actionaid international

5 reasons why a comprehensive review of Green Box subsidies is required within the WTO[1]

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This should lead to a tightening of the criteria for subsidies that are eligible for green box classification

28th June 2004
Final discussion paper
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THE FIVE ARGUMENTS	
1.	**Green box 'decoupled' payments in the US distort production and trade because of wealth effects, risk reduction, planting flexibility restrictions and keeping a production history should the system change. Production has remained high.**
2.	**It is predicted that green box 'decoupled' payments in the EU will continue to distort production and trade – that high levels of production will remain with some farmers potentially treating the new payments as 'coupled'.**
3.	**The interaction with other policies (ie supplementary trade distorting amber and blue box subsidies) will have a 'coupling' effect on 'decoupled' green box payments.**
4.	**If the EU's decoupled payments were taken away, EU farming would be decimated - thus instantly challenging the assumption that they are production neutral.**
5.	**Dumping from the EU will continue.**

Purpose of this briefing and recommendation

This paper is a response by ActionAid International regarding the increased use of green box 'direct payment' subsidies by developed country members within the WTO.

One of the arguments put forward by proponents of decoupling is that by breaking the link between subsidy and production, this removes an incentive for farmers to maximise production, effectively freeing farmers to produce what the market and consumers want rather than what the subsidy regimes dictate.[2] Farmers would, for example, respond to low price market signals by

[1] This paper is a slightly longer and updated version contained within the ActionAid International briefing *The EU and Agriculture, Post Cancun* (May 2004). It incorporates comments received in late May and early June. This is the final discussion paper but has changed little from the draft of 8th June although there is an update on the WTO cotton dispute ruling on pages 4-5 and on the EU's position on the green box (footnote 10). Comments are welcome to timr@actionaid.org.uk

[2] DEFRA, 2004. Common Agricultural Policy – Reform. Department for Environment, Food and Rural Affairs. http://www.defra.gov.uk/farm/capreform/index.htm

reducing crop acreage and production. Drawing mainly on evidence from the US – where decoupled payments have been a feature of US agriculture since 1996 – and also initial reviews of the decoupled system that is about to be introduced in the EU, this briefing brings forward sufficient evidence to refute the above arguments. ActionAid would contend that such subsidies continue to distort production and trade. WTO members should demand an urgent review of all green box subsidies and this should lead to a tightening of the criteria for subsidies that are eligible for green box classification.

Introduction

The US has had decoupled green box payments since the 1996 FAIR Act and the system was changed slightly in the 2002 Farm Bill.

Table 1. US decoupled payments 1999-2002[3]

Billion $	1999	2000	2001	2002
Decoupled Payments 1996 FAIR Act	5.0	5.0	3.9	3.0
Decoupled payments 2002 Farm Bill				5.0

The EU has also spent a considerable amount of political capital within the recent 2003 CAP reforms to move some of its support out of the blue box into the green box.

The 2003 CAP reform package permitted the current EU-15 member states (and this may be extended to the newly acceding states) the option to retain some of their current coupled (blue box) payments. For example, each member state is permitted to retain up to 25% of their cereal payments as coupled whilst the remainder will have to be decoupled (green box). France, the largest cereal producer has taken up this option (see table 2) but some member states are still considering their options. What we now have within the EU – and implementation will start in 2005 - is 'partial decoupling' in some member states (of the big agricultural producers this includes France) and 'decoupling' in others (the UK and Germany).

So, as result of the CAP final agreement of 2003, it is estimated that the EU will be able to shift about 70-75% of subsidies that are currently in the blue box into the green box. Currently blue box subsidies in the EU-15 amount to about 29.4 billion euros.[4] Following the 2003 reforms, the analysis goes as follows: "*As a working hypothesis, it might be assumed that roughly half the member states will take up the option of 25% coupled payments in the arable sector, while a majority decide to retain some coupled aids in the livestock sector. It could thus be supposed that the global amount of coupled (Blue Box) aid notified post-reform in the arable sector will be at 12.5% of the pre-reform level, while the level of coupled livestock payments stands at 50% of the pre-reform volume … If these assumptions are (approximately) correct, it would cut Blue Box notifications for crops to €2.2bn and for livestock to €5.95bn, giving a total of €8.15bn – a reduction of about 75% compared with the pre-reform level.*"[5] Or put another way, for the EU-15, about 21.3 billion euros will soon fall within the green box. These assumptions are not too far off the mark although so far only one country – France – has opted for the coupled cereal option (admittedly the largest producer).

