

# Implications of WTO Negotiations and Litigation for US Farm Programs<sup>1</sup>

David Blandford  
Penn State University

In this paper I discuss the potential implications of recent WTO developments for future US farm policies, focusing on two issues:

1. The implementation of reductions in domestic support under the Doha Round Framework Agreement.
2. The future status of the Green Box.

I also make some comments about the potential impact of changes in market access requirements, focusing on dairy and sugar.

## Implications of the Domestic Support Provisions of the Framework Agreement

The Doha Ministerial Declaration calls for “substantial reductions in trade distorting domestic support” (WTO 2001). The Framework document (WTO 2004) specifies the following key provisions:

1. A substantial reduction in the overall level of trade-distorting support (defined as the bound Total AMS, plus permitted *de minimis*, plus Blue Box support) from base period levels with a strong element of harmonization, in which higher levels of permitted trade-distorting support will be subject to deeper cuts.
2. In addition to the overall reduction commitment, a substantial reduction in the bound Total AMS and permitted *de minimis* levels; the capping of Blue Box support at 5 percent of the average value of total agricultural production for an historical period; and the capping of product-specific AMS at their respective average levels according to a methodology to be agreed.

Under the Uruguay Round Agreement the United States binding on the Total AMS (TAMS) is \$19.1 billion. In line with URAA rules, in evaluating its current TAMS, the United States can exclude any product-specific AMS that is less than 5 percent of the value of production of that commodity (the product specific *de minimis* provision, PSDM) and its non product specific AMS, providing that this is less than 5 percent of the total value of agricultural production (the non product specific *de minimis* provision NPSDM).

Table 1 and Figure 1 summarize the situation with respect to US domestic support derived from the most recent three years of notifications to the WTO (1999-2001). In this paper I use data from this period (the “base period”), plus information from earlier WTO notifications (1995-1998).

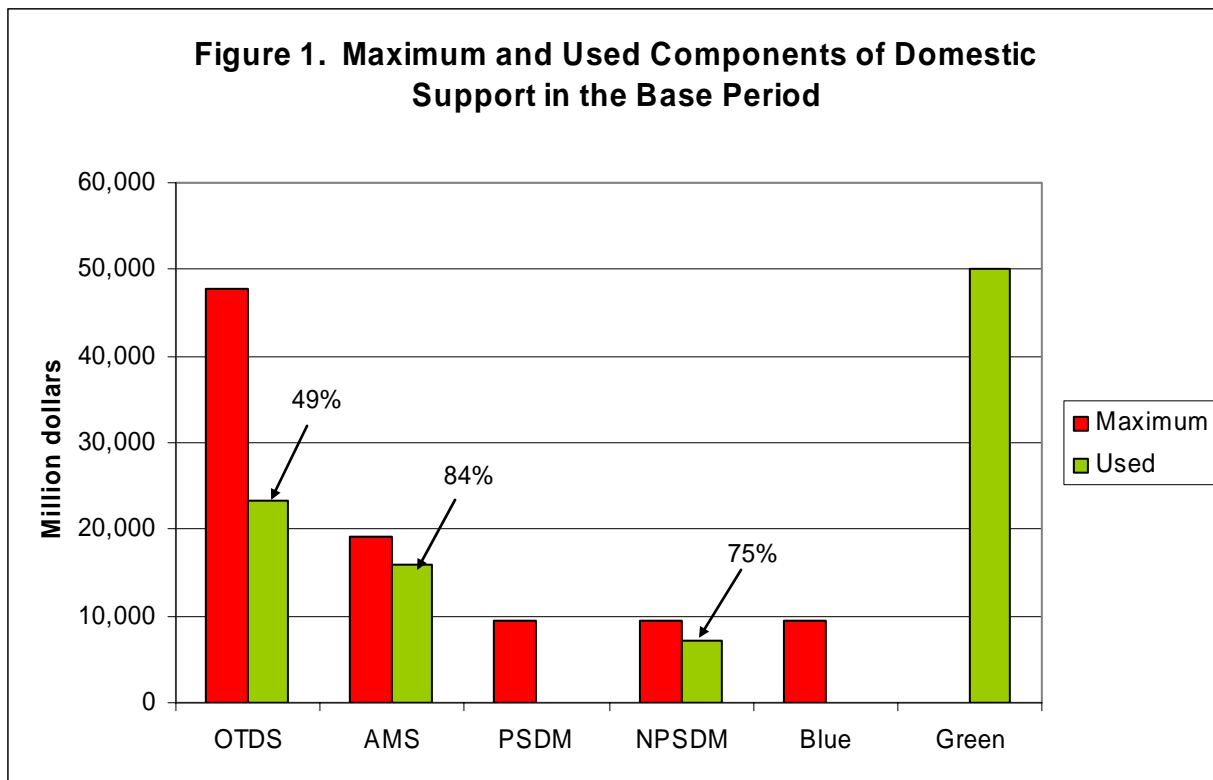
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Table 1. Base Period Domestic Support Average, 1999-2001

