



The State of Play in the Agricultural Negotiations: Behind and Beyond the Numbers

International
Food & Agricultural Trade
Policy Council



Table of Contents:

	Page
International Policy Council Statement: Recommendations for Hong Kong.....	3
DOMESTIC SUPPORT	
Trade Distorting Support.....	6
Amber Box	6
Preliminary Assessment of Recent Doha Round Proposals for Domestic Support.....	7
De Minimis.....	10
Product-Specific Caps in the Blue Box.....	14
Green Box.....	21
EXPORT COMPETITION	
End Date.....	24
Export State Trading Enterprises.....	24
Food Aid.....	25
MARKET ACCESS	
Preliminary Assessment of Recent Doha Round Proposals for Market Access.....	27
Sensitive Products.....	31
Special Products.....	35
Preference Erosion.....	36
OTHER ISSUES	
Monitoring and Surveillance.....	40
Peace Clause.....	41

International Policy Council: Recommendations for Hong Kong

In October, proposals submitted by the United States, the European Union and the Group of Twenty on domestic supports and market access broke the logjam that was holding back the Doha agricultural negotiations. These offers dispelled the notion that countries were unwilling to show leadership on agriculture, and were welcome signs of progress. However, they were not a sufficient basis for a final agricultural agreement in the Doha Round.

Even though they were bolder than previous offers, by and large these latest proposals will not result in much, if any, reduction in actual subsidies or applied tariffs. Further progress will eventually be needed to reach a final agreement that makes real improvement in market access and real reductions in trade distorting subsidies—and that achieves a fairer, more open and less distorted global agricultural trading system.

Notwithstanding governments' inability to agree on final modalities, the International Policy Council believes that the Hong Kong Ministerial can and should move the process forward. Ministers must not lose the chance to consolidate the gains already on the table, even if further movement is needed for a final agreement in 2006. Governments cannot afford to walk away and risk losing the progress that has been made in the last fifteen months.

While it may not be possible to agree on specific numbers in Hong Kong, Ministers can make progress on the shape and the contours of the final agreement:

- **It should be possible to move further in some areas than on others in Hong Kong.** The link between the market access, domestic support and export competition is still important, but perhaps needs to be less rigid. In particular, there has been positive movement in export competition, and these gains should be consolidated. It should be possible to set a date certain to eliminate direct export subsidies and to limit export credits to 180 days, contingent on a satisfactory outcome on food aid and state trading entities. It is also possible to further elaborate the July Framework Agreement in the market access and domestic support. For example it is fairly clear from the market access offers on the table that there will be four tariff bands for tariff reductions, and that there will be a linear formula cut within each band, even though it might not be possible at this stage to specify the exact bands or reductions. There is also convergence around having three bands for domestic support reductions, and for grouping countries in those bands according to countries' absolute spending levels, even though the precise level of reductions is still subject to debate. Any elaborated framework should also spell out the areas where further negotiations are needed. The final agreement, of course, must achieve balanced progress on all three pillars: market access, domestic support and export competition.
- **The developed countries and the more advanced developing countries should commit to providing duty and quota free access to their markets for all least developed countries.** Numerous studies have shown that the biggest benefit for low income countries from agricultural trade reforms results from increased market access into developed and developing country markets.
- **The recent focus on numbers and percentages has obscured the need for clear definitions disciplines and criteria that are essential in disciplining agricultural policies.** These include disciplines on Blue Box, the implementation of product specific caps in domestic support, the criteria and the selection of Special and Sensitive Products, the approach to reducing tariff escalation, the criteria for the Green Box, etc. These are very important—especially if the actual numbers agreed in eventual modalities are not “large” in real terms. Equally important, loose definitions disciplines and criteria can create loopholes that undermine the effectiveness of even large subsidy and tariff cuts. An agreement on these issues in Hong Kong would be a positive development.
- **Ministers in Hong Kong need to once again reiterate that food should never be subject to export embargoes and restrictions.** The best way to achieve national food security is a well-functioning and open global trading system. Export embargoes and prohibitions undermine the ability and the willingness of countries to rely on the global trade system to satisfy their food security needs.

- **Developed Country Ministers in Hong Kong should commit to providing economic assistance to help developing countries take advantage of new market opportunities and to weather economic adjustments through multi- and bilateral aid agencies.** While improved market access will open opportunities for some developing countries, the reduction of domestic supports and the elimination of export subsidies will be important for others. In order to take advantage of these trade opportunities, many developing countries will need financial assistance and domestic policy reforms to create an enabling environment—including infrastructure, information and institutions—in their own countries. And, there will certainly be dislocations in some developing countries and for some people within developing countries due to trade reforms. Developed and developing country governments, bilateral and multilateral donors, need to commit to providing adjustment assistance, particularly targeted to the needs of the poorest farmers within poor countries.
- **Developing country governments, advocacy groups and policy institutes need to do a better job explaining the benefits of trade reforms to their farmers and their consumers.** Many recent analyses have suggested that developing countries will not benefit from additional market access or improved market conditions that will result from trade liberalization. This analysis needs to be put in context. Many of the economic models do not take sufficient account of the impact of trade on technological change, investment climate, and labor productivity, and underestimate the impact on countries' long term growth. Unless developed countries also reform their agriculture and trade policies, developing countries will be unable to generate the economic growth needed to lift their citizens out of poverty.
- **Equally, governments, policy makers, advocacy groups and policy institutes in developed countries need to do a better job of educating their farmers about real outcomes and realistic expectations of a Doha Round Agreement.** The political reactions among developed country farmers to the proposals emerging from Zurich demonstrate that governments have done little to prepare their farmers for the final stages of Doha negotiations. In both domestic support and market access, the levels of support and tariffs from which the Doha Round cuts will be made are quite high, relative to the actual level of support and the applied levels of tariffs existing in many countries. This means that even the large percentage reductions in subsidies and tariffs being proposed will have less impact than has been touted.
- **Stakeholders need to understand that any final agreement must contain adequate flexibilities to allow countries to ease the transition to more open, less distorted trade.** Developed country farmers need to understand that the proposed reductions in domestic subsidies affect trade-distorting subsidies. Governments can shift policies from more to less trade distorting and can continue to provide direct, uncoupled payments to farmers to mitigate economic adjustments and to facilitate transition. The Doha Round Agreement will not limit or reduce these payments. Farmers in developed and developing countries need to understand that countries can select a limited number of “sensitive” and “special” products in order to insulate producers from drastic reductions in tariffs. Developing country farmers need to understand their governments will also have access to Special Safeguard Measures and Special and Differential Treatment. It also needs to be clearly stated that the poorest countries—the Least Developed Countries—will be under no obligations under the Doha Development Round to reduce their tariffs or open their markets.
- **These flexibilities have been built into the WTO and into July Framework Agreement to allow countries to manage difficult economic and political transitions. While some flexibility is essential to reach political agreement, too much flexibility and too many exclusions and exemptions in any of these areas would undermine the benefits of the Doha Round.** In particular, too large a “carve out” for Sensitive Products risks negating all the benefits associated with improved market access. Governments also need to explain that real reductions in tariffs and in trade-distorting subsidies will be required if there is to be any agreement—or indeed any real benefits to the world's farmers. Developing countries need to see real reductions in subsidies and real improvements in market access if they are to support a final agreement. Developed country governments, political leaders, advocacy groups and policy organizations need to explain both the real impact of the proposed subsidy and tariff cuts, the options open to governments in domestic support and market access to address farmers' concerns and to manage the adjustment process and the need to make real—not paper—reductions in the level of trade distorting support provided by government policies.