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[3] Skorburg, J., 2002. An Economic Approach to the WTO Amber Box. American Farm Bureau Federation. http://www.ifbf.org/commodity/pdf/20020718_economicapproachtowto.pdf

[4] European Parliament, 2003. Report on the proposal for a Council Regulation on Establishing Common Rules for Direct Support Schemes under the CAP and Support Schemes for producers of certain Crops. May. Rapporteur, Arlindo Cunha. Page 93.

[5] AgraEurope, 2003. A CAP reform agreement that – just about - delivers. 27th June.

Table 2: Details on the remaining 'coupled' payments by sector.

SECTOR	PERCENTAGE OF REMAINING 'COUPLED' PAYMENTS	EU-15 COUNTRIES OPTING FOR 'COUPLED' PAYMENTS (some countries – such as Spain, Italy – have yet to announce) Most countries will have implemented the reforms by 2006.
Durum Wheat	Up to 40 per cent	
Cereals	Up to 25 per cent	France
Beef	**Option 1**: up to 100 per cent of the present suckler cow premium and 40 per cent of the slaughter premium, **or** **Option 2**: either up to 100 per cent of the slaughter premium or alternatively up to 75 per cent of the special male premium	Belgium, France, Austria, Portugal Denmark, Netherlands
Sheep and goat	Up to 50 per cent	France, Portugal
Dairy	Decoupled payments to be introduced from 2005	
Cotton	Up to 35 per cent	

Sources: http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/03/898|0|RAPID&lg=EN&display= and AgraEurope, April 21st 2004.

ActionAid has consistently challenged the assertion that decoupled payments – as implemented in the US and soon to be introduced in the EU – are not trade distorting. A number of authoritative sources have commented that the continued use of green box payments have been responsible for keeping production levels at higher levels than would have been the case without them[6] whilst the OECD has stated that it is "*difficult to contend that any policy measure can be entirely production and trade neutral*."[7] Even using the OECD's less restrictive definition of decoupling – that a payment is effectively fully decoupled if production and trade does not differ from the level that would have occurred in the absence of that measure – it is increasingly clear that decoupled payments do not fall into this classification. A recent paper on decoupling by the World Bank and Cornell University led the authors to conclude that "[t]*he outcome of* [decoupling] *programs has not been encouraging. The primary motivation for decoupling is to compensate farmers with transitional assistance to free markets while at the same time making it politically palatable and transparent.'*[8] As the paper concludes, politics play an important role in the move towards decoupling. It would be politically unpalatable for Northern countries to take away all support from farmers given their political importance (and because so much of northern agriculture would be unprofitable without subsidies). In addition, governments are simply re-arranging subsidies between boxes to make them WTO compatible.

ActionAid has long proposed that all links to production – historical or otherwise – should be broken and subsidies only given on the delivery of public goods; for example, conserving the environment, supporting small-scale farmers, enhancing rural development and promoting sustainable agriculture.

[6] *AgraEurope*, 2000. US 'neutral' subsidies influence production. 20th October.
[7] OECD, 2001. Decoupling – a conceptual overview. http://www.oecd.org/dataoecd/23/51/25481500.pdf
[8] Baffes, J. and H. de Gorter, 2003. *Decoupling Support to Agriculture: An Economic Analysis of Recent Experience*. World Bank and Cornell University, second draft, May 2003. http://wbln0018.worldbank.org/eurvp/web.nsf/Pages/Paper+by+De+Gorter/$File/DE+GORTER.PDF

