HONG KONG SERIES - 2

Agricultural Subsidies and Negotiations

Strategies and Options

Centad

Centre for Trade & Development

Agricultural Subsidies and Negotiations

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Foreword

The World Trade Organisation (WTO) negotiations have reached a critical stage. With only a few days remaining for the Sixth Ministerial Conference, there is immense pressure on developed countries to accede to any reduction commitment in agriculture. Developing countries are cautious about their commitment to market access. The present paper series is an initiative to bring the glaring facts of trade distortions in agricultural trade into the mainstream and the strategies and options to reduce these distortions. The new proposals put forward by the US, EU and G-20 share a common direction towards reducing trade-distorting measures, but the formulae are conditionally linked to each other's mistrust. With this approach it certainly looks difficult for WTO Member-countries to move forward and reach a consensus.

Agriculture is the mainstay of most people of the world and in India it is the way of life. In the current round of negotiations the main crux of differences is the level of trade-distorting measures. If any development agenda has to come out it, has to remove the serious distortions which divide the globe between rich farmers and poor farmers in both developing and least developed countries. Agricultural subsidies have been a major thorn in the Uruguay Round negotiations and it has taken years for the multilateral round to come up with concrete modalities and commitments.

This paper attempts to discuss the existing framework of the July Package and the strategies India should take care to adopt while proceeding with the negotiations. It has tried to cover some of the deficiencies in the July Package and has suggested options on improving the framework by correcting the anomalies. The paper suggests that there are enormous distortions prevailing in global agricultural trade that affect lives across boundaries and that developing countries like India with a huge agrarian population need to be cautious in its approach towards making any commitment. One of the most important facts illustrated by the paper is that these trade subsidies are benefiting a few firms and are causing serious distortions in equity and distribution of wealth. In the Annexures it lists some of the implications of the latest proposals submitted for the concurrent negotiations. This paper is the second in the Hong Kong Series and looks into the strategies and options available to India for facilitating a fair and even playing ground for its agrarian interests in the multilateral trade arena.

Samar Verma
Executive Director
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Abbreviations

AB	:	Appellate Body
AD	:	Anti Dumping
ADM	:	Archer Daniels Midland
AMS	:	Aggregate Measure of Support
AoA	:	Agreement on Agriculture
BoP	:	Balance of Payment
CAP	:	Common Agricultural Policy
CVD	:	Countervailing Duties
DSB	:	Dispute Settlement Board
EC	:	European Commission
ERP	:	External Reference Price
EU	:	European Union
FIPs	:	Five Interested Parties
FOB	:	Free On Board
GATT	:	General Agreement on Tariffs and Trade
GDP	:	Gross Domestic Product
HDR	:	Human Development Report
ICTSD	:	International Centre for Trade and Sustainable Development
IFPRI	:	International Food Policy Research Institute
MDG	:	Millennium Development Goal

Mn	:	Million
MPS	:	Market Price Support
MSP	:	Minimum Support Price
NPC	:	Nominal Protection Coefficient
NTBs	:	Non-Tariff Barriers
OECD	:	Organisation for Economic Co-operation and Development
PSE	:	Producer Support Estimate
QR	:	Quantitative Restriction
S&D	:	Special and Differential
SSG	:	Special Safeguard
TDS	:	Trade-Distorting Subsidies
Ton	:	Metric Tonnes
TRQ	:	Tariff-Rate Quota
TSE	:	Total Support Estimate
UNDP	:	United Nations Development Programme
UR	:	Uruguay Round
USAID	:	US Agency for International Development
WTO	:	World Trade Organisation

Contents

List of Boxes

List of Figures

List of Annexures

Executive Summary

The implementation experience of the Uruguay Round (UR) indicates that the Agreement on Agriculture (AoA) was unable to curb the widespread use of domestic farm subsidies by developed countries. As a result, the distortions in international agricultural trade continued. The Doha Ministerial declaration, which launched the Doha Development Round of trade negotiations, called for 'substantial reductions in trade-distorting domestic support' in agriculture. However, the failure of the Cancun Ministerial and lack of convergence among World Trade Organisation (WTO) Members on key issues stalled the current round of negotiations. The impasse was broken by the 'July Package', a set of WTO framework agreements finalised in July 2004. These framework agreements spell out the broad parameters within which subsequent negotiations for the current round of trade talks will be based. Annex A of the July Package deals with agriculture; it proposes a number of new measures to reduce domestic subsidies in developed countries substantially. The July Framework has been seen by many as a breakthrough that may lead to the reduction in farm subsidies by billions of dollars.

This paper analyses the provisions of Annex A of the July Framework and shows that, by itself, the July Package will not lead to any real decrease in the domestic levels of subsidies in developed countries. This paper points out that there are some waivers built into the Framework, which may allow developed countries to maintain and, in some cases, even to increase domestic farm support and still remain WTO-consistent. However, in most cases, the July Framework only provides broad guidelines and leaves the specific modalities of subsidy reduction to be decided through negotiations. It will be possible for negotiators to plug some of these loopholes if appropriate subsidy reduction formulae are used. This forms the crux of the current phase of negotiations on domestic subsidies.

It is expected that WTO Members will try to reach a consensus on a 'modalities text' during the Hong Kong Ministerial meet of the WTO. Therefore, the run-up to the Hong Kong Ministerial will experience active negotiations among WTO Members for converging towards a set of formulae and numerical targets which will then form the basis for the final agreement of the Doha Development Round. As the negotiation on agriculture is now entering a crucial phase, it will be extremely important for the negotiators to identify the shortcomings of the July Package and to plug these legal loopholes using appropriate techniques. Otherwise, the current round of farm trade talks on disciplining domestic subsidies may end up being as ineffective as the UR talks.

India has followed a two-pronged approach towards domestic subsidies in the current round of negotiations: it wants substantial reduction in domestic subsidies in developed countries, and proposes sufficient flexibility in the rules to allow developing countries to pursue support measures towards non-trade concerns like poverty alleviation, rural development, rural employment and diversification of agriculture. As a part of the Group of Twenty (G-20) initiative, India is now pursuing a similar set of objectives.

To arrive at these goals, the G-20 must ensure that significant and effective reduction in trade-distorting domestic support is achieved in this round. Secondly, they must draw lessons from the implementation experience of the UR AoA and take measures to prevent 'box shifting' of subsidies as far as possible. It will also be important to impose strong and legally tight definitions of Blue Box and Green Box subsidies to ensure that subsidies within these boxes are not production- or trade-distorting. Also, any pressure to re-introduce the 'Due Restraint' clause or the Peace Clause as given in the US proposal should be resisted. The Peace Clause expired in 2004 and its expiry has made many commodity-specific agricultural subsidies of the EC and the US vulnerable to legal challenges.

To protect the poor farmers of developing countries, the G-20 should insist that sufficient flexibility is provided to developing countries to address rural development, food security and livelihood security issues in these countries. There has been a feeling that the provisions of the UR AoA, particularly the Green Box subsidies, were targeted more towards support mechanisms used in developed countries. In the current round of negotiations developing countries must insist on a re-structuring of the provisions on Green Box subsidies to suit the legitimate concerns of these countries.

Fortunately, the G-20 initiative seems to be moving in the right direction. Submissions by the G-20 group in the current round of negotiations indicate that they have flagged almost all these issues. Now the biggest challenge for them will be to arrive at a consensus on these issues. However, it must be kept in mind that farm subsidy is a politically-sensitive issue in many developed countries and these countries will be playing all their cards as evident in the latest proposals to avoid any substantial actual cuts in their subsidy levels.

In this context, it is of utmost importance to strengthen the G-20 initiative. In the current round of negotiations, this group has emerged as a counterweight to the traditional big players in the WTO. A 'Blair House' kind of deal will be difficult to impose in the current context. However, there will be pressure from different groups to break the G-20 alliance. The apparent mistrust that was created in the alliance when Brazil and India joined the Five Interested Parties group seems to have subsided. However, India should be extremely careful while joining these exclusive clubs of powerful WTO Member-countries. While India gains greater leverage and voice in the negotiations by joining these groups , it must remain very careful to convey the concerns of other G-20 members and not soften its stance towards countries responsible for the current distortions in international agricultural trade.

1. Introduction

The Ministerial Declaration launching the Uruguay Round (UR) observed that there was an 'urgent need to bring more discipline and predictability to world agricultural trade by correcting and preventing restrictions and distortions including those related to structural surpluses so as to reduce the uncertainty, imbalance and instability in world agricultural markets.'[1]

This concern was not misplaced as, prior to the World Trade Organisation (WTO), agriculture was among the most distorted sectors in international trade. The principal source of these distortions (which were in addition to those resulting from international market concentration) was the co-existence of a very high level of domestic and export subsidies and almost impenetrable import barriers for agricultural goods in developed countries.

Farm subsidies distort the production structure of a country by raising crop prices in a country's internal market. Higher prices induce over-production of the subsidised crop. Most agricultural goods are price- and income-inelastic in nature and therefore, high-income countries tend to have a stagnant demand for such commodities. Over-production and stagnant demand for agricultural goods lead to a 'structural surplus' in these countries. This surplus not only squeezes out imports in the already restricted domestic markets, it is also dumped in the international market at a cheaper rate. This leads to price suppression of that commodity in the international market. Export subsidies are used to cover the price difference between high domestic prices and lower international prices.

[1] WTO/GATT Ministerial Declaration on the Uruguay Round (Declaration of 20 September 1986).

Domestic support in developed countries thus leads to low international commodity prices that presently have forced many developing countries out of the farm trade. Though many developing countries are low-cost producers of agricultural goods, they have not been able to compete with the artificially cheap exports from developed countries. The UR Agreement on Agriculture (AoA) tried to discipline the farming sector by imposing restrictions and reduction commitments on domestic and export subsidies. It was expected that the integration of agriculture in the multilateral system would reduce distortions in the international agricultural trade and would benefit the developing countries.

In more than ten years since the UR AoA was implemented, the experience has been that domestic subsidy reduction commitments turned out to be the least reliable. Farm support given by Organisation for Economic Co-operation and Development (OECD) countries still amounts to more than US$ 300 billion a year, that is about half the total value of international trade in agricultural goods, which in 2003 was around US$ 674 billion[2] (also see Box 1.1).

Box 1.1. **To put the extent of Farm Support in Perspective, Anne Krueger has some Interesting Observations:**

I'd like to start by sharing with you one of my favourite – and most telling – illustrations of the folly of agricultural support. Somebody has taken the trouble to do some calculations putting the cost of farm support in the OECD countries into context. It turns out that those countries spend enough to send every one of the 56 million cows in the OECD's dairy herd on a first class round the world ticket – complete with US$ 1450 spending money – every year.

Anne O. Krueger, Moving on from Cancun: Agricultural Trade and the Poor, First Deputy Managing Director, IMF, Agricultural Trade Policy Workshop, 3 November 2003, Washington D.C.

[2] Source: International Trade Statistics 2004, WTO. http://www.wto.org/english/res_e/statis_e/its2004_e/section4_e/iv03.xls

Given this backdrop, it is expected that the current round of WTO negotiations on agriculture will have a more effective emphasis on reduction of domestic farm subsidies. Not surprisingly, the Doha Ministerial Declaration, launching the Doha Development Round calls for 'substantial reductions in trade-distorting domestic support'.[3]

However, the progress of the Doha Round of negotiations has not been smooth. The failure of the Cancun Ministerial Meet and the lack of convergence among Members on key issues have slowed down the progress of negotiations on agriculture in the WTO. It is not surprising that the farm talks are lagging much behind the timetable published by the WTO during the Doha Ministerial Meet. According to this timetable, a consensus on the modalities of agricultural negotiations was supposed to have been met by 31 March 2003. It was also decided that, based on the 'modalities', WTO members would produce their offers or 'comprehensive draft commitments' by the Cancun Ministerial. As things stand now, Members have not yet managed a consensus on an official 'modalities text' on agriculture. Negotiations in other areas are also lagging much behind the Doha schedule. However, Members managed some sort of a breakthrough in July 2004 when they reached an agreement on a set of broad guidelines for the current round of negotiations. The text of this agreement is known as the 'July Package' or the 'July Framework'.[4]

One of the most prominent features of the July Package is the mention of some of the major elements of a still elusive 'modalities text' for the current round of negotiations on agriculture in its Annex A and Appendix. In the WTO negotiations, the 'modalities text' attempts to set the terms of reference and broad targets (including numerical targets) for achieving the objectives set out for the negotiations. A framework can be considered one step behind a formal modalities text. It only provides broad guidelines and leaves many finer details to

[3] Paragraph 13, Doha Ministerial Declaration, WTO document number WT/MIN(01)/DEC/1, 20 November 2001.

