

Consequences of Reducing Limits on Aggregate Measurements of Support

*Hans G. Jensen and Henrik Zobbe**

Formatted

Throughout the history of the General Agreement on Tariffs and Trade (GATT), agriculture has been a major issue of conflict. That has been especially obvious since the full inclusion of the sector in the Uruguay Round negotiations (1986–93). For many developed countries, agricultural policies are sensitive. These domestic policies are deeply founded in a long list of historical events and conditional economic and political structures and institutions (Zobbe 2003). Further domestic reforms are complicated and are slowing the multilateral process under the World Trade Organization's (WTO) current Doha Round. The overall aim of this round is to discipline agricultural protection and ensure serious reductions in support programs that distort agricultural production and trade.

The Uruguay Round Agreement on Agriculture (URAA) established the disciplinary framework for domestic agricultural support in WTO member countries by categorizing support into three boxes: an Amber Box, with support coupled with production, a Blue Box, with production-coupled support combined with production reduction programs, and a Green Box, with decoupled support programs (see chapter 8 for details). The URAA introduced commitments on reductions in the amount of domestic support allowed in the Amber Box, while subsidies paid under the Blue and Green Boxes were exempt from reduction commitments.

In the Amber Box, an aggregate measure of support (AMS) was defined, after long and tough negotiations, as an indicator of the amount of support found in this box category. Initial levels of AMS were determined, and developed countries agreed to cut these initial levels by 20 percent (13 percent in developing countries) in the URAA. In principle all production-coupled support should have been cut. But because of the exemption of the Blue Box, a historical base period reflecting very high initial support levels, and *de minimis* exemptions, domestic support cuts following the URAA have been rather disappointing (OECD 2001).¹

The objective of this chapter is to analyze prospects for significant reductions in AMS, *de minimis*, and Blue Box domestic support commitments across WTO member countries, and to compare those prospective reductions in commitments with recent policy reforms in the European

* <<unnumbered note>>The authors thank Soren Frandsen, Will Martin, Kym Anderson, John Nash, Harry de Gorter, and other workshop participants for their comments and discussions.

Union and the United States. The next section introduces the concept of AMS more formally and presents current AMS values distributed both by products and by countries. A scenario of possible AMS, de minimis, and Blue Box reductions is then presented. The third section compares that scenario with post-2001 policy changes in the European Union and the United States, before conclusions are drawn in the final section.

<<A>>Domestic Support Levels<<end>>

As a basis for projecting the effects of commitments that might be undertaken following the current negotiations, table 9.1 presents a snapshot of notified current total AMS levels in 1999 (the most recent year with a full data set) by economy for 18 aggregated products and for non-product-specific support. The European Union, the United States, and Japan account for more than 90 percent of the \$81 billion notified AMS in 1999. The European Union alone accounts for more than 60 percent (\$50 billion). This snapshot also gives some information about politically sensitive products, which include beef, fruits and vegetables, grains, milk, and sugar. Table 9.2 presents notified data for domestic support under the de minimis rule for 1999, by country and products. The United States accounts for more than 80 percent (\$7 billion) of total de minimis, and just about all of it is non-product-specific. Only a few other countries have some de minimis payments.

<<tables 9.1 and 9.2 near here>>

For both the European Union and the United States, which are critically important providers of domestic support, AMS notifications are also available for 2001. These are presented in tables 9.3 and 9.4. Total AMS in the EU equaled €4 billion, and the most supported products were beef, fruits and vegetables, grains, milk, and sugar. Market price support was the most important support element. For the United States, total AMS was \$14 billion, and the most supported products were milk, oilseeds, and non-product-specific support. But because of the de minimis rule, the \$6.8 billion in non-product-specific support is not included in total AMS. Direct payments not eligible for exemption from the reduction commitments were the most important support element in the United States, in contrast with the EU where market price support was the dominant form.

