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Delivering on the Doha Agenda: Are the Proposed Cuts in EU and US Agricultural Subsidies Real?

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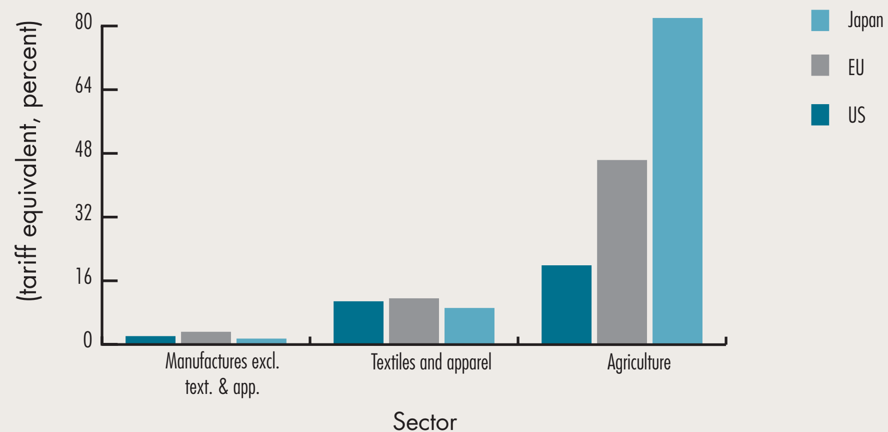
Liberalization of agricultural markets in rich countries is the linchpin for a successful conclusion to the Doha Round of World Trade Organization (WTO) negotiations. Agriculture is where the highest remaining barriers are in rich countries and liberalization of these markets is the major demand of developing countries (Figure1). Trade negotiations committed to promoting economic development and poverty reduction also cannot ignore agriculture when more than half the people in developing countries and 70 percent of the poor live in rural areas.

Market access is the key issue in these negotiations, but reductions in trade-distorting subsidies are important for certain countries and commodities, notably poor cotton farmers in West Africa. Subsidy cuts are also *politically* necessary to achieve a balanced outcome in the negotiations. The United States relies more on subsidies than import barriers and, as the world's third largest provider of agricultural support, it must also contribute.[1] Finally, there is a great deal of confusion about how the WTO addresses domestic subsidies and the potential effects of recent proposals. This brief seeks to clarify these issues and point the way to a meaningful result, something that is not guaranteed by what is currently on the table.

The WTO Approach to Reducing Agricultural Subsidies

The Uruguay Round of trade talks (1986-93) divided agricultural support into three categories according to how trade-distorting it is. The "amber box" contains the most trade-distorting, "coupled," support, while

Figure 1. Aggregate Measure of Protection against Developing Countries



Source: Cline 2004, p. 127.

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the "green box" is for minimally-distorting subsidies, including "decoupled" payments to farmers and general support, such as for research and development. The intermediate "blue box" is for payments regarded as less trade-distorting than amber box support because production is limited. The ultimate goal is to reduce the level of support and replace amber and blue box subsidies with "decoupled" green box payments.

The amber box is centered on an "aggregate measurement of support" (AMS) that includes both price supports backed by trade measures, and payments linked to prices or production. Payments that would otherwise be included in the AMS can be deducted as long as they are "de minimis," adding up to no more than 5 percent of production of individual commodities or 5 percent of total production if they are non-product specific. Currently, no country makes much use of the former and only the United States reports significant spending in the latter category.[2]

The AMS concept is confusing because it encompasses some but not all of the support provided via trade barriers. The value of "market price support" included in the AMS is calculated as the difference between a government-set "administered price" and an "external reference price," defined as an average unsupported price in 1986-88. Crops protected purely through trade measures are not included.[3] Thus, Japan was able to sharply reduce its AMS by eliminating the administered price for rice while maintaining an

Potential Implications of Doha Round for US Farm Programs (billion US dollars)

	Currently permitted	Actually used	Proposed ceilings	Programs affected
Trade-distorting (Amber)	19.1	11.9 (2003-06 avg.) 15.7 (2005)	US: 7.6 EU: same	Market price support for sugar, dairy = 5.5 Subsidies for other commodities = 6.4 (2003-06 avg.) 10.2 (2005)
Non-product-specific de minimis	9.5	6.8 (last reported, 2001)	US: 4.8 EU: 1.9	If CCPs moved to Blue Box, other de minimis programs = ~2 (2001, last reported)
Less trade-distorting (Blue)	Unlimited	2.7 (2003-06 avg.) 5.9 (2006)	US: 4.8 EU: 9.5?	Counter-cyclical payments