The IPC released the recommendations at its 36th Plenary Session in Hanoi, Vietnam on October 31, 2005.

The statement reflects the consensus of the IPC membership but not necessarily the individual views of the members.

Introduction:

In the past few weeks, a great deal of attention has been focused on the size of the cuts proposed in domestic support and in tariffs. Rightly so. Yet the numbers in countries' proposals often bear little resemblance to their impact on actual policy measures. But, more importantly, there are many issues behind and beyond the numbers, which will affect just how effective the final Doha Development Round will be at disciplining agricultural trade policies.

The IPC has commissioned, with the support of the Hewlett Foundation, papers by leading agricultural trade experts to elucidate these issues, many of which were highlighted by Chairman of the Special Agricultural Committee Crawford Falconer (exerpts from his draft report are quoted in bold at the beginning of each section of this paper to provide context).

These papers have benefited from discussion and review by the International Policy Council membership, and have been revised to reflect the views of the International Policy Council's members. But the papers are the responsibility of the authors, and do not reflect the views of any individual International Policy Council member.

DOMESTIC SUPPORT

Trade Distorting Support

Overall Trade Distorting Support

“There is a working hypothesis of three bands for overall cuts by developed countries. There is a strongly convergent working hypothesis that the thresholds for the three bands be US\$0-10 billion, US\$10-60 billion, and US\$60+ billion. On this basis, the European Union would be in the top band, the US and Japan in the second band, and all other developed countries in the third band. For developing countries, there is a view that either developing countries are assigned to the relevant integrated band (the bottom) or that there is a separate band for them. Based on the post-July 2005 proposals, there has been an undeniably significant convergence on the range of cuts. Of course, this has been conditional. But subject to that feature, a great deal of progress has been made since the bare bones of the July 2004 Framework.” The following matrix provides a snapshot:

Bands	Thresholds (US\$ billion)	Cuts
1	0-10	31%-70%
2	10-60	53%-75%
3	> 60	70%-80%

Amber Box:

“There is a working hypothesis of three bands for developed countries. There is a close (but not full) convergence on the thresholds for those bands. There appears to be convergence that the top tier should be US\$25 billion and above. There is some remaining divergence over the ceiling for the bottom band: between US\$12 and US\$15 billion. There is a working hypothesis agreement that the EU should be in the top tier, and the US in the second tier. The basis for Japan’s placement between these two tiers has been narrowed, but remains to be fully resolved. There has been an undeniably significant convergence on the range of cuts. Of course, this has been conditional. But, that understood, a great deal of progress has been made since the bare bones of the July 2004 Framework. The following matrix provides a snapshot.

Bands	Thresholds (US\$ billion)	Cuts
1	0-12/15	37-60%
2	12/15-25	60-70%
3	>25	70-83%

For developed countries in the bottom band, with a relatively high level of AMS relative to the value of agricultural production, there is emerging consensus that their band-related reduction should be complemented with additional effort. What is needed now is a further step to bridge the remaining gap in positions regarding the US and the EU, it being understood that this is not a matter to be resolved in isolation from other elements in this pillar and beyond. On the base period for product specific caps, certain proposals (such as for 1995-2000 and 199-2001) are on the table. This needs to be resolved appropriately, including the manner in which Special and Differential treatment should be applied.”

Preliminary Assessment of Recent Doha Round Proposals for Domestic Support¹

Reductions in Domestic Support

In the Uruguay Round Agreement limits were placed on the amount of production and trade distorting (Amber Box) support. The total amount of support that could be provided under this category was defined by the Total Aggregate Measure of Support (AMS) which was agreed by each member and their Uruguay Round Agreement on Agriculture. Amounts of support that fell under the *de minimis* provisions were not counted against the Total AMS (Support specific to a given commodity that was equal to less than 5 percent of the value of production of that commodity qualified for the product specific *de minimis* exclusion. Support that was not specific to any commodity qualified for the non product specific *de minimis* if it totalled less than 5 percent of the total value of agricultural production.) The total amount of support provided under the Blue and Green Box categories of support were not limited.

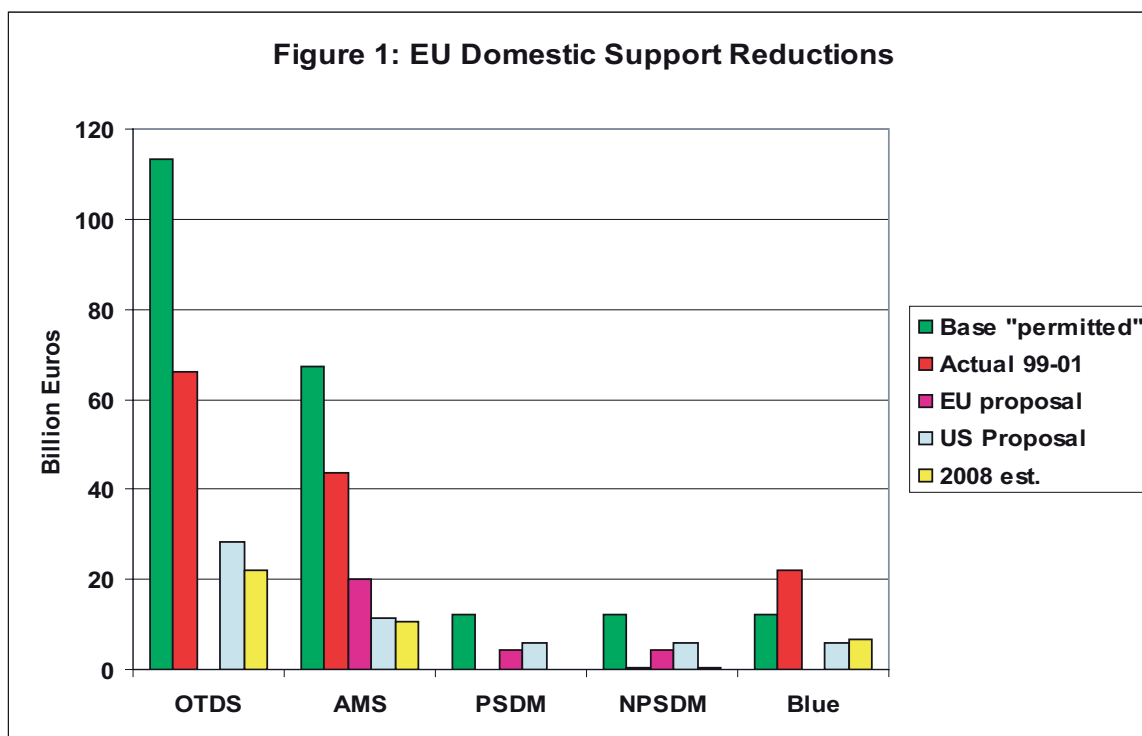
The Doha Round has adopted a more complicated approach in which limits will be placed on overall trade distorting support (OTDS) and its components. The OTDS is defined as the sum of Total AMS, Product Specific *De Minimis*, Non Product Specific *De Minimis*, and Blue Box Payments. As things currently stand it appears that reduction percentages will be applied to a base period OTDS and to each of its elements. Countries will then be obligated to conduct their agricultural policies in such a way as to stay within the new limits for the OTDS and each of its individual components.

