Domestic Support in Agriculture: The Struggle for Meaningful Disciplines

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The current basis for multilateral negotiations of global agricultural trade is the July 2004 Agriculture Framework of the World Trade Organization (WTO). Negotiators had hoped to reach an agreement on how, by how much, and when cuts in agricultural support should be made by the end of July 2005, but that hope was not realized because of major disagreements on the level and method of reductions. The focus now is how to move from the 2004 Agriculture Framework to a more specific agreement in time for approval at the WTO's Hong Kong Ministerial in December 2005, so that agreed modalities can be translated into draft schedules of subsidy reductions.

This note examines the provisions of the July 2004 Framework concerning disciplines specific to domestic support, discusses the main issues under negotiation and their prospects for success, and makes specific recommendations for more effective disciplines.[1]

Domestic support disciplines in the WTO Agreement on Agriculture and in the July 2004 Framework

Domestic support—support provided through subsidies paid by government to producers or through administered prices—is classified under the WTO 1995 Agreement on Agriculture as falling into three "boxes." *Amber Box policies* are those deemed to be the most trade-distorting and hence are subject to disciplines. The extent of subsidies is gauged by the "aggregate measurement of support" (AMS) that they provide. Exempted from discipline is so-called *de minimis* support—defined as subsidies up to a fixed proportion (presently 5 percent) of the current value of production in each category of product-specific and non-product-specific support. *Blue Box policies* are potentially trade-distorting, but because they include supply restrictions they are currently exempted from reductions. *Green Box payments* are not related to current output and therefore are considered minimally trade-distorting. Like Blue Box policies, they are exempt from reductions.

The Agreement on Agriculture called on developed countries to reduce Amber Box support (or total AMS) by 20 percent by 2000. Developing countries were to reduce AMS by 13 percent by 2004. For developing countries, a wider list of policies was exempt from reductions. The least developed countries were wholly exempt from subsidy-reduction commitments.

The July 2004 Framework retains many of the concepts of the 1995 Agreement on Agriculture but adds new ideas of great significance. In addition to disciplining the AMS, the framework calls for a minimum 20 percent cut in “overall trade-distorting support” (OTDS), defined as the sum of the AMS bound ceiling and the allowed maxima of Blue Box payments and *de minimis* support (table 1). In addition, it also caps each component of overall support—specifically AMS, *de minimis* support, and Blue Box subsidies. Reductions in support for each component are to count toward the country’s commitment to reduce overall support. The overall commitment to reduce trade-distorting support may become binding when the ceilings are below actual overall support. Similarly, one or more of the individual component reduction commitments may require reduction in actual support to be under the ceiling. Reduction commitments for individual categories are required even if together they exceed the required reduction in overall support. In addition, the framework calls for deeper cuts in OTDS and its individual components by countries that provide higher levels of support. This tiered approach to progressively reduce domestic support is designed to help harmonize support levels among countries. The specific details of the tiered formula are not specified in the framework.

The framework calls for an expansion of the Blue Box criteria to include payments on fixed areas and yields that are not linked to production constraints. Total Blue Box subsidies would be limited to 5 percent of an historical average value of production. The framework includes an exception for countries currently above the cap to gradually make reductions to the 5 percent cap during the implementation period. Green Box definitions are to be reviewed and clarified, but the framework does not call for a numerical cap on this form of support. However, tighter scrutiny, along with implementation of the outcome of the WTO Cotton Panel, could yet cause some significant adjustments in Green Box criteria and policies.

An empirical assessment of the 2004 framework for a sample of countries

The likely effects of the framework on current support ceilings for a select group of countries are illustrated in table 2. Product-specific and non-product-specific *de minimis* and Blue Box ceilings are each 5 percent of the value of production, except for EU Blue Box payments, where actual levels exceed the 5 percent limit by $8.74 billion.

The actual level of OTDS is much lower than the ceilings for all countries. For example, the current level of OTDS in the European Union is $62.7 billion, well under the ceiling of $93.5 billion. This begs the essential question of whether commitments to reduce support will affect current policies at all. As for the individual components of OTDS, current support is also below the ceiling except for Blue Box payments in the European Union. Also notable are several cases where the current level of support is close to the ceilings: AMS and non-product-specific support in the United States, AMS in Korea, and non-product-specific support in Canada.