Potential Implications of Doha Round for EU Common Agricultural Policy (billion euros)

	Currently permitted	Actually used	Proposed ceilings	Programs affected
Trade-distorting (Amber)	67.2	39.3	US: 11.4 EU: 20	Reforms to cereals, rice, dairy, sugar (if approved), olive oil, tobacco, and cotton estimated reductions = ~12 5-7 more from not yet reformed fruit and vegetable sectors? (2001 AMS = 8)
Non-product-specific de minimis	12.5	negligible	US: 6.3 EU: 2.5	Not relevant for EU.
Less trade-distorting (Blue)	Unlimited	23.7	US: 6.3 EU: 12.5?	Single Farm Payment decouples most payments from production. Depending on degree to which member countries take advantage of flexibility to keep some payments coupled, OECD estimates remaining Blue Box payments = 6-13

Source: Author's calculations.

equivalent level of protection for farmers through a highly restrictive tariff-rate quota.[4] Reducing protection for commodities with AMS administered prices thus requires reducing or eliminating those prices *and* lowering associated trade barriers. Almost all of the EU AMS is of this type, which is why its weak market access proposal has been greeted with such disappointment. The US AMS is divided between market price support for sugar and dairy, and price-linked subsidies for most grains, cotton, rice, and soybeans. Most of the proposed EU decoupling involves shifting payments from the blue to the green box. The EU blue box contains payments created in the early 1990s as compensation for reductions in administered prices for some commodities. They remain linked to production of specific commodities but production is limited and payments are based on fixed areas and yields or numbers of animals. Under the 2003 Common Agricultural Policy (CAP) reform, most of these payments will be converted to a "single farm payment" that is decoupled and is eligible for the green box. US negotiators are also now seeking to use the blue box for "counter-cyclical payments" (CCPs) included in the 2002 farm bill. These payments are partially decoupled because they do not require production of any specific commodity and they are based on historical areas and yields, but the value of the payment is linked to current prices.

The US and EU Proposals for Cutting Trade-Distorting Subsidies

In early October 2005, US Trade Representative Robert Portman offered to cut the US AMS by 60 percent from the current bound ceiling if the EU and Japan would cut their much higher bound levels by 83 percent. Portman further proposed reducing de minimis ceilings by half and cutting the blue box to 2.5 percent of production from the 5 percent cap agreed in the 2004 Geneva framework. EU negotiators countered with an offer to reduce their AMS by 70 percent and reduce de minimis by 80 percent, leaving open the possibility of blue box cuts beyond the 5 percent cap.

The table summarizes potential effects of these proposals. Both would require large cuts in the applied AMS—35-50 percent for the United States and from 50-70 percent for the European Union. Neither of the proposals would cut into Japanese support because the elimination of the administered price for rice reduced its applied AMS to 80 percent below of the bound level.

In the other categories, each party tries to reduce the other's room for maneuver while protecting its own. Changes to US programs in the 2002 farm bill, combined with the US proposal to move CCPs to the blue box, probably mean that US-proposed cuts in de minimis payments would have little impact. The more aggressive EU proposal on de minimis might constrain US non-product-specific de minimis spending in bad years, if Congress wanted to appropriate large new ad hoc emergency payments.[5] The US proposal to cut the blue box to 2.5 percent of production over five years would be relatively more likely to pinch EU spending than its own, based on average levels of counter-cyclical payments under the 2002 farm bill. The US proposal would, however, require cuts in the congressionally-authorized level of spending on CCPs and would have constrained projected payment levels if in place this year.

The analysis in the table suggests that the AMS cuts would be real, but how large depends on the details of implementation. Options for reaching the new US AMS target include:

- Reallocate support among commodities:
  - Buy out the sugar and dairy programs (thereby shifting them from coupled amber box support to decoupled green box support) and modestly cut price floors for other crops.
  - Maintain sugar and dairy support and impose large cuts in subsidies for other crops.
- Pursue cosmetic reform by eliminating the administered prices for sugar and dairy, maintaining tariff-rate quotas, and declaring these commodities "sensitive products" in the market access negotiations. All of the AMS could then be allocated to subsidies for other commodities with only modest cuts in target prices.

For the European Union, it appears that the 2003–04 CAP reforms, plus removal of the administered prices for fruits and vegetables, would allow the EU to meet a 70 percent AMS cut. Real reductions in support for fruits and vegetables would then depend on concessions in the market access negotiations, which EU negotiators appear to be trying to minimize. The US-proposed cut in the EU AMS would require additional reforms, which France appears set to veto. Whether the EU can agree to the US-proposed reduction in the blue box depends on how aggressively member states implement the CAP reform.