<<tables 9.3 and 9.4 near here>>

<<A>>Possible Reduction Scenarios<<end>>

Since the conclusion of the URAA in 1994, the agenda for the current round of negotiations on domestic support has been more or less clear. The negotiating framework decided upon by the WTO General Council on August 1, 2004, is the most specific document available that sketches some possible outcomes (WTO 2004a). Overall, the so-called July Framework Agreement calls for

“substantial reductions in trade-distorting domestic support” and specifies that special and differential treatment remain an integrated part of domestic support. It also calls for strong harmonization in the reductions made by developed countries. To secure substantial reductions, both the de minimis level and the allowed amount of Blue Box support are to be capped. More specifically, overall trade-distorting domestic support, as measured by the final bound total AMS plus the permitted de minimis level plus the highest level of Blue Box payments (or 5 percent of the value of output as a ceiling on Blue Box payments) during a recent representative period, is to be reduced according to a tiered formula. In the first year of implementation, countries are to reduce total trade-distorting support by 20 percent relative to this overall base. Total AMS is also to be reduced according to a tiered formula. Reductions in de minimis are to be negotiated during this Doha Round; Blue Box support in the future is not to exceed 5 percent of a WTO member’s average total value of production during a historical period to be agreed upon; and direct payments that do not require production can be placed in the Blue Box under certain conditions.

Following these guidelines, table 9.5 was constructed to analyze the outcome of a possible future agreement. For all countries, the overall base value of all trade-distorting domestic support (column 4) is presented in the first row (base commitments) for each country listed. This level was calculated by adding total AMS base levels from the URAA final bound AMS levels (column 1) to the permitted de minimis payments in a given reference period (column 2) plus the highest of existing Blue Box payments during the 1995–2002 period or 5 percent of the total value of agricultural production, whichever was highest (column 3). The reduction modeled in this chapter uses a tiered formula reducing base AMS commitments and total trade-distorting domestic support by 75 or 60 percent in developed countries and by 40 percent in all developing countries.²

<<table 9.5 near here>>

The second row presents for each country the new commitments: 75, 60, or 40 percent reductions are made in both total AMS and the overall base level of trade-distorting domestic support. The percentage reduction for each country is shown in column 7. The de minimis is reduced from 5 (10) percent of the value of production to 2.5 (5) percent of the value of production in developed (developing) countries. This second row can be compared to the third row, which for each country presents the latest notification to the WTO for each element of support.

That set of domestic support commitments would be binding for just ten countries or regions, namely Iceland, Norway, Switzerland, EU, Canada, the United States, Australia, Argentina, Republic of Korea, and Thailand (see table 9.5). Consider the examples of the United States and the European Union (table 9.6). In the United States, the new commitments for total AMS, non-product-specific de minimis, and total domestic support are binding, compared with the latest

notification from the United States to the WTO. Of the notified total AMS to the WTO of \$14.4 billion, \$5.8 billion stems from market price support (MPS) through official administered prices. In the modeled domestic support reduction scenarios outlined in this chapter, we allow for the possibility of removing (vaporizing) the MPS from the current total AMS notification by simply abolishing the “official administered prices.” without necessarily changing the trade policies needed to maintain an administered price out of line with world market prices. But the measured MPS in the base period remains in the commitment limits, so that current AMS falls relative to the commitment level, without any reduction in actual protection.

<<table 9.6 near here>>

We also assume that all MPS (\$5.8 billion) is abolished, which, together with reductions in non-MPS schemes, makes the United States able to meet its new commitments. The non-MPS payments are actual cash payments (subsidies) supporting farming, which amounted to \$15.6 billion in the U.S. notification to the WTO for the year 2001. These payments would have to be reduced by \$6.0 billion. Once this has been done, the United States would be within its new total domestic support limit of \$9.6 billion when no support is given in the Blue Box. Overall the United States would have to reduce its notified domestic support in the year 2001 by 55 percent, with MPS accounting for 27 percentage points of the reduction and a cut in cash payments (non-MPS) accounting for 28 points.

In table 6b a similar story is shown for the European Union. The same method of reducing domestic support is implemented.³ As can be seen, the EU has to reduce its reported total domestic support in the year 2001 by 62 percent, where 46 percentage points, or about three-fourths, of the reduction is accounted for by the abolition of MPS and 16 percentage points by reduced cash payments (Blue Box subsidies) to farming.⁴

<<A>>Recent Policy Reforms and Implications for Domestic Support<<end>>

Since the mid-1980s most Organisation for Economic Co-operation and Development (OECD) countries have made some reforms to their agricultural policies. Many economists argue that the OECD Trade Mandate of 1982 and the launch of the Uruguay Round negotiations in 1986 triggered this reform process. Others argue that the reform process in the European Union and the United States has been driven mainly by domestic rather than international politics (Paarlberg 1996). During the Uruguay Round negotiations, the EU implemented the MacSharry Reform of the Common Agricultural Policy (CAP) and the United States implemented new agricultural policies enacted in 1990. Both sets of legislation introduced more market-oriented policies and helped the multilateral agreement on its way and, in turn, the URAA agreement helped reinforce the market

policies. Since the conclusion of the URAA in late 1993 and the official launch of the Doha Round, both the EU and the United States have enacted further agricultural policy legislation.