We believe that a comprehensive review of all green box subsidies is urgently required due to the following five interlinked reasons. Some might argue it is premature to be talking about a review when the EU has yet to implement its ‘decoupled’ scheme. But there are already severe doubts – and enough evidence – to seriously question the criteria under which some subsidies qualify for the green box. The EU, for example, has been reluctant for a review on the grounds that they are non-trade distorting and therefore should not be disciplined within the WTO.[9] But if the EU is so convinced that its green box subsidies are non-trade distorting, why this reluctance?[10] As AgraEurope states: “[A review] *gets to the heart of the confidence trick which underlies the entire agricultural subsidisation debate in the WTO.*”[11]

1. Green box ‘decoupled’ payments in the US distort production and trade

Green box ‘decoupled’ direct payments have been a feature of the US subsidy regime since 1996 when the FAIR act introduced production flexibility contracts – PFCs – which ran from 1996 to 2002. These were replaced by a similar scheme in the 2002 Farm Bill. Many believe that PFCs were not totally decoupled and distorted production for the following reasons:[12,13]

- Wealth effects; guaranteed payments were an annual flow of income that the farmer may invest in the farm operation, potentially increasing production.
- Any income that reduces income variability – and thus risk – will tend to increase output.
- The PFC programme ran from 1996 to 2002. The farmer may well have felt compelled to keep production and acreage high in case the base reference changed to more recent years. This is what happened in 2002 when the programme changed under the US Farm Bill (the Farm Security and Rural Investment Act – FSRIA).
- The payments were not totally decoupled because, whilst a farmer did not have to produce anything to receive the subsidy, the farmer was not allowed to grow certain other crops – such as fruit and vegetables – on the land. The farmer thus has an incentive to keep growing the crops that were eligible for the programme.

Whilst production estimates are difficult given the limited data available, evidence from the US on PFCs suggests that these subsidies have increased the total planted acreage.[14] The Economic Research Service (ERS) predicts that under the PFCs the area of total plantings increased by between 225,000 to 725,000 acres.[15]

The 2002 US Farm Bill replaced PFCs with ‘Direct Payments’ (DPs) and this new programme appears to be slightly more flexible but there are still limitations on planting certain crops, for example fruit and vegetables - thus casting doubts as to whether DPs are totally decoupled. This was confirmed in the recent WTO dispute settlement body’s ruling against cotton subsidies in the US. As reported by Oxfam, the ruling confirmed: “*The USA misreported certain programmes as*

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[9] AgraEurope, 2003. EU Ministers at sea on WTO future. 26th September 2003.

[10] The following is a report of a meeting between Franz Fischler with NGOs on 18th June 2004: "When asked about the EU’s position on the green-box he re-stated the EU’s incoherent approach of not wanting to change the criteria, on the one hand, but include payments for higher animal welfare standards on the other. At the same time the EU was “open” to for a review of the green-box criteria to ensure they are not trade distorting, but only if this would not result in a change of these criteria. He strongly spoke against further disciplines or a ceiling for green-box payments."

[11] AgraEurope, 2003. Lessons to be learnt from Geneva. 26th September 2003.

[12] Gardner, B., 2002. *North American Agricultural Policies and Effects on Western Hemisphere Markets since 1995, with a Focus on Grains and Oilseeds*. Department of Agricultural and Resource Economics. University of Maryland, page 18. http://www.arec.umd.edu/Publications/papers/Working-Papers-PDF-files/02-12.pdf

[13] Andrews, N., R. Nelson, S Hagi Hirad and I. Shaw, 2002a. *Grains Policies in a Global Market.* Abare Research Project, Report 02.8.

[14] Gardner, 2002. Op cit.