Recent negotiating proposals by the European Union and the United States involve the following reductions:

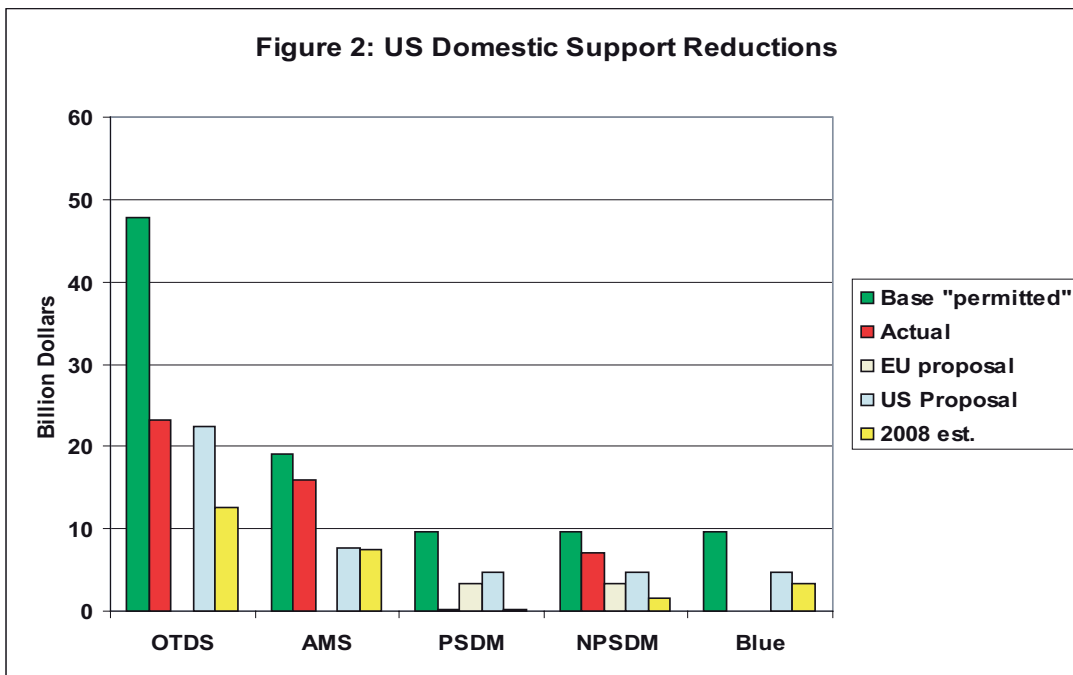
European Union – A reduction in the EU’s Total AMS of 70 percent; reductions in the *de minimis* caps from the current 5 percent to 1.75 percent of the relevant production values.

United States – A reduction in the OTDS for the European Union of 75 percent, and 83 percent in its Total AMS; a reduction of 53 percent in the OTDS for the United States and 60 percent cut in its Total AMS; *de minimis* and blue box limits set at 2.5 percent of the relevant production values.

Figures 1 and 2 summarize the implications of these proposals for the European Union (15) and the United States. In preparing the graphs it has been assumed that a base period of 1999-2001 will be used for calculating the reductions.

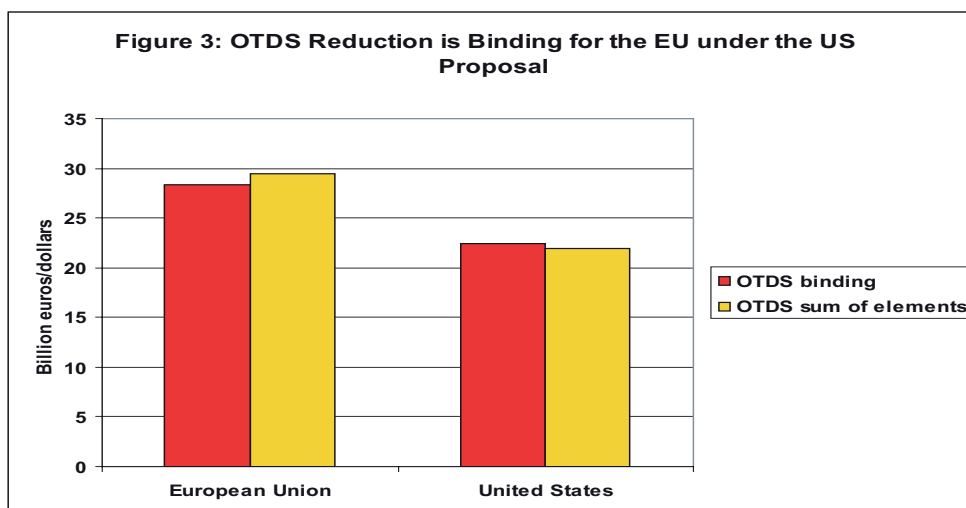


¹ Prepared on the basis of information assembled by David Blandford (Penn State Univ.), Tim Josling (Stanford Univ.), Ann Tutwiler, (IPC) and CEPII/INRA.



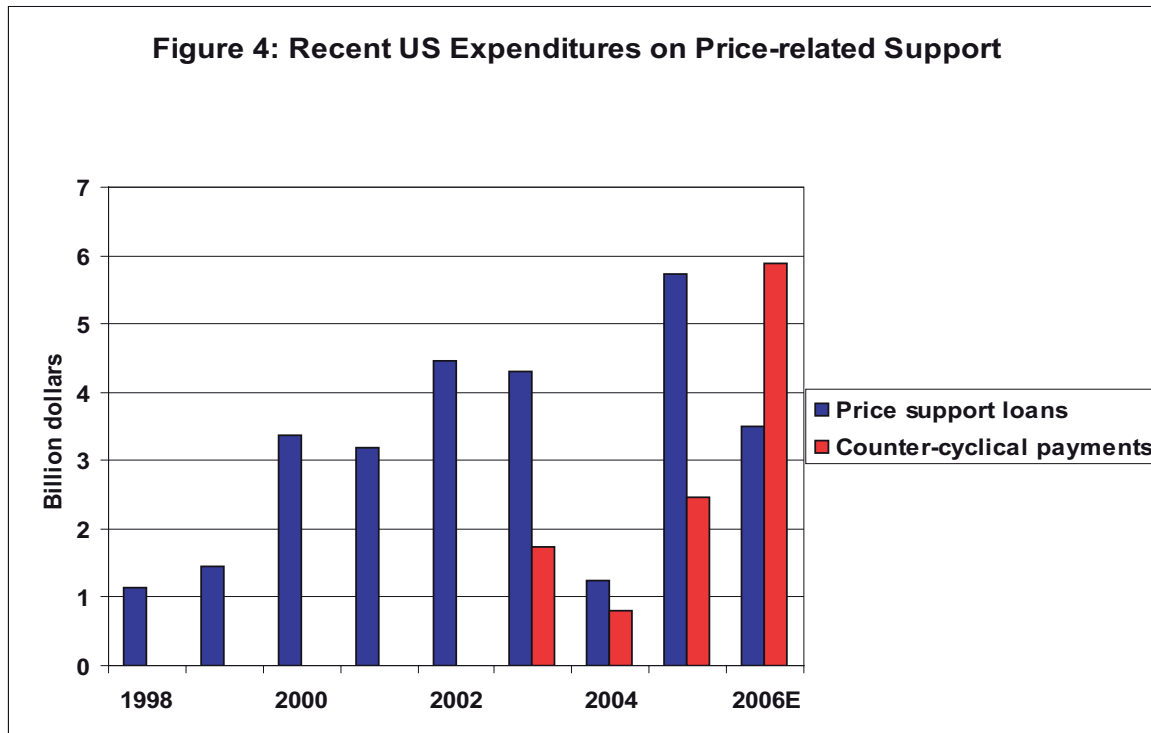
The first bar in the charts gives the base "permitted" values determined by the Uruguay Round Agreement, and specified in the July Framework Agreement. The second bar indicates the actual use of support in each category in the base period (annual average for 1999-2001 computed from country notifications to the WTO). The third and fourth bars indicate the European Union and United States proposals (where applicable). A final bar contains estimates of actual levels of support for a representative future year (2008). These estimates are subject to considerable uncertainty, but the numbers given are plausible values based on current information about policies. They are intended to provide a point of reference for assessing the possible impact of the proposals.