[4] The July Framework is officially called 'Doha Work Programme: Decision Adopted by the General Council on 1 August 2004'.

be decided through the subsequent negotiation process. A framework agreement also shows the areas where a consensus has already been reached.

In the context of the current round of negotiations on agriculture, the importance of the July Framework is paramount because of two reasons. The failure at the Cancun Ministerial virtually stalled the progress of negotiations on agriculture in the WTO. The July Package ended the stalemate and brought the current negotiations back on track. Secondly, since the July Package, there has not been an updated framework text on agricultural negotiations from the WTO. There was supposed to be an updated text during July 2005 and it was tentatively named the 'July Approximation'. However, due to key differences among Members, the 'July Approximation' could not be achieved. Consequently, the July Framework still forms the basis of negotiations on agriculture and the current round is being conducted within the parameters set by it.

In general, the July Package has been received well by WTO Members. On the surface, the July Package does look like a step in the right direction as it promises a substantial reduction in domestic subsidies in developed countries. However, a closer scrutiny of the July Framework reveals the existence of some glaring loopholes that have the potential to lead to a much lower level of subsidy reduction in developed countries. This paper looks closely at the domestic subsidy reduction provisions of the July Framework and analyses these issues, particularly from India's point of view. In this context, it also reviews the post-July Framework negotiations on agriculture. Based on the findings, this study suggests a few negotiating options for India.

This paper is organised into five sections. Section 1 is the introduction. Section 2 briefly reviews the status of domestic farm subsidies in developed countries since the implementation of the UR AoA. Section 3 discusses the provisions of the July Framework regarding domestic subsidies while keeping in mind the experience of the implementation of the UR AoA. It also looks at the developments of agricultural negotiations since the July Package was announced. Section 4 analyses how the provisions of the July Package and the subsequent negotiations on domestic farm subsidies are likely to affect India. Section 5 concludes the study and suggests some negotiating options for India.

2. Domestic Subsidies in Developed Countries: A Status Check

The UR negotiations explicitly recognised the extreme trade-distorting impact of domestic support and the necessity to impose restrictions on it. As mentioned before, domestic support encourages overproduction, which in turn increases supplies in world markets (by reducing import demand or increasing export supply) and depresses world prices.

The UR AoA distinguishes between support programmes that directly stimulate production and trade and those that are considered to have no direct effect. It does not impose restrictions on the latter category. Support measures that are exempt from reduction commitments are categorised as 'Blue Box' and 'Green Box' subsidies. Production and trade-distorting subsidies are classified as 'Amber Box' subsidies and are subject to reduction commitments. Amber Box subsidies are measured by Aggregate Measure of Support (AMS).

The UR AoA allows developed countries to have Amber Box subsidies up to five percent of the value of agricultural production (and upto 10 percent for developing countries). This is called the *de minimis* level. Amber Box subsidies above the *de minimis* level qualify for reduction commitments. It was stipulated that developed countries should reduce their Amber Box subsidies from the base period level (1986-88) over a period of five years (1999-2000) by 20 percent.

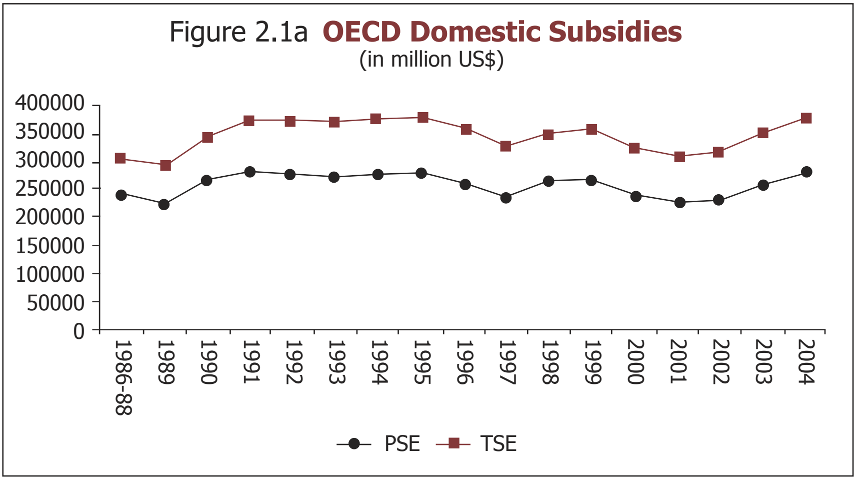
Empirical evidence shows that although most WTO Member countries have fulfilled their AoA commitments and have reduced their AMS, the total support given to agriculture in developed countries has not declined. The OECD statistics report different farm support estimates for its member countries. Among these, the Producer Support Estimate (PSE) and Total Support Estimate (TSE) provide a good marker of farm support levels in these countries. The PSE is an indicator of the annual monetary value of gross transfers from consumers and taxpayers to agricultural producers, measured at the farm-gate level, arising from policy measures that support agriculture, regardless of their nature, objectives or impacts on farm production or income.

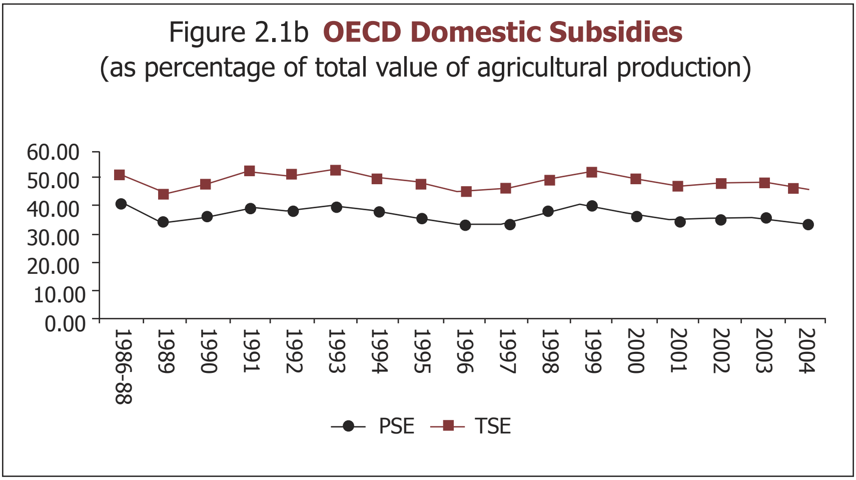
Another measure, which provides a wider definition of farm subsidies, is the TSE. The TSE is an indicator of the annual monetary value of all gross transfers from taxpayers and consumers arising from policy measures that support agriculture, net of the associated budgetary receipts, regardless of their objectives and impacts on farm production and income or consumption of farm products. The TSE can be considered as an indicator of the total amount of support given to the farm sector in the OECD countries.

The aggregate data for OECD countries show that both PSE and TSE were actually higher in 2003 as compared to the corresponding figures in 1986-88 (see Figure 2.1a & b). The figure further shows that in the last few years there has been an increase in the amount of farm support provided in the OECD countries. However, as a percentage of total value of agricultural production, the PSE and TSE figures indicate that there has been a slight decline in the levels of support. Between 1986-88 and 2003, TSE as a percentage of total value of agricultural production has declined from about 51 percent to about 49 percent. Over the same period, PSE as a percentage of total value of agricultural production has declined from 40.4 percent to 36 percent.

These data show that in spite of the disciplines introduced in the UR AoA, the total amount of support extended to the farm sector in developed countries has not shown any significant decline. This large-scale subsidisation of the agricultural sector in developed countries has continued to have a considerable impact on the agricultural market.

It is notable here that in two recent dispute settlement cases the WTO has found that subsidies in developed countries are directly responsible for price suppression in the international market. In a dispute between Australia and the European Communities (EC) regarding export subsidies on sugar (WTO Dispute DS265), the WTO





Source: Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005, http://www.oecd.org/dataoecd/56/33/35009952.xls.

dispute settlement panel ruled that EC export subsidies have allowed it to export sugar below its cost of production. Similarly, in another dispute (WTO Dispute DS267), Brazil alleged that US domestic subsidies to its producers, users and exporters of upland cotton has led to price suppression in the international market. The WTO Panel Report and the Appellate Body Report have ruled that US domestic subsidies are indeed leading to an oversupply of cotton in the international market which leads to a price decline of cotton in the international market (see Annexure 1 for a more detailed discussion on this dispute).

To put the extent of US cotton subsidies into perspective, a study by Oxfam highlights that

> 'America's cotton farmers receive
>
> - more in subsidies than the entire GDP of Burkina Faso – a country in which more than two million people depend on cotton production. Over half these farmers live below the poverty line. There is no poverty among recipients of cotton subsidies in the US.
> - three times more in subsidies than the entire US Agency for International Development (USAID) budget for Africa's 500 million people.'[5]

To justify such huge subsidies, it is sometimes argued that agricultural support in developed countries protects the interests of vulnerable communities and serves the objective of rural development in those countries. However, there is little evidence to support this justification. The WTO Annual Report 2003 shows that, contrary to popular belief, subsidies in most developed countries are not targeted towards poor farmers. In fact, in most OECD countries, a very high proportion of subsidies go to the top 25 percent of farmers. Quoting an OECD study, the WTO annual report highlights that in the European Union (EU), the US, Canada and Japan, the top 25 percent of farmers receive 70 percent, 89 percent, 75 percent and 68 percent respectively of total agricultural subsidies.[6] These findings are not surprising because farm subsidies in the US and the EC are linked to output and size of land holding. As a consequence, the bigger farmers garner more subsidies. As large agribusiness firms

[5] Oxfam (2002). 'Cultivating Poverty: The Impact of US Cotton Subsidies in Africa', Oxfam briefing paper 30. http://www.oxfam.org.uk/what_we_do/issues/trade/bp30_cotton.htm
[6] WTO Annual Report 2003, p 21.

control a very high percentage of agricultural trade in developed countries (see Box 2.1), a significant portion of farm subsidies is appropriated by these firms.

Box 2.1 **Concentration of Agribusiness Firms in US Agriculture**

- Four companies (Cargill, Cenex Harvest States, Archer Daniels Midland (ADM) and General Mills) own 60 percent of terminal grain handling facilities.
- Three companies (Cargill, ADM and Zen Noh) carry out 82 percent of corn exporting.
- Four companies (Tyson, ConAgra, Cargill and Farmland Nation) make up 81 percent of the beef-packing industry.
- Four companies (ADM, ConAgra, Cargill and General Mills) own 61 percent of flour milling capacity.

Source: 'Agricultural Restructuring and Concentration in the United States: Who wins, who loses?' by Sanaz Memarsadeghi and Raj Patel, August 2003.

http://www.foodfirst.org/node/270/print.

The Human Development Report (HDR) 2005 also finds that the farm subsidy system in developed countries is extremely inequitable. According to the figures quoted in the HDR 2005, more than three-quarters of Common Agricultural Policy (CAP) support in the EU goes to the top 10 percent of subsidy recipients. The distribution is also skewed in the US where the top five percent get over half the total subsidies.[7] The inequitable nature of farm subsidies becomes more evident if one constructs a Gini coefficient for farm subsidies in the US and the EU. Quoting Samman (2005), the report shows that the subsidy Gini coefficients for the US and the EU (66 and 77, respectively) are much higher than the income Gini coefficient (60) for Brazil, one of the most unequal countries in the world. These figures

[7] See Box 4.5, p 130, Human Development Report 2005, UNDP.

corroborate the conclusion of the HDR that the annual multi-billion dollar farm subsidies are a regressive form of financial transfer where the real gainers in subsidies are not poor farmers but large-scale farmers, corporate agribusiness interests and land-owners.[8]

OECD data[9] also highlight that these countries still provide high levels of market- distorting subsidies like Market Price Support (MPS). OECD statistics show that for the year 2004, MPS accounted for about 60 percent of total PSE.[10] The high level of MPS is directly reflected in the producer Nominal Protection Coefficient (NPC)[11] of OECD countries. The NPC shows that the prices received by the OECD farmers were 31-33 percent higher than international prices during 2002-04. On this, the WTO Annual Report 2003 comments: '… the continued dominance of the most distortive forms of support means that farmers in many OECD countries remain largely insulated from world market signals. They also constrain agricultural growth and development opportunities in non-OECD countries.'[12]

Recent domestic policies undertaken in most OECD countries suggest that the high subsidisation of agriculture is going to continue. The proposed reform of the CAP of the EU will only restructure, not reduce, the subsidy regime. An OECD study projects that under the new CAP, the PSE will still amount to about one-third of the value of agricultural production in the EC (resulting in about a one-percentage-

[8] HDR 2005 says: 'It would be hard to design a more regressive – or less efficient-system of financial transfer than currently provided through agricultural subsidies.' Ch 4, p 130, HDR 2005.