	Million dollars
Bound Total AMS	19,103
Current Total AMS	16,026
Product specific <i>de minimis</i>	102
Non product specific <i>de minimis</i>	7,171
Blue box payments	0
Green box payments	50,159
Value of Production	190,919
Current Overall Trade Distorting Support	23,299
As percent of production	12%
Maximum Overall Trade Distorting Support	47,741
Blue Box cap	9,546

Source: Derived from U.S. notifications to the WTO.



The United States used 84 percent of its bound Total AMS of \$19.1 billion (note that all figures cited are with respect to the 1999-2001 base period used in the analysis). It also used roughly 75 percent of its NPSDM.

Under the new concept of the Overall Trade Distorting Support (OTDS), the US support entitlement would be \$47.7 billion. This is made up of the Bound TAMS (\$19.1 billion), and the PSDM, NPSDM and Blue Box cap, each of which amounts to just over \$9.5 billion (5 percent of the value of production). The US used 49 percent of that OTDS entitlement in the base period. Note also that Green Box payments averaged \$50.2 billion – more than the OTDS entitlement.

The Framework extends the definition of Blue Box payments to those made under production limiting programs or payments that do not require production (to be negotiated). It also specifies that such payments must be made on “fixed and unchanging” areas or number of animals. This expansion of the Blue Box definition is intended to capture the Counter-Cyclical Payments (CCPs) introduced by the United States as part of the 2002 Farm Act.

The Framework contains limited information on the modalities to be applied for domestic support in a new WTO agreement. It indicates that a tiered approach will be used in determining reductions in the OTDS and TAMS, but does not indicate what these tiers will be. Apart from the 5 percent Blue Box cap, the only other specific figure contained in the Framework is that for a downpayment reduction of 20 percent in the OTDS. The Harbinson modalities were more specific on some points, for example, indicating that the *de minimis* allowances for developed countries would be cut from 5 percent to 2.5 percent (WTO 2003).

For the purposes of the current analysis, I examine the implications of the following scenario:

1. a 60 percent reduction in the OTDS and Bound TAMS
2. a reduction from 5 percent to 2.5 percent in the two *de minimis* components.

The effects of these assumptions with respect to the base period data for the United States are given in Table 2 and their implications are summarized in Figure 2.