Although the EU and US proposals imply large reductions in the amount of support that *can* be provided to agriculture they may not have a major impact on the actual amount of support that will be provided. Recent reforms in the Common Agricultural Policy and anticipated future reforms affecting sugar and fruit and vegetables are likely to substantially reduce the amount of support that will be included in the Total AMS. As a result, the European Union should be able to meet the commitments implied by either the EU or the US proposals. Two observations are in order. First the US proposal would require the EU to reduce its overall level of support beyond the reductions required and the individual components. The US proposal would not require any further cuts in OTDS that would be required of the various components (Figure 3). That is, some additional reduction would be required in the elements of the actual OTDS to meet the reduction commitment. Since the European Union tends to use very little of its *de minimis* allowance, and could reduce this category without much difficulty, this should not pose a problem.



Perhaps of greater significance, the European Union might violate the ceiling on Blue Box payments under the US proposal. In reality this is unlikely. The expansion of the Union to 25 member countries will increase the amount of unused Blue Box credits and this should be more than sufficient to absorb the likely amount of payments.

Estimates of actual payments in the United States under average market conditions imply that it will be able to meet any commitments under its own reduction proposal. However, unlike in the European Union, where the amount of payments tends to be relatively predictable, a large share of US payments are affected by price and production variability. The potential implications of this are illustrated by Figure 4.



Annual variations in price support loans and counter-cyclical payments could cause the United States to exceed its AMS and Blue Box support ceilings, even if counter-cyclical payments are included in the Blue Box, rather than the Amber Box. If such payments are to be continued in the next Farm Bill, it might be necessary to include a “circuit breaker” under which the total amount of payments would be limited if levels under WTO commitments are approached.

As currently constituted, neither the United States nor the European Union proposals will require any substantial reductions in the Overall Level of Trade Distorting Support. However, both proposals will require the two major agricultural exporters to reduce Amber Box support below current spending levels. But, future policy reforms in the European Union mean that neither the United States nor the European Union’s proposals will require any additional Amber Box cuts beyond those envisioned in these reforms. The United States proposal might require additional cuts in the European Union’s Blue Box supports, but this is less likely because of the extended Blue Box covering the ten new member states.

Similarly, both the United States and the European Union proposals will require reductions in Amber Box support, although probably not below what is envisioned under future policy evolution in the United States. The proposed cuts in Blue Box spending will also not be difficult to meet for the United States in an “average” year. However, because United States counter-cyclical supports can vary greatly from year to year, the United States may have some problems meeting its WTO commitments in low price years.

De Minimis:²

“On product specific de minimis and non-product-specific de minimis, there is a zone of engagement for cuts between 50% and 80% for developed countries. As regards developing countries, there are still divergences to be bridged. In addition to the exemption specifically provided in the Framework, there is a view that, for all developing countries, there should be no cut in de minimis at all. Alternatively, at least for those with no AMS, there should be no cut and in any case, any cut for those with an AMS should be less than 2/3 of the cut for developed countries.”

Under WTO rules, Amber Box policies are deemed to be the most trade-distorting and are subject to the tightest disciplines in the WTO. *De minimis* support is exempt from these disciplines, as long as the level of these subsidies is below five percent of the current production value in any individual product (product specific de minimis) and the value of overall production (non product specific support). Developing countries can exempt up to ten percent of their subsidies in each of these categories.

Under *de minimis* policies, countries can exempt subsidies accounting for up to ten percent (20 percent for developing countries) of the value of production, as shown in Table 1. These levels may at first glance appear insignificant, but can actually be quite large in terms of both distorting and total support.

When compared to the total amount provided to producers via government subsidies (the Producer Subsidy Equivalent), maximum use of *de minimis* subsidies could provide countries with effective and significant exemptions from agricultural support disciplines. *De minimis* support in 2001, if used to the maximum, would have been equivalent to roughly one-third of total Producer Subsidy Equivalent (PSE) on average for OECD countries, exceeded 100 percent of the total PSE in four countries and peaked at 1,207 percent of New Zealand's total PSE (column 5 of Table 1). If countries had used the maximum allowed *de minimis*, it would have averaged 87 percent of total support provided to producers in all OECD countries in the same year.

Table 1: Maximum de minimis versus Producer Support Estimate, 2001(US\$ millions)

	Value of Production	Maximum de minimis{1}	Total PSE	Domestic Support PSE	Max. de minimis as % of:	
					Total PSE	Domestic Support PSE
	[1]	[2]	[3]	[4]	[5]= [2]/[3]	[6]= [2]/[4]
Australia	20,169	2,017	827	824	244	245
Canada	20,558	2,056	3,928	2,071	52	99
Czech Republic	3,143	314	585	351	54	90
European Community	227,413	22,741	93,083	38,793	24	59
Hungary	4,391	439	580	512	76	86
Iceland	122	12	108	61	11	20
Japan	74,737	7,474	47,243	4,755	16	157
Korea	25,194	5,039	16,838	1,202	30	419
Mexico	32,704	6,541	6,537	2,493	100	262
New Zealand	6,283	628	52	21	1,207	2,991
Norway	1,946	195	2,173	1,314	9	15
Poland	14,034	1,403	1,447	533	97	263
Slovakia	1,210	121	151	216	80	56
Switzerland	4,189	419	4,214	1,933	10	22
Turkey	25,250	5,050	3,978	1,203	127	420
United States	201,442	20,144	49,001	29,194	41	69
O.E.C.D.	662,784	74,593	230,746	85,476	32	87

[1] As defined in the WTO -- 10% of the value of production (5% PS support and 5% NPS support) and twice this for developing countries (Korea, Mexico and Turkey).

Source: OECD and WTO notifications

Although most countries have yet to fully utilize their allowed *de minimis*, for some countries, the use of *de minimis* is significant. When actual total *de minimis* levels are compared with total domestic support (Green, Blue and Amber Boxes and *de minimis*) Canada provided the equivalent of 54 percent of its support as *de minimis* in 1999, followed by the United States and Korea with about 25 percent, (column 3 of Table 2).