Because of the wide gap between the permitted level of support and the actual level of support, a gap often known as “water,” a reduction in ceilings and permitted

Table 1. Summary of the domestic support provisions of the WTO Framework Agreement on Agriculture, July 2004

Overall trade-distorting support	Move to harmonize maximum allowed levels of or ceilings in overall trade-distorting support - OTDS - def Aggregate Measurement of Support (AMS) plus *de minimis* plus Blue Box. A tiered formula is to be used: reduce support by countries with higher OTDS ceilings. Reduce overall trade-distorting support substantially: downpayment (20%) in first year.
Amber Box	Reduce the total AMS substantially by use of a tiered formula: greater efforts to reduce support by countrie Box support. Cap product-specific AMS levels at historical averages. Reductions in total AMS should lead to product-specific reductions.
Blue Box	Redefine to include payments with production limiting requirement and those with no production required: based on fixed areas and yields and headage as well as payments based on less than 85% of base productior Cap payments to 5% of agricultural production from start of implementation period.
Green Box	Review Green Box criteria and improve surveillance and monitoring.
***De minimis* level**	Negotiate the reduction of the level of *de minimis* support.
Special and differential treatment for developing countries	Developing countries: ▪ have longer implementation periods. ▪ have lower reduction coefficients and higher *de minimis* levels. ▪ retain the use of Article 6.2, allowing extra scope for domestic programs.

Source: Josling (2005).

Table 2. Analysis of the 2004 Framework Agreement proposals on domestic support, selected countries (in millions of U.S. dollars)

	EU [a]	U.S.	Japan	Korea	Mexico	Canada
Current ceilings						
Overall trade-distorting support (OTDS)	93,503	44,118	43,622	7,261	15,476	5,412
AMS	59,538	19,103	34,031	1,321	8,718	2,771
Product-specific *de minimis* [b]	1,428	5,773	1,497	2,132	2,703	692
Non-product-specific *de minimis*	11,900	9,621	4,047	2,539	2,703	974
Blue Box	*20,637*	9,621	4,047	1,269	1,352	974
Current levels						
OTDS	62,679	23,299	7,096	1,814	876	1,391
AMS	41,505	16,026	6,017	1,325	876	577
Product-specific *de minimis*	103	102	131	121	0	137
Non-product-specific *de minimis*	434	7,171	175	368	0	677
Blue Box	*20,637*	0	772	0	0	0
Potential "water" in the AMS due to price gap [c]	29,058	5,862	3,725	1,317	777	287

Note: The data in the table correspond to the average of the last three years of notified support for each region or country: European Union and United States = 1999–2001; Japan = 2000–02; Korea and Canada = 1998–2000; Mexico = 1996–98.
a. The EU blue box ceiling here is the historical average of actual support, higher than the permitted 5 percent of value of production of $11.9 billion.
b. Product-specific *de minimis* ceiling is less than 5 percent of the total value of production because support for some products are over five percent of the value of production and so is included in the AMS. The proportion varies by country, with the European Union having the highest share of *de minimis* in the AMS, whereas Mexico has none.
c. Assumes all countries eliminate official support prices without actually changing support, so the price-gap portion of the AMS simply evaporates.
Source: WTO notifications and authors' calculations.

levels is likely to have much less impact on actual policy—for several reasons. First, proposed reductions affect the AMS ceilings and the newly created maximum permitted levels for *de minimis* and Blue Box support—*not the actual levels of support*. This alone greatly dilutes the disciplines. The permitted level of *de minimis* support (10 percent of the value of production—5 percent each for product- and non-product-specific) is a large number by itself. The maximum allowed *de minimis* would average one-third of the producer support estimate (PSE) for OECD countries in 2001 and 87 percent of the domestic-support component of the PSE (defined as total support less border support). Current use of *de minimis* support is already quite significant for some countries. Current levels in Canada, for example, exceed notified total AMS support by more than 40 percent (see the last column in table 2). U.S. *de minimis* support is almost 50 percent of total notified AMS.

But additional water has accumulated because of an inflated baseline, shifting between boxes, and double counting of border support. Policy shifts occurring after the base period of the Agreement on Agriculture (1986–88) but before the implementation period (starting in 1995) are exemplified by the European Union's conversion of approximately $20 billion of Amber Box support to the Blue Box in 1992, which lowered reported AMS relative to the baseline that included these payments. Another factor was the shift of payments from the Blue Box to the Green Box during the implementation period. Crop deficiency payments in the United States, for example, were in the Blue Box before the 1996 Farm Bill. But with decoupling in the 1996 Farm Bill, this program was shifted into the Green Box. The change in policy was a positive step, but the baseline remained high and allowed water to accumulate in the Blue Box, as shown in the U.S. column in table 2.