Table 2. Doha Support Reduction Scenario<sup>1</sup>

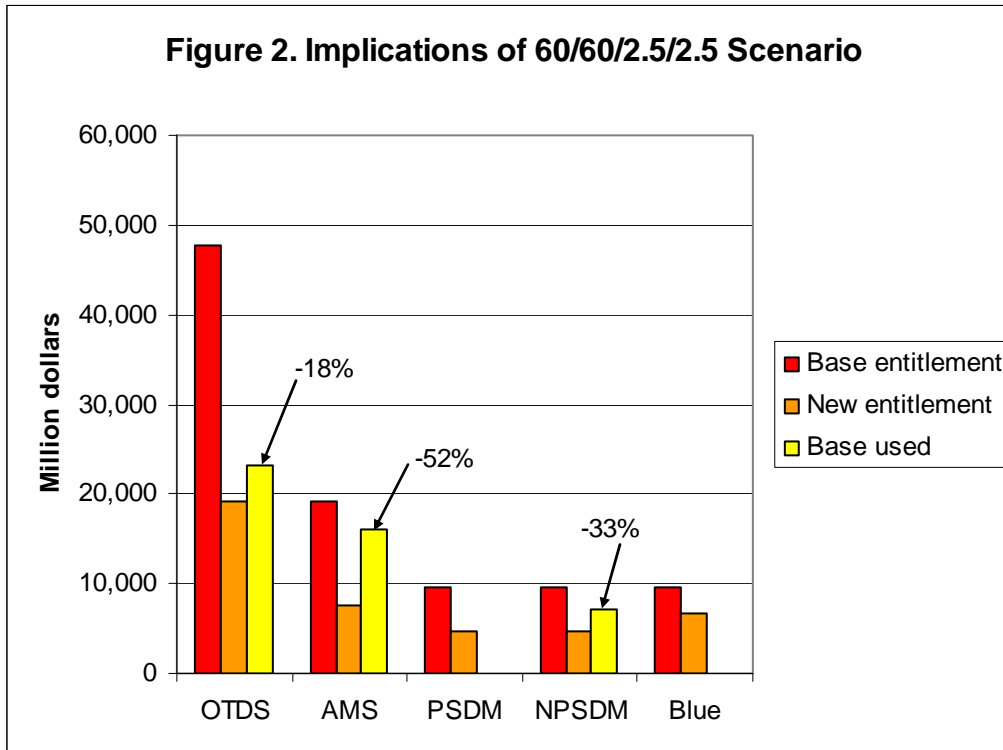
	Million dollars
Overall Trade Distorting Support Entitlement	19,096
Bound Total AMS (60 percent reduction)	7,641
Product specific <i>de minimis</i> entitlement (2.5% of production value)	4,773
Non-product specific <i>de minimis</i> entitlement (2.5% of production value)	4,773
Blue Box payment cap (5% of production value)	9,546
Blue Box entitlement under the proportionate reduction <sup>2</sup>	1,909
Maximum actual Blue Box payment entitlement <sup>3</sup>	6,580
Maximum Overall Trade Distorting Support as a percent of production	10%
Percentage reduction in OTDS needed to eliminate Blue Box support	74%
Overall Trade Distorting Support allowance with a 20 percent reduction downpayment	38,193

<sup>1</sup> Reduction of 60 percent in the OTDS and TAMS, 2.5 percent cap on the *de minimis* components, 5 percent cap on Blue Box support.

<sup>2</sup> Assuming that the other components of the OTDS are binding.

<sup>3</sup> Assuming that the Total AMS and non product-specific *de minimis* are binding; and that the actual base period non product-specific *de minimis* applies. In fact, movements of products from the product specific *de minimis* category to the TAMS would increase this figure by approximately \$80 million.

A cut of 60 percent would reduce the maximum OTDS from \$47.7 to just under \$19.1 billion (from 25 percent to 10 percent of the value of production). This would require an 18 percent cut in the actual OTDS for the base period. The 60 percent reduction in the Bound TAMS would imply a cut of \$8.4 billion or just over half in the actual TAMS in the base period; the reduction in the *de minimis* percentage would result of a cut of roughly one third in the actual NPS *de minimis*.



The use of the PS *de minimis* by the United States in the base period was small (an average of \$102 million). The impact of the reduction from 5 to 2.5 percent depends on whether commodities that previously qualified for *de minimis* would now no longer do so. This affects the following commodities in the base period:

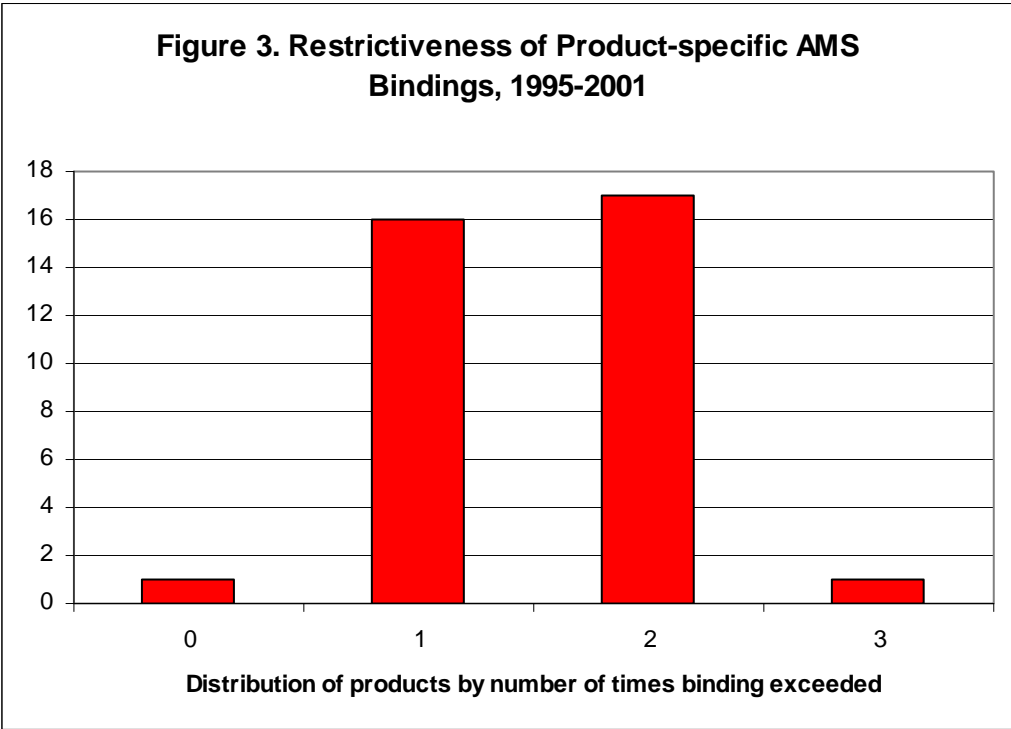
1. Barley – 2001 (AMS of \$16 million)
2. Safflower – 1999 (\$2 million)
3. Sheep and lamb – 1999 (\$13 million), 2000 (\$10 million)
4. Wheat -2001 (\$189 million)