² Paper prepared by Harry de Gorter, Associate Professor of Economics, Cornell University, and J. Daniel Cook

Table 2: Product Specific (PS) and Non-product Specific (NPS) de minimis Support in Perspective, 1999 (US\$ millions)

Maximum allowed (5% [10%] of VoP) (1)	de minimis (exempt)								Over de minimis product specific (3)				
	Used				Unused				Value of Production (VoP) 5% of VoP for PS Support Notified		% reduction needed for AMS=0(4)		
	Total PS and NPS		PS	NPS	Total PS and NPS		PS	NPS	value	% of max de minimis			
	Value	% of Total Domestic Support	Value	Value	% of maximum allowed de minimis			Value	% of 5% of Total VoP	[12]=[11] / AMS Notified	[13]= ([1]-[11])/[1]		
[1]	[2]	[3] = [2]/TDS	[4]	[5]	[6]= (([1]-[2])/[1])	[7]= (([1]-[4])/[1])	[8]= ([1]-[5])/[1]	[9]	[10] = [9]/[2]	[11]	[13]		
European Union	12,465	493	1	183	310	98	99	98	10,954	88	40,130	79	322
United States	9,237	7,435	25	29	7,406	60	100	20	3,663	40	13,199	78	143
Japan	4,149	288	4	92	196	97	98	95	2,600	63	3,988	61	96
Korea	2,777	410	24	69	341	93	98	88	447	16	859	66	31
Mexico (2)	2,819	-	-	-	-	100	100	100	-	-	500	-	18
Canada	964	742	54	114	628	62	88	35	278	29	354	56	37

(1) PS and NPS Support are each allowed a maximum of 5% (10%) of VoP.

(2) Year is 1998.

(3) Support above the maximum de minimis level for commodities over the limit.

(4) Minimum reduction necessary for each country to remove all AMS support.

Source: WTO Country Notifications

The *de minimis* support notified to the WTO can vary greatly, with Canada notifying the equivalent of 117 percent of its total Aggregate Measure of Support as *de minimis*. Other countries provided significantly less, but still considerable amounts. The Canadian case clearly shows that *de minimis* support is providing an “escape clause” for countries to provide significant levels of trade distorting support above and beyond AMS limits. The measure of unused *de minimis* as a share of maximum *de minimis* that would be allowed more clearly shows which countries are making the least and most use of their *de minimis* exemption abilities (column 6 of Table 2). The EU, Japan, Korea and Mexico all have over 92 percent of their total allowed *de minimis* unused, while the US and Canada each have about 60 percent unused.

There is very little difference between countries in terms of unused product specific *de minimis*, while variation between countries was more prevalent for non-product specific support. All six countries analyzed use non-product specific *de minimis* support more extensively than product specific (column 7 v. column 8). The United States used all but 20 percent of its non-product specific *de minimis* and Canada used all but 35 percent, leaving the other four countries with at least 88 percent of non-product specific *de minimis* unused. The European Union and Canada were the largest users of product specific support in actual terms. The US is both the smallest user of product-specific support and largest user of non-product specific support. To date, most countries use very little of their *de minimis* compared to what they are allowed. This means that there is substantial room for these countries to increase the use of *de minimis* support, if cuts in other categories of support are too large.

If the total Aggregate Measure of Support ceiling is reduced sharply over time, countries can shift support into other boxes, increase support provided through product specific *de minimis* subsidies or shift support toward non-product specific support. The United States is the only country using a majority of its non-product specific *de minimis* and no country currently includes any non-product specific in their AMS. It is therefore plausible that countries could raise such non-product specific support to the maximum allowed. Countries would have the option of increasing *de minimis* support, if current policies are below *de minimis* levels, or shifting support from product to non-product specific, in cases where product specific support is above the permitted *de minimis* level (Most countries do not have an AMS commitment, only de minimis commitments. Therefore these countries, mostly developing, can only use the first method).

The countries facing the most difficulty reducing support to meet their future reduction commitments will be those with high levels of product specific de minimis support. If a country reaches its product specific *de minimis* value, that total value of that support is added to the country’s AMS levels. Table 2, column 10 shows the maximum allowed *de minimis* for those commodities where countries’ allowed *de minimis* has been exceeded. The EU and Japan will have a hard time reducing their Amber Box subsidies by shifting support into the *de minimis* box, since nearly 88 and 63 percent (respectively) of their allowed maximum *de minimis* is already being used.

Not all commodities will face the same challenges undergoing liberalization. Countries will try to maintain support for those commodities facing the greatest political pressures as long as possible. While product-specific caps on Amber Box support proposed in the July Framework Agreement will help, reduction commitments

on only the aggregated level of product specific support and the use of the *de minimis* exception will allow subsidy peaks to remain. As with tariff peaks, the average level of domestic support underestimates what is actually happening. A few commodities receive a bulk of the support, while most commodities receive little support or none at all. Without disciplines on specific commodities within all components of the Amber Box, these subsidy peaks are likely to continue or even become more prevalent as support to other less vulnerable commodities is decreased.

The October Proposals

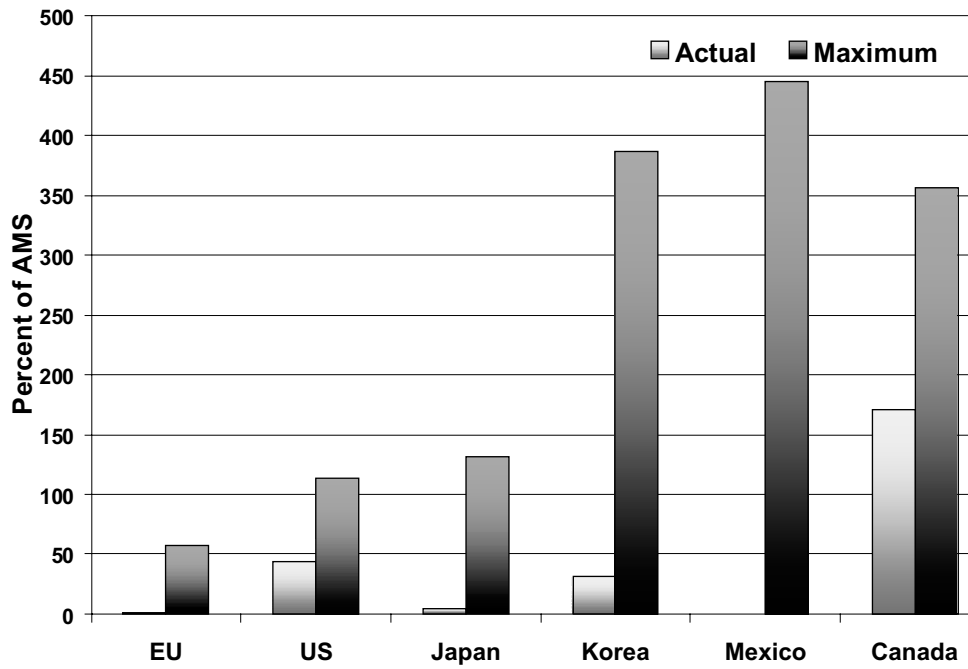
As with the proposed reductions in Overall Trade Distorting Support and total Aggregate Measures of Support, there is a wide gap between the permitted level of *de minimis* support and the actual level of support. Therefore, the lower ceilings being proposed are unlikely to have any impact on actual policy—for several reasons.

