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Rethinking Agricultural Domestic Support under the World Trade Organization

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The World Trade Organization (WTO) negotiations under the Doha Round are slowly progressing toward an eventual new agreement on agriculture. A new framework for the agriculture agreement was approved by the WTO membership in August 2004. The changes in the guidelines for domestic support could have effects on many countries and many types of support. However, details on the specific regulations of the agreement have yet to be determined. Dramatic reforms in agriculture could take place under the framework, but the decisions made to implement the framework will determine if that potential is realized. If countries lack ambition and commitment to make genuine reforms, changes in support will not happen in this round.

Governments provide support to agriculture in numerous ways, for example, direct payments, research grants, loan programs, and storage programs to name a few. Under the current Uruguay Round Agreement on Agriculture (URAA), domestic support programs are divided into three “boxes” that indicate the trade-distorting effects of the programs. “Green Box” programs are considered minimally trade distorting. The agreement sets out specific guidelines for the structure of such programs but does not set limits on these program expenditures by WTO members. “Blue Box” programs are considered more trade distorting but have production limits embedded in them. These programs also are not limited under the current agreement.

All other programs are “Amber Box” programs. Amber Box programs are considered the most trade distorting and are limited under the current agreement. Within the Amber Box, programs are classified as product-specific or non-product-specific. These classifications determine the so-called de minimis rules, by which certain Amber Box programs may be exempt from domestic support limits. Support that counts against the limits is referred to as the Aggregate Measure of Support (AMS).

The New Framework, Recent Policy Changes, and WTO Rulings

The newly agreed upon framework for agricultural domestic support is targeted at achieving substantial reductions in trade-distorting support, the Amber and Blue Box programs. New limits are put in place on de minimis support, Blue Box support, and the product-specific AMS. Total support, as measured by the sum of AMS, de minimis, and Blue Box support, is to be limited. This limit on total support will be tightened during the implementation period. All member states face a 20 percent reduction in the total support limit in the first year of implementation. This reduction is referred to as the “down payment.” Recent estimates indicate the United States would have a total support limit of $49 billion per year at the start of the new agreement; a 20 percent reduction would lower the limit to $39 billion. Additional reductions in the total support limit will be based on a tiered formula that is yet to be determined. However, the formula will result in larger reductions for WTO members that have higher levels of permitted support.

Total AMS and de minimis permitted levels will also be reduced over the implementation period. The agreement stipulates that product-specific AMS and Blue Box support should only be capped, rather than reduced. However, the framework states that the required reductions in total support and total AMS should also result in reductions in product-specific support. The Blue Box has been redefined to include direct payment schemes that are either production limiting or do not require production at all. A member state’s limit for Blue Box support will be based on 5 percent of its average total value of agricultural production over a historical period or the amount of existing Blue Box payments over a historical period, whichever is higher. Green Box guidelines are to be reviewed to ensure that all

WTO Support Categories

Amber Box Support. Measures with minimal impact on trade, which can be used freely. They include payments made directly to farmers that do not stimulate production, such as certain forms of direct income support, assistance to help farmers restructure agriculture, and direct payments under environmental and regional assistance programs.

Blue Box Support. Direct payments to farmers whereby the farmers are required to limit production. The new framework would also include direct payments based on a fixed base that do not require production in the blue box.
Green Box programs are minimally trade or production distorting. Both the United States and the European Union have significantly altered their agricultural programs over the last few years. They have moved a great deal of their subsidies to direct payments to agricultural entities. The U.S. direct and countercyclical payments and the E.U. Single Farm Payments all fit the description of direct payments. Given the current structure of the Green Box and the new definition of the Blue Box, U.S. direct payments and E.U. Single Farm Payments would be placed as Green Box. U.S. countercyclical payments would go in the Blue Box. These moves give the United States and the European Union a great deal of flexibility in dealing with the proposed reductions.

However, the WTO panel ruling on the Brazil-U.S. cotton dispute has concluded that U.S. direct payments “do not fully conform” to the guidelines for Green Box direct payments because of the exclusion of fruit and vegetable production on the payment-base acreage. By the same measure, E.U. Single Farm Payments, too, would not conform to the Green Box requirements. However, it should be relatively easy to fix both issues, so this is probably of minor concern to U.S. and E.U. negotiators.

The framework explicitly states that the reductions in total AMS permitted levels “will result in reductions of some product-specific support.” But true reductions may not materialize because there are loopholes in market price support (MPS) programs, and member states still have flexibility to provide support through other mechanisms. The change in Japanese rice policy in the late 1990s provides one example of an MPS loophole. Another example would be if the United States made superficial changes to the dairy and sugar programs to fulfill a target in product-specific support reductions without truly affecting actual support. The United States could also lower loan rates in the marketing loan program (reducing product-specific AMS) and augment the countercyclical program to make up the support difference (by changing the target price). Aggregate support would remain the same but would shift from the Amber Box to the Blue Box. The ability of reductions in total AMS permitted levels to force reductions in product-specific support will also hinge on the product-specific AMS limits. These limits have yet to be determined, although the framework does state that the limits will be based on “respective average levels.” To guarantee product-specific support reductions, the final level of total permitted AMS must be less than the sum of the product-specific AMS limits.