In the case of the EU, the Agenda 2000 reform was adopted in 2000 and a more far-reaching Midterm Review (MTR) reform will be implemented across Europe in 2005 (Jensen and Frandsen 2003). The Agenda 2000 reform made further reductions in some of the administrative prices in key market organizations under the CAP. In contrast with the MacSharry Reform, these price cuts were only partly replaced by compensatory payments based on areas planted or numbers of livestock. The price support element of the CAP is part of the Amber Box and hence of AMS. The compensatory payments are paid to farmers in combination with set-aside programs and are therefore allocated to the Blue Box. The MTR reform introduces decoupled payments. The idea is to change both the hectare and animal premiums into payments based on historical criteria. EU member countries can choose to keep a small amount of the production-coupled premiums, and the European Commission expects about 10 percent of payments to remain coupled to production. This policy change will probably mean that most of the support now placed in the Blue Box will be moved to the Green Box. Nevertheless, the EU will still need the Blue Box for future reform scenarios. The MTR reform introduces only minor changes in the market price support regimes.

The EU sugar regime has not yet been reformed, but the European Commission has put forward a rather serious reform plan. The administrative sugar price would be reduced by 39 percent over a few years. Sugar beet growers would be partly compensated by decoupled payments. Table 9.7 sums up the reductions in administrative prices included in Agenda 2000, the MTR reform, and the commission proposal. Table 9.8 shows what the total AMS would be if the commission's price reductions are implemented, and compares that AMS with the new possible commitment presented in table 9.5a. The bottom line is that the EU's total AMS is reduced from €44 billion to €29 billion, €1.9 billion above the calculated new commitment of €16.8 billion.

<<tables 9.7 and 9.8 near here>>

In the United States, the 1996 farm bill fundamentally changed the traditional approach to agricultural policy to one of market reliance. Supply management in most areas was abolished, and deficiency payment programs were converted to decoupled payments based on historical production data. The income security net also was lowered. The loan rate and hence loan deficiency payments were reduced. The consequences for the commitments under the WTO were lower Amber Box support and a move of all Blue Box support to the Green Box. For political reasons the United States then argued for complete abolition of the Blue Box, but soon thereafter things changed for the worse: market prices fell, and bad weather across the country squeezed farm incomes. The political response was to provide ad hoc payments year after year, which brought the total AMS

back up to its former levels. The 2002 farm bill introduced a new policy instrument, which institutionalized the former ad hoc arrangements as countercyclical payments that are non-product-specific and partly decoupled.

Table 9.9 incorporates legislation already implemented and possible future policy changes together with the new commitments from table 9.5a. The new commitment equals a total AMS binding of \$4.8 billion. The most likely result in the Doha negotiations will be that the ad hoc payments, notified in 2001 as \$4.0 billion, will be moved to the Blue Box. Another issue, touched on by Sumner (2000), relates to dairy policy. His argument is that the notified MPS amounting to \$4.4 billion could be removed from AMS without affecting U.S. farmers. The high domestic milk price is supported by border measures, with the administered market price playing little independent role. The current small support element could then be changed to a more or less decoupled direct payment (Sumner 2003). After these changes, the new total AMS is \$10.1 billion— \$5.3 billion short of the calculated new commitments.

<table 9.9 near here>>

<<A>>Conclusions<<end>>

The most important messages from this chapter are that serious reductions are needed in both the bound AMS and de minimis support, tiered reductions are needed to level the playing field, and future commitments need to be placed not only in the Amber Box but also in the Blue Box. The July Framework Agreement provides a basis to develop a reduction scenario for countries that hold commitments, and that scenario suggests that Australia, Argentina, Canada, the EU, Iceland, Korea, Norway, Switzerland, Thailand, and the United States are the members most likely to need to reduce support. More specifically, the scenario indicates that the EU15 (not counting its 10 new members) needs to make serious reductions in both Amber and Blue Box support. The United States needs to make serious reductions in its Amber Box and de minimis support.