[9] 'Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005'. http://www.oecd.org/dataoecd/56/33/35009952.xls.

[10] It must be mentioned here that the Market Price Support (MPS) is calculated differently for Amber Box and Producer Support Estimate (PSE) subsidy calculations. The MPS component of Aggregate Measure of Support is calculated with fixed external reference price (base period 1986-88), whereas for PSE, the price gap is updated and calculated on yearly average prices.

[11] For a commodity, the Nominal Protection Coefficient (NPC) is defined as the ratio of domestic prices to international prices. An NPC of 1.3 indicates that domestic price is 30 percent higher than international prices.

[12] WTO Annual Report 2003, p 22.

point-decline from the present regime).[13] There are also strong indications that CAP payments are set to increase over the next decade. It is also notable here that CAP reforms have run into problems in countries like France and it is not yet certain whether and when the CAP reforms will be eventually implemented.

Secondly, the US, through its Farm Bill 2002 (Farm Security and Rural Investment Act of 2002), has proposed to increase its agricultural subsidies significantly. Under this law, federal spending on US agriculture is slated to increase by US$ 82.6 billion over the next 10 years. This will be in addition to the US$ 100 billion in TSE which the US Government has already set apart to give its farmers. This increase in US farm subsidies is reflected in the increased PSE for 2004. OECD statistics show that between 2003 and 2004, the PSE of the US has increased from US$ 35,618 million to US$ 46,504 million, a jump of about 30 percent. The WTO Annual Report 2003 indicated that this huge increase would primarily be in production-enhancing subsidies. It says:

> 'Several of the subsidies contained in the bill would provide incentives to boost production. This is particularly true of the "counter-cyclical payments", under which growers of wheat, corn, rice, soyabean and cotton will be guaranteed a certain price irrespective of market conditions, thereby distorting both production and trade; in the event that prices fall further, such subsidies will rise accordingly, although a "circuit- breaker" built into the legislation is designed to keep spending within the WTO ceiling.'[14]

This large increase in production-enhancing subsidies in the US is likely to exacerbate the distortions present in global agricultural trade.

AoA Implementation and Box Shifting: Are Blue and Green Boxes Really Non-Trade Distorting?

It has been mentioned above that many WTO Member-countries,

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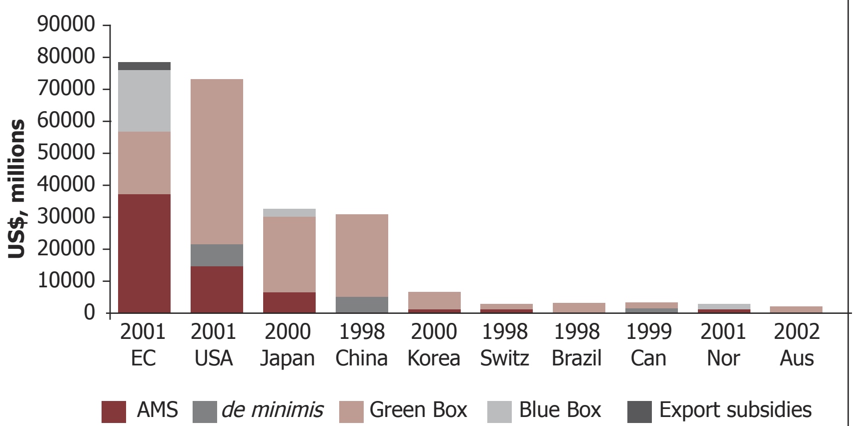
[13] OECD (2004). 'Analysis of the 2003 CAP Reform.' Working Party on Agricultural Policies and Markets, Directorate for Food, Agriculture, and Fisheries, Paris.

[14] WTO Annual Report 2003, p 22.

particularly the developed countries, have increased their domestic subsidies, while at the same time they have fulfilled their WTO subsidy reduction commitments. Apparently, this puzzling situation can be explained by the fact that after the Uruguay Round, most developed countries have shifted a significant part of the prohibited subsidies (the Amber Box subsidies) to the permissible Blue Box and Green Box subsidies, which are supposedly less trade-distorting. Currently, Blue Box and Green Box subsidies account for a significant share of domestic subsidies in many WTO Member countries (see Figure 2.2).

Figure 2.2 **Notified Subsidies in the WTO**



Source: Aggarwal (2005)[15]

However, there is a growing consensus among economists that many Blue Box measures and some of the Green Box measures indeed have trade-distorting effects, and by providing exemptions to these types of subsidies, the agreement has allowed distortions in agricultural trade to continue.

[15] Aggarwal, Vandana, presentation made at a conference in Delhi on 'Pre-Hong Kong Ministerial Meeting: Agriculture Negotiations.' http://www.unctadindia.org/subevents.asp?eventid=197&seqid=8&eventtype=Workshop.

India, in its proposal to the WTO,[16] has categorically pointed out that all Blue and Green Box subsidies are not as minimally trade-distorting as is made out, on account of the following reasons:

(1) The ability of the farmers to take risk as well as to make farm investments substantially increase, if support in the form of assured payments including decoupled income support is provided, since such payments entail insurance and wealth effects.
(2) These direct payments encourage greater use of farm inputs and enhance access to technology leading to over-production, which in turn distorts agricultural markets.
(3) Decoupled or direct payments can be a powerful incentive to maintain or increase current production in the expectation of receiving higher levels of future support.
(4) Decoupled or direct payments have been found to increase land values resulting in maintenance of land in farming rather than putting it to some other economically better use.
(5) Decoupled or direct payments heavily subsidise the cost of production, which enables the receivers of such support to capture a substantial share in the export markets at the cost of more efficient producers.'

Box shifting allowed developed countries to maintain and in some cases increase trade- and production-distorting support to their farm sector and yet remain WTO-consistent. In fact, data presented in the next section will show that the EU and the US have managed to bring their actual levels of AMS much below their committed levels. If one juxtaposes this finding with the increased PSE and TSE in these countries, the failure of the AoA to reduce domestic farm subsidies becomes even more stark. Given the continuation of very high levels of domestic subsidies in developed countries, it is not surprising that some of the chronic problems of international agricultural trade like secular decline in and high volatility of commodity prices continue unabated even after the UR. High subsidies in developed countries

[16] WTO Document No. G/AG/NG/W/102, Proposals by India in the areas of: (1) Food Security, (2) Market Access, (3) Domestic Support and (4) Export Competition; date 15/01/2001. Also see OECD (2001): 'Decoupling: A Conceptual Overview' and World Bank (2003): 'Trade Note: Domestic Support for Agriculture: Agricultural Policy Reform and Developing Countries', September 2003.

Box 2.2 **The HDR 2005 has some Strong Words against the Prevalent Farm Subsidy System in Developed Countries. It says:**

'The financial commitment to a small group of largely high-income beneficiaries in developing countries puts the financing requirements for the MDGs in perspective. Rich countries spend just over US$ 1 billion a year on aid to developing country agriculture and just under US$ 1 billion a day supporting their own agricultural systems. For a fraction of what rich countries spend subsidising the overproduction of crops like rice and sugar, it would be possible to meet the financing requirements for achieving the MDGs in areas such as education, health and water. Adding insult to injury, the subsidies in rich countries not only divert resources but also reinforce poverty in poor countries. Industrial countries are locked into a system that wastes money at home and destroys livelihoods abroad. When it comes to world agricultural trade, market success is determined not by comparative advantage, but by comparative access to subsidies – an area in which producers in poor countries are unable to compete.'

Human Development Report 2005, UNDP, p 130.

are hurting the developing countries. Recent estimates by the International Food Policy Research Institute (IFPRI) reveal that protectionism and subsidies in industrialised countries cost developing countries about US$ 24 billion in agricultural and agro-industrial income. If all dynamic and spillover effects are taken into account, the gains will be much higher. Simulations suggest that the real cost of farm subsidies for developing countries in developed countries can be as high as US$ 72 billion a year.[17] It is not surprising that the HDR 2005 squarely blames the present subsidy regime for helping very few but depriving a large section of the poor population across the world from reaching a number of UN Millennium Development Goals (MDG), including poverty reduction (see Box 2.2).

[17] See Diao, Xinshen, Eugenio Diaz-Bonilla, and Sherman Robinson (2003): 'How Much Does It Hurt: The Impact of Agricultural Trade Policies on Developing Countries.' International Food Policy Research Institute, Washington, DC.

Given the serious implications of the present subsidy regime, it is of great importance to have a more effective subsidy-reduction mechanism in this round of negotiations. The loopholes in the UR AoA have allowed developed countries to continue with high subsidisation of their farm sector by allowing box shifting of subsidies.[18] Any meaningful subsidy reduction strategy for the next round of negotiations should keep the implementation experience of the UR AoA in mind and develop a tighter legal clause to restrain domestic subsidies. In this light, it is important to probe the July Framework and review the current negotiations to evaluate how effective they will be in reducing subsidies.

3. The July Framework and Domestic Subsidies: A Critical Look

As mentioned before, the July Framework was seen as a major breakthrough in the current round of negotiations. After the Framework was signed, most developing country representatives projected it as a victory that would help protect the interests of the developing countries by eliminating billions of dollars in farm subsidies. It is undoubtedly true that the July Package is an improvement over the Derbez text[19] and it proposed a number of new measures to reduce domestic subsidies in developed countries substantially. Among the salient points of the July Framework are the following proposals:

1. Reduction of AMS commitments by a tiered formula, with higher AMS levels to be reduced by a proportionately higher amount thereby leading to near harmonisation. The appropriate formula has not been spelt out and has been left to be decided through negotiations.

[18] For a more detailed exposition of the problems with Uruguay Round Agreement on Agriculture see Pal, Parthapratim (2002): 'Implementation Issues in Agreement on Agriculture and its Implications for Developing Countries', available at http://www.networkideas.org/themes/agriculture/sep2002/ag09_AOA.htm

[19] This is the draft of the Cancún Ministerial text that was eventually rejected. The Derbez text was almost a total endorsement of the US-EU view on agriculture.

2. Reduction of *de minimis* subsidies by a certain percentage. The extent of reduction is to be negotiated.
3. Capping of Blue Box subsidies. The July Framework suggested that the Blue Box subsidies should not exceed five percent of the total value of agricultural production during a 'historical period', which is to be decided.
4. An overall reduction in Trade-Distorting Subsidies (TDS) which includes disciplining Amber Box, *de minimis* and Blue Box subsidies. This is discussed below in more detail.
5. An explicit recognition that Special and Differential (S&D) Treatment for developing countries is an integral component of domestic support.

At first glance, these measures look impressive. However, closer scrutiny of the July Framework reveals the existence of a few escape clauses which might lead to a much lower level of subsidy reduction than what appears possible.

This section will carefully look at the July Framework text on domestic subsidies to analyse and probe what it actually means for developing countries. More importantly, it will look for caveats and escape clauses in the text that might allow countries to get away with little or no subsidy reduction. To facilitate the discussion, this section will quote the relevant paragraph of Annex A (Framework for Establishing Modalities in Agriculture) of the July Framework and discuss its implications. Paragraphs 6 to 16 of Annex A are devoted to domestic subsidies.

Paragraph 6

'The Doha Ministerial Declaration calls for "substantial reductions in trade-distorting domestic support". With a view to achieving these substantial reductions, the negotiations in this pillar will ensure the following:

- S&D Treatment remains an integral component of domestic support. Modalities to be developed will include longer implementation periods and lower reduction coefficients for all types of trade-distorting domestic support and continued access to the provisions under Article 6.2.

- There will be a strong element of harmonisation in the reductions made by developed Members. Specifically, higher levels of permitted trade-distorting domestic support will be subject to deeper cuts.
- Each such Member will make a substantial reduction in the overall level of its trade-distorting support from bound levels.
- As well as this overall commitment, Final Bound Total AMS and permitted *de minimis* levels will be subject to substantial reductions and, in the case of the Blue Box, will be capped as specified in paragraph 15 in order to ensure results that are coherent with the long-term reform objective. Any clarification or development of rules and conditions to govern trade-distorting support will take this into account.'

