
Reduction in the Base OTDS and applied levels

Member	% Reduction Tiered formula	Bound Base	Final post-Doha Bound	Applied	Applied reduction %	Unit of measurement
EU–27	80%	119,464	23,893	34,180	30%	millions of euros
US	70%	48,491	14,547	8,513	0%	millions of USD
Japan	75%	5,449	1,362	678	0%	billions of JPY
Norway	60%	21,206	8,482	14,343	33%	millions of NOK
Switzerland	60%	5,970	2,388	2,521	5%	millions of CHF
Canada	55%	8,918	4,013	3,184	0%	millions of CAD

Source: CEI based on TN/AG/S/21, TN/AG/S/21/Rev.3, TN/AG/S/13, TN/AG/S/14 and notifications to the WTO submitted by Members subject to review.

In the case of the EU, Table 2 shows that an 80 per cent reduction in the Base OTDS implies an effective 30 per cent reduction in the levels of trade-distorting domestic support applied during the marketing year 2006/2007, when the applied trade-distorting domestic support plunged with respect to previous marketing years.[14]

It is worth mentioning that due to the substantial reform of the Common Agricultural Policy initiated in 2003—which includes a progressive reduction in the price support for several products following a fall in the administered price[15], a significant reduction in the area payments for cereals and oilseeds, and a substantial transfer of subsidies to the system of Green Box direct payments (which will be analysed in section 4 of this paper)—the 2013 OTDS applied levels are expected to be between EUR 19 and 26 billion a year (Kutas, 2006), that is, very close to the maximum levels Members committed not to exceed.

It could be said that the Fischer reform[16] of the CAP in 2003 took account of the fact that the disciplines on domestic support that were to be agreed in Doha would substantially limit trade-distorting domestic support in the EU, and therefore policies falling outside the scope of reduction commitments had to be implemented.

In the case of the United States, although the reduction in the Base OTDS does not imply a cut in the applied trade-distorting support, it is important to mention that 2007—the last notified year used to calculate the applied levels—was a year when the international prices of the main commodities were high, and therefore it was not necessary to implement the main price support programmes (see Box 1).

The 60 per cent cut in the case of Norway would lead to a 33 per cent reduction in its applied OTDS, whereas Switzerland must reduce its applied overall trade-distorting domestic support by 5 per cent. Once the cuts have been made, Canada would not have to reduce its applied trade-distorting support; yet, it is worth mentioning that Canada's latest

[14] This topic is commented on in section 4.1 and, in particular, it can be observed in Graph 5.
[15] Dairy products, olive oil, rice, sugar, etc.
[16] Named after Mariann Fischer Boel, Danish, EU Commissioner for Agriculture at the time.

notification to the WTO was in 2004, and the data contained therein may not be representative of the current support.

For Norway, Switzerland and Canada the disciplines on OTDS are not operative because the sum of the final bound values of the AMS[17], the Blue Box[18] and the *de minimis* levels[19]—once the specific cuts have been carried out—results in an overall domestic support which is lower than the final OTDS.

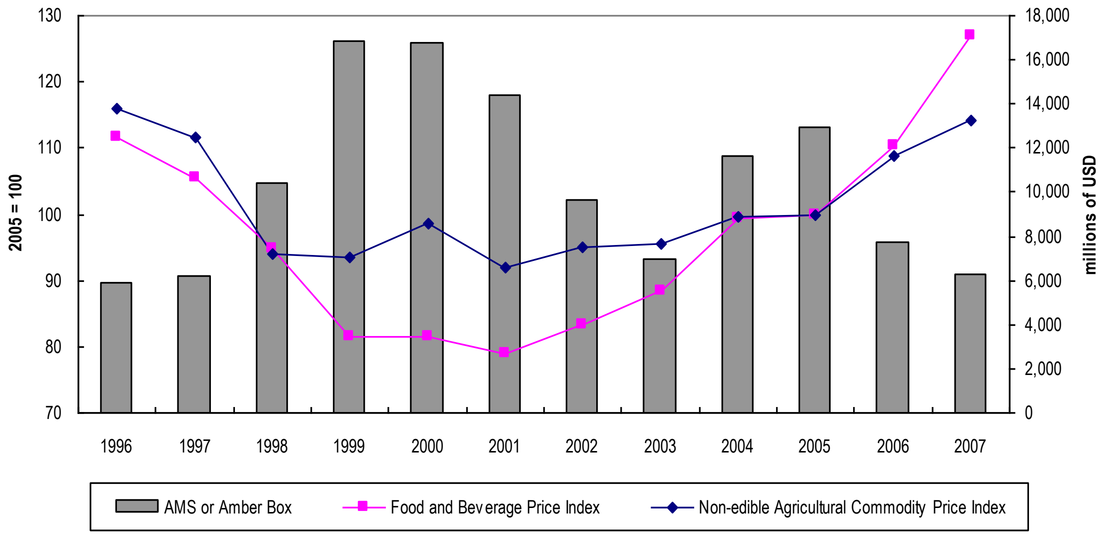
It is worth remembering that Doha Round negotiations began in 2001. What today may be seen as a low level of ambition due to the absence of substantial cuts in the applied levels was not so then, and it will certainly not be so in the future, when, because of the volatile and cyclical behaviour of commodity prices (Bastourre, Carrera and Ibarlucia, 2008), trade-distorting domestic support programmes—if there is no commitment on OTDS—could be effective once again.