- Proposed cuts are from the maximum permitted levels for *de minimis*—*not the actual levels of support*. This alone dilutes the disciplines. The permitted level of *de minimis* support (10 percent of the value of production—5 percent each for product- and non-product-specific) is a large number by itself. The maximum allowed *de minimis* alone would have averaged one-third of the Producer Support Estimate for OECD countries in 2001 and nearly 90 percent of the domestic-support component of the Producer Subsidy Equivalent (defined as total support less border support).
- Most countries do not fully utilize their allowed *de minimis*, so they could increase subsidies provided through the *de minimis* category. When actual total *de minimis* levels are compared with total domestic support (green, blue and amber boxes and *de minimis*) Canada provided roughly one third of its support as *de minimis* in 1999, while the United States provided one fifth of its support via *de minimis* policies.
- Countries' ability to shift support between categories of support further weakens any disciplines on *de minimis*. Under the Uruguay Round Agreement, lax criteria allowed countries to move support toward undisciplined or less constrained categories. For example, the United States declared its new emergency crop subsidies of 1998–2001 as non-product-specific *de minimis* support even though they were based on specific product prices. The move arguably allowed the United States to avoid breaching its ceiling on Amber Box support.

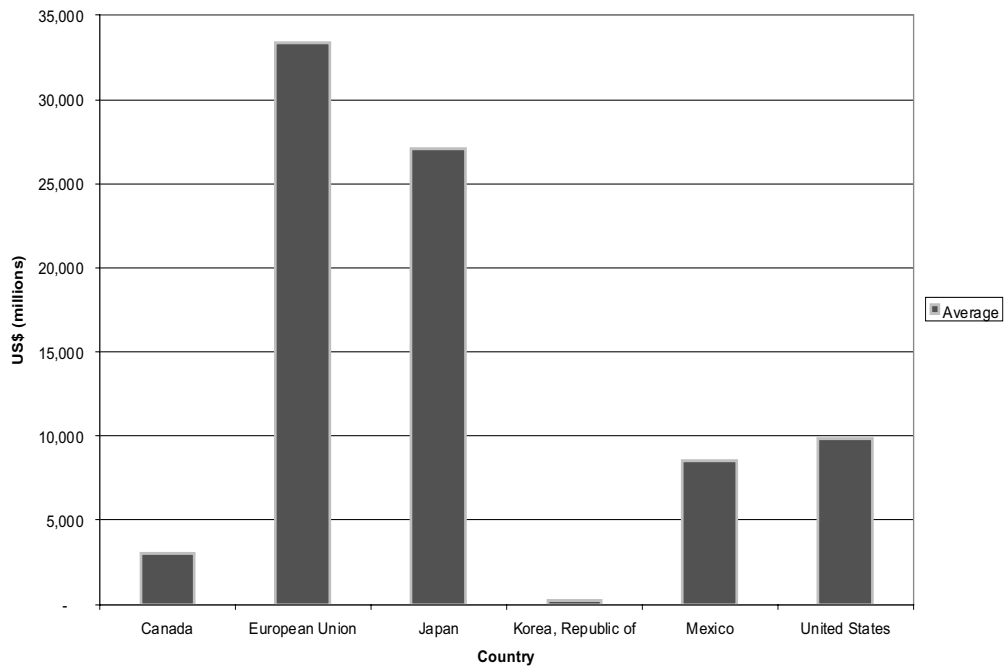
However, current use of *de minimis* support is quite significant for some countries, and deep cuts in allowed *de minimis* levels would constrain policy options or force policy reforms. In Canada, for example, current levels of *de minimis* exceed the notified total Amber Box support by more than 40 percent (Table 2). In the United States, *de minimis* support accounts for almost half of total notified Amber Box support. (This is mainly because the United States has classified the counter-cyclical payments in the *de minimis* box). The European Union uses nearly 88 percent of its allowed maximum *de minimis*, is already exceeded and so is counted towards its Amber Box support.

In October 2005, the United States proposed cutting *de minimis* levels in half, to 2.5 percent. Analysis indicates that a 50 percent reduction, for each *de minimis* category, would constrain non-product-specific *de minimis* support in the United States and Canada. The United States would be required to reduce non-product-specific *de minimis* support by \$2.36 billion. Canada will be required to cut non-product-specific *de minimis* support by \$189 million.

Actual vs Maximum De Minimis Support as a Share of Countries Domestic Support



Average Unused AMS for Notified Years



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Further Reading

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Product-Specific Caps in the Blue Box³

"There is important and significant convergence on moving beyond (i.e. further constraining) Blue Box programme payments envisaged in the July 2004 Framework. However, the technique for achieving this remains to be determined. One proposal is to shrink the current 5% ceiling to 2.5%. Another proposal rejects this in favor of additional criteria disciplining the so-called "new" Blue Box only. Others favor a combination of both, including additional disciplines on the "old" Blue Box."

The creation of a New Blue Box, if not accompanied by strict and detailed rules that guarantee that it is significantly less trade distorting than the Amber Box, contradicts the WTO's goal of promoting increasingly open, fair and undistorted competition. It is crucial at this stage of the negotiations to develop firm disciplines for the implementation of a New Blue Box.

When created in the Uruguay Round, the Blue Box was needed to accommodate the EU's CAP reforms. It excluded significant portions of trade distorting domestic support from reduction commitments, and allowed countries to undertake cuts in Amber Box subsidies that did not require adjustments in the form or level of existing practices.

In the Doha Round, countries are on the verge of creating yet another category of trade distorting support, custom made to accommodate the domestic policies of the United States. This is especially worrisome if the New Blue Box is more trade distorting than the Old Blue Box, because it no longer requires farmers to idle productive resources. As the US plans to use the New Blue Box to accommodate some of the subsidies now declared as non-product specific *de minimis* (in order to avoid the US limit on Amber Box subsidies) enhanced disciplines are needed to ensure that the New Blue Box is less trade distorting.

Additional disciplines should be considered to ensure that the new Blue Box is less trade distorting than the Amber Box and the Old Blue Box. New Blue Box payments could be subject to product specific caps (similar to those imposed on Amber Box support) to avoid the accumulation of high levels of support on a limited number of products, and to prevent the extension of support to products that were previously not heavily subsidized. Product specific caps can be established in at least four different ways.

³This section is part of a broader paper on Blue Box Criteria, by Mario Jales (ICONE), commissioned by the IPC.

- Blue Box spending on a given product could be limited to a share of its domestic production value. A cap set at 10% of the value of production would require significant reductions in the support to cotton, peanuts, rice and wheat in the United States. A cap of 20% would require spending cuts only on rice. In the EU, a cap of 10% would require substantial cuts on current Blue Box spending for all products, except rice. A 20% cap would require cuts on barley, corn, ewes and goats, oats, oilseeds and wheat. However, with the introduction of the Single Farm Payment, the EU is shifting support away from the Blue Box to the Green Box, and might find it easier to implement product specific caps than these figures might suggest.
- Product Specific caps could be established in relation to the average level of Blue Box spending during a reference period, such as the Uruguay Round implementation period. Tables 2A and 2B show the average expenditure levels in the US and the EU. In the US, this approach would restrict Blue Box payments on corn to 7.5% of its production value, on wheat, cotton and peanuts to 13% - 15% of production value, and on rice to over 27%. In the EU, the resulting caps would range from 9% (rice) to 122% (durum, wheat) of average production value in 1995-2001. This would leave substantial differences in level of support across commodities.