Another source of water in domestic support ceilings is the peculiar manner in which the AMS is calculated. In addition to trade-distorting, taxpayer-funded domestic subsidies, the AMS includes "market price support," defined as eligible production multiplied by the difference between the administered price and a fixed world reference price. The product of that operation does not depict "domestic support" per se. Instead, it is a faulty measure of support provided at the border through tariffs, import quotas or export subsidies (box 1) since and administered price cannot be sustained without supporting border measures. Reducing or even eliminating an official support price without altering border protection need not have any market impact. Japan is a case in point. There the official support price for rice was eliminated in 1997, and Japan's total AMS, as notified to the WTO, dropped by $20 billion. However, because the country made no changes in import controls, effective support remained the same. So a substantial portion of the water in Japan's total AMS of approximately $34 billion (table 2) can be attributed to an adjustment made to an administered price in order to "achieve" reduction commitments without actually reducing support. As discussed below, the redundancy of this "price-gap" component of the AMS must be recognized when assessing the impact of any given cuts.

Because of the ambiguity of the legal text of the Agreement on Agriculture and the discretion given to governments in how they declare specific support programs, there is evidence that support has been moved from box to box to meet domestic support disciplines. This is possible because there are no product-specific limits for the Amber Box—it is an aggregate sectorwide limit for all agricultural products and policies. This enables countries that reform policies in one sector to increase support in other sectors or introduce new support for the reformed sector.

Support can be shifted between, as well as within, boxes. Lax criteria have allowed countries to move support toward either undisciplined or less constrained categories. For example, the United States declared the new emergency crop subsidies of 1998–2001 as non-product-specific *de minimis* support even though they were based on specific product prices. This move allowed the United States to circumvent the ceiling on total AMS. In anticipation of ceilings becoming a constraint, the 2004 framework now proposes to expand the definition of the Blue Box and its

Box 1. How part of the AMS can evaporate without changing actual support

The Agreement on Agriculture included a measure of border protection in the AMS called "market price support" (MPS), which is measured by production multiplied by the difference between the current administered "official" domestic price support and a fixed world reference price in 1986–1988:

$$MPS = Q*(P_d^{off}-P_w^{ref})$$

where Q is current production, P_d^{off} is the official domestic price support and P_w^{ref} is the fixed world reference price. Actual world prices fluctuate above and below the world reference price, while domestic market prices do likewise relative to the domestic administered price. Measuring MPS in this way can cause a major discrepancy between actual MPS levels and the level notified to WTO. So the MPS component of the AMS is a poor measure of border protection for a subset of commodities that have official domestic support prices. This problem in measuring the AMS is highlighted by the fact that it sometimes is notified to the WTO as a negative number (when the support price is below the fixed world reference price) and thus may offset taxpayer-financed, trade-distorting subsidies. At the other extreme, support prices have sometimes been so far above world reference prices that the AMS has exceeded the OECD's total PSE for some countries in the past, even though the AMS is supposed to measure trade-distorting domestic support, which is just one component of the PSE. But most importantly, the MPS component of the AMS is very arbitrary because a country can simply reduce or eliminate the official price support without changing actual support.

Source: Baffes, Cook, and de Gorter (2005).

ceiling to 5 percent of an historical value of production for all of agriculture. With little change in the levels of emergency payments (except in name: they are now called countercyclical payments), the United States will be able to dramatically reduce its non-product-specific *de minimis* support by shifting it to the Blue Box. The United States and other countries will be able to do so simply because of a proposed change in the definition of what is "less trade distorting."

Current Formula Proposals

Since October 10, the United States, EU and G-20 have advanced specific proposals based on the July 2004 Framework Agreement. These all involve tiered reductions with larger cuts in those economies with the largest absolute amount of domestic support.[2] The U.S. proposal calls for a 75 percent reduction in Overall Trade Distorting Support (OTDS) for countries with over $60 bil., a 53 percent reduction for OTDS between $10 and $60 bil., and a 31 percent reduction for lower levels of OTDS. The corresponding reductions in the Aggregate Measurement of Support (AMS) are 83-60-37 percent.[3]

The EU calls for 70-60-50 percent cuts in each of OTDS and AMS. The EU places itself in the highest band, the United States in the middle and all others except Japan in the lowest. The proposal calls for the Japan to be in the middle band for OTDS, but either in the highest for AMS or otherwise in the middle with "additional contributions".[4] The G-20 is the most ambitious of all, with 80-75-70 percent cuts in OTDS ceiling and 80-70-60 percent cuts in AMS ceilings

The United States calls for a 50 percent reduction in allowed *de minimis* (to 2.5 percent of the value of production) for each of product and non-product specific support. The EU calls for an 80 percent reduction in allowed *de minimis* to one percent of the value of production while G-20 argues for reductions in *de minimis* as needed to meet overall OTDS reductions.