Implications

This paragraph spells out some broad guidelines about farm subsidy reduction. It reiterates the goal of the Doha Development Agenda about substantial reduction in domestic subsidies and also categorically mentions that S&D treatment is going to be an integral component of the new subsidy-reduction schemes.

However, the rider in this paragraph lies in the third bullet point. This provision mentions that reductions are to be made not from the actual levels of AMS but from the bound levels of AMS committed during the AoA negotiations. This provision looks quite innocuous, but its implications become clearer if one looks at the difference between the Annual Bound Commitment Level of some developed countries and their current total AMS levels. Table 3.1 shows the total and bound levels of AMS for EU countries. Thus the current level of AMS in these countries is already about 40 percent lower than their bound or committed levels of AMS. This gap (or 'water content' in WTO jargon) implies that the EU countries will not have to undertake any reduction in their current level of AMS even if a 40 percent reduction from the bound level of AMS is called for. If the actual reduction requirement is less than 40 percent, the EU countries will, in fact, have some headroom for increasing their current level of AMS.

Similarly, the data on the US show that its current level of AMS for the year 2001 is about 24.5 percent lower than its committed level.[20]

Table 3.1 **Current and Bound Commitment Levels of AMS for the EU Countries (in million Euros)**

Year	Annual Bound Commitment	Current Total AMS	Gap	Gap in Percentage
1	2	3	4 (2-3)	5
1995	78672	50026	28646	36.41
1996	76369	51009	25360	33.21
1997	74067	50194	23873	32.23
1998	71765	46683	25082	34.95
1999	69463	47886	21577	31.06
2000	67159	43654	23505	35.00
2001	67159	39281	27878	41.51

Source: EU Notifications to WTO, G/AG/N/EEC/47 (29 July 2003), G/AG/N/EEC/49 (1 April 2004) and G/AG/N/EEC/51 (4 November 2004).

Therefore, for the biggest subsidisers of agriculture, the requirement of AMS reduction from the bound level allows them significant latitude in any reduction of their TDS.

In defence of the EU and the US it can be argued that if a country has undertaken more subsidy reduction than the UR AoA called for, then the country should not be penalised by being asked to schedule its reduction commitments from the current level of AMS. However, as has been discussed in the previous sections, it must be kept in mind that OECD countries, including EU member-countries and the US, have not made any meaningful reduction in farm subsidies during the last ten years. They took advantage of the loopholes present in the UR AoA to reschedule their subsidies. The provision in the July Framework to allow AMS reduction from the bound level looks like another of those

[20] WTO Document No. G/AG/N/USA/51 (17 March 2004).

escape clauses which will allow developed countries to maintain their trade-distorting supports with some cosmetic changes.

Paragraph 7

'Overall Reduction: A Tiered Formula

The overall base level of all trade-distorting domestic support, as measured by the Final Bound Total AMS plus permitted *de minimis* level and the level agreed in paragraph 8 below for Blue Box payments, will be reduced according to a tiered formula. Under this formula, Members having higher levels of trade-distorting domestic support will make greater overall reductions in order to achieve a harmonising result. As the first instalment of the overall cut, in the first year and throughout the implementation period, the sum of all trade-distorting support will not exceed 80 percent of the sum of Final Bound Total AMS plus permitted *de minimis* plus the Blue Box at the level determined in paragraph 15.'

Paragraph 8

'The following parameters will guide the further negotiation of this tiered formula:

- This commitment will apply as a minimum overall commitment. It will not be applied as a ceiling on reductions of overall trade-distorting domestic support, should the separate and complementary formulae to be developed for Total AMS, *de minimis* and Blue Box payments imply, when taken together, a deeper cut in overall trade-distorting domestic support for an individual Member.
- The base for measuring the Blue Box component will be the higher of existing Blue Box payments during a recent representative period to be agreed and the cap established in paragraph 15 below.'

Implications

Paragraphs 7 and 8 spell out some modalities of reduction of domestic subsidies. The language used in the paragraph 7 is somewhat complicated. There have been a few interpretations of this paragraph but the general consensus is that it implies at least a 20 percent initial reduction in the first year of the implementation period of

Total Bound AMS + Permitted de minimis + Blue Box cap determined by Paragraph 15 (1)

Before proceeding, it is important to analyse the Paragraph 15 of July Framework. It says:

'Blue Box support will not exceed five percent of a Member's average total value of agricultural production during an historical period. The historical period will be established in the negotiations. This ceiling will apply to any actual or potential Blue Box user from the beginning of the implementation period. In cases where a Member has placed an exceptionally large percentage of its trade-distorting support in the Blue Box, some flexibility will be provided on a basis to be agreed to ensure that such a Member is not called upon to make a wholly disproportionate cut.'

This paragraph is important because of a few interesting caveats. This paragraph implies that Blue Box subsidies are to be capped at 5 percent of the total value of production during an 'historical period'. The experience with the UR AoA has shown that the choice of a base period has a significant bearing on the actual levels of commitment. In the July Framework, countries have been given the choice of selecting an appropriate base period for calculation of the cap on Blue Box subsidies. It is obvious that if a 'historical period' is chosen in which the total value of agricultural production was very high, it will inflate the ceiling imposed on the Blue Box subsidies.

Secondly, the sentence 'This ceiling will apply to any actual or potential Blue Box user from the beginning of the implementation period' implies that countries who were not existing users of Blue Box subsidies will be allowed to introduce this form of subsidy. Here it is notable that during the UR AoA, the Blue Box subsidy was thought of as a transitory subsidy measure, which should be phased out by the end of the implementation period of the UR. However, this has not happened, and the July Framework actually legitimises the Blue Box measure and facilitates its introduction in countries like the US, which previously have not used this form of subsidy.

Thirdly, and most importantly, the final sentence of the paragraph 15 is a big let-off for the EU. The EU is the biggest user of Blue Box subsidies and in 2000-01 these subsidies accounted for about 10 percent of its total value of agricultural production. Capping the Blue Box at five percent of the total value of agricultural production (even with the 'historical period' caveat) would have required the EU to cut its Blue Box subsidies. However, the last sentence of Paragraph 15 is a clear escape route allowed to the EU.

So, if one reads Paragraphs 7, 8 and 15 together, an interesting scenario emerges. Table 3.2 shows data on subsidies and agricultural production in the EU.

Table 3.2 **Subsidies in the EU in 2001 (in billion Euros)**

Item	Amount
Bound AMS	67.2
de minimis Entitlement (five percent of value of agricultural production)	12.3
Existing Blue Box	23.7
Actual AMS	39.3
Memo Item	
Value of Agricultural Production	246.0

Source: Committee on Agriculture - Notification - European Communities - Domestic support G/AG/N/EEC/51.

Assuming that the current value of agricultural production is used for calculation of the Blue Box cap and assuming that the five percent Blue Box cap is imposed on the EU, the base level of trade-distorting subsidy (i.e. equation 1) will be 97.16 billion Euros. A 20 percent reduction from this means that EU can use 73.4 billion Euros worth of subsidies in the first year of implementation. However, in 2001, the actual AMS of the EU was 39.3 billion Euros, the actual Blue Box was 23.7 billion Euros and the EU used only 0.25 percent of its total agricultural production as *de minimis* support.[21] Therefore, if one sums up the existing support, it comes to around 63.6 billion Euros.

[21] The data on *de minimis* is taken from a presentation by Vandana Aggarwal at a workshop organised by UNCTAD, India in New Delhi. The presentation is available at http://www.unctadindia.org/subevents.asp?eventid=197&seqid=8&eventtype=Workshop

Therefore, if the July Framework formula were to be applied to the EU in 2001, it would not have to undergo any subsidy reduction. In fact, it could increase its TDS by almost 10 billion Euros. One must remember that this calculation is based on the assumption of a five percent cap on the Blue Box. As discussed earlier, because of the leeway given in Paragraph 15, it is likely that the EU will get a higher cap on its Blue Box payments.

The requirement of a 20 percent down-payment in the first year will not be binding for the US either. This is because currently the US does not use Blue Box subsidies. The provisions of July Framework will allow the US to add five percent of the value of its total agricultural subsidies as Blue Box subsidies. Therefore, in its case, the total TDS, which it will have to cut by 20 percent, will be

> *Bound AMS + five percent of total value of agricultural production as de minimis + five percent of total value of agricultural production as permissible Blue Box*

Calculations based on 2001 data for the US and the reduction commitments specified by the US under the July Framework show that it can subsidise up to US$ 38 billion in trade-distorting subsidies. It is notable that in 2001 the AMS and *de minimis* support of the US added up to only US$ 21 billion.[22] Therefore, the July Framework gives ample headroom to the US to increase its TDS.

In fact, there have been allegations that Paragraph 13, of the 'Framework for Establishing Modalities in Agriculture', actually proposes to alter Article 6.5 of the UR AoA to facilitate counter-cyclical payments introduced in the latest US Farm Bill to be categorised as Blue Box support. A study by the International Centre for Trade and Sustainable Development (ICTSD) has pointed out that Paragraph 13.2 of the July Framework has made provisions for the creation of a new category of Blue Box measure called 'direct payments that

[22] In 2001, *de minimis* support of the US was 3.5 percent of the value of total agricultural production. The US currently does not use Blue Box subsidies.

do not require production'.[23] According to the study, this provision allows counter-cyclical payments under the US Farm Bill to be categorised as Blue Box subsidies. As counter-cyclical payments are not decoupled from prices, these cannot be put under the Green Box, and without this new provision made by Paragraph 13.2, these payments would have been included under the Amber Box and thus would have been subject to substantial reduction commitments. Thus, as far as the US is concerned, the July Framework not only does not demand any reduction in the present level of subsidy, it also allows the inclusion of trade-distorting counter-cyclical payments in its new Blue Box.[24]

Paragraph 9

'Final Bound Total AMS: A Tiered Formula

To achieve reductions with a harmonising effect:

- Final Bound Total AMS will be reduced substantially, using a tiered approach.
- Members having higher Total AMS will make greater reductions.
- To prevent circumvention of the objective of the Agreement through transfers of unchanged domestic support between different support categories, product-specific AMS will be capped at their respective average levels according to a methodology to be agreed.
- Substantial reductions in Final Bound Total AMS will result in reductions of some product-specific support'.

Implications

Capping of product-specific support seems to be a welcome move. This is likely to prevent developed countries from putting a very high percentage of their domestic support into a small group of com-

[23] 'Agriculture Negotiations at the WTO: The July Package and Beyond' Quarterly Intelligence Report No. 12, ICTSD, Geneva, Switzerland.

[24] It should be reiterated here that, during the Uruguay Round (UR), the Blue Box measures were introduced as a transitory measure with a commitment to phase them out by the end of the implementation period of the UR.

modities. This provision is likely to be helpful for commodities like cotton and sugar which attract very large subsidies in developed countries.

However, this provision may have some negative implications for developing countries also. In many developing countries, the domestic prices of agricultural products are lower than the reference international prices. Aggregate product-specific support, therefore, is negative for such countries. But on the other hand, the non-product specific supports (e.g. input subsidies and power subsidies) are almost always positive.

There was an ambiguity in the UR AoA about the treatment of negative AMS. Taking advantage of that ambiguity, many countries clubbed their negative product-specific AMS with their positive non-product specific AMS which resulted in a negative total AMS. However, it appears that the July Framework provisions may not allow clubbing negative product-specific support with positive non-product specific support. This might have implications for countries which so far have managed to offset the positive non-product specific AMS by negative product-specific AMS. Taking a hypothetical situation, Table 3.3 shows how calculation of total AMS differs under the two different scenarios.

Paragraph 11

De Minimis

'Reductions in *de minimis* will be negotiated taking into account the principle of special and differential treatment. Developing countries that allocate almost all *de minimis* support for subsistence and resource-poor farmers will be exempt.'