Assessment

A final agreement that cuts the EU AMS by 70 percent and the US AMS by 60 percent, eliminates product-specific de minimis and cuts non-product specific de minimis by half, and caps the blue box at 2.5 percent of production would reduce the overall measured level of trade-distorting support by more than half in the EU, from 63 billion euros (2001) to 26 billion euros.[6] If the EU reaches the final target by making only cosmetic changes to the fruit and vegetable sector, the reduction in the measured level of trade-distorting support would be nearly 50 percent. Most of the reduction would come in the dairy and sugar sectors (if the latter reform is approved by member states, which is not guaranteed) and the effects on trade would be primarily reductions in subsidized exports, not increased imports.

For the United States, the new ceiling for overall trade-distorting support proposed here (which goes beyond the US proposal by eliminating the product-specific de minimis) might require cuts of a third or more in very bad years, for example from the roughly $24 billion projected for 2006 to $17 billion ($4.8 billion each for de minimis and blue box payments and $7.6 billion for the AMS). But average actual and projected spending for 2003-06 suggests a $17 billion ceiling might be binding but not require cuts in "average" years. Whether the separate amber box ceiling requires large or small cuts in US programs depends on whether policymakers undertake real reforms, such as buying out the sugar and dairy programs, or make

only cosmetic changes by removing administered prices for those commodities. But even real reform for sugar and dairy would leave substantial room in the AMS to protect programs for other commodities. To guard against this possibility, either the AMS calculation should be changed to remove market price support, leaving only government payments, or the United States (and any other country in a similar situation) should be required to make proportional cuts in each of the two types of amber box support. This is the only means of ensuring that at least some cuts are made in US subsidies for grains, cotton, rice, and oilseeds. That, combined with a buy-out of the sugar and dairy programs and substantial increases in market access in Europe, Japan, and Korea would be a major step in delivering on the Doha Development Agenda.

Endnotes

1 Japan, Korea, and the other rich countries that protect agriculture even more generously will also have to make significant concessions in the market access negotiations.

2 Product-specific de minimis is ignored in the analysis that follows and the best outcome in the negotiations would be to eliminate it.

3 Market price support with administered prices is more distorting than tariffs because it requires governments to intervene in markets when prices threaten to breach the price floor, buying and storing or exporting surpluses and more effectively insulates producers from global price changes.

4 Tariff-rate quotas (TRQs) impose a higher, often prohibitive, tariff on imports above a designated quota ceiling.

5 Roughly $5 billion of the $7 billion in average annual US de minimis payments in 1998-2000 were emergency payments passed by Congress to compensate formers for low prices. The CCPs were intended to replace these emergency payments, suggesting that de minimis payments could fall to $2 billion or less if the CCPs are allocated to the blue box.

6 This assumes that the EU does not increase use of the remaining de minimis category.

Related CGD Work

Trade policy is one of the Center's core areas of policy-based research. Our work on trade policy concentrates on the challenges and opportunities that trade presents to global development and poverty reduction, including issues of trade protectionism and liberalization. For related CGD materials on this issue, please refer to the following works, which are available online at www.cgdev.org.

Kimberly Elliott, Big Sugar and the Political Economy of Agricultural Policy. Policy Brief (Washington, DC: Center for Global Development, 2005).

Kimberly Elliott and Debapriya Bhattacharya, Adjusting to the MFA Phase-Out: Policy Priorities. Policy Brief (Washington, DC: Center for Global Development, 2005).

William Cline, Trade Policy and Global Poverty (Washington, DC: Center for Global Development and Institute for International Economics, 2004).

Tim Josling and Dale Hathaway. This Far and No Farther? Nudging Agricultural Reform Forward. Policy Brief (Washington, DC: Institute for International Economics, 2004).

Scott C. Bradford, Paul L.E. Grieco, Gary Clyde Hufbauer, "The Payoff to America from Global Integration." The United States and World Economy: Foreign Economic Policy for the Next Decade. ed C. Fred Bergsten. (Washington, DC: Institute for International Economics, 2005).

Forthcoming CDG Work

Kimberly Elliott, Delivering on the Doha Agenda: Agriculture in Rich and Poor Countries. (Washington, DC: Center for Global Development, 2006).

William Cline, Toward a Grand Bargain in the Doha Round. Policy Brief (Washington, DC; 2005).

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