Box 1

Evolution of prices and US AMS

Observing the evolution of international prices and comparing the use of Amber Box subsidies in the United States for the same products in the same period 1996–2007 (Graph 4), a basic rule in terms of domestic support for the agricultural sector can be drawn: the direct correlation between the evolution of prices and subsidies, that is, the higher the prices, the lower the subsidies, and the lower the prices, the higher the subsidies.

Graph 4
Agricultural prices vs. US applied AMS
1996–2007



Source: CEI based on IMF and US notifications to the WTO.

In the periods 1995–1998 and 2006–2007 and, to a lesser extent, in 2003, the level of specific subsidies was low in the United States for most of the products due to high international prices, thus rendering government intervention unnecessary. On the contrary, during 1999–2001 and, to a lesser extent, during 2004–2005, the plummeting of international prices caused the escalation of US AMS non-exempt direct payments, in particular through the support granted for cereal and oilseed production (Table 3).

Table 3
Evolution of main international commodity prices and of the specific AMS applied by the United States

Year	Wheat		Maize		Rice		Barley		Soybean	
	HRW G. México	Applied AMS[1]	Yellow No.2 G. México	Applied AMS[1]	White 5% Thailand	Applied AMS[1]	No.1 Canada	Applied AMS[1]	Yellow No.2 Chicago	Applied AMS[1]
	USD per tonne	millions of USD	USD per tonne	millions of USD	USD per tonne	millions of USD	USD per tonne	millions of USD	USD per tonne	millions of USD
1995	177	3	123	32	321	11	104	1	244	16
1996	207	8	165	28	338	6	120	1	277	14
1997	160	36	117	150	302	6	97	4	281	45
1998	126	515	102	1,533	305	20	85	84	223	1,275
1999	112	973	90	2,554	249	434	76	40	175	2,856
2000	114	847	88	2,756	204	624	77	70	183	3,606
2001	127	189	90	1,264	173	762	94	16	169	3,610
2002	149	22	99	187	192	711	109	4	189	52
2003	146	107	105	232	199	503	105	1	233	24
2004	157	90	102	3,059	246	130	99	83	277	505
2005	152	28	98	4,490	288	131	95	46	223	70
2006	192	2	122	18	304	3	117	9	217	64
2007	255	0	163	17	332	3	172	0	317	5
2008	326	n.a.	223	n.a.	700	n.a.	200	n.a.	453	n.a.

[1] It includes specific *de minimis* values

Source: CEI based on the International Monetary Fund and notifications submitted by the United States to the WTO.

In 2007, the last period notified to the WTO, the United States recorded significant expenditures in terms of prices only for dairy products and sugar, whose price support programmes proved to be relatively stable from the beginning of the Uruguay Round implementation period, since the difference between the administered price and the fixed external reference price is counted as a subsidy.

Since the reform of the 2008 Farm Bill[20], the US government has started to indirectly subsidise the price of milk by guaranteeing minimum purchase prices for butter, cheddar cheese and skimmed milk. The change observed in the form of granting direct support is expected to have a considerable impact on the levels of subsidies granted for the dairy sector, going down from USD 5 billion a year recorded until 2007 to USD 3 billion recorded as of 2008 (Inside US Trade – 21 May 2010[21]).