Implications

The issue of the reduction of *de minimis* support is likely to become contentious in the present round of negotiations. Developing countries, particularly, have already expressed their reservations about any reduction of *de minimis* support. It is notable that the July Framework exempts developing countries from a reduction in the

Table 3.3 **Treatment of Product-Specific and Non-Product Specific Subsidy Under Different Scenarios**

	Product-Specific AMS	Non-Product Specific AMS	*de minimis*	Total AMS
Clubbing Allowed	-100	50	5	-100 + 50 = -50 So, the total AMS is below the *de minimis* level and no action is required.
Clubbing Not Allowed	-100	50	5	Product-specific AMS is below the *de minimis* level, so it is taken as 0. Non-product specific AMS is (50-5) = 45, where the *de minimis* level is 5. So, total AMS is 0 + 45 = 45. This is much higher than the *de minimis* level and therefore may need action.

de minimis level of subsidies if a high percentage of such subsidies are given to 'subsistence and resource-poor' farmers. However, the term 'subsistence or resource-poor farmers' has not been defined in the July Framework. It is notable here that the UR AoA also contained a clause which provides the exemption of input subsidies to 'low-income or resource-poor farmers' for developing countries. However, the term 'low-income or resource-poor farmers' is not defined in the agreement. In a notification submitted to the

WTO by India[25] it is claimed that farmers holding less than 10 hectares of land are considered to be resource-poor or low-income. In India, operational land holdings of 10 hectares or less account for 80 percent of agricultural land. So, if the above definition of 'resource-poor farmer' is accepted, India stands a good chance of getting a significant exemption from the reduction of *de minimis* subsidies.

Green Box

Paragraph 16 has discussed the Green Box subsidies in terms of tightening the provisions so that only minimal trade- and production-distorting subsidies are included in it. The modalities of tightening the Green Box provisions have been left for negotiation.

The provisions of the Green Box are seen to reflect the nature of the support programmes administered by developed countries. The agricultural sector in developing countries often has different requirements and may require a different set of agricultural support instruments. Developing countries are of the opinion that the Green Box provisions should be modified to suit their requirements and needs also.

Subsequent Negotiations on Domestic Subsidies

The discussion shows that the July Framework allows enough room to allow developed countries to get away with much less than 'substantial reductions in trade-distorting domestic support'. This retraces to the UR AoA where the domestic subsidy reduction commitments turned out to be the least reliable of all WTO commitments. However, the negotiation is still going on and will decide many important details of subsidy reduction.

Developments following the announcement of the July Package show that countries are now trying to devise a specific tiered formula for AMS reduction. A few approaches have been suggested by negotiating countries and groups of countries. However, the discussion is still on the structure of the tiers. The actual reduction formula (including numerical values) will be negotiated once the structure of the tiers is finalised.

[25] India's Notification to WTO on Domestic subsidies, WTO Document No. G/AG/N/IND/2.

Different structures of the tiered formula have been suggested by Member countries. For example, according to the approach suggested by the G-20 , there would be four bands: the first band comprising countries with support of less than US$ 2 billion; the second band comprising countries with support of US$ 2-12 billion; the third band comprising countries with support of US$ 12-25 billion; and the fourth band comprising countries with support of above US$ 25 billion. The rate of reduction would be higher for countries with higher levels of support. Other countries, like the US and Australia, have also proposed different variants of this tiered formula. These proposals are shown in Table 3.4. The EU, on the other hand, has proposed a three-tier formula that has the EU in the highest bracket with the US and Japan falling into the second category.

Regarding the reduction formula for the overall TDS, the negotiations are stuck again at the stage of structuring the tiers. In this case also there are also a few approaches suggested by negotiating groups (see Table 3.5). It is notable that the G-20 has suggested a three-stage structure for developed countries whereas for developing countries it has suggested a separate category. The G-20 has suggested that the reduction commitments for developing countries be at two-thirds of the reduction commitment for the developed countries, which are in the lowest bracket. It is notable here that the tiered formulas for the reduction of both AMS and TDS will be based on absolute – not relative – levels of subsidies.

Recent reports indicate that there is some convergence among the Members that there would be three bands, with the EU in the top band and Japan and the US in the middle band. However, there are unresolved issues regarding the treatment of developing countries within this structure.[26]

On the reduction of *de minimis* support by developed countries, the G-20 has proposed that reductions be made for both product-specific and non-product specific *de minimis* support. Developing countries

[26] 'Agriculture Negotiations - Status Report, Key Issues to be Addressed by 31 July 2005', WTO Document No. JOB(05)/126.

Table 3.4 **AMS Reduction Tiers Suggested in the WTO Negotiations**

US: four bands		G-20: four bands		Australia: four bands	
US$ 10 billion or less	All other countries	US$ 2 billion or less	Most developing, a few developed countries	US$ 1 billion or less	Most developing countries, Australia, New Zealand
Between US$ 10-20 billion	US	Between US$ 2-12 billion	Mexico, other developed countries	Between US$ 1-10 billion	Thailand, other developed countries
Between US$ 20-40 billion	Japan	Between US$ 12-25 billion	US	Between US$ 10-25 billion	Mexico, the US
More than US$ 40 billion	The EU	More than US$ 25 billion	The EU, Japan	More than US$ 25 billion	The EU, Japan

Source: Aggarwal (2005), see note 15.

with no AMS entitlements shall be exempt from reductions. India has a strong position in this context and thinks that the *de minimis* support by developing countries should not be subject to any reduction commitments.

Though some progress has been made in the area of structuring the tiers for AMS and TDS reductions, significant differences exist regarding the treatment of Blue Box and Green Box subsidies. There has hardly been any convergence on the issue of tightening the Blue Box payments to ensure that these payments are least trade distorting. Developing countries are particularly concerned about the provisions (under Paragraph 13.2 of Annex A of the July Framework) to incorporate counter-cyclical payments under the Blue Box category. However, there are indications that an additional restriction on the use of the Blue Box subsidies (along with the five percent cap suggested in the July framework) is under consideration.

Table 3.5 **TDS Reduction Tiers Suggested in the WTO Negotiations**

US: four bands		G-20: three bands for developed countries		Australia: five bands	
		No cuts for developing countries with no AMS			Developing countries with no AMS
Less than US$ 20 billion	Other countries	Separate band for developing countries (2/3 cut of lowest band of developed countries)		Less than US$ 5 billion	Switzerland, Norway, South Africa, Tunisia, etc.
Between US$ 20-40 billion	The US, Japan and Canada	Less than US $10 billion	Other developed countries	Between US$ 5-30 billion	Canada, Mexico, Korea, Brazil, etc
Between US$ 40-60 billion		Between US$ 10-45 billion	The US and Japan	Between US$ 30-90 billion	The US and Japan
More than US$ 60 billion	The EU	More than US$ 45 billion	The EU	More than US$ 90 billion	The EU

Source: Aggarwal (2005), see note 15.

Developing countries are approaching the issue of Green Box subsidies from two different angles. While they want the Green Box subsidies to be tightened to ensure that they are non-trade distorting, they also want a review of the provisions under this box to include the support programmes suited to the requirements of agriculture in developing countries provided these support programmes are minimally trade-distorting.

Overall, it can be said that after the breakthrough achieved in the July Framework, the negotiation has not progressed very well. There is hardly any chance that a full 'modalities text' on agriculture will be achieved before the Hong Kong Ministerial. However, the negotiation will soon be entering a crucial stage where details regarding the actual agriculture modalities such as percentages for tariff and subsidy cuts, reduction formulae, criteria for domestic support and deadlines and transition periods will have to be decided. The negotiators from developing countries should try to identify the loopholes present in the July Framework and bargain hard to plug these using appropriate measures. During the negotiations for the UR AoA, the existence of the loopholes was not fully understood and many developing countries are still paying for that mistake. Negotiators should make sure that this does not happen again.

4. Domestic Subsidies and July Framework: Implications for India

Any multilateral rule regarding domestic farm subsidies can have an impact on India through two different routes. The most obvious and direct impact will be on the way the government provides subsidies to its farm sector. A less direct but equally important impact of the rule will be through the trade route. As has been mentioned before, domestic subsidies in other countries can influence the supply and prices of commodities in the international market. In an open trade regime, these effects get transmitted directly to the local economy. This section will analyse how the changes introduced in the July Framework can affect India through these two routes. The possible impact of the July Framework will be discussed with reference to India's domestic subsidy-related commitments under the UR AoA.

4.1. July Framework and Domestic Farm Subsidy in India

India had no specific total AMS reduction commitments in its schedule. India's notifications submitted to the WTO show that India's product-specific support is negative and its non-product specific support is well below the *de minimis* level. India's product-specific support is negative because its minimum support prices (MSP) for most commodities were below the external reference price (ERP)[27] for the concerned periods, and because India does not provide any product-specific support other than MPS.

From India's first submission to the WTO, document no. G/AG/N/IND/1 (17 June 1998) about domestic subsidies, it can be seen that, in 1995-96, India had market price support programmes for 22 products. Among these 22, 19 were reported in the document. Among the products reported in the document, only sugarcane had a support price higher than the external reference price. For all the other products, the MSPs were lower than the corresponding ERPs and hence India's total product-specific support was negative.

India's second and latest submission to the WTO[28] about domestic subsidies, however, reports fewer commodities under the MSP scheme. The commodities reported in these tables are rice, wheat and coarse cereals (bajra, jowar, maize and barley). The supporting table produced in document no. G/AG/N/IND2 (11 June 2002) show that all these products had lower MSPs than ERPs for both the marketing years. As a consequence, India's total product-specific support was negative for both the years.

India's non-product specific support shows some interesting changes over the years. For the marketing year 1995-96, India's non-product specific subsidies were in fertiliser subsidy, credit subsidy, subsidy on electricity, irrigation subsidy and subsidy on average supply of seeds. These subsidies amounted to about US$ 5,722 million, which was

[27] The average international price of a commodity for the period 1986-88 is taken as the External Reference Price for calculating product-specific support for that commodity. To be more specific, market price support for a product = (administered price at the farm gate minus fixed external reference price) multiplied by eligible production, where fixed external reference price = c.i.f. unit value for 1986-88 and eligible production = quantity of production receiving the administered price.

[28] The WTO document no. G/AG/N/IND/2 (11 June 2002) notifies India's domestic subsidies for the marketing years 1996-97 and 1997-98. This is the latest publicly available document on India's domestic subsidy notification to the WTO (last visited 24 July 2005).

about 7.52 percent of the corresponding total value of Indian agricultural production. This was below the *de minimis* level of 10 percent allowed for developing countries. Subsidies given under the S&D Provisions (Article 6.2 of the UR AoA) amounted to only US$ 254.3 million.

However, for the marketing years 1996-97 and 1997-98, there were some noticeable changes in the way India categorised its non-product specific subsidies and subsidies given under the S&D Provisions of Article 6.2 of the UR AoA. Using them, India put a significant share of its non-product specific subsidies under the heads 'investment subsidies generally available to agriculture' and 'agricultural input subsidies to low income or resource poor producers'. The way this classification changed India's non-product specific support can be understood from Table 4.1.

Table 4.1. **India's Non-Product Specific Support and Support under the S&D Provisions**

Year	S&D	Non-Product Specific Support	Total Value of Agricultural Production	S&D	Non-Product Specific Support
	In million US$			As a percentage of total value of agricultural production	
1995-96	254.31	5772.06	76736	0.33	7.52
1996-97	4855.09	930.34	85280	5.69	1.09
1997-98	5171.80	1003.48	84972	6.09	1.18

Source: Calculated from India's Notification to WTO on Domestic Subsidies, WTO Document No.G/AG/N/IND/1 (for 1995-96) and G/AG/N/IND/2 (for 1996-97 and 1997-98).

Note: For developing countries, *de minimis* level is 10 percent of the value of agricultural production.

It may be noted from the table that once a large percentage of India's non-product specific support has been shifted under the S&D category, India's notified non-product specific subsidy becomes rather insignificant[29].

India does not have any Blue Box payments but India has notified Green Box subsidies. Green Box subsidies were around US$ 2,502 million in 1996-97 and US$ 2,873 million in 1997-98. Among the Green Box subsidies a very high percentage (68 percent in 1996-97 and 70 percent in 1997-98) of subsidies went into public stockholding for food security purposes.