A country's position in the Doha negotiations necessarily reflects domestic politics, both current and prospective. As under the Uruguay Round negotiations, the direction of causality is not obvious: domestic politics influence the negotiations and the negotiations influence domestic politics. A comparison of recent agricultural policy reforms in the EU and the United States gives some insight. In the case of the EU, we looked at the effects of Agenda 2000, the Midterm Review reform and the proposed sugar reform; in the United States, we looked at the farm bills of 1996 and 2002 and a possible milk policy reform.

Finally, two important assumptions behind this analysis need some discussion. First, further negotiations may alter the details of the framework agreement on which this analysis is based. For

example, the potential loopholes regarding base periods, reference periods, and specific percentages of reduction will be decided later. Second, AMS is not the complete story on domestic support. AMS is politically defined, and it excludes some important current support measures because it uses historical prices fixed by the URAA and because it uses administrative prices as the indicator of whether the particular support policy will be included in the measure at all. A discussion to broaden the concept of AMS is thus needed.

<<A>>Endnotes<<end>>

1. See chapter 8 for a discussion of de minimis measures.
2. In developed countries the 75 percent reduction in total AMS and total trade-distorting support is implemented in countries where the total value of possible trade-distorting support as a percent of the value of agricultural production is equal to or greater than 20 percent.
3. Appendix Table 9.A1 shows the reductions in domestic support in Iceland, Norway, Switzerland, Canada, Australia, Argentina, Korea, and Thailand.
4. It is very doubtful that official administrative prices would be abolished in the EU. Since the establishment of the Common Agricultural Policy in 1960, the backbone of the system has been various market organizations. The core of this market price support has always been an administrative price, and this is still true for the CAP today. The Midterm Review reform barely touched on the level of market price support.

<<A>>References<<end>>

Anderson, K., W. Martin, and D. van der Mensbrugge. 2005. "Market and Welfare Implications of Doha Reform Scenarios." In *Agricultural Trade Reform and the Doha Development Agenda*, ed. K. Anderson and W. Martin. Washington, DC: World Bank.

European Commission. 1999. Council Regulation (EC) No. 1254/1999 of 17 May, on the Common Organization of the Market in Beef and Veal. European Commission, Brussels.

_____. 2003a. Council Regulation (EC) No. 1787/2003 of 29 September, on the Common Organization of the Market in Milk and Milk products. European Commission, Brussels.

_____. 2003b. Council Regulation (EC) No. 1785/2003 of 29 September, on the common organization of the market of rice. European Commission, Brussels.

- _____. 2003c. Council Regulation (EC) No. 1784/2003 of 29 September, on the Common Organization of the Market in Cereal. European Commission, Brussels.
- _____. 2005. "Proposal for a Council Regulation on the Common Organization of the Market in the Sugar Sector." COM (2005) 263 final. European Commission, Brussels.
- Jensen, H. G., and S. E. Frandsen. 2003. "Impacts of the Eastern European Accession and the 2003 Reform of the CAP: Consequences for Individual Member Countries." Working Paper 11, Danish Institute of Food Economics, Copenhagen.
- OECD (Organisation for Economic Co-operation and Development). 2001. *The Uruguay Round Agreement on Agriculture: An Evaluation of its Implementation in OECD Countries*. Paris: OECD.
- OECD. 2003. *OECD Agricultural Databases*, 2003 ed. Paris: OECD.
- Paarlberg, R. L. 1996. "The Uruguay Round and Agriculture: International Path to Domestic Policy Reform?" Paper 96-1, Weatherhead Center for International Affairs, Harvard University, Cambridge, MA. January 30.
- Sumner, D. A. 2003. "Implications of the US Farm Bill of 2002 for Agricultural Trade and Trade Negotiations." *Australian Journal of Agricultural and Resource Economics* 46 (3): 99–122.
- USDA (United States Department of Agriculture), Economic Research Service. 2004. Data on WTO Domestic Support Notifications.
http://www.ers.usda.gov/db/Wto/AMS_database/Default.asp?ERSTab=3&view=DS6
(accessed June 2005).
- WTO (World Trade Organization). 2004a. "Doha Work Programme, Decision Adopted by the General Council on 1 August 2004." Report of the General Council, WT/L/579, August 2.
http://www.wto.org/english/tratop_e/dda_e/ddadraft_31jul04_e.pdf (accessed October 2004).

_____. 2004b. WTO Notifications. http://docsonline.wto.org/gen_home.asp?language=1&_=1
(accessed August 2004).

Zobbe, H. 2003. "The Economic and Historical Foundation of Agricultural Policy in Europe and the United States." Ph.D. thesis, Royal Veterinary and Agricultural University, Copenhagen.