[20] Public Law 110–246 – 18 June 2008
[21] www.InsideTrade.com

4. The disciplines under negotiation in the Doha Round for the Green Box

4.1. Which policies under Annex 2 to the AoA are likely to be more trade-distorting?

Taking into account that they are exempt from reduction commitments, the policies included in the Green Box under the Agreement on Agriculture shall comply with the main objective of being non- or only minimally trade-distorting.

As yet, there is no definition as to what the acceptable scope of the word “minimum” in this context is. Moreover, it cannot be said that this is an operative principle which is applicable *per se* to all programmes, nor that it is simply a statement that serves as an introduction to the two basic criteria of paragraphs 1 a) and b), and to the specific criteria of paragraphs 2 to 13 of Annex 2 to the Agreement.

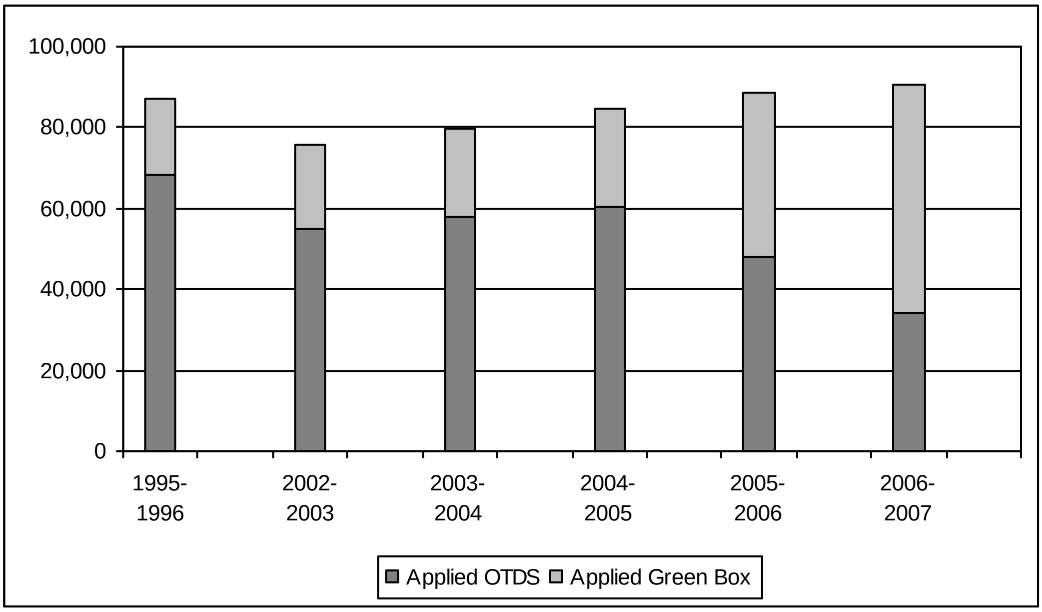
During the Uruguay Round implementation period (1995–2000), and according to estimates made by India, the provisions of Annex 2 to the Agreement on Agriculture—and in particular paragraphs 5, 6, 7 and 11—have enabled high subsidising countries to enhance their overall level of support to agriculture (WTO, 2001). This is revealed by the Producer Support Estimate (PSE) in OECD countries, which went up from USD 246 billion in 1986–1988 to USD 283 billion in 1999 (OECD, 2000).

In the last years, this trend has been exacerbated in industrialized countries. In 1995 the US Green Box totalled USD 48 billion, whereas during 2003 said expenditures reached USD 74 billion, and in 2007 they reached USD 87 billion[22]. It is important to mention, however, that most of the US Green Box corresponds to expenditures on food aid (granting of food item coupons).

Taking the EU as an emblematic case, during the last period notified (marketing year 2006/2007) there was an exponential growth of Green Box expenditures in absolute terms and in relation to overall domestic support (Graph 5), as well as a substantial increase in the direct payments within total Green Box expenditures (Graph 6).