The effects are fairly small with the exception of the year 2001, when a total of \$205 million of previously excluded support would now be included in the TAMS (due primarily to wheat) and would be subject to reduction under the assumptions made.

The impact of the assumed reductions on the Blue Box is interesting. If one were to assume a proportionate reduction in the Blue Box (i.e., the figure that would be implied by the

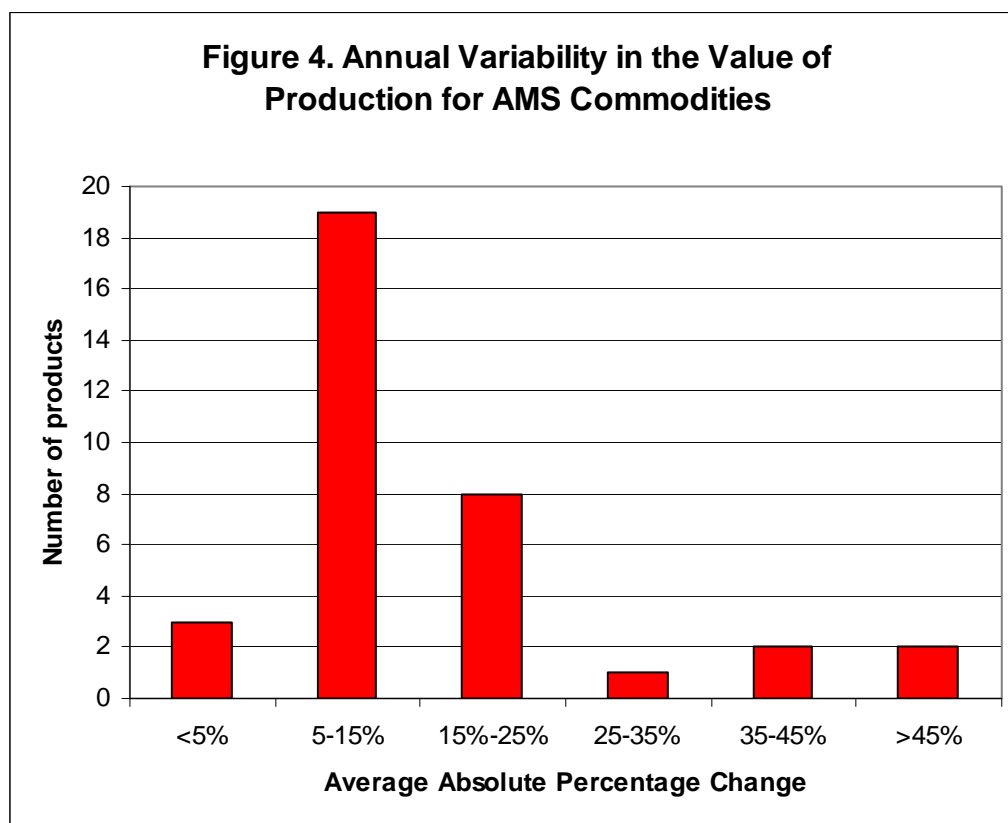
percentage reductions in the other components of the OTDS) then the Blue Box entitlement would be roughly \$1.9 billion, which is substantially below the capped level of \$9.5 billion. However, since the actual Blue Box support entitlement is a residual, unused support under other categories can be applied to actual Blue Box payments, providing that these remain below the capped level. Because the United States did not use much of its PSDM in the base period, this feature would increase the permitted spending under the Blue Box category to roughly \$6.6 billion. We might also note a reduction percentage of roughly 74 percent in the OTDS would be required (holding other bindings constant) to eliminate the US Blue Box support entitlement entirely (Table 2).