This discussion shows that India's current domestic subsidy levels are well below the permissible *de minimis* category both in product-specific subsidies and non-product specific subsidies. To reiterate, for product specific subsidies, India's support level was negative for all the years reported by India and the non-product specific subsidies for India was only about 1.2 percent of the total value of agricultural production in the latest year reported by India. Therefore, the subsidy reduction formula suggested in the July Framework is unlikely to cause any problems for India. Subsidisation of agriculture in India will be constrained more by fiscal compulsions rather than any incipient WTO rules.[30]

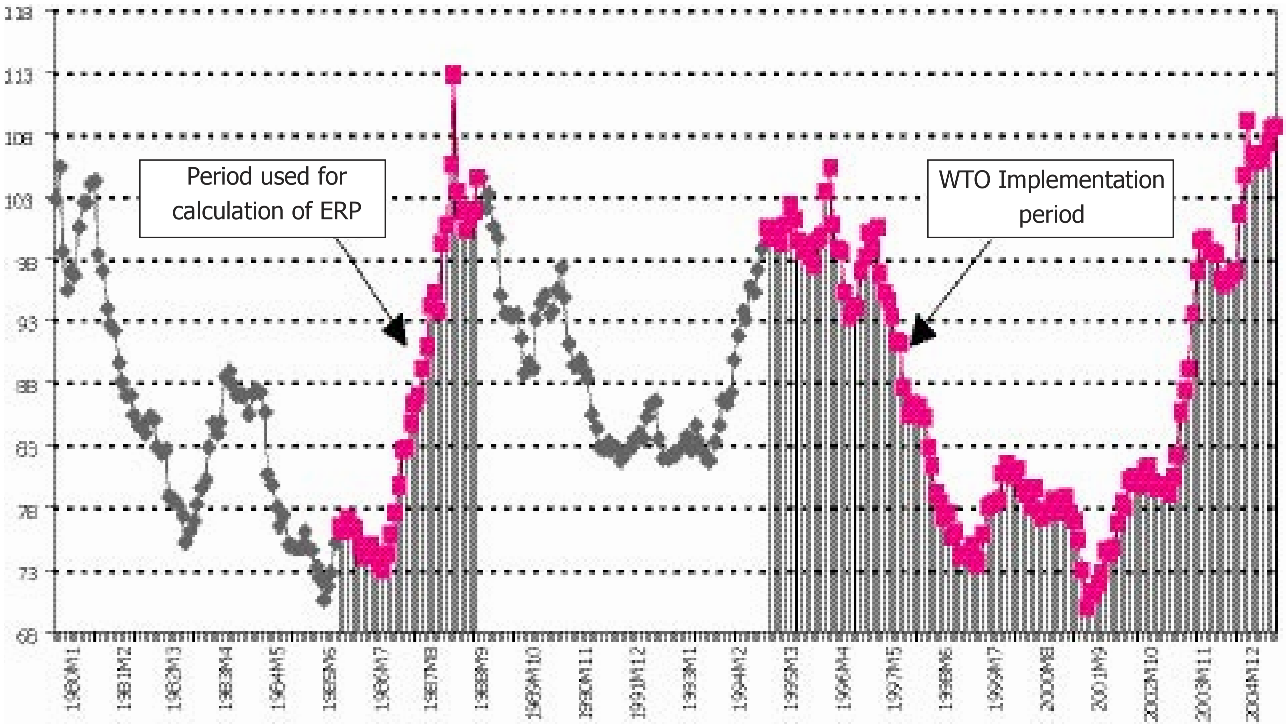
However, as a small note of caution, it can be pointed out that the base year for calculation of ERP in the UR AoA was 1986-88. During this period, commodity prices were at a high level. However, after 1996-97, there was a decline in commodity prices till about early 2002. As Figure 4.1 shows, commodity prices were at a very low level during the period 1996-2002. If, in the current round of negotiations, there is a change in the base period, and if the new base period happens to coincide with one of the low commodity-price

[29] As mentioned in Section 3, India assumes that farmers with less than 10 hectares of land can be called resource-poor, and, as four-fifth of landholdings in India are of less than 10 hectares, India shifted 80 percent of its non-product specific support under the S&D Provisions.

[30] It must be mentioned here that though the pressure to reduce non-product specific subsidies (like water and power subsidies) and Green Box subsidies (public investment in agriculture) does not come from the WTO, it comes from other multilateral organisations like the International Monetary Fund and the World Bank. The fiscal disciplines imposed on the Government of India by these two Bretton Woods institutions are forcing it to cut down on some farm subsidies although they are WTO-compatible.

Figure 4.1 **IMF Non-Fuel Commodity Price Index, 1995=100**

(includes food and bevarages and industrial input price indices)



Source: IMF Primary Commodity Prices, (http://www.imf.org/external/np/res/commod/index.asp)

Note: M1 stands for Month 1, i.e. January.

years, then India's product specific subsidy may turn positive. This can happen because the MSPs given by the Government of India have steadily increased over the years whereas the international commodity prices have undergone a steep decline. In fact, for a few commodities in certain years, India's MSPs were higher than international prices. But, to be realistic, the base change, even if it happens, is unlikely to coincide with a low-price period as it will harm the bigger subsidisers of agriculture much more than it will harm India.

4.2. The July Framework on Domestic Subsidies and its Impact on India through Trade

Global agricultural trade has fared badly in the post-WTO period. In spite of the projections that the UR AoA would lead to a boom in global agricultural trade, the share of agricultural products in total world merchandise exports has declined from 11.7 percent in 1995 to 9.2 percent in 2003.[31]

India's agricultural trade in the last 10 years has also been far from satisfactory. The anticipated gains from the UR AoA eluded India, as they did most other developing countries. Data from a recent paper by Chand (2005) show that India's agriculture trade virtually stagnated for most of the post-WTO period, and has recovered marginally in the past two years (see Table 4.2).[32] Continued distortion of the global agricultural trade market is said to be one main reason for this poor performance of India in agricultural trade. Box 4.1 highlights the view of *The Economist* that farm support is hurting agricultural exporters from developing countries like India.

[31] WTO International Trade Statistics http://www.wto.org/english/res_e/statis_e/its2004_e/section4_e/iv01.xls

[32] Chand, Ramesh. 'India's Agriculture Trade During Post WTO Decade: Lessons for Negotiations', paper presented at a seminar titled 'Off the Blocks to Hong Kong: Concerns and Negotiating Options on Agriculture and NAMA', organised by Centre for Trade and Development, 22 July 2005, New Delhi.ns for Negotiations', paper presented at a seminar titled 'Off the Blocks to Hong Kong: Concerns and Negotiating Options on Agriculture and NAMA', organised by Centre for Trade and Development, 22 July 2005, New Delhi.

Table 4.2 **India's Agriculture Trade before and after WTO, Million US$**

Year	Import	Export	Trade Surplus
1990-91	672	3352	2680
1991-92	604	3203	2599
1992-93	938	2950	2012
1993-94	742	4013	3271
1994-95	1891	4211	2320
1995-96	1761	6098	4337
1996-97	1863	6806	4943
1997-98	2364	6685	4321
1998-99	3462	6064	2602
1999-00	3708	5842	2134
2000-01	2646	6273	3627
2001-02	3408	6234	2826
2002-03	3542	7161	3619
2003-04	4765	8029	3264

Source: Chand (2005), see footnote 33.

Box 4.1 reiterates that subsidies in developed countries can hurt farmers in countries like India. Therefore, it is imperative that this round of negotiations tries to correct the prevailing problems of global agricultural trade by ensuring a more effective reduction of subsidies.

Subsidies in developed countries have affected the trading pattern of a number of Indian agricultural products as well. The example of rice may be pertinent here. During the early 1990s, India removed restrictions on rice exports. Following the removal of export restrictions, India emerged as a major rice-exporting country. However, just after the Asian crisis, the international price of rice started declining (see Figure 4.2). The low demand from a few big importers of rice in Asia and Latin America was one of the reasons behind

Box 4.1 How Subsidies in Developed Countries Hurt Developing Countries

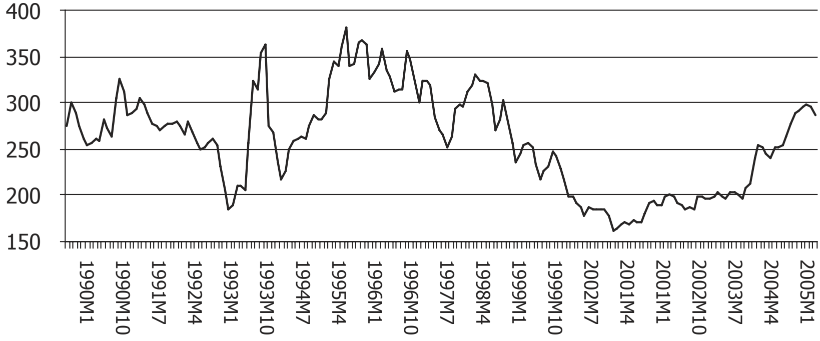
'But agricultural policies in rich countries still distort markets at home and abroad. Worse, they hurt the poor. Price-support mechanisms make domestic consumers pay more for their food, hitting low-income families the hardest. And for farmers in poor countries, OECD agricultural policies are disastrous. If those farmers aren't being kept out of export markets by quotas or tariffs, they are being undercut in domestic markets by heavily subsidised produce from the developed world. While some have argued that rich-world subsidies are a net boon to poor countries because they provide cheap food to the masses, in those countries the poorest are often rural farmers, whose lives would be improved by higher prices for their products'.

Farm Support's Deep Roots, The Economist, 22 June 2005.

http://www.economist.com/agenda/displayStory.cfm?story_id=4100673

Figure 4.2 **International Price of Rice**

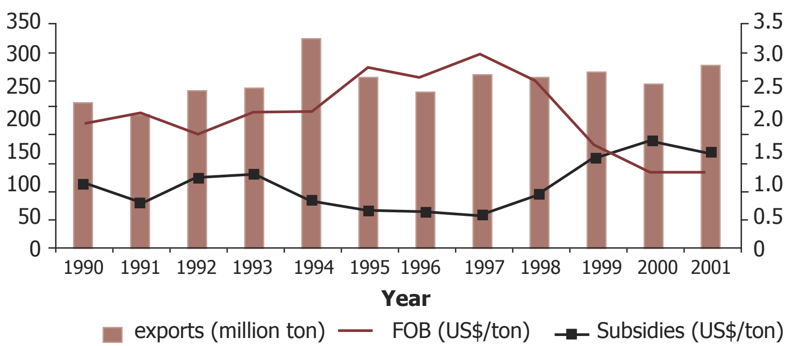
(Rice, 5 percent broken milled white rice, Thailand nominal price quote, US$ per metric tonne)



Source: International Monetary Fund (see notes for Figure 4.1) this decline. On the supply side, China's entry as an exporter in the international rice market and domestic policies undertaken by developed countries increased the supply-demand gap. This decline in the international price of rice was accentuated by the heavy subsidisation of rice farmers in the US.

Hoda and Gulati (forthcoming)[33] show that during the period when the international rice price was declining, a massive dose of counter-cyclical subsidies were provided to US rice farmers (see Figure 4.3). As a result, US rice producers were insulated from the price shock and managed to maintain their high trading volumes. As the US is a major rice-exporting country, this resulted in an oversupply of rice in the international market and exacerbated the decline in the international price of rice. The sharp drop in the international price of rice affected all other rice-exporting countries negatively. During this period, the domestic prices of most efficient rice producers like Thailand, Vietnam and India were above the international price of rice. India's exports of rice started declining

Figure 4.3 **US: Domestic Support, FOB Price and Exports of Rice**



Source: Hoda and Gulati (forthcoming)

[33] Hoda, Anwarul and Gulati Ashok (forthcoming). 'WTO, Agricultural Negotiations, and Developing Countries: Lessons from the Indian Experience', Indian Council for Research on International Economic Relations, New Delhi.

from 1998 and picked up again in 2000 when India started subsidising freight and marketing costs for rice exporters. This managed to counter, to some extent, the negative effect created by international demand-supply imbalances and high subsidies in the US.

India had to change its tariff structure to counter this fall in the international price of rice. Till 1999, India did not impose a duty on some foodgrains including rice. However, the steady decline in international prices and the threat of an import surge led India to renegotiate tariff bindings on some products including rice. The tariff renegotiation also became important because India's quantitative restrictions permitted due to Balance of Payment (BoP) problems would no longer be allowed. India undertook tariff renegotiations under Article XXVIII of the General Agreement on Tariffs and Trade (GATT) and as a result, in 1999-2000, bound tariffs on various rice types were established, at 70-80 percent. As a part of the deal, India had to make a compensatory reduction in tariff rates for some other agricultural commodities.

The instability of international prices has negatively affected the export performance of a few crops in which India is internationally competitive. The NPC-based analysis carried out Hoda and Gulati highlights that India has demonstrated competitiveness in three temperate-zone crops—rice, wheat and cotton. However, exports of these crops have been sporadic because of the low international prices faced by these commodities since the mid-1990s. The paper also points out that India can emerge as a competitive supplier of sugar and dairy products if the distortions in the international market caused by the policies of support and protection pursued by some of the developed countries can be eliminated.