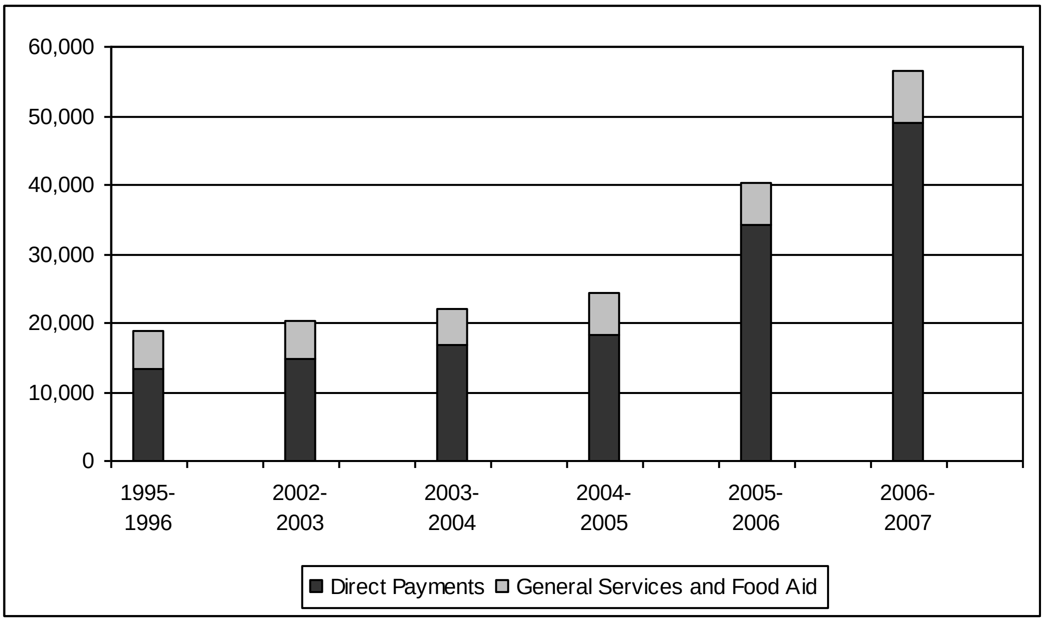
[22] Source: notifications of the United States to the World Trade Organization.

Graph 5
Evolution of EU domestic support
in millions of EUR



Source: CEI based on notifications submitted by the EU to the WTO.

Graph 6
Composition of EU Green Box
in millions of EUR



Source: CEI based on notifications submitted by the EU to the WTO.

Among Green Box measures, direct payments under paragraphs 6, 7 and 11 are considered to be more likely to distort trade and production due to the following reasons:

- Support in the form of direct payments, including "decoupled" income support, substantially increases the ability of farmers to take risk as well as to make farm investments, since such payments entail insurance and wealth effects.
- Direct payments encourage greater use of farm inputs and enhance access to technology leading to over-production, which in turn distorts agricultural markets.
- Decoupled or direct payments can be a powerful incentive to maintain or increase current production in the expectation of receiving higher levels of future support.
- Direct payments increase land values and, for this reason, land continues to be used for agricultural production instead of being used for other activities.
- Decoupled or direct payments heavily subsidise the cost of production, which enables the receivers of such support to capture a substantial share in the export markets at the cost of more efficient producers.

From the experience gained since the implementation of the commitments assumed in the Uruguay Round and with the aim of improving the disciplines under Annex 2 to the Agreement, in the Doha Round Members began to negotiate the modification of the existing rules, especially those related to the direct payments mentioned in paragraphs 5 to 13, in order to guarantee that the programmes thereunder are non- or only minimally trade-distorting.

4.2. The modifications to the Green Box proposed in the last draft Modalities: do they guarantee that the measures included therein distort trade and production only minimally?

From the beginning, the negotiations aimed at modifying the Green Box were extremely difficult. The greater divergences in the positions of Member States were observed when considering the possibility of updating base periods in the case of production-decoupled income support (paragraph 6).

While some developing agro-exporting countries such as Argentina consider that the current text of paragraph 6 a) of Annex 2 to the AoA does not allow the update of base periods since it requires that said periods are "defined and fixed", industrialized countries consider that such text does not preclude the possibility of occasionally updating base periods and, in fact, they have updated them from time to time since the creation of the World Trade Organization in 1995, for example in each new US Farm Bill or Reform of the European Common Agricultural Policy.