A further issue for the United States, is the capping of product specific AMS. The intent behind this requirement is to discipline the reallocation of support among commodities within the TAMS, and to prevent the escalation of support for individual commodities. The Framework indicates that the methodology to be applied for product specific AMS caps is to be negotiated, but for the purposes of illustration I assume that the bindings would be equivalent to the average AMS for each commodity in the base period. If one uses those figures, the United States would have exceeded that binding at least once during the period 1995-2001 for all but one of the 35 commodities for which it reported an AMS in the base period (Figure 3). Admittedly many of these “violations” were associated with 2000 and 2001, when levels of support were very high for many commodities, but the figures suggest that product-specific AMS bindings could pose a challenge for the United States.



One of the issues associated with the use of bindings is the extent to which variations in the product specific AMS are actually due to policy changes. Even though some of the potential

variation in the AMS is controlled through the use of a fixed set of reference prices in making domestic/international price comparisons, variation that is unrelated to policy changes is not eliminated. An important potential source of such variation in the AMS is variation in the volume of production for an individual commodity. Some insight into this issue can be gained from Figure 4, which shows the frequency distribution of absolute percentage year-to-year changes in the value of production for US AMS commodities between 1995 and 2001 (only those years for which data were available in the notifications were used for individual commodities). The majority of US products (19) had percentage variations in the value of production of 5-15 percent per year on average. Only 3 had average variations of less than 5 percent. More striking is the fact that 13 commodities had average annual variations in the value of production of more than 15 percent. While it is not possible to make direct inferences from production values, which combine both changes in prices and volumes, for potential variations in the AMS for individual commodities, the high variability in the value of production suggests that the United States might have difficulty in staying within product specific AMS caps for some commodities, even if the level of support were relatively stable.<sup>2</sup> The problem would be exacerbated if such caps were to be reduced in line with reductions in the TAMS.



What do the requirements of the framework agreement mean for future US farm policies? It is difficult to determine this without firmer information on the parameters that will be applied,

<sup>2</sup> A comprehensive analysis of this issue would require the decomposition of variability in the value of production into three components: 1. price; 2. systematic changes in output; and 3. random changes in output.

particularly the bindings and reduction percentages. If reductions in the OTDS and TAMS are modest there may not be much of an effect. With respect to the base period the US could have absorbed a reduction of roughly \$3 billion in the Bound TAMS (16 percent) without any effect on actual levels of support. The downpayment of a 20 percent reduction in the OTDS would also seem to be achievable without any changes in policy, since the implied maximum of \$38 billion was substantially above the \$23 billion dollars of actual OTDS in the base period. Although it is difficult to map the current level and composition of support to that in the base period, it seems reasonable to infer that modest reductions of 25 percent or less in the OTDS and TAMS would not have a great impact on current US price support policies for major crops. More aggressive reduction percentages, such as the 60 percent analyzed here, would start to bite, but would still leave some flexibility for Blue Box payments (CCPs). Such flexibility would be important if there were substantial year-to-year variations in market prices. Product specific AMS caps could impose constraints on the amount of price support provided to individual commodities in the future, but would only become a major issue if they were to be subject to a reduction formula.

**Implications of the Market Access Provisions of the Framework Agreement**

Reductions in permitted domestic support would not be the only way through which domestic farm programs could be affected by a new WTO agreement. Increased market access could also have an impact by reducing domestic market prices.<sup>3</sup> The two commodity groups likely to be most affected are dairy products and sugar. For both of these, imports are controlled by tariff rate quotas (TRQs) and high tariffs are applied to over-quota imports. Table 3 shows the average levels of imports for major dairy products and sugar for the period 2000-03.

