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A little blue lie: harmful subsidies need to be reduced, not redefined

21 July 2005

New criteria for 'Blue Box' agricultural subsidies under consideration by trade negotiators at the World Trade Organization will create large opportunities for trade-distorting agricultural subsidies. This would fundamentally undermine a key objective of the Doha Development Round negotiations:

'…we commit ourselves to comprehensive negotiations aimed at… substantial reductions in trade-distorting domestic support.'[1]

The Doha Development Round offers an historic opportunity to make trade fair for developing countries. In particular, farmers in developing countries have a great deal at stake. The Round could lead to an end to the dumping of subsidized commodities on global markets, improving agricultural livelihoods for 900 million people who live in rural poverty. Alternatively, millions of poor farmers across the globe could face increased poverty.

To fulfil its positive potential, the Doha Round must strictly clamp down on trade-distorting agricultural subsidies. However, several analyses, including Oxfam's, project that negotiations, if they follow their current trajectory, will actually create new opportunities for rich countries to expand trade-distorting agricultural subsidies.[2] This would severely reduce the value of the Doha Round.

Negotiators must face the truth: an expanded Blue Box will turn the promise of substantial reductions in trade distortion into a lie. Shifting definitions and parsing words will not change the underlying truth that rich countries maintain heavily subsidized agricultural production. Without strong new rules, agricultural dumping will continue, and the potential to reduce poverty and encourage development will be unfulfilled.

Punching holes in the Blue Box

The Blue Box is a category of agricultural subsidies created in the Uruguay Round of trade negotiations. The Uruguay Round negotiations established a hierarchy of subsidies, with the most trade-distorting subsidies requiring the highest levels of regulation and control. Most subsidies for agriculture are understood to distort trade, usually by encouraging increased production. These trade-distorting subsidies are categorized in the Amber Box. A separate category, the Green Box, was created for subsidies understood to be minimally distorting or non-distorting. At the last stages of the Uruguay Round negotiations, a new category of subsidies was introduced as a compromise measure: the Blue Box.[3]

As commonly understood, the Blue Box subsidies had two main aims:

- to provide forms of agriculture support that are less trade-distorting than Amber Box support;
- to support transitional programs enabling countries to move away from trade-distorting subsidies (Amber Box) and toward non-distorting subsidies (Green Box).

The WTO describes the Blue Box as the 'Amber Box with conditions' — conditions designed to reduce distortion. Subsidies that would normally be in the Amber Box can be categorized as Blue Box if the subsidies also require farmers to limit production.[4] Because Blue Box subsidies carry conditions, the Uruguay Round rules did not place quantitative limits on them, which means that countries are permitted to provide unlimited levels of Blue Box subsidies.

Historically, the largest user of Blue Box subsidies has been the European Union, which spent a little more than 20 billion Euros annually in production-limiting subsidies before its 2003 reform. This represented a significant proportion of EU subsidies, and about 10 per cent of the total value of EU agricultural production (prior to the addition of the newly acceded countries).[5] In the Doha negotiations, the EU has very clearly stated that it regards preserving the existing Blue Box as a key negotiating objective.[6]

Aside from Norway, no other WTO members currently report significant Blue Box subsidies. Prior to 1996, the USA used subsidies that qualified as Blue Box, but it has since eliminated them and does not currently report any Blue Box subsidies.

USA opens the box

The USA proposed to eliminate the Blue Box in its original negotiating position for the Doha Round in 2002.[7] More recently, however, the USA has become the leading proponent of proposals to expand the definition of the Blue Box to permit other forms of agricultural subsidies. While the current Blue Box currently permits only subsidies that have a 'production-limiting' function, the USA promotes inclusion of subsidies 'that do not require production'.[8]

This is an interesting semantic distinction, but it could have a major impact on the allocation of subsidies, and ultimately it could determine the impact of new WTO rules on trade-distorting agricultural subsidies. The strong interest in expanding Blue Box definitions indicates that the USA intends to use the Blue Box in the future.

A safety net or a perpetual support?