[15] ERS, 2000. *US Farm Program Benefits*. Economic Research Service/USDA. http://www.ers.usda.gov/publications/agoutlook/oct2000/ao275e.pdf

non-trade distorting when in fact they were. Direct payments on cotton, amounting to $617 million [2002/3], *are not minimally-trade distorting, therefore they cannot be classified as green box payments. Hence they should be re-classified as trade distorting domestic support.*"[16]

The ERS also continues to highlight some of the issues encountered under the PFCs: "*The economic impacts for DPs are similar to those for production flexibility contract payments under the 1996 Farm Act. DPs increase farm income. Since PFC payments increased producer wealth and could have facilitated additional investment, PFC payments likely led to slightly higher crop production… since producers have the option of updating base payment acres in 2002 from 1996 levels, and since new crops have been added to the program, farmers may have an incentive to continue producing crops and/or to expand production in order to maintain a production history in anticipation of future opportunities to expand payment acres.*"[17]

2. It is predicted that green box 'decoupled' payments in the EU will continue to distort production and trade

Whilst it is too early to predict with any certainty what impact the EU decoupled payments will have on production and trade (implementation will start in 2005), most, but not all, models show that it will either make little difference on current EU production levels or in fact increase production in certain sectors - ie, that the decoupled payments will continue to produce surpluses in certain sectors which have to be sold (and often dumped) onto world markets.[18] Most of these models were also conducted before the final agreement in June 2003 – see table 3 which shows four such models conducted for the European Commission[19] - but more recent modelling shows a similar trend.[20] Increased cereal production is also confirmed in an assessment conducted by the EU which showed a moderate EU-15 cereal production increase from 217 million tonnes in 2004 to 223 million tonnes in 2010 – although the Commission argues this surplus could be absorbed by internal EU demand.[21] An OECD study reveals a similar trend.[22]

In terms of specific sector studies, one of the most recent surveys was conducted in the UK dairy sector[23] and summarised by AgraEuropa:[24] "*The European Union's new direct payments for dairy*

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[16] Oxfam, 2004. *Dumping: The Beginning of the End?* http://www.oxfam.org/eng/pdfs/bp64_cotton_wto.pdf

[17] ERS, 2004. *ERS Analysis – Direct Payments.* Economic Research Service/USDA.
http://www.ers.usda.gov/Features/farmbill/analysis/directpayments2002act.htm

[18] ActionAid has been critical of the interpretation by the European Commission and EU member states that these models actually show a reduction in production, although this is how the results are often presented. The models show how production under decoupling would change in say 2009 compared to a continuation of existing policy to 2009. They do not show how production under decoupling in 2009 compares with actual production in say 2002 (which we would contend is a much more useful and valid comparison).

[19] The reader is referred to the following assessments of the EU's decoupled payments:
http://www.fapri.missouri.edu/FAPRI_Publications.htm
http://europa.eu.int/comm/agriculture/publi/reports/mtrimpact/rep_en.pdf
http://statistics.defra.gov.uk/esg/reports/decoupling/Cambridge.PDF
http://statistics.defra.gov.uk/esg/reports/decoupling/HAdSAC.PDF
http://www.dardni.gov.uk/file/con0317i.doc
http://www.defra.gov.uk/foodrin/milk/colman-harveyreport.pdf

[20] See Analysis of the 2003 CAP Reform Agreement. FAPRI. http://www.fapri.missouri.edu/FAPRI_Publications.htm September 2003. The original European Commission's proposals for CAP reform were more 'reformist' compared to that which was agreed in the final CAP agreement of June 2003. The EC's original proposal called for full decoupling but member states eventually agreed to partial decoupling. One would therefore argue that with partial decoupling, the effects on production will be even less.

[21] European Commission, 2003. *Reform of the CAP: Mid Term Prospects of Agricultural Markets and Income in the EU 2003-2010*"http://europa.eu.int/comm/agriculture/publi/caprep/prospects2003b/fullrep.pdf

[22] OECD, 2004. Analysis of the 2003 CAP Reform. Paris.

[23] Colman, D. and D. Harvey. *The Future of UK Dairy Farming*. http://www.defra.gov.uk/foodrin/milk/colman-harveyreport.pdf

[24] AgraEurope, 2004. New EU Dairy Aid Payments will Boost Milk Production. 6th February.

farmers which come into operation in 2005 are likely to act as an incentive to increased efficiency, will stimulate the consolidation and enlargement of dairy holdings – and will maintain production at current levels." The basis for this conclusion is as follows. Despite the fact that EU farmers do not have to produce anything to get the new decoupled payments, the authors assume that farmers do not respond in an economically rational manner – they are determined to remain in farming despite low returns. Their likely policy response is thus to "*treat the direct* [decoupled] *payments as coupled if that is necessary to achieve their ambitions* [ie remain in farming]".[25] It is thus expected that farmers will include the financial payments as part of their revenue, thus influencing their production decisions and potentially using the new decoupled payments to bridge the gap between low prices and higher costs of production.