Even more disturbing is that as a result of the sustained decline in commodity prices, producers of a large number of agricultural crops in India are becoming increasingly uncompetitive, even at the domestic level. After the abolition of quantitative restrictions (QR), the only instrument of protection available to governments is the tariff rate. If the price decline continues, it is possible that the tariff-adjusted prices of a few agricultural goods can make the local production uncompetitive even at the domestic level. This is likely to lead to an erosion of the domestic production base, which may have serious consequences on food and livelihood security in India.

It can be argued that, in a free trade regime, producers of uncompetitive commodities should shift to commodities in which the country is internationally competitive. Under the current circumstances, this argument suggests that farmers in India should diversify into cultivation of cash crops. However, this argument does not take into account the fact that, for small and medium farmers of poor developing countries, it is not easy to shift from one crop to another. Low capital, inadequate rural credit which results from an increased withdrawal of the State, and lack of information about conditions in the international commodity market make it difficult for farmers to make this transition. Also it is important to recognise that diversification is crucially dependent on food security. Unless a basic cushion of food security is assured, it will be extremely risky for small and medium-size farmers to diversify into non-foodgrain crops.

The opening up of the agriculture sector has also introduced a new element of risk in the system. International commodity prices are highly volatile in nature. A study by Pal (2004) shows that, for a large number of commodities, price volatility has actually increased in the period after the UR AoA.[34] In a tariff-only regime, the instability of international commodity prices is likely to be transmitted directly to the domestic market. The high volatility of agricultural commodities alters the risk perception of farmers and introduces a speculative element in agricultural prices. This is likely to have serious implications for farmers in India.[35] In fact, a committee looking at the issue of suicide by farmers in Andhra Pradesh has found that the volatility of

[34] Pal, Parthapratim. 'The WTO Agreement on Agriculture and Its Impact on Employment and Gender in India', Paper Prepared for the Conference on Gender and Macroeconomics, University of Utah, June 2004.

[35] See Nayyar, Deepak and Sen, Abhijit (1994). 'International Trade and the Agricultural Sector in India' in G.S. Bhalla. (ed.) Economic Liberalisation and Indian Agriculture,. Institute for Studies in Industrial Development, New Delhi.

crop prices has been a major source of income instability and distress for farmers (see Box 4.2).[36]

To a large extent the decline and volatility of international commodity prices can be attributable to the subsidy regime in developed countries.[37] The findings of the WTO Dispute Settlement Board (DSB) on sugar and cotton subsidies have clearly established the causal relationship between farm subsidies, over-production of subsidised products and the consequent decline in international commodity prices. This brings the issue of interaction between domestic subsidies and market access into the picture. If international commodity prices can be artificially manoeuvred by developed countries using their domestic subsidies, then there is a case for non-subsidising countries to protect their domestic markets from unfair competition through some form

Box 4.2 **Cash Crops, Price Volatility and Food Security Problem in India**

Higher returns from some export-oriented cash crops like tobacco and sunflower have lured even smaller farms to undertake cash crop cultivation at the expense of traditional crops including foodgrains. This is a risky move because these farmers are now totally dependent on the revenue from the cash crops even for their domestic consumption. International prices for cash crops are volatile and fluctuate wildly from year to year. Every now and then, low prices of these commodities lead to heavy losses for farmers. For farmers who do not maintain a cushion of self-produced foodgrains to support them, such losses can create huge food security problems. In southern India, there have been numerous cases of farmer suicides because of this reason.

[36] See 'Report of the Commission on Farmers' Welfare', Government of Andhra Pradesh http://www.macroscan.net/pol/apr05/pol070405Andhra_Pradesh.htm

[37] The basic argument is that continued subsidisation of agriculture and the dominance of a few developed countries in world agricultural trade have not allowed other countries to join the international farm trade. As a result, the depth of international agriculture trade market has not increased. Therefore, prices of agricultural goods remain as volatile as before.

of market access barriers. In the UR AoA, almost all forms of explicit Non-Tariff Barriers (NTBs) are prohibited. Variable levies (i.e. tariffs that are imposed as an inverse function of international prices) are not allowed either under the UR AoA. The Special Safeguard (SSG) mechanism, which allows countries to impose higher duties if there is an import surge, is available only to countries which took the Tariff-Rate Quota (TRQ) route in the UR AoA. As India took the ceiling-binding approach (or the Bound Tariff route) in the UR AoA, the SSG mechanism is not available to India. In the absence of the SSG mechanism, countries like India derive their flexibility in application of tariffs from the difference between bound and applied tariff rates. There have been suggestions that India's bound tariff rates are inordinately high and should be brought down to more reasonable levels. While it is indeed true that a 300 percent tariff rate is unlikely to be required for the protection of any commodity, to counter the threat of subsidies and artificially low international commodity prices it is important to allow for some headroom (in the form of difference between bound and applied tariff rates) and flexibility in tariff application. Therefore, India should be careful about its market access strategy. In this context, in the current round of negotiations, developing countries should link the issue of tariff reduction with the level of subsidisation in developed countries.

However, it must be mentioned here that in the current round of negotiations, there are indications that a SSG-type instrument will also be made available to developing countries. Moreover, there are talks about providing additional protection to some agricultural commodities in the form of 'Special Products' and 'Sensitive Products'.[38] If these new instruments are made available, then the need for the additional headroom in the application of tariff rates may be less.

[38] For a detailed discussion on these issues, see 'Special Products: Options for Negotiating Modalities' by Anwarul Hoda, International Centre for Trade and Sustainable Development, 2005. http://www.ictsd.org/dlogue/2005-06-16/Hoda.pdf

5. Conclusions and Negotiating Options for India

The discussion in this paper once again highlights the fact that the UR disciplines to reduce domestic farm subsidy have been largely unsuccessful in bringing down trade- and production-distorting domestic subsidies in developed countries. Given the demand for a substantial reduction of trade-distorting subsidies in the Doha Ministerial Declaration, there is a measure of optimism that the current round of negotiations will achieve a more meaningful reduction in these subsidies.

The July Framework has been seen by many developing countries as a breakthrough that would eliminate billions of dollars of farm subsidies. According to Celso Amorim, Foreign Minister of Brazil,

> 'Obviously, developing nations did not get everything they asked for in Geneva. But the overall direction is clear: This is the beginning of the end to export subsidies; the stage is set for a substantial reduction in all types of trade-distorting domestic support; market access negotiations will open up new opportunities for trade, without prejudice to the needs of developing countries.'[39]

However, a closer scrutiny of the July Framework reveals that there are some waivers built into it that may allow developed countries to maintain and, in some cases, increase domestic farm support and still remain WTO-consistent. Negotiators from developing countries should be cautious about these possibilities and should try to plug these legal loopholes. Otherwise, the current round of farm trade talks on disciplining domestic subsidies may end up being as ineffective as the Uruguay Round talks.

As far as India is concerned, it appears that the subsidy disciplines introduced in the July Framework are not going to have a constrain-

[39] Financial Times, 4 August 2004.

ing impact on the domestic subsidies given to the farm sector in this country. India's farm subsidy levels are well below the *de minimis* level prescribed by the UR AoA and it is unlikely that India will be hitting the *de minimis* level either in the product-specific or non-product specific subsidies any time soon. However, the current round of negotiations and its subsidy reduction provisions will be extremely important for India on the trade front. The poor performance of India's agricultural trade in the post-WTO period can be attributed largely to the distortions in the international agricultural trade market. In the current round of trade talks, India must negotiate hard to reduce the production- and trade-distorting subsidies in developed countries effectively and significantly. In this context, it is imperative that negotiators try to plug the loopholes of the July Framework by supplementing it with appropriate subsidy reduction formulae.

5.1 India's Negotiating Strategies and Options in the Current Round of Negotiations

India has followed a two-pronged approach towards domestic subsidies in the current round of negotiations. It wants a substantial reduction in domestic subsidies in developed countries and proposes that there should also be sufficient flexibility in the rules to allow developing countries pursue support measures towards non-trade concerns like poverty alleviation, rural development, rural employment and diversification of agriculture.[30]

As a part of the G-20 initiative, India is now pursuing a similar set of objectives. To achieve these goals, the G-20 group has adopted the following strategies:

1. It has been recognised by the G-20 that under the framework suggested by the July Package, effective reduction in trade-distorting domestic support is not going to be achieved unless significant reduction commitments are undertaken by the developed countries. Therefore, it has proposed an appropriately structured 'tiered subsidy reduction formula' with high reduction coefficients

[40] WTO Document No. G/AG/NG/W/102, Proposals by India in the areas of: (1) Food Security, (2) Market Access, (3) Domestic Support and (4) Export Competition (15 January 2001).

for countries with a high level of TDS. If effectively calibrated, such a formula can lead to a near-harmonisation of subsidy levels and can also take care of some of the shortcomings of the July Framework which this paper has highlighted. The G-20 should try to fine tune the subsidy reduction formula in a way that will allow them to plug the loopholes present in the framework agreement. It should take a firm stand on this issue and ensure that an appropriate formula with high reduction coefficients is adopted in this round.

2. The G-20 feels that the present definition of Blue Box subsidies does not ensure that subsidies categorised under this box are "minimal or least trade-distorting." According to it, any change in the Blue Box subsidy system 'should be contingent upon agreement on additional criteria in order to make it substantially less trade-distorting than it is now.'[41] The G-20 is particularly concerned about the possibility of re-classification of US counter-cyclical payments as Blue Box subsidies. It has been historically seen that counter-cyclical payments insulate farmers from price fluctuations and lead to over-production and price suppression in the international market. Therefore, these payments are neither 'production-limiting' nor 'minimally trade-distorting'. The G-20 should resist any attempts to classify these subsidies as Blue Box subsidies.

3. The G-20 is also proposing to tighten the Green Box subsidies for developed countries. However, it also feels that the provisions categorised as Green Box subsidies do not adequately cover the subsidy measures specifically required to cater to the needs of developing countries (like poverty alleviation and rural development). Therefore, a restructuring of the Green Box subsidies has been proposed to ensure that they will not only be non-trade distorting but will also take into account the legitimate concerns of developing countries. The G-20 also suggested putting in place a monitoring mechanism to ensure that Member countries are not misusing the provisions of the Green Box. These are valid concerns, because during the UR

[41] Paragraph 12, G-20 Delhi Declaration, 18 and 19 March 2005.

implementation period, there were evidences that countries like the US were providing a lot of support by 'dressing up all support measures in Green'.[42] The G-20 should take utmost care to ensure that the possibility of such 'box shifting' remains minimal in this round of negotiations.

4. Regarding the *de minimis* level of subsidies, the G-20 is of the opinion that the *de minimis* ceiling should not be reduced for developing countries, because for many of these countries, this is the only form of support available to most farmers. The Indian position suggests that India wants the *de minimis* ceiling for developed countries to be reduced by one percent (to four percent of the value of agricultural production) but does not want any reduction in the *de minimis* level for developing countries. India's position is not unjustified because in developing countries, a very large number of people are dependent on agriculture for their livelihood and food security. Putting a tighter lid on governments of developing countries from supporting these people will not be fair. Secondly, the amount of subsidies given to the farmers in developing countries under the *de minimis* clause is virtually insignificant in comparison with the subsidy levels of the developed countries.

Strategies followed by the G-20 group suggest that it is moving in the right direction. It must ensure that the current round of negotiations leads to a substantial and effective reduction in domestic farm subsidy levels in developed countries. However, it must be kept in mind that farm subsidy is a politically sensitive issue in many developed countries and these countries will be playing all their cards to avoid any substantial cuts in their subsidy levels. One possible way of pressurising developed countries will be to link market access in developing countries to the levels of domestic subsidies in developed countries. Inter-sectoral bargaining may also be attempted to force a significant reduction in subsidies in this sector.

[42] See 'The Green Barrier to Free Trade' by Chandrasekhar, C.P., Jayati Ghosh and Parthapratim Pal, available at http://www.networkideas.org/focus/feb2003/fo03_Free_Trade.htm

Secondly, any pressure to re-introduce the Due Restraint Clause or the Peace Clause should be resisted. It is noteworthy that a Due Restraint Clause or Peace Clause was incorporated in the UR AoA, which provided significant immunity to the subsidisers of agricultural products from countervailing duties. The Peace Clause expired in 2004 and now WTO Member countries have the option to use Anti Dumping (AD) and Countervailing Duties (CVD) against subsidised agricultural exports. The expiry of the Peace Clause has made many commodity-specific EC and US agricultural subsidies vulnerable to legal challenge (see Steinberg and Josling).[43]

Most importantly, the G-20 initiative should be strengthened. Brazil, China, India and other members of the G-20 group have emerged as a counterweight to the traditional big players in the WTO. A 'Blair House' kind of deal[44] will be difficult to impose in the current context.[45] However, there will be pressure from different groups to break the G-20 alliance. It must not be forgotten that the G-20 is still a fragile alliance and there were some signs of mistrust among members when Brazil and India joined the Five Interested Parties (FIPs) group during the signing of the July Package.