The text of the new paragraph 6 a) on decoupled support included in the last draft Modalities (TN/AG/W/4/Rev.4)—which is applied to the provisions of paragraph 11 on structural adjustment assistance provided through investment aids—only addressed industrialized countries' concerns, leaving aside the proposals of countries such as India and Argentina. Said text stipulates the following:

a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined, fixed and unchanging historical base period which shall be notified to the Committee on Agriculture. Transfer of entitlements to existing decoupled income support between producers or landowners shall not be precluded. An exceptional update is not precluded, *provided that producer expectations and production decisions are unaffected, in particular due to a) ensuring that any updated base period is not only a significant number of years in the past but is also determined and promulgated by the administering authority in such a way that the updated base concerned could not have been reasonably anticipated by producers such that their production decisions could be materially altered, b) that such updating is not made in conjunction with, or otherwise amounts de facto to, a decision to increase the uniform unitary rate per crop and c) that this updating shall not, in itself or otherwise by reason of its introduction, have the effect, directly or indirectly, of circumventing the obligation regarding domestic support measures and price support to producers pursuant to paragraph 1.*

Members which have not previously made use of this type of payment and thus have not notified and which cannot establish a historical base period because of a lack of data shall not be precluded from establishing an appropriate base period which, provided that it is not based on any future factor use or production, need not be based on a pre-existing determinate historical record, but which shall be fixed and unchanging and shall be notified. This is without prejudice to the possibility for Members to establish appropriate base periods for substantially different decoupled income support in accordance with the conditions laid down in this paragraph.

The only effective remedy to guarantee that "decoupled" direct payments are really decoupled from production has been included in JOB (06)/145 of the G-20 in May 2006 (WTO, 2006) and consists in including the concept of "defined, fixed and unchanging". Although this concept appears in the text, the use of exceptional updates turns it into a wishful thinking that simply consolidates the present *statu quo*.

The key political issue behind the idea that base periods—base areas and yields—cannot be updated lies on the fact that the text, as it is, is perceived as pushing farmers to bet in favour of frequent update of the basis for the direct payments. Thus, if farmers increased their current output level, the basis on which future decoupled support is calculated would grow, since the decoupling occurs with respect to the production at the time of granting the support, but not with respect to the production corresponding to certain period of the past used as the basis for calculation. In other words, there is always the risk that direct payments, although intended to be decoupled, may indeed be "re-coupled" through the updating of base areas and yields.

It is also important to mention that the draft Modalities has not included other Argentina's and G-20's concerns and demands on Green Box decoupled direct payments. Among the most relevant concerns and demands, the following stand out:

- The need to include a paragraph clarifying that it should not be a requirement for inputs and production factors to be included under "agricultural use" in order for farmers to receive decoupled income support.
- The fact that Green Box direct payments be not cumulative with Blue Box and Amber Box payments. It is undeniable that, in the presence of trade-distorting payments, "green" policies cannot adequately reach their goal. On the contrary, there is an abuse of their neutral character and they simply follow the general pattern of trade-distorting measures. Consequently, "green" money is simply added to "blue" and "amber" money, thus making it impossible to distinguish "green" money from the other two (Galperín and Doporto Miguez, 2009).

4.3. The potential circumvention of the commitments to limit and reduce the amount of OTDS through the flexibilisation of Annex 2 to the Agreement on Agriculture: the case of the European Community

In order to comply with the Doha Round mandate to substantially reduce all trade-distorting domestic support, the Green Box must be modified to guarantee that the programmes thereunder do not distort trade and production. OTDS reductions will not have a concrete impact on industrialized countries' production policies; instead, only "cosmetic" changes will be made to guarantee farmers' incomes.

Developing countries expected that, as a result of the domestic support reduction commitments assumed under the Agreement on Agriculture, the production of agricultural products—notably cereals—in highly subsidised countries would fall and the output in non-subsidising and, therefore, low-cost producing countries would expand by 2000 (FAO, 1995). However, as a consequence of the asymmetrical provisions of the AoA and their lackadaisical implementation by developed countries, the post-AoA experience establishes that the anticipated production changes in terms of levels and locational shifts have not materialised (WTO, 2001).

Not only do the changes that have been included in the last draft Modalities to Annex 2 to the Agreement—and mainly those introduced to paragraphs 6 and 11—leave these concerns unattended, but they also legitimize governments' interference in production decisions by consolidating exceptions to the principle of not updating base periods.

The programmes that used to be included in the Amber Box and/or the Blue Box can now become Green Box direct payments (box shifting), but their distorting effects on trade and production will remain practically unchanged. The decoupled payments aimed at maintaining a farm based on a base period which is updated keep their distorting nature due to the expectations they generate in farmers: future payments will depend on current production.