For all products except rice and beef, capping payments as a percentage of production value would be more restrictive than capping payments based on a historical reference period. However, capping payments based on a reference period results in static payments that do not allow for increased support, as production values rise. Capping payments based on a reference period also does not necessarily constrain support to products that did not benefit from support during the reference period. Nor does it facilitate the migration of policies from Amber to Blue Box. If the New Blue Box is truly less trade distorting, then such a shift should be encouraged, not constrained.

- Caps could be established on the combined level of Amber and Blue Box expenditures during a reference period. As the Doha Mandate calls for substantial reductions in trade distorting domestic support, a cut of 50% could be applied to the average level of combined Amber and Blue Box support per product. (Tables 3A and 3B) In the US, this approach would be more restrictive than either approach described above for barley, corn, oats and sorghum. However, it would be less restrictive in relation to important commodities such as cotton, peanuts, rice and wheat. In the EU, this approach is less restrictive for all products than is capping support as a percentage of production value.
- Product specific spending could be limited to a certain share of total Blue Box support in a given year. This limit could supplement any of the approaches already described. A limit could be set on the total value of production (10% or 20% of total Blue Box spending) in addition to a limit on every single product specific cap of, say, 20% in a given year (Tables 4A and 4B). Using these combined approaches, the US would have to constrain payments to corn, cotton, soybean and wheat growers. The combined approach would have no additional impact on the EU.

Table 5A and 5B compare these four approaches for key commodities in the United States and the European Union.

**Blue Box Payments and Other Payments in the Proposed New Blue Box
as a Percentage of the Value of Production
(1995 - 2003)**

Table 1A: US

Product	1995	1996	1997	1998	1999	2000	2001	2002	2003	1998-2003 average
Barley	15%	-	-	0%	0%	0%	0%	0%	0%	0%
Corn	13%	-	-	7%	15%	14%	11%	0%	1%	8%
Cotton	12%	-	-	7%	14%	12%	14%	36%	7%	15%
Oats	4%	-	-	0%	0%	0%	0%	0%	0%	0%
Peanuts	-	-	-	-	-	-	-	27%	13%	20%
Rice	34%	-	-	14%	38%	44%	43%	34%	8%	30%
Sorghum	23%	-	-	0%	0%	0%	0%	0%	0%	0%
Soybeans	-	-	-	-	-	-	-	0%	0%	0%
Wheat	22%	-	-	11%	26%	25%	22%	0%	0.4%	14%

*For peanuts and soybeans, average is for 2002-2003 only.

(-) indicates that Blue Box (or New Blue Box compatible) payments were not applicable.

1995: Deficiency Payments.

1998-2001: Marketing Loss Assistance (MLA) Payments, formally notified as non-product-specific *de minimis* support.

2002-2003: Counter-Cyclical Payments (CCP), not yet notified.

Sources: US Notifications to the WTO; US Commodity Credit Corporation (CCC).

Table 1B: EU

Product	1995	1996	1997	1998	1999	2000	2001	1995-2001 average
Barley	56%	54%	55%	56%	59%	64%	77%	60%
Beef	17%	17%	15%	15%	15%	18%	24%	17%
Corn	20%	22%	23%	26%	23%	33%	39%	27%
Ewe and goats	37%	24%	28%	41%	46%	36%	13%	32%
Oats	66%	58%	58%	61%	65%	67%	74%	64%
Oilseeds	89%	90%	72%	62%	44%	73%	64%	71%
Rice	0%	0%	5%	10%	17%	19%	15%	9%
Wheat, common	52%	50%	50%	52%	56%	60%	76%	56%
Wheat, durum	109%	106%	107%	95%	116%	174%	186%	128%

1995-2001: Exempt Direct Payments (based on fixed area/yields or on 85% or less of the base level of production).

Sources: EU Notifications to the WTO; OECD.

Table 2A
US: Average Expenditures on Payments that Could Be
Compatible with the Proposed New Blue Box (1998 - 2003)
(US\$ million)

Product	1995	1996	1997	1998	1999	2000	2001	2002	2003	Average support	Average prod value	Support / prod value
Barley	151	-	-	0	0	0	0	0	0	0	646	0%
Corn	3,009	-	-	1,308	2,544	2,545	2,157	0	339	1,482	19,782	7.5%
Cotton	901	-	-	316	613	613	524	1,312	393	629	4,498	14.0%
Oats	12	-	-	0	0	0	0	0	0	0	195	0%
Peanuts	-	-	-	-	-	-	-	161	98	130	896	14.5%
Rice	511	-	-	238	464	464	398	318	124	334	1,222	27.4%
Sorghum	320	-	-	0	0	0	0	0	0	0	915	0%
Soybeans	-	-	-	-	-	-	-	0	0	0	14,004	0%
Wheat	2,127	-	-	745	1,445	1,444	1,223	0	28	814	6,215	13.1%

*For peanuts and soybeans, average is for 2002-2003 only.

(-) indicates that Blue Box (or New Blue Box compatible) payments were not applicable.

1995: Deficiency Payments

1998-2001: Marketing Loss Assistance (MLA) Payments, formally notified as non-product-specific *de minimis* support.

2002-2003: Counter-Cyclical Payments (CCP), not yet notified.

Sources: US Notifications to the WTO; US Commodity Credit Corporation (CCC).

Table 2B
EU: Average Blue Box Expenditures
and Average Production Values (1995 - 2001)
(EUR million)

Product	1995	1996	1997	1998	1999	2000	2001	Average support	Average prod value	Support / prod value
Barley	3,202	3,655	3,413	3,159	3,194	3,399	3,810	3,405	5,720	60%
Beef	3,877	3,321	3,081	2,990	2,930	3,948	5,028	3,596	20,613	17%
Corn	973	1,223	1,213	1,182	1,159	1,486	1,614	1,264	4,862	26%
Ewe and Goats	1,321	1,007	1,171	1,536	1,734	1,449	554	1,253	3,950	32%
Oats	473	531	477	422	433	481	536	479	751	64%
Oilseeds	2,381	2,439	2,369	2,264	1,318	1,984	1,846	2,086	2,987	70%
Rice	0	0	41	81	124	113	113	67	785	9%
Wheat, commo	5,888	6,320	5,684	5,757	5,826	6,294	6,808	6,083	10,914	56%
Wheat, durum	1,449	1,686	1,495	1,557	1,550	1,703	1,873	1,616	1,325	122%

1995-2001: Exempt Direct Payments (based on fixed area/yields or on 85% or less of the base level of production).

Sources: EU Notifications to the WTO; OECD.

Table 3A
US: Combined New Blue Box Compatible and Amber Box Expenditures (1995 - 2001)
(US\$ million)

	1995	1996	1997	1998	1999	2000	2001	Average support	50% of avg support	Average prod value	Support / prod value
Barley	152	1	4	84	40	70	16	52	26	646	4.1%
Corn	3,041	28	150	2,841	5,098	5,301	3,426	2,841	1,420	19,782	7.2%
Cotton	933	3	466	1,251	2,966	1,662	3,334	1,517	758	4,498	16.9%
Oats	12	0	0	20	31	45	4	16	8	195	4.1%
Peanuts	415	229	306	340	349	438	305	340	170	896	19.0%
Rice	523	6	6	259	899	1,088	1,161	563	282	1,222	23.0%
Sorghum	321	1	2	63	154	84	6	90	45	915	4.9%
Soybeans	16	14	45	1,275	2,856	3,606	3,610	1,632	816	14,004	5.8%
Wheat	2,132	8	36	1,260	2,419	2,292	1,413	1,366	683	6,215	11.0%

Sources: US Notifications to the WTO; US Commodity Credit Corporation (CCC).