Recent reports from Geneva indicate that high level bilateral talks on agriculture between the EU and the US have taken place in Paris during September 2005. Along with these two countries, these talks also involved Brazil and India (called the 'new QUAD') and a few other

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43 Steinberg, Richard H. and Timothy E. Josling. 'When the Peace Ends: The Vulnerability of EC and US: Agricultural Subsidies to WTO Legal Challenge', November 2003. http://www.ictsd.org/issarea/atsd/products/docs/Steinberg_Josling.pdf

44 The Blair House Accord was an in-house deal struck at an informal meeting between the developed countries during the Uruguay Round negotiations on agriculture. The accord resulted in the creation of the Blue Box subsidies. A set of support measures that were officially defined as trade-distorting was incorporated in the Blue Box and was exempted from reduction commitments. This allowed some developed countries, especially the EU, to provide substantial protection for their farming community. Moreover, it was agreed at Blair House that the AoA would incorporate a 'Peace Clause' that prevented countries from challenging those support measures during the implementation period.

45 For example, in Cancun, developing countries managed to fend off the so called 'Derbez Text' which was based closely on a joint EU-US proposal on agriculture circulated a few days before the Cancun Ministerial.

countries (dubbed FIPS+).[46] Though apparently the Paris meet did not yield any significant results, India's participation in this meet may again raise some uneasy questions within the G-20 group. While joining these select groups of powerful WTO Member countries must be giving India greater leverage and voice in the negotiations, India must remain very careful that it conveys the concerns of other G-20 members and does not become soft towards countries that are responsible for the current distortions in international agricultural trade.

[46] Bridges Weekly, 21 September 2005 and 28 September 2005. http://www.ictsd.org/weekly

Annexure 1
WTO Ruling against US Cotton Subsidies

Domestic subsidies given to farmers in the US and their impact on other cotton-exporting countries have become an issue of serious discontent among WTO Members. According to estimates, 20,000 US cotton farmers will be given subsidies to the tune of around US$ 4.7 billion in 2005, which is an amount equivalent to the market value of the crop.[47] In October 2002, the Government of Brazil disputed the legal status of US cotton subsidies under the WTO and requested consultations with the Government of the United States about prohibited and actionable subsidies provided to producers, users and exporters of upland cotton in the US. In its submission to the WTO[48], Brazil argued that at the core of this case are US$ 12.9 billion of US subsidies for upland cotton for the years 1999-2002. According to Brazil, these subsidies increase and maintain the production of high-cost US upland cotton, increase US cotton exports, suppress US, world and Brazilian prices and lead to the US having a more than equitable share of world export trade. Brazil has also established that US subsidies caused significant price suppression of cotton in the international market between 1999 and 2002. Brazil alleged that these US subsidies are inconsistent with various provisions of the Agreement on Agriculture (AoA), the Agreement on Subsidies and Countervailing Measures (SCM) and the General Agreement on Tariffs and Trade (GATT).

The submission of Brazil also highlighted some interesting facts. It showed that in spite of a steady decline in the prices of cotton over the past few years, the US planted acreage of cotton has increased. The paper argued that without the subsidies, many US upland cotton producers would have to switch to crops providing a higher market return or take marginal land out of production. Estimates published in the submission show that the US acreage and production of cotton would have fallen considerably without subsidies. In addition to fall-

[47] Human Development Report 2005, p 131.

[48] 'United States - Subsidies on Upland Cotton - Request for Consultations by Brazil', WTO Document No. G/AG/GEN/54.

ing production, the removal of subsidies would have also resulted in significantly lower US exports and would have contributed to increased world prices. Calculations show that for the period 1999-2002, in absence of subsidies, US cotton exported would have fallen by 41.2 percent, from the annual actual average export of 8.62 million bales to 5.07 million bales. This reduction of 3.55 million bales represents 13.4 per cent of the total average world export market between 1999 and 2002. This paper argues that, given the relatively inelastic demand for upland cotton, the 13.4 percent decrease in the supply of cotton to the world export market would have led to an increase in the price of cotton in the international market.[49]

Price distortions caused by US subsidies have a direct impact on other cotton-exporting countries. The worst sufferers are a few countries from West Africa, which are heavily dependent upon cotton for their export earnings. In Benin, Burkina Faso, Mali and Chad, cotton production accounts for five to ten percent of gross domestic product (GDP). Cotton also plays a central role in their trade balance, accounting for close to 30 percent of total export revenue, and more than 60 percent of agricultural export revenue.[50] It is notable here that cotton export is of marginal relevance to the US. Estimates by the International Monetary Fund show that when world cotton prices fell to a 50-year low in 2001, losses attributable to US subsidies were estimated at one percent to three percent of GDP for countries such as Burkina Faso and Mali.[51]

A Panel was established on 18 March 2003 to consider claims by Brazil that various support measures given by the US to its cotton sector constituted actionable subsidies. The WTO Panel Report[52] ruled in

[49] Submissions regarding this dispute settlement case are available at http://www.wto.org/english/tratop_e/dispu_e/cases_e

[50] WTO Document No. TN/AG/SCC/GEN/2

[51] International Monetary Fund (2005): 'Burkina Faso: Second and Third Reviews under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Requests for Waiver of Nonobservance of Performance Criteria and Extension of Commitment Period.' IMF Country Report 05/95. Washington, DC. http://www.imf.org/external/pubs/ft/scr/2005/cr0595.pdf

[52] United States – Subsidies on Upland Cotton Report of the Panel WTO Document No.WT/DS267/R.

favour of Brazil, saying that some of the subsidies given by the US result in serious prejudice to Brazil's interests in the form of price suppression in the world market. The Panel Report also found a causal link between US price-contingent subsidies and significant price suppression in the international cotton market. The Panel Report gave four reasons for this. They are:

1. The US exerts a substantial proportionate influence in the world upland cotton market.
2. The US price-contingent subsidies are directly linked to world prices for upland cotton, thereby insulating US cotton producers from low prices.
3. A coincidence of suppressed world market prices and the price-contingent United States subsidies.
4. The divergence between US producers' total costs of production and revenue from sales of upland cotton. This finding supported the claim by Brazil that US upland cotton producers would not have been economically capable of remaining in the production of upland cotton had it not been for the US subsidies at issue and that the effect of the subsidies was to allow US producers to sell upland cotton at a price lower than would otherwise have been necessary to cover their total costs.[53]

On 18 October 2004, the US notified the WTO Dispute Settlement Body (DSB) of its intention to appeal against some of the conclusions reached by the Panel. The US appealed to the DSB and in its submission to the WTO[54] sought a 'review by the Appellate Body of the Panel's legal conclusion that certain US decoupled income support measures – that is, production flexibility contract payments under the Federal Agricultural Improvement and Reform Act of 1996 ("1996 Act"), direct payments under the Farm Security and Rural Investment Act of 2002 ("2002 Act"), and "the legislative and regulatory provisions which establish and maintain the [direct payments] programme"

[53] WT/DS267/R, para 7.1351.

[54] 'United States - Subsidies on Upland Cotton - Notification of an Appeal by the United States under Paragraph 4 of Article 16 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU")', WTO Document Number WT/DS267/17.

– are not exempt from actions under Article 13(a) of the Agreement on Agriculture'.

The Appellate Body (AB) ruled mostly in favour of Brazil and upheld all the major conclusions of the earlier Panel Report. Taken together, the recommendations and conclusions of the AB and the Panel Report can have far reaching implications for future trade disputes. Apart from giving a much tighter interpretation of permissible agricultural subsidies (Blue Box and Green Box subsidies), it appears that the long-standing question of whether agricultural subsidies should be dealt with under the SCM agreement has also been resolved. The Panel Report has made it clear that the SCM is applicable to agricultural products and that the obligations under the SCM run parallel to the AoA provisions. This is an important verdict as the expiry of the Peace Clause will allow many countries to initiate countervailing measures against subsidised agricultural exports. It is also worth highlighting here that this ruling is the first ever to target domestic agricultural subsidies in the WTO.

Annexure 2

Recent Proposals in the WTO

The US Proposal for Negotiation in the WTO

http://www.ustr.gov/Trade_Sectors/Agriculture/US_Proposal_for_WTO_Agriculture_Negotiations.html

Implications of US Proposal

The US proposal submitted in Zurich suggested substantial reduction in trade-distorting measures, but it is contingent upon comprehensive reform in all pillars and conditional on the level of ambition in market access in developing countries. The proposal has sought the elimination of all forms of trade- distorting subsidies over a period of 15 years in a phased manner. It has suggested three phases of elimination, under which in the first five years there will be an effort on part of countries subsidising agricultural production and exports to reduce their subsidies at specified levels of reduction; the next five years will form the review period; and the last five years will completely eliminate all forms of trade-distorting support. The reduction modalities follow the harmonisation approach as envisioned in the July Framework, but the conditional modalities at this stage do not indicate any reduction in actuals, which seem to suggest there will not be any reduction in actual terms. Though the proposal has talked of Special and Differential Provisions, clear-cut measures have not been illustrated. The proposal is silent on the cotton initiative which is crucial for African and Asian cotton producers. The broad reduction modalities suggested are:

Bound AMS Level (Billion US$)	Reduction percentage
> 25	83
12-25	60
0-12	37

It has suggested substantial reduction in the overall measure of support.

Overall Allowed Level (Billion US$)	Reduction percentage
> 60	75
10 - 60	53
0 - 10	31

However, it is silent on the manner these reductions will be made and also on counter-cyclical payment measures and measures to stop box shifting. The Proposal has re-introduced the Peace Clause that gives developed countries the freedom to continue trade-distorting measures without being challenged. The Proposal will move the negotiation process back to the Derbez Text and leave the development agenda behind. The idea of recalculating the AMS measurement on the 1999-01 base has serious flaws as it might dampen the existing level of subsidies to a lower level and as most countries involved in subsidy disbursement have not notified their Measure of Support to WTO since 2001.

The EU Proposal for Negotiation in the WTO

http://europa.eu.int/comm/agriculture/external/wto/index_en.ht8m

Implications of the EU Proposal

The EU proposal has come up with an ambitious cut of 70 percent in the AMS, an additional cut of 65 percent in the *de minimis* and reduction in the 'partially-distorting Blue Box payments'. However, these suggested measures are conditional on the level of proportional reduction commitments of other countries and the level of reforms in Non-Agricultural Market Access (NAMA) and services. The EU proposal is silent on the Peace Clause and the way the Blue Box and export subsidies will be reduced. The reduction commitments are suggested in a manner that all the subsidies are shifted to safer boxes in the process, and give an impression that distortions in agricultural trade will remain. The EU has expressed its commitment to remove the distortive export subsidies but still has the frontloading mechanism in place to suggest possible efforts in reducing them. In reality, the actual level of trade-distorting subsidies will remain at the level planned in the CAP.

The G-20 Proposal for Negotiation in the WTO

http://www.ictsd.org/ministerial/hongkong/docs/G20proposal.pdf

Implications of the G-20 Proposal

The G-20 reaffirmed its July 2005 document and suggested continuing with the Doha mandate combining further reductions, disciplines and monitoring. The G-20 proposal talked of the S&D Provisions component as an integral part of all negotiation and reaffirmed developing countries to undertake reduction in domestic support by less than two-thirds of the cuts undertaken by the developed countries. It suggested that the reduction commitments need to get reflected in the actual distortions prevailing in the agricultural trade. The G-20 proposed a similar three-tiered reduction approach with a 70 percent reduction in AMS and called for reduction of both product-specific and non-product specific support. It called for exemption of *de minimus* support by developing countries to their resource- poor farmers. It has suggested the use of AD and CVDs against subsidised imports (against re-imposing Article 13 of the AoA). However, with the EU and the US not agreeing on market access commitments, convergence on subsidy issues looks difficult.

Centre for Trade and Development (Centad) was established by Oxfam GB in 2004, as a not-for-profit organisation, to carry out policy research and advocacy on issues around trade and development, with a principal focus on South Asia.

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