For the USA, the apparent purpose of redefining the Blue Box is to permit the inclusion of counter-cyclical payments (CCPs). Counter-cyclical payments are subsidies that are paid to producers when commodity prices fall below specific levels. In this way, they resemble price-support subsidies, which distort trade and are subject to WTO reduction commitments in the Amber Box. Though the USA never officially notified the WTO about the nature of counter-cyclical payments since their creation in 2002, the USA is expected to classify these payments as trade-distorting in the Amber Box or as 'de minimis'. This is consistent with the findings of the recent WTO ruling in the Brazil/USA cotton dispute, in which the panel concluded that US counter-cyclical payments on cotton were trade distorting and had caused damage to other cotton exporting countries by encouraging US production and depressing world cotton prices.[9]

Creating new criteria for the Blue Box would allow the USA to shield counter-cyclical payments from cuts to trade-distorting subsidies. Doha Round negotiations could cut the Amber Box and 'de minimis' subsidies by 50 per cent or more. If the USA is successful, the Blue Box will serve as a safety-valve against the pressure to reduce subsidies, and could make it possible to avoid any subsidy reduction at all.[10]

To justify this move, the US argues that counter-cyclical payments are of a hybrid nature. They are based on current prices, but not on current production. Instead, they are based on historical production and acreage. In this way, they resemble 'decoupled' payments, i.e. payments that are not coupled with current production levels. 'Decoupled' subsidies are thought to have a minimal, limited impact on farmers' production decisions, and so do not distort trade in the way that production-oriented subsidies do. Subsidies that are completely unrelated to ('decoupled' from) production and prices are eligible for the Green Box and are not limited by WTO rules. According to the US line of reasoning, counter-cyclical payments belong to a middle category between Amber Box subsidies and Green Box subsidies, i.e. in a revamped Blue Box.

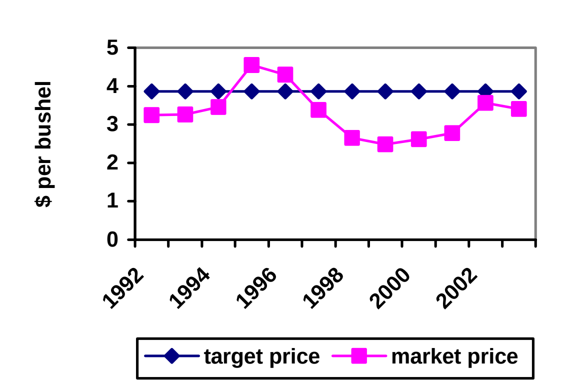
Counter-cyclical payments are the codification of a change of heart that politicians in the USA experienced after the enactment of the 1996 Farm Bill. This measure introduced new 'decoupled' payments, called 'production flexibility contracts', and generally set a path toward reduction of trade-distorting agricultural subsidies. However, the 1996 Farm Bill was enacted at a time when historically high prices of agricultural commodities prevailed. By 1998, prices had fallen dramatically, partly as a result of the Asian financial crisis, and the US Congress leapt into the breach with a series of *ad hoc* 'emergency' payments, as well as massive shipments of 'food aid'. These 'emergency' agricultural payments continued until 2002, when Congress wrote a new Farm Bill. Thus were born the counter-cyclical payments.

When Congress enacted the 2002 Farm Bill, politicians described the legislation as a 'safety net' for US farmers: Representative Charles Stenholm, the Democratic leader of the House Agriculture Committee, said, 'First and foremost, it provides for a strong safety net for our agricultural producers.'[11] Counter-cyclical payments were advertised as a program that would respond to low prices: '…in place we have counter-cyclical payments that come in case prices are low: we all hope prices stay high. But in case they do go down, we do have the counter-cyclical program.'[12]