**Recommendations for Moving Forward**

The issues embedded in the current WTO agriculture negotiations are numerous because of the multitude of agricultural programs used by member states throughout the world. Putting all of the programs into categories has allowed negotiators and their advisers to condense this support into manageable points so that further clarifications can be

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**Table 1. Estimated Changes in Taxpayer Costs From Crop Insurance Reform (FY 2006)**

<table>
<thead>
<tr>
<th>Current Program</th>
<th>No Optional Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>(billion $)</td>
<td>(billion $)</td>
</tr>
<tr>
<td>Total premiums</td>
<td>4.00</td>
</tr>
<tr>
<td>Total indemnities</td>
<td>4.30</td>
</tr>
<tr>
<td>Total premium subsidies</td>
<td>2.37</td>
</tr>
<tr>
<td>Administrative and operating cost</td>
<td>0.92</td>
</tr>
<tr>
<td>Underwriting gains</td>
<td>0.40</td>
</tr>
<tr>
<td>Taxpayer cost of crop insurance</td>
<td>3.99</td>
</tr>
</tbody>
</table>

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**IS SMART REFORM DOABLE?**

The word around Washington is that departments and agencies are being asked to identify perhaps 8 percent of their budgets that can be cut. If these cuts were to be made on a program-by-program basis, then the USDA’s Risk Management Agency would be forced to cut projected spending by 8 percent. Elimination of optional unit coverage would accomplish this 8 percent cut in the crop insurance program with no impact on the total amount of insurance provided to U.S. farmers.

Of course, the beneficiaries of optional units can be expected to fight their elimination. The primary beneficiaries are crop insurance agents, who will find that their commissions will be cut by about 8 percent; crop insurance companies, which will have reduced underwriting gains; and farmers, who will have reduced payments. But if cuts are going to be made, one would hope that they are made with an objective of doing the least harm to the mission of the agency or program being cut. Elimination of optional units is the type of reform that makes sense in an era of scarce federal resources.
Rethinking Agricultural Domestic Support
Continued from page 5

made. Building on the framework for agricultural domestic support, we recommend additional changes.

The definition of Green Box policies needs to be re-examined. Given the possible effects of decoupled income support and marketing, transportation, and infrastructure support on world trade, these programs may not truly fit the Green Box target of minimally trade-distorting policies. However, these programs are not directly linked to current production or prices and may have large non-agricultural benefits. Therefore, leaving them in the Green Box but tightening the rules for them may make the most sense.

An initially generous Green Box definition may facilitate negotiation of a phase-out of the Amber Box policies, which are the most damaging distortions. Developing countries complain about the large expenditures that sustain E.U. and U.S. farm policies. As these expenditures take place no matter what, competing exporters would be better off with Green Box types of policies than with Amber Box policies. However, this change would mean that net food-importing countries would lose access to cheap food. The export subsidies that keep the costs of food down would disappear with the Amber Box. But trade would be undeniably much less distorted.

The current AMS framework for market price support cannot adequately reflect actual support levels. The MPS examples of Japanese rice and U.S. dairy and sugar show the flaws in current AMS calculations for these programs. Moving to an AMS based on current world and domestic prices will better capture the actual level of support and align market price support programs with other Amber Box programs in which actual expenditures are used in the calculations. An alternative would be to remove the MPS programs from both the AMS limits and the current AMS calculations. The way AMS is calculated for MPS in the current agreement has a significant loophole, allowing the possibility that countries can make small changes in official policy (resulting in minimal changes in agricultural trade protection) and provide themselves large cushions from agricultural support reductions. Either of the proposals suggested here would close this loophole.

Although the framework has provided the possibility for significant agricultural trade reform in domestic support, the Blue Box cap proposed in the framework is so generous that many programs could be folded into the Blue Box with no effective change in policy. Actually, the MPS loopholes, generous initial AMS bindings, and generous Blue Box caps taken together ensure that no actual change in aggregate support would occur. As the agricultural framework stands now, actual cuts in support may well have to wait for a third round of agricultural negotiations, unless negotiators develop a sudden desire for radical reforms. It may help to remember that it took eight rounds of world trade negotiations to get rid of trade distortions in manufacturing.

This article was drawn from a larger working paper of the same name. The full text is available at http://www.card.iastate.edu/publications/synopsis.aspx?id=557.

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**TABLE 2. U.S. HIGH FRUCTOSE CORN SYRUP CONSUMPTION BY TYPE OF USER (THOUSAND SHORT TONS)**

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Confectionery and related products</td>
<td>27</td>
<td>114</td>
<td>106</td>
<td>83</td>
<td>202%</td>
</tr>
<tr>
<td>Bakery, cereals, and allied products</td>
<td>411</td>
<td>442</td>
<td>402</td>
<td>513</td>
<td>25%</td>
</tr>
<tr>
<td>Ice cream and dairy products</td>
<td>402</td>
<td>568</td>
<td>772</td>
<td>258</td>
<td>-36%</td>
</tr>
<tr>
<td>Canned, bottled, and frozen foods</td>
<td>593</td>
<td>647</td>
<td>502</td>
<td>686</td>
<td>73%</td>
</tr>
<tr>
<td>Beverages (mostly soft drinks)</td>
<td>3,888</td>
<td>3,878</td>
<td>5,845</td>
<td>6,693</td>
<td>80%</td>
</tr>
<tr>
<td>Miscellaneous food manufacturing</td>
<td>101</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>5,126</td>
<td>5,506</td>
<td>7,632</td>
<td>8,533</td>
<td>66%</td>
</tr>
<tr>
<td>Contribution of beverages to total HFCS consumption</td>
<td>76%</td>
<td>70%</td>
<td>77%</td>
<td>82%</td>
<td></td>
</tr>
</tbody>
</table>

Source: Calculated from U.S. Census Bureau data.

a For some categories and some years, the Census Bureau withholds data in order to avoid disclosing information about individual companies or if estimates did not meet publication standards.

b The reduction in HFCS consumption by the ice cream and dairy products industry may reflect a change in classification of the industry.

c Authors’ estimate.