All three proposals agree with the expanded definition of the Blue Box as put forth in the July Framework to encompass payments with production-limiting requirements and payments that do not require production. However, the United States calls for the cap to be set at 2.5 percent of the value of production, instead of five percent as proposed in the July Framework.

Both the United States and the EU propose product specific caps in the Amber box but with differing base periods: the United States recommends a base period of 1999-2001 while the EU argues that product-specific caps should be based on the entire implementation period.

An empirical assessment of the October proposals

The effects of these proposals on AMS and OTDS levels are shown in Figures 1 and 2. The height of the bars in each figure shows the ceilings, while the percentage above the bar shows the share of that support that could be eliminated without reducing actual support[5]. Therefore, the white area is equivalent to actual support levels and the grey area represents overhang (i.e., "water") in the ceiling. The three lines across the bars show the level of the ceilings after the reductions implied by each proposal.

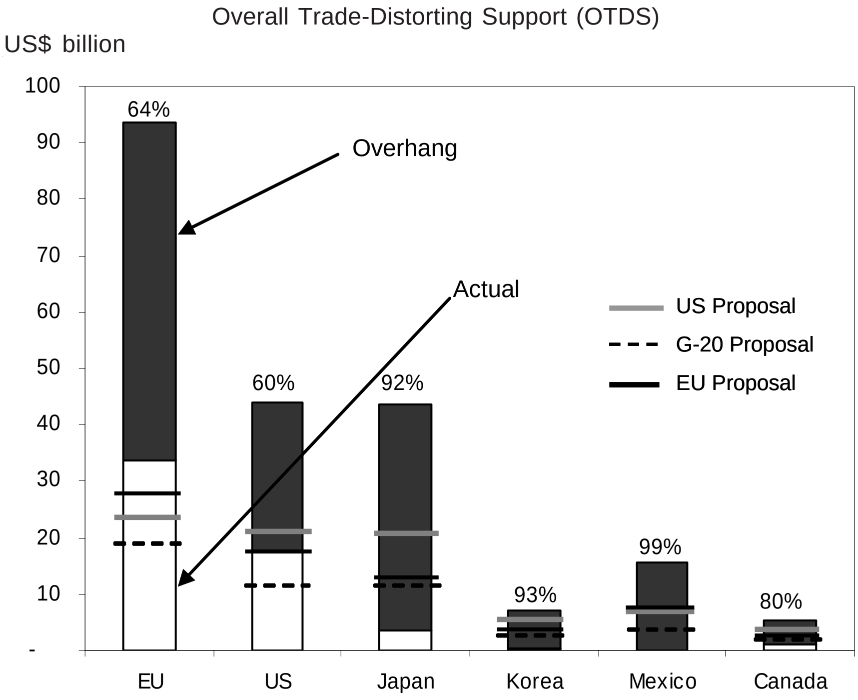
These figures highlight the very large gaps between committed and actual support in recent years, and the consequent need for large reductions in ceilings before any real policy changes will be required.

In Figure 1, the EU would be required to reduce OTDS relative to the historical benchmark under all three proposals. This is politically feasible as the EU will be converting most of its trade distorting payments into green box payments after the 2003 CAP reforms.[6]

The ceiling for U.S. OTDS in Figure 1 shows that no reduction in support relative to the historical benchmark would be required under its own proposal, while a slight reduction would be required under the EU proposal and a significant reduction under the G-20 proposal. Of the other countries considered only the EU would be required to reduce its AMS support relative to 1999-2001 levels, and only by 1 percentage point under the G-20 proposal.