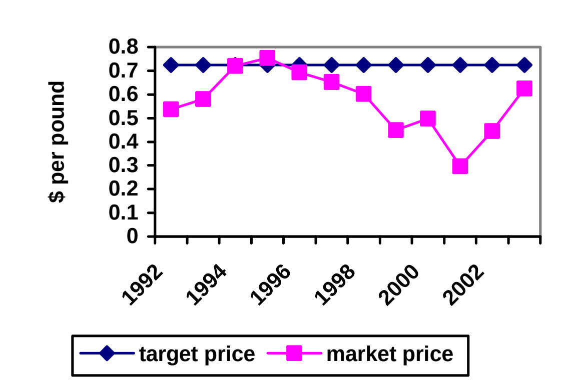
However, rather than providing a 'safety net' against low prices, the counter-cyclical payments set price targets so high that payments are perpetual, rather than cyclical. For most eligible commodities, target prices were set unreasonably high in the 2002

Farm Bill. For example, counter-cyclical payments for wheat were targeted at $3.86 per bushel. However, average wheat prices for the previous 15 years had been $3.22 per bushel. Market prices for wheat have not reached $3.86 for decades, except for two exceptional years in the mid-1990s. Similar patterns prevail for other commodities subsidized by counter-cyclical payments. For cotton, counter-cyclical payments were set to begin when prices fall below $0.72 per pound. However, cotton prices had averaged $0.59 per pound for the previous 15 years.

Counter-cyclical target is above average wheat prices

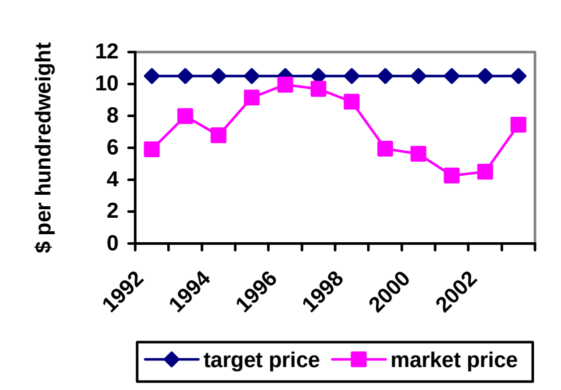


Counter-cyclical target far above average cotton prices

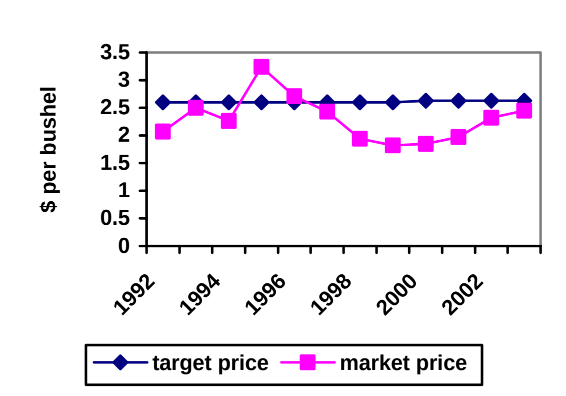


In fact, counter-cyclical payments reflect very unrealistic projections for commodity prices in the future. For most covered commodities, the US Department of Agriculture does not expect that prices will reach the counter-cyclical target price through 2013 (when the estimates end). In most cases, the government agency projects prices to decline gradually - an expectation that is based on assumptions about growth in global demand, trade, and consumption.[13] Target prices and the resulting counter-cyclical payments are set by political bargaining, not by any discernible policy foundation.

Counter-cyclical target is above rice prices



Counter-cyclical target is above average maize prices



There is little reason to think that the counter-cyclical payments are less trade-distorting than other forms of subsidy. In fact, there are a number of reasons to believe the contrary: the calculation of payments is based on current prices, maintaining linkages between market conditions and subsidies. In addition, farmers are restricted from planting many crops in order to receive counter-cyclical payments — a requirement that undermines the planting flexibility that is intended with 'decoupled' payments.[14] The OECD points out: 'Although potentially less distorting, counter-cyclical payments, together with marketing loans that also offset lower prices, continue to be significant and limit market signals.'[15]

