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Agriculture: No real cuts in subsidies from WTO text  
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Geneva, 18 July (Martin Khor) -- When the WTO mini-Ministerial week begins on 21 July, perhaps the most anticipated question is what the United States will offer in reducing its overall trade-distorting domestic support in agriculture. The EU's own offer is presumably also linked to what the US may propose.

The G20 has insisted that agriculture is the "locomotive" of the Round and the most politically-charged issue is whether agricultural subsidies in the major developed economies are going to be reduced, in terms of bound commitments

(what is the maximum level to be allowed) and in real terms (the actual levels of spending on domestic support). Thus, one of the first questions that interested delegations will want to ask is whether the US and EU have fresh offers to make, especially on their level of overall trade-distorting domestic support (OTDS).

The latest modalities paper (10 July) of the Chair of the agriculture negotiations, Crawford Falconer, remains basically the same as the previous three versions on this question of reduction of the bound or allowable level of the Overall Trade Distorting Support (OTDS). For developed countries, the base OTDS shall be the sum of (i) the final bound total AMS; plus (ii) 10% of value of production in the 1995-2000 base period (comprising 5% of value of production for product specific AMS and 5% of value of production for non-product specific AMS). [This is usually termed de minimis support]; (iii) the higher of existing average Blue box payments or 5% of average total value of production in the 1995-2000 base period.

The reduction of the developed countries' OTDS base level will be in accordance with the following tiered formula: (a) Where the OTDS base level is over US \$60 billion, the reduction shall be [75-85] per cent; (b) Where the OTDS base level is over \$10 to 60 billion, the reduction shall be [66-73] per cent; (c) Where the OTDS base level is less than or equal to \$10 billion, the reduction shall be [50-60] per cent.

Given the above proposed formula by the Chair, the following is the estimated reduction for the US and the EU.

1. The US OTDS base allowable level is estimated at \$48.2 bil. It is thus in category (b) and would have to cut by 66-73 per cent. After the cut, the OTDS would be in the range \$13-16.4 bil.
2. The EU OTDS base allowable level is estimated at Euro 110 bil. It is thus in category (a) and thus would have to cut its OTDS by 75-85 per cent. After the cut the OTDS would be in the range of Euro 16.5-27.6 bil.

#### BACKGROUND TO BOUND AND APPLIED (ALLOWED AND ACTUAL) DOMESTIC SUPPORT

On domestic support, there is a lot of confusion: (a) on the difference between the allowed levels (i. e. the maximum levels) that members commit not to exceed, and the applied (or actual) levels of the various subsidies; and (b) on the different types or "boxes" of subsidies. The WTO's Agreement on Agriculture (AoA) distinguishes between different types of domestic support. Firstly a distinction is made between "trade-distorting" and non-trade-distorting subsidies. Members are obliged to fix maximum levels for trade-distorting subsidies and to reduce some of these allowed maximum levels. For subsidies considered non-trade-distorting (the Green Box), there are no maximum levels, and thus members can increase these subsidies without limit.

The Green Box subsidies (such as payments to farmers to protect the environment) are supposed to be "decoupled" from production, and thus they supposedly do not distort trade; however, some experts have pointed out that many of these subsidies are also distorting in that they provide grants to recipients which assist them to maintain farming as a viable occupation, and that without these payments some of the farms or some of their production would not exist.

On the first category of domestic support, the developed countries have been permitted by the AoA to maintain high allowed levels of trade-distorting domestic support or TDS. These trade-distorting subsidies are in three categories:

(1) the Aggregate Measurement of Support (AMS) or Amber Box, which is linked to intervention on agriculture prices and considered the most trade-distorting; (2) de minimis support (certain amounts of domestic subsidy that are allowed, calculated as a percentage of the value of agricultural production); and (3) the Blue Box subsidies (which are supposed to be linked to setting limits on production), which are also considered trade-distorting but less distorting than the Amber Box.

The OTDS thus comprises these three types. The AoA obliges developed countries to reduce their total AMS by 20% by 2000 below the 1986-88 level, and to limit their de minimis support to 5% of production value; developing countries have to reduce their AMS by 13% and limit de minimis support to 10%. No limit was set on the Blue Box.

Since the Uruguay Round, the developed countries have been reducing their actual levels of AMS to below the allowed levels, and they were able to do this partly by shifting the subsidies from one box to other boxes. In a dispute settlement case on cotton, it was found that the US had been wrongly shielding some trade-distorting subsidies within the Green Box, and was asked to change its policies accordingly. The US has to remove these subsidies, or to shift them into one of the trade-distorting boxes. One option is to move the subsidies to the Blue Box (which it has previously not used), and the US thus seeks to change the definition or criteria of this box to enable the shifting to take place. The EU, which makes extensive use of the Blue Box, is reducing its "trade-distorting" subsidies, but significantly increasing its Green Box subsidies (decoupled payments) under its Common Agricultural Policy (CAP) reform. The Green Box subsidies are not under reduction discipline and thus can be raised without limit.