Table 3. U.S. Imports of Dairy Products and Sugar Averages 2000-03			
	Imports	Utilization	Percentage
Milk	5,076	172,665	2.9%
Butter	44	1,296	3.4%
Nonfat dry milk	8	1,339	0.6%
Condensed and evaporated milk	14	667	2.1%
American cheese	67	3,691	1.8%
Other cheese	382	5,144	7.4%
 Sugar	 1,218	 9,920	 12.3%

Notes: Dairy units are million pounds; sugar is thousand short tons  
Milk imports are total imports of dairy products in milk equivalent, fat solids basis  
Sugar imports are those under URA TRQs  
Source: Data from USDA (ERS).

Imports as a percentage of domestic use are low for most dairy products. Import penetration is highest for non-American cheese (roughly 7 percent of domestic consumption). In contrast,

<sup>3</sup> The reduction or elimination of export subsidies and future restrictions on the use of export credits are unlikely to have a significant effect on U.S. farm programs.

roughly 12 percent of total sugar use is made up of imports. The Framework does not indicate what increases will be required in TRQs or the formula to be applied to tariffs. However, on the basis of the figures in Table 3, it seems likely that changes in these are most likely to affect dairy products. The Harbinson Modalities contained a figure of 10 percent of consumption for the future level of TRQs. That would imply no additional imports of sugar, but substantial additional imports of dairy products.<sup>4</sup> On that basis, the domestic support program for milk and dairy products might have to be modified, by reducing support prices.

### **Implications of Litigation and the Doha Negotiations for the Green Box**

As illustrated by Figure 1, Green Box payments are important for the United States. The Framework indicates that a review and clarification of criteria will be conducted to ensure no, or at most minimal, trade-distorting effects or effects on production and to provide for improved monitoring and surveillance of Green Box payments. The Harbinson Modalities suggested amendments to Annex 2 of the Agreement on Agriculture, clarifying the characteristics of payments with respect to income insurance and safety-net programs; disaster payments; structural adjustment assistance; and payments under environmental programs (with these to be extended to include animal welfare payments). There are clearly concerns among some countries that payments that are currently declared by countries as falling under the Green Box heading may be less than minimally distorting with respect to production and trade.

The future of Green Box payments is currently uncertain because of the recent WTO ruling under the Cotton Case. In that case, Brazil brought a complaint against certain aspects of the cotton policies of the United States. A key aspect of the complaint, for the purposes of the current discussion, was the panel's finding that US direct payments and the legislative and regulatory provisions which establish and maintain the direct payments program do not fully conform to the conditions set out in Annex 2. Following an appeal by the United States, the Appellate Body upheld the original panel decision.

A key issue in the decision was whether the payments provided by the United States actually have an impact on production. Annex 2 states that the amount of decoupled income support payments in a given year shall not be related to, or be based on, the type or volume of production undertaken in any year after the base year used in establishing the payments. The panel concluded that since the payments were conditional on producers not planting certain commodities (specifically fruits and vegetables) on the land upon which payments were based, and that producers were subject to penalties if they chose to do so, there was indeed a link to production decisions after the base period. This is an important decision not only for the United States, but also for the European Union, whose single farm payment (SFP), which is currently being introduced as a result of the Mid-term review in 2003, involves a similar requirement. One might conclude that a simple solution to this problem would simply be to

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<sup>4</sup> The sugar program may have to be modified to cope with increased imports from Mexico under NAFTA. By 2008, Mexico will be permitted unlimited duty-free access to the US market. The current price support program, which is supposed to operate at no-cost to the Federal government, may be unsustainable when this occurs.

relax the restriction on the ability of producers to devote their land to other crops, and that may indeed be the case. However, the decision appears to open up a broader set of issues.

In both the European Union and the United States there appears to be a desire to link the provision of income support for agriculture to specific uses of agricultural land. Although the broader implications of conditionality were not considered in the cotton case, in some circumstances this might be interpreted as linking the provision of payments to agricultural activity (i.e., to production). To the extent that it could be demonstrated that a particular requirement increases agricultural output directly or indirectly (the emphasis in the Green Box is on marketable agricultural output), the requirement might be challenged on the basis that it does not satisfy the condition of being minimally production and trade distorting. The broader implications of the Cotton Case for the provision of income support to agriculture remain to be determined, but may put into question support that is linked in any way to the continuance of agricultural activities that lead (directly or indirectly) to additional marketable output by the recipients of such support. That would clearly have implications for the future of US “decoupled” payments.