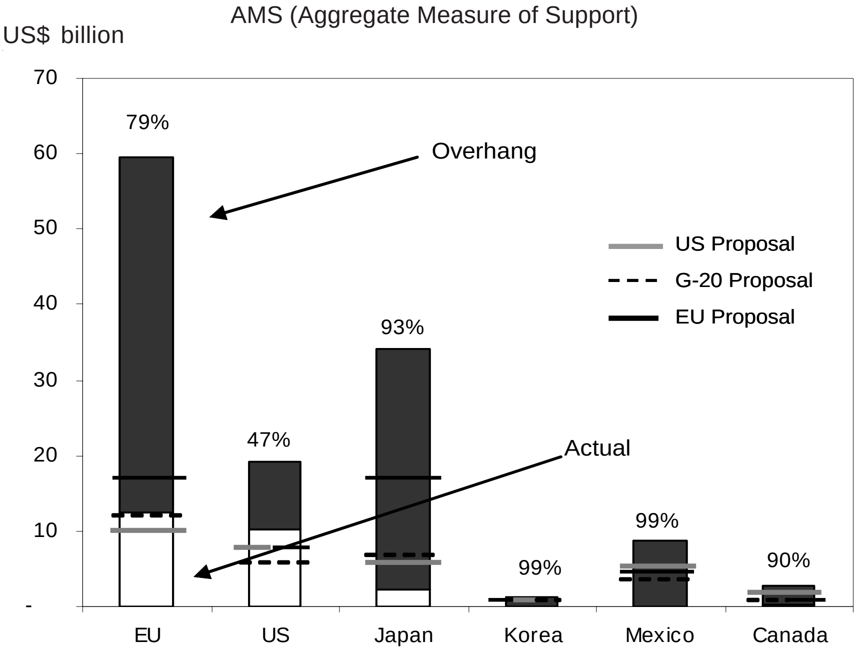
In regards to the AMS ceilings for each of the three proposals shown in Figure 2, only the United States would be required to make sizeable cuts in its actual AMS. Assuming the water due to the price-gap is eliminated simply by taking official price supports off the book, the United States would be left with a required cut of only $2,523 million, far less than the proposed 60 percent nominal reduction.

Figure 1. Water in domestic support



Source: Authors calculations based on data from WTO notifications

Figure 2. Water in domestic support



Source: Authors calculations based on data from WTO notifications

While the reductions in actual support required by even the most ambitious of these proposals would be modest, the potential value of such disciplines is perhaps greater than it seems in that it would rule out the possibility of countries' potentially reverting to much higher levels of support in the future.

Suggestions for New Rules

Which formula is finally adopted will be hugely important. In addition, negotiators will need to give careful attention to a number of other issues, either in the current negotiations or in the future, including:

- The 2004 Agriculture Framework proposed a cap on product-specific AMS. This is important as it would limit countries' ability to shift support among sensitive commodities. The WTO also should consider introducing a commitment to reduce support per unit and by sector, along the lines of a tariff, to make reductions more effective.

- Because of the WTO Cotton Panel ruling, product-specific direct-income payments to farmers in the Green Box should be distinguished from expenditures for public goods. The former should be reported as part of a new Amber Box.
- Reduction commitments should be imposed only on the taxpayer-financed portion of the current AMS—plus the Blue Box, product-specific and non-product-specific *de minimis* subsidies, and product-specific, direct farm income payments under the current Green Box. This new (flashing?) Amber Box would report only domestic subsidies that distort trade and that are not border protection. Such a discipline will minimize countries' ability to avoid reductions in support by shifting support from box to box.
- The Green Box should be maintained for expenditures that provide public goods or prevent negative externalities. But programs listed in Annex 2 of the Agreement on Agriculture as non-trade-distorting or minimally trade-distorting must be more tightly defined to screen out abuses. For example, crop insurance programs, which have been found to be very trade-distorting, are currently in the Green Box, and tax concessions are not even considered support. Strict rules, definitions, and monitoring arrangements are required. In recognition of the fact that even these newly defined Green Box expenditures are likely to have some effect on production (and therefore on trade), consideration should be given to introducing a cap on the value of production.

Notes

1. The World Bank–Netherlands Partnership Program and the United Kingdom's Department for International Development provided much-appreciated support for the research reported here. The note was written by Harry de Gorter, Associate Professor of Agricultural Economics at Cornell University in Ithaca, New York, and by J. Daniel Cook, an international trade analyst in the Agriculture and Fisheries Division, Office of Industries of the U.S. International Trade Commission (USITC). This paper's view's do not necessarily represent those of the USITC or any of its individual Commissioners. We are grateful to William J. Martin for the useful comments he provided .

2. All three proposals use the same three tiers of >$60 bil, $10-$60 bil, and < $10 bil.

3. U.S. and G-20 proposals use tiers of >$25 bil, $12-25 bil, and < $12 bil.

4. For purposes of this analysis a 65 percent cut in Japan's AMS will be used as the "additional contribution." It is possible for Japan to make the larger "contribution" and still not have their AMS ceiling binding.

5. In making this calculation, we assume that WTO members would utilize their right under current rules to exclude support provided through Market Price Support from their AMS by abolishing administered support prices while not changing any policies (as Japan did for rice in 1997, thereby eliminating reported support calculated by the "price-gap").

6. Also stated by the EU in their "Statement of EU conditional negotiating proposals – with explanatory annotations". 10 October 2005. Memo/05/357.

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Further Reading

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