The EU and US have considerable leeway to (1) move trade-distorting subsidies from the Amber Box to the Blue Box and de minimis in order to make fuller use of their total allowed TDS; (2) make creative use of the Green Box which has no limits and has loose criteria at present, and thus enable some subsidies that are in effect trade-distorting to be counted as non-trade-distorting subsidies. The level of the total actual OTDS is presently far below the level of total allowed OTDS for the US and the EU. Therefore, the developed countries can afford to reduce the level of allowed OTDS significantly, before the cut reaches the level where the present actual OTDS is affected.

In the informal language of WTO negotiations, this would mean the US and EU would only cut "water" (i. e. the difference between allowed and actual subsidies) and not their actual subsidies. This is why the EU and US have been able to announce offers to cut their AMS and their total allowed TDS by a seemingly large degree, while in reality these offers do not necessitate real cuts in the present applied level (in the case of the US) or in the applied level that is already planned for (in the case of the EU, with reference to its CAP). This is one of the present stumbling blocks to the reaching of an agreement on agriculture modalities.

## THE US OTDS, ITS OFFER AND THE CHAIR'S PROPOSAL

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In October 2005, the US announced the following offer: It would cut the allowed AMS by 60%; restrict the Blue Box to 2.5% of production value; and reduce the allowed de minimis support

from 10% to 5% of production value. This may sound generous at first sight. However, analysis has shown that in fact this offer would allow the US to have a level of total allowed OTDS of \$22.7 billion. This compares with the \$21.4 billion of actual OTDS in 2001 and the \$19.7 billion of actual TDS in 2005 that was estimated in a simulation exercise by WTO members. In other words, the US offer would allow it to maintain an OTDS of \$22.7 billion, which is \$3 billion higher than its actual 2005 level. This offer was not acceptable to its partners (namely the EU, Brazil, India and Australia) in the June and July 2006 meetings of the G6 Trade Ministers in the WTO.

They argued that the US would not have to effect any real cuts in its present OTDS but would even have the "water" or space to increase its OTDS by \$3 billion. The refusal or inability of the US Trade Representative to improve on this offer was the immediate cause of the breakdown of the G6 talks, which in turn led to the suspension of the Doha negotiations in July 2006. The demand of the developing countries in the Group of 20 (G20) was that the US reduce its allowed TDS to \$12 billion, and the EU reportedly asked for a level of \$15 billion.

From 2001 onwards (to now), the allowed levels of trade-distorting support for the US were estimated as follows: (1) Amber Box \$19.1 billion; (2) de minimis \$19.8 billion (being 10% of production value), made up of \$9.9 billion for product-specific support (5% of production value) and \$9.9 billion for general support (5% of production value); and (3) an implied level of Blue Box subsidy of about 5% of production value. The total allowed TDS is estimated at \$48.2 billion. The US actual levels in 2001 (as notified to the WTO) were: (1) Amber Box \$14.4 billion; (2) de minimis \$7.0 billion (made up of \$216 million product-specific support and \$6.8 billion general support); (3) Blue Box zero; and (4) total actual TDS \$21.4 billion. The Green Box subsidies were \$50.7 billion. Thus total domestic support was \$72.1 billion.

The US offer of October 2005 was that it would: (1) reduce allowed AMS by 60% to \$7.6 billion; (2) reduce the allowed de minimis to 5% of production or \$10 billion [made up of \$5 billion product-specific support (2.5% of production) and \$5 billion general support (2.5% of production)]; and cap the blue box to 2.5% of production value or \$5 billion. The total allowed TDS would be \$22.7 billion (or a 53% cut from the present total allowed TDS of \$48.2 billion). In accordance with the Chair's July 2008 text, the US (being in category (b) of the tiered formula) would have to reduce its OTDS by 66-73 per cent from its base level of \$48.2 bil. Thus, after the cut, the OTDS would be in the range \$13-16.4 bil. In September 2007, the US indicated it could consider within the ranges of figures proposed in the Chair's text, provided the parameters of the Chair's text on other issues and the figures in the text of the Chair of the NAMA negotiations are also acceptable to other members. (See SUNS # 6328, dated 21 September 2007). This has been taken by other members to mean that the US can now consider to reduce its bound (or allowed) OTDS to \$13-16.4 billion.