Finally, counter-cyclical payments distort agricultural production by shielding producers from price signals, reducing risk, and encouraging increased production. One study found that counter-cyclical payments may have the same effect on a farmer's attitude to risk as subsidies which are clearly trade-distorting Amber Box subsidies. The study found that, by reducing overall risk, the impact of counter-cyclical payments extends beyond decisions about planting on subsidized acreage to decisions about planting on land that does not enjoy subsidies.[16] Another empirical study found that counter-cyclical payments had larger production impacts than other 'decoupled' payments.[17] The impact of risk reduction relates not simply to the payments themselves, but to the expectation that subsidies may expand in the future. The 2002 Farm Bill permitted producers to update their acreage and production history for 'decoupled' payments, meaning that the payments could increase if production increased. This sort of update completely subverts the concept of 'decoupling' and creates an expectation of subsidies based on current production patterns, an incentive to increase production. This problem has been recognised by the US Department of Agriculture, which, when explaining the economic effects of counter-cyclical payments, says, '... economic efficiency in production is reduced because producers would not be fully responding to signals from the marketplace, but instead would be responding to market signals augmented by expected benefits of future programs and future program changes.'[18]

Conclusions

'So, coming back to the question on the "Blue Box", if Europe can eliminate the "Blue Box" that is great, we don't use it. Now, if it's there, we would have to explain, and I have been doing this for some of our colleagues, how it would not undermine our overall efforts to cut our trade distorting subsidies.' – US Trade Representative Robert B. Zoellick, 20 February 2004.[19]

Agricultural dumping depresses global and local agriculture markets, distorts trade, and hurts local producers. Because most poor people rely on agriculture for their livelihood, this has a very harmful impact on them.

Unfortunately, the current negotiating proposal seeks redefinitions rather than reductions in trade-distorting subsidies. The USA seeks changes in the Blue Box so that counter-cyclical payments qualify for favored treatment. The burden should be on the USA, as the primary *demandeur* of Blue Box changes, to prove that an expanded Blue Box, and continued counter-cyclical payments, will lead to a reduction in trade-distorting subsidies.

Recommendations

- **Reject new eligibility criteria for Blue Box subsidies.** Observers differ on the current state of negotiations. Although new Blue Box criteria were included in the July Framework Agreement, it may still be possible to prevent this unfortunate relaxation of rigor. Progress toward the goal of reducing trade-distorting support would certainly be assisted.

If the USA is successful in introducing a new definition of Blue Box, then limits such as the following must be placed on its use, to prevent it from expanding agricultural subsidies:

- **A strict ban on updating payment rates, acreage, and production for 'decoupled' subsidies.** The agreement should enforce the July Framework language of 'unchanging areas, yields, and base periods'.
- **Price-contingent criteria.** If the Blue Box is expanded to include price-contingent subsidies, new criteria should be introduced to ensure that target prices minimize the distortional effect. Current target prices for counter-cyclical payments are set by politics. As a result, the payments are not cyclical but constant, and they provide an on-going subsidy. An alternative could be setting annual price targets based on the preceding five-year average, with counter-cyclical payments kicking in only when prices fall below 85 per cent of the target price. This would provide much clearer market signals to producers, while providing a form of safety net.
- **Product-specific caps**. Proposed limits on the use of the Blue Box in the July Framework Agreement are too generous and too general. The July Framework specifies that Blue Box subsidies should be limited to five per cent of the total value of agricultural production. For the USA, this is still an enormous amount of money, approximately $10bn annually. This cap is far above current use of counter-cyclical payments, which are estimated to total $3.9bn in 2005. More importantly, the USA only provides direct subsidies to a limited number of commodities, a fraction of total agricultural production. The sum of $10bn, spread among a small number of commodities, can have a very large production impact.
- **A 50 per cent reduction in the overall permitted Blue Box level**, down to 2.5 per cent of the value of total agricultural production. The reference basis at the beginning of the implementation period should be the most recent notification for the EU, and five per cent of value of total agricultural production for the USA.
- **Proportionality between set-aside measures and payments in production-limiting programmes**, so that high levels of subsidy in the Blue Box must be accompanied by similarly large production-limiting measures. In addition, the actual production-limitation impact of Blue Box subsidies should be demonstrated.

Notes

[1] Doha Ministerial Declaration, November 2001. Paragraph 13.