Table 3: EU-15 cereal production 2002 and 2009 (after the introduction of the MTR reform proposals)[26,27,28]

		______Impact models – EU Production in 2009______					Projected EU15
	EU Production 2002 (mill tonnes)	CAPSIM	FAPRI	CAPRI	CAPMAT	Average increase	consumption 2002-07
Soft Wheat	97.2	99.9	108.2	96.5	102.2	101.9 (+5%)	+4%
Maize	40.7	42.6	42.0	38.9		41.2 (+1%)	(+2%*
Barley	48.5	47.8	51.5	50.0		49.8 (+3%)	(
Durum wheat	9.2	8.8	9.6	7.0	9.8	8.8 (-4%)	
Rice	1.5		1.8	2.9	1.2	2.0 (+33%)	+0.5%
Rye	5.4		4.7	6.0	4.5	5.1 (-6%)	

* Coarse Grains (Maize, barley, oats etc)

It is also predicted that there will be little change in the production of EU cotton under a recent agreement. In September 2003, the Commission proposed a set of reforms to the EU cotton sector that would provide producers with 60% decoupled income payments (green box) but the remainder would remain coupled to production (ie trade-distorting blue box subsidies). Member states have now agreed to this proposal with a slight modification (65% will be decoupled and 35% will be coupled).

The original cotton proposal by the Commission was severely criticised by the Dutch Ministry of Foreign Affairs: "*From the perspective of poverty reduction, this reform proposal is seriously inadequate because it will have little or no effect on the volume of subsidised cotton production within the EU, and will therefore continue to disadvantage more efficient cotton producers in many developing countries.*"[29] The slightly different agreement reached by the EU member states in April 2004 will have done nothing to allay these fears.

It is also interesting to note how some member states reached their decisions regarding whether to decouple or remain partially decoupled. France for example opted for the 25% coupled option in the cereal sector so as to maintain production levels across the country. Austria also expressed a desire to protect farm production, particularly in the beef and dairy sector (consequently it decided to only partially decouple the livestock sector) and only went with the decoupled cereal option because analyses had predicted that it would have a marginal impact on arable crop cultivation.[30]

[25] Colman and Harvey, op cit.
[26] Goodison, P. Some Critical Reflections on the Impact Assessment Studies of the CAP MTR Proposals. ERO, Brussels.
[27] European Commission, 2003d. *CAP Reform: Impact Analyses of the Mid-term Review Proposals.* http://europa.eu.int/comm/agriculture/publi/reports/mtrimpact/index_en.htm
[28] OECD, 2001. *OECD Agricultural Outlook 2001-2006*. Organisation for Economic Co-operation and Development. http://www1.oecd.org/publications/e-book/5101061E.PDF
[29] Netherlands Ministry of Foreign Affairs, 2003. Assessing the Commission's Cotton Reform Proposals from the Perspective of Development C0operation. Preliminary non-paper, October.
[30] AgreEurope, 2004. CAP Reform Methods Scrutinised. March 5th.

All this points to some governments being less interested in breaking the link between subsidies and production and producing what the market wants, and more to do with maintaining production.

A further concern of the EU system is that the reference years for the EU decoupled payments (2000-2002) are even more recent than in the US effectively tying it to recent production (most EU member states have opted for this proposal). Similar to the situation in the US, EU farmers may feel compelled to keep production high in order to have a production history in case the system changes in the future.

3. The interaction with other policies (ie supplementary trade distorting amber and blue box subsidies) will have a 'coupling' effect on 'decoupled' green box payments.