Many other countries, while cautiously welcoming this indication, have also stated that the US needs to agree to the lower end of the range (i. e. \$13 billion). This is especially because the actual OTDS level in 2006 had come down to \$11 billion, according to reports and to officials of other countries, such as India's Commerce Minister Mr. Kamal Nath. And according to recent estimates commonly referred to at the WTO and elsewhere, the OTDS level of the US fell further to around \$7 billion in 2007. The recent declines are tied to the rapid increase in agricultural prices, which has reduced the need for subsidies. Thus, the Chair's proposed range of \$13-16.4 billion for the allowed level is above the present level of \$7 billion for 2007, thus providing considerable "water" for increases.

Actually, when the US indicated its acceptance of the Chairs' range of \$13-16.4 billion, it was not far off from the provisional offer of \$17 billion that the US Trade Representative Susan Schwab had made at the Potsdam meeting of the G4 Ministers in June. She later explained to the media that if the OTDS level the US was offering had been applied in the last nine years, it would have led to cuts in 5 to 7 of those years. "Most of the years we would have seen real cuts. The US has shown extensive flexibility." What the USTR said is only partially true. In 5 recent

years the United States' applied OTDS level was above \$17 billion (1999, 2000, 2001, 2004 and 2005). But she forgot to mention that at the start of the implementation period of the Uruguay Round, the OTDS level was far, far below - at \$7 billion.

The agriculture domestic support simulations paper (JOB(06)/151 dated 22 May 2006) prepared by Canada shows that the applied OTDS of the US was \$7.7 bil in 1995, \$7.1 bil in 1996, and \$7 bil in 1997. It then shot to \$15.1 bil in 1998, \$24.3bil in 1999, \$24.1 bil in 2000, \$14.9 bil in 2000, \$10.2 bil in 2003, \$18.6 bil in 2004 and \$19.7 bil in 2005. Thus, an offer of a cap at \$17 bil or at \$16 billion or even at \$13 billion does not reflect a decrease especially when compared to the 1995-1997 levels of a decade ago, and also allows for a large amount of "water" if the 2006 level was \$11 bil. And the 2007 level was \$7 billion.

In any case, as the Indian Minister has correctly stated several times, domestic subsidies in agriculture are structural flaws which should not be permitted at all, similar to industrial subsidies (which are banned in the WTO). "The flaws have no exchange rates," said Kamal Nath. "Correcting flaws and distortions have no exchange rates." What he meant was that the US and EU should remove their domestic subsidies and do so without asking anything in return, since these are structural flaws. They cannot be placed in an equation of asking developing countries to "give."

#### THE EU OTDS, ITS OFFER AND THE CHAIR'S PROPOSAL

The European Union made its offer on domestic support on 28 October 2005. This comprised the following: 70% cut in allowed AMS; 80% cut in allowed de minimis; and restriction of the Blue Box to 5% of production. The total allowed OTDS would be cut by 70%.

Some independent analysts have estimated that the EU would also not have to reduce its already planned level of actual domestic support with its proposal. In fact there will be some "water" between on one hand what the EU has already scheduled to do under its CAP reform, and on the other hand the proposed new level of allowed trade-distorting support in its WTO proposal; and thus the proposal enables the EU to have a level of domestic support beyond what it had planned in the CAP. According to one estimate, this "water" is around Euro 6 to 13 billion, depending on the assumptions, according to the agriculture analyst Jacques Berthelot in a 2005 paper.

In an analysis of the EU offer on domestic support, Berthelot concludes: "The claim by the EU that it is offering huge cuts in agricultural domestic supports is not backed by the evidence. In fact, the EU has given itself room to increase its supports beyond what the CAP reforms have mandated it to do. This analysis shows that [EU Trade Commissioner Peter] Mandelson's offers are actually compatible with the CAP reforms of 2003-04, in that they do not commit the EU to do more than what it has already planned to do, and in fact give it the space to have supports at levels higher than it had planned under the CAP reforms."

The present estimated allowed levels of trade-distorting support of the EU are as follows: AMS Euro 67.2 billion; de minimis Euro 19 billion; and with the inclusion of the actual blue-box level (of year 2001/2) of Euro 23.7 billion, the total allowed OTDS is estimated at Euro 110 billion. In 2001/2, the actual levels of trade-distorting support of the EU were: AMS Euro 43.7 billion; de minimis Euro 1 billion; Blue Box Euro 23.7 billion. Total actual OTDS was Euro 68 billion.

Through the CAP reform, these actual levels are planned to be scaled back so that by 2008 the actual levels are expected to be: AMS Euro 18.8 billion; de minimis Euro 1 billion; Blue Box Euro 7 billion; Total OTDS Euro 26.8 billion. The EU's

28 October 2005 offer at the WTO would bring the allowed levels to the following: the allowed AMS to be cut by 70% to Euro 20.2 billion; de minimis to be cut by 80% to Euro 3.8 billion; Blue Box restricted to 5% of production at end of implementation period to Euro 12.3 billion. The total of these three would be Euro 36.3 billion. However the EU also committed to bring down its allowed OTDS by 70%, implying a level of Euro 33 billion.