In the European Union, the 2003 Fischer reform has imposed the idea of "decoupling" for the Common Agricultural Policy. Generally speaking, the European Union has gradually stopped subsidising agricultural production through price support mechanisms, and has instead granted direct payments to farmers based on the hectares of farmland and the payments received in a previous period (Swinbank, 2009).

This paper does not intend to analyse the scope nor the impact of the Common Agricultural Policy reform[23] such as the link between the support given and the compliance with standards on environment, food safety, animal welfare; the cut in direct support ("regressivity") provided to large farms; the reduction in intervention prices for certain products, among others. Instead, it intends to highlight the implementation of the single farm payment scheme, independent of production. The replacement of most direct price support—arable crops, beef, milk, butter, sheep, olive oil, potato starch, grain legumes, rice, seeds, dried fodder, among others—by a single farm payment was based on a global amount of support received in the reference period 2000–2002. Leaving aside for now the trade-distorting effects of maintaining a percentage of coupled payments, the impossibility of planting fruits and vegetables on eligible land[24] and the numerous requirements to keep land in good agricultural condition so as to receive support (Swinbank, 2009), it is important to mention that, if the areas and yields used in that period were updated, then the core objective of the reform—that is, to decouple payments from production—would not be fulfilled.

[23] In this respect, see Doporto Miguez and Galperín (2006).

[24] Supposedly abolished after the 2007 health check of the CAP, but not fully implemented to date.

The substantial OTDS reduction and the implementation of green programmes that do not distort production and trade should result in a reduction in the planted area and output of developed countries having fewer competitive advantages (Ray, 2003), as is the case of the EU, thus causing a supply contraction and a subsequent price increase. This situation would bring about several advantages for developing countries, since, as is well known, production subsidies have three main effects: 1) the reduction in imports in countries granting subsidies, 2) the exportation of the surpluses generated by that country to the international market, and 3) the fall of international prices.

Moreover, in the case of the European Union, the fact that direct price support for cereals was partially replaced by Green Box decoupled direct payments has not as yet entailed any reduction in the planted area or in output.[25]

If an analogy is drawn with the reform made a long time ago in the European Community coal sector[26]—where a system of direct support was negotiated to enable miners to retire receiving high pensions and on the only condition that workers' unions accepted that firms owning unprofitable mines would close them down—the expected result for the agricultural sector should be the same: i) the retirement of farmers and ii) the reduction in planted areas, output levels and supply of heavily subsidised agricultural goods.

5. Conclusions

The disciplines on OTDS that are under negotiation are aimed at providing all WTO Members with predictability as regards the maximum level of distorting support that farmers can receive in developed countries, which are the main target markets for developing countries.

Even though the cut percentages of the tiered formula would not substantially affect the OTDS levels applied in the last notified period, the impossibility of increasing production subsidies in a context of moderate and low international prices provides a certain degree of certainty.

The disciplines on OTDS that are currently under debate will, sooner or later, cause EU and US farmers to be subject to market discipline, but without the "mattress" of subsidies that has historically protected them.

The main expected effect is a new market balance generated as a result of a reduction in the supply of agricultural goods by the EU and the United States, and a price increase that mainly benefits those countries that depend most heavily on agriculture.

The Green Box must be modified to guarantee that the programmes thereunder do not distort trade and production. OTDS reductions will not have a concrete impact on industrialized countries' production policies; instead, only "cosmetic" changes will be made to guarantee farmers' incomes through the box shifting carried out between the Amber, Blue and Green boxes.

In view of the foregoing, it is necessary to ensure that the new disciplines limiting OTDS cannot be eluded by transferring programmes—guaranteeing prices and/or income coupled to production—to the Green Box.

[25] The evolution of planted areas and output levels can be seen in the online Eurostat database. See http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database

[26] The EC used to produce—and still does, but on a limited basis—coal at extremely high prices, instead of importing it at much lower prices and thus causing much less pollution and danger to the ecosystem.

It is therefore necessary to agree upon a new drafting of Annex 2 to the AoA so as to ensure i) the prohibition to update the base periods for direct payments, as well as disciplines on the agricultural use of land so that farmers receive decoupled income support, and ii) that Green Box direct payments are not cumulative with Blue Box and Amber Box payments.

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