When production flexibility contracts were introduced into the US in the 1996 Fair Act, they appeared to be minimally distorting in that they were not related to current production volumes, areas or prices. However, PFCs were supplemented by massive emergency payments which were paid when prices fell: "*the provision of these emergency payments calls into question whether the production flexibility contracts themselves remain decoupled …. Farmers are still responding to government policy rather than to undistorted market prices. Consequently the system as a whole is not decoupled.*" [31]

This remains an important consideration in both the 2002 US Farm Bill and the 2003 EU CAP reform. In the former, direct payments (green box) sit along side counter cyclical payments (amber/blue box), loan deficiency payments and marketing assistance loans (amber box). In the 2003 EU Cap reform, direct decoupled payments (green box) will sit alongside direct coupled payments (blue box), price support (amber box) and export subsidies. It would thus appear impossible that green box subsidies are decoupled given the additional influence on farmers' decisions from blue and amber box support.

4. EU decoupled subsidies would fail the OECD definition of decoupling

As AgraEurope concludes:

> "*The EU is effectively asking developing countries to accept that the 30 billion euros or so which the EU is proposing to pour into the [decoupled] Single Farm Payment scheme every year… will have no real influence on agricultural production and trade. At the very least, the question could be asked whether the level of EU farm production would be affected in any way if these subsidies were no longer paid (the answer of course is that it would be decimated – thus instantly challenging the assumption that they are production neutral.)*"[32]

Why does AgraEurope come to this conclusion? It is almost certainly because so much of EU agricultural production would be unprofitable without subsidies (see section 5). Clearly, the decoupled payment scheme in the EU (also called the Single Farm Payment) does not fall within the OECD definition outlined above (page 3).

5. Dumping from the EU will continue

If the future projections for, say, increased cereal production in the EU by the European Commission and others are correct, then there is little doubt that a substantial proportion of cereal exports from 2005 will continue to be dumped despite decoupling. This is because, currently (mid 2004), many arable products are still being sold at less than the cost of production (see table 4)

[31] ABARE, 2002. Global Grains Policy and WTO Agricultural Negotiations.
[32] AgraEurope, 2003. Lessons to be learnt from Cancun. 26th September 2003.

and ActionAid would contend that decoupled subsidies are very likely to be used by EU producers – particularly in the short to medium term - to cover the continuing difference between higher costs and lower domestic and world prices.

Advocates of decoupling will argue that, in the longer-term, producers may well decide not to produce if the cost of production continues to be higher than farm gate prices and instead just keep their land in good agricultural order (but still receive decoupled subsidies). However, the study by Colman and Harvey (see above) on the future of dairy farming in the UK under a decoupled system casts some serious doubt on this assessment (in the long term, the UK dairy farming sector would consolidate and dairy holdings would get bigger). Also the evidence from US – admittedly where farming structures and operations are slightly different – would also point to the fact that the PFCs increased investment in farming operations and led to higher overall production in the long run.

Table 4: The Difference between farm and export prices in the UK and cost of production[33,34]

£/tonne	UK ex-farm price Mid May 2004	UK export prices Mid May 2004	UK cost of production 2004*
Wheat	88-95	79 (feed wheat)	105
Barley (feed)	75	78	130
Rape	200	-	240

The UK is one of the more efficient arable producers in the EU
* According to the alternative definition of dumping in Article 6 of the GATT, dumping is said to occur if the export price is less than the cost of production in the country of origin plus a reasonable addition for transportation, handling and profit. This calculation does not include these three items.

A further issue raised by the new CAP reform agreement is that some sectors – most notably dairy products, poultry meat, pig meat and fruit and vegetables - will, for the first time, get direct payments. Evidence has already shown how poultry products have been dumped in parts of West Africa due to the actions of private companies[35] but from 2005 direct payments (often called indirect export subsidies) could be used to increase the dumping of products in these sectors.

[33] Nix, J. 2003. Farm Management Pocketbook. 34th (2004) Edition. Imperial College London, Wye Campus.
[34] HGCA, 2004. Home Grown Cereal Authority web site. http://www.hgca.co.uk/
[35] Heremelin, B., 2004. Agricultural Dumping in the Chicken Sector: The Case of Western and Central Africa. In Stop Dumping: Promote Food Security. Germanwatch.