The significant conclusion is that the EU offer to cut its allowed total TDS by 70% to Euro 33 billion still allows it to have "water" of Euro 6.2 billion above the Euro 26.8 billion that it had already planned for its actual total TDS in 2008, in line with the CAP reform. In other words, the EU's offer to the WTO allows it to increase its planned actual OTDS by more than Euro 6 billion. According to an estimate by the G20, the EU's OTDS level is scheduled to drop to 12 billion euro at the end of the CAP reform in 2014. With this estimate, the "water" would be even much larger.

In accordance with the Chair's 17 July 2007 draft modalities text, the EU (being in category (a) of the tiered formula) would have to reduce its OTDS by 75-85 per cent from its base level of Euro 110 bil. Thus, after the cut, the OTDS would be in the range Euro 16.5-27.6 bil. The EU had earlier said it could undertake a reduction rate ten percentage points higher than the US. In September 2007, at a Room E agriculture meeting at the WTO, after the US said it could work within the Chair's range of 66-73 per cent, the EU was asked if it could stick to its "10 percentage points higher than the US" position. The EU reportedly said that was still its view, but it expressed scepticism that the US would be able to undertake an upper limit of 73% cut, and the EU thus did not expect to do a cut itself that was above 80%. (SUNS #6328 dated 21 Sept 2007).

If the EU were to make an offer for a 80% cut (mid-way between the Chair's 75-85 range), it implies taking its allowed or bound OTDS to Euro 22 billion. Assuming the negotiations conclude in 2008 and take effect in 2009 or 2010, and assuming that there will likely be a 5-year implementation period, the allowed level would then be Euro 22 billion in 2012 or 2013. And this compares with the estimate of euro 12 billion at the end of the CAP reform in year 2014. There will thus be a lot of "water". At a meeting on 24 July to provide feedback to the Chair's text, the G20 stated that the EU and Japan retain considerable amounts of "water" and this is not adequately addressed in the Chair's text. The Round started with the EC commitment to bind the CAP reform; now cuts fall short even of that modest original commitment.

#### **CONCLUSION ON DOMESTIC SUBSIDY OFFERS, CHAIR'S RANGES AND THE GREEN BOX ESCAPE ROUTE**

The conclusion from the above is that even when considering only the trade-distorting support, the US and EU offers are not sufficient to ensure real cuts in the actual or the already planned levels of domestic support.

According to the trade expert Chakravarthi Raghavan, it was significant that the US had said that what it was offering was conditional on other countries making concessions. This seemed like a prelude to its strengthening the demands it would make on the developing countries, in agriculture market access, as well as NAMA and services. "This shows the folly of 'negotiating' with the US administration, when it has no trade authority," said Raghavan. "Even in private contract negotiations, no one will negotiate unless the other party has the power to negotiate and sign." Raghavan added that in substance the US offer on the OTDS cap did not really amount to anything.

"Substantially, so long as the green box category of subsidies is not disciplined and capped, it would not matter what the US offers on capping its "trade-distorting support", since it can then operate more of its subsidies through the Green Box which has no limit and hardly any discipline at present. "And more so when at the end, the US will tell the other WTO members that any deal will also be conditional on having a new peace clause," predicted Raghavan.

[The "peace clause" in the Agreement on Agriculture exempted WTO members from being taken to a dispute settlement panel if they were in violation of certain aspects of disciplines relating to agricultural subsidies. The peace clause has expired, thus opening members to dispute procedures. However, it is believed that the US is asking for the restoration of a peace clause (or some version of it) as part of the outcome of the Doha negotiations.]

The Green Box can be expected to be even more the major category of domestic support in future, as this constitutes an escape from having to really reduce overall subsidies. The

developed countries can continue to use the Green Box subsidies without limit as the August 2004 Framework and the Hong Kong Declaration do not put a cap on these. Some of these Green Box subsidies are actually trade-distorting (as the cotton dispute decisions have shown) and should have been allocated to the trade-distorting boxes such as Amber or Blue or de minimis. As the trade expert Bhagirath Lal Das has pointed out: "The really significant escape route is the Green Box which amounts to US\$50 billion and Euro 22 billion in 2000 respectively in the US and EU and the possibility of unlimited increase in future... Thus, the Green Box, particularly its window of "decoupled income support" (paragraph 6 of Annex 2 of the AoA) will continue to be the route to give farmers unlimited amounts as subsidies."