A separate element of the Green Box that appears to recognize the legitimacy of such a linkage relates to the provision of payments under environmental programs. These have become increasingly important in US Farm policy. Annex 2 acknowledges that producers may be required to meet certain conditions relating to production methods or inputs as part of such a program, but specifies that the amount of any payment made must be limited to the extra costs or loss of income involved in complying with the conditions of the program. The underlying assumption appears to be that governments may provide payments in order to secure the supply of environmental benefits associated with agriculture’s use of the land, but it is unclear whether some of the environmental programs that are being developed around the world would conform to the Green Box conditions. The thrust of the Annex 2 conditions appears to be on programs that compensate producers for the private costs of complying with environmental regulations or conditions set by the government, they do not appear to condone an approach that would reward producers for the social value of those services, i.e., on the basis of what the general public would be prepared to pay for the provision of such services if there were actually a market for them.

The underlying assumption behind the concept of “multifunctionality” that is being promoted in Europe (agriculture as a source of both commodities and non-commodity outputs), seems to be that the optimal supply of agriculture’s non-commodity outputs, such as landscape, wildlife habitat, biodiversity, and cultural heritage can only be guaranteed by providing farmers a sufficient economic incentive to provide those attributes. That incentive may need to cover the opportunity costs faced by farmers (their potential earnings in non-agricultural activities or use of the land for alternative purposes), rather than simply covering the additional costs that environmental programs may impose due to their impact on specific agricultural or land-use practices. Blandford and Boisvert (2005) argue that payments for such services that are established through competitive bids, as in the Conservation Reserve Program, may satisfy the income foregone condition of Annex 2, since it can be argued that farmers’ individual bids will

be related to the opportunity costs of the use of their land, i.e., to income foregone. However, it is by no means clear that incentive payments that are set by governments for producers to participate in environmental schemes or the provision of direct income payments that have environmental conditions attached to them would conform to current Green Box rules.

A more general and difficult issue with the Green Box, as currently defined, is that some categories of payments may, of necessity, have an impact on production. This is particularly true for environmental payments. What is clear is that the current Green Box includes many different types of payments, some of which are likely to be more distorting than others. One might argue that there should be an attempt to move some of these payments that *a priori* are likely to have the greatest impact on production (in particular, those relating to direct income supports, income insurance and income safety-net programs, and crop insurance) into a more conditional Box that will be subject to reduction – perhaps into the Blue Box. So-called decoupled payments may indeed have an impact on production that cannot be justified on the basis of correcting for market failure (Abler and Blandford forthcoming).

Even with a clearer elaboration of the characteristics of Green Box payments, it is unclear whether attempts to impose greater discipline through the WTO on the types of payments provided will be possible. One issue is that Annex 2 refers to payments not programs – there is considerable flexibility to change payment names and forms (e.g., the changes in US payments between the 1996 and 2002 Farm Acts) while keeping fundamental instruments the same. Finally, it is unclear how improved monitoring and surveillance, as called for in the Framework, will be implemented. One option would be to have a formal WTO review process for new payments with a panel to review their conformity with the minimally distorting requirement. In such a process the responsibility would rest on the country proposing to create a new program to demonstrate that it is minimally distorting (Blandford 2001). If it were judged not to be so, the support under such a program would be included in the Amber Box and counted against the OTDS commitment. It is unclear whether the United States and other countries would be willing to accept such a level of international discipline on domestic agricultural programs.

## **Conclusions**

The elements of a new agreement relating to domestic support for agriculture are set out in the WTO Framework document of July 2004. This introduces the concept of the Overall Trade Distorting Support (OTDS), which is to be disciplined and subject to reduction. In addition, some of the individual components of the OTDS will be subject to minimum required reductions and other elements will be capped. The caps and reduction percentages will define the future “entitlement” to Amber and Blue Box support in the United States.

It is unclear whether this approach will require the United States to make significant changes in its future farm policies. Much will depend on the reduction percentages for overall trade distorting support and the Total AMS. Reduction percentages in excess of 25 percent seem to be required for there to be much of an effect. Reduction percentage of 60 percent or more in the permitted OTDS and the TAMS binding would be required to create the need for significant

policy reform. Changes in market access, in particular significant increases in TRQs, could be important for the price support program for milk and dairy products.

The United States, in common with many other developed countries, has increased the use of Green Box payments in recent years. The Framework proposes a tightening of the rules for inclusion. Changes in rules for income support measures will be required as a result of the Cotton Case ruling in the WTO, but there are other important issues relate to the eligibility of other support measures and environmental payments. Whether changes in these rules and more active surveillance will constrain the future use of Green Box measures by the United States and other countries is an open question.

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