[2] See Oxfam International, 'A Round for Free', 15 June 2005 (http://oxfam.org/eng/pdfs/bp76_dumping_roundforfree_050615.pdf); I. Roberts (2005) 'The Blue Box in the July 2004 Framework Agreement', Abare eReport, March 2005; Lars Brink, 'WTO 2004 Agriculture Framework: Disciplines on Distorting Domestic Support', paper delivered at the Annual Meeting of the International Agricultural Trade Research Consortium (see http://agecon.lib.umn.edu/cgi-bin/pdf_view.pl?paperid=16672&ftype=.pdf).

[3] A submission by The European Communities describes the formation of the Blue Box in similar terms in a proposal to the WTO Committee on Agriculture, 28 June 2000, 'The Blue Box and Other Support Measures to Agriculture'. See http://europa.eu.int/comm/agriculture/external/wto/document/prop3_en.pdf

[4] WTO description of the 'boxes' on its website: http://www.wto.org/english/tratop_e/agric_e/agboxes_e.htm

[5] Detail contained in 'Blue Box Support: Note by the Secretariat', WTO (TN/AG/S/14), 28 January 2005.

[6] See European Committee's proposal to the WTO Committee on Agriculture, cited above.

[7] The initial USA agriculture proposed: "to simplify the domestic support disciplines into two categories": exempt and non-exempt. See: http://www.fas.usda.gov/itp/wto/background.htm

[8] Annex A of the July Framework, WTO General Council Decision adopted 1 August 2004, (WT/L/579).

[9] See "findings and conclusions" of "United States - Subsidies on Upland Cotton - Ab-2004-5 Report of the Appellate Body", 3/3/05. see: (WT/DS267/AB/R)

[10] See Oxfam International, 'A Round for Free', 15 June 2005 (http://oxfam.org/eng/pdfs/bp76_dumping_roundforfree_050615.pdf), p. 37.

[11] Statement by Rep. Charles Stenholm, on the Floor of the House of Representatives. Congressional Record, 2 May 2002.

[12] Congressional record, Senate, 10 December 2001. Floor statement of Senate Agriculture Chairman Tom Harkin (D-IA) during debate on the Agriculture, Conservation, and Rural Enhancement Act of 2001 (page 12764).

[13] Office of the Chief Economist, 'USDA Agricultural Baseline Projections to 2013', staff report, 2004 (WAOB-2004-1). See http://www.ers.usda.gov/publications/waob041/waob20041.pdf

[14] According to the rules of the 2002 Farm Bill, farmers receiving CCPs may not switch to planting fruits, vegetables, or wild rice. In addition, the Farm Bill requires farmers 'to use the land on the farm… for an agricultural or conserving use, and not for a nonagricultural commercial or industrial use…' (sect. 1105). Interpreted broadly, this means that CCP are not really decoupled, since farmers must keep farmland in farming use.

[15] OECD 'Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005, Highlights'. See http://www.oecd.org/dataoecd/33/27/35016763.pdf

[16] J. Antón and C. Le Mouel (2003) 'Do Counter-Cyclical Payments in the FRSI Act Create Incentives to Produce?', contributed paper for the 25th International Conference of Agricultural Economists, Durban, August 2003.

[17] Barry Goodwin and Mishra Ashok, 'Are 'Decoupled' Farm Program Payments Really Decoupled? An Empirical Evaluation'. Accepted for publication in the *American Journal of Agricultural Economics*, forthcoming. Revised 28 June 2005. The study examined the period before the 2002 Farm Bill, so was not actually considering CCP, but the 'emergency payments' that CCP was based upon.

[18] ERS (Economic Research Service), US Department of Agriculture 'Counter-Cyclical Income Support Payments' athttp://www.ers.usda.gov/Features/farmbill/analysis/countercyclicalpayments2002act.htm

[19] Press Briefing by U.S. Trade Representative Robert B. Zoellick, Friday, 20 February 2004, U.S. Mission to the United Nations, Geneva, Switzerland. See http://www.ustr.gov/assets/Document_Library/Transcripts/2004/February/asset_upload_file671_5397.pdf?ht=blue%20box%20

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For further information on the issues raised in this paper please e-mail advocacy@oxfaminternational.org.

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