New Blue Box compatible measures include Marketing Loss Assistance (MLA) Payments in 1998-2001 (formally notified as non-product-specific *de minimis* support) and Counter-Cyclical Payments (CCP) in 2002-2003 (not yet notified).

Table 3B
EU Combined Blue Box and Amber Box Expenditures (1995 - 2001)
(EUR million)

	1995	1996	1997	1998	1999	2000	2001	Average support	50% of avg support	Average prod value	Support / prod value
Barley	5,449	6,339	6,116	5,845	5,734	5,594	5,450	5,790	2,895	5,720	51%
Beef	17,838	17,108	16,606	16,366	16,019	15,139	14,736	16,259	8,129	20,613	39%
Corn	1,759	2,159	2,258	2,134	2,162	2,193	1,993	2,094	1,047	4,862	22%
Ewe and Goats	1,321	1,007	1,171	1,536	1,734	1,449	554	1,253	626	3,950	16%
Oats	484	544	490	434	444	466	466	475	238	751	32%
Oilseeds	2,381	2,439	2,369	2,264	1,318	1,984	1,846	2,086	1,043	2,987	35%
Rice	507	540	552	519	517	506	509	522	261	785	33%
Wheat common	8,481	9,283	8,545	8,847	8,749	8,565	8,045	8,645	4,323	10,914	40%
Wheat durum	1,247	1,923	1,705	1,327	1,332	1,364	1,490	1,484	742	1,325	56%

Sources: EU Notifications to the WTO; OECD.

Table 4A
US: The Impact of Product-Specific Caps Set at 20% of Total
Blue Box (or New Blue Box Compatible) Expenditures (1995 - 2003)
(US\$ million)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total exp	7,030	-	-	2,811	5,468	5,463	4,640	3,587	1,203
Cap at 20%	1,406	-	-	562	1,094	1,093	928	717	241
Barley	137%	-	-	82%	183%	168%	173%	116%	31%
Corn	6%	-	-	3%	6%	6%	5%	3%	1%
Cotton	19%	-	-	12%	25%	22%	24%	20%	4%
Oats	529%	-	-	281%	624%	622%	474%	342%	113%
Peanuts	n/a	-	-	50%	112%	122%	93%	119%	31%
Rice	93%	-	-	33%	89%	104%	100%	76%	16%
Sorghum	100%	-	-	62%	117%	129%	95%	86%	24%
Soybeans	10%	-	-	4%	9%	9%	7%	5%	1%
Wheat	14%	-	-	8%	20%	19%	17%	13%	3%

(-) indicates that Blue Box (or New Blue Box compatible) payments were not applicable.

1995: Deficiency Payments

1998-2001: Marketing Loss Assistance (MLA) Payments, formally notified as non-product-specific *de minimis* support.

2002-2003: Counter-Cyclical Payments (CCP), not yet notified.

Sources: US Notifications to the WTO; US Commodity Credit Corporation (CCC).

Table 4B
EU: The Impact of Product-Specific Caps Set at 20% of
Total Blue Box Expenditures (1995 - 2001)
(EUR million)

	1995	1996	1997	1998	1999	2000	2001
Total exp	20,846	21,521	20,443	20,504	19,792	22,223	23,726
Cap at 20%	3,127	4,304	4,089	4,101	3,958	4,445	4,745
Barley	55%	64%	66%	73%	73%	83%	96%
Beef	14%	21%	20%	21%	20%	21%	22%
Corn	64%	77%	77%	89%	79%	98%	116%
Ewe and Goats	87%	104%	98%	109%	105%	109%	114%
Oats	436%	469%	497%	597%	596%	614%	656%
Oilseeds	117%	158%	124%	112%	134%	163%	164%
Rice	413%	450%	460%	525%	526%	748%	622%
Wheat, common	28%	34%	36%	37%	38%	42%	53%
Wheat, durum	235%	271%	293%	250%	296%	455%	472%

1995-2001: Exempt Direct Payments (based on fixed area/yields or on 85% or less of the base level of production).

Sources: EU Notifications to the WTO; OECD.

Table 5A
US: Comparison of Results Obtained through Different Approaches
(product-specific cap as a percentage of production value)

	Approach 1	Approach 2	Approach 3	Approach 4
Barley	10%	5%	4%	31%
Corn	10%	7%	7%	1%
Cotton	10%	14%	17%	4%
Oats	10%	5%	4%	113%
Peanuts	10%	14%	19%	31%
Rice	10%	27%	23%	16%
Sorghum	10%	5%	5%	24%
Soybeans	10%	5%	6%	1%
Wheat	10%	13%	11%	3%

Sources: US Notifications to the WTO; US Commodity Credit Corporation (CCC).

Table 5B
EU: Comparison of Results Obtained through Different Approaches
(product-specific cap as a percentage of production value)

	Approach 1	Approach 2	Approach 3	Approach 4
Barley	10%	60%	51%	96%
Beef	10%	17%	39%	22%
Corn	10%	26%	22%	116%
Ewe and Goats	10%	32%	16%	114%
Oats	10%	64%	32%	656%
Oilseeds	10%	70%	35%	164%
Rice	10%	9%	33%	622%
Wheat common	10%	56%	40%	53%
Wheat durum	10%	122%	56%	472%

Sources: EU Notifications to the WTO; OECD.

Another way to limit the trade distorting potential of the New Blue Box would be to limit the price gap that could be compensated by Blue Box measures. Under the Old Blue Box, farmers were required to idle land (or constrain animal numbers) to qualify for support. These supply controls offset to some degree the level of trade distortion caused by the Blue Box support. If supply controls are no longer to be required for the receipt of Blue Box payments, then limiting the amount of price compensation could also offset, to some degree, the trade distorting impact.

Green Box⁴

“The review and clarification commitment has not resulted in any discernible convergence on operational outcomes. There is on the one side a firm rejection of anything that is seen as departing from the existing disciplines while there is on the other an enduring sense that more could be done to review the Green Box without undermining ongoing reform. Beyond that, there is however, some tangible openness to finding appropriate ways to ensure that the Green Box is more “development friendly” i.e. better tailored to meet the realities of developing country agriculture but in a way that respects the fundamental requirement of at most minimal trade distortion.”

The July Framework is explicit on the issue of reviewing the criteria for policy payments to come under the Green Box:

Green Box criteria will be reviewed and clarified with a view to ensuring that Green Box measures have no, or at most minimal, trade-distorting effects or effects on production. Such a review and clarification will need to ensure that the basic concepts, principles and effectiveness of the Green Box remain and take due account of non-trade concerns. The improved obligations for monitoring and surveillance of all new disciplines foreshadowed in paragraph 48 below will be particularly important with respect to the Green Box.

However, relatively little negotiating effort has been put into this aspect of the talks. But a review and clarification of Green Box criteria will be needed as a part of a broader package, and a hasty “last minute” deal on the Green Box definition could undermine the clarity of the URAA agricultural subsidy classification and lead to years of controversy on the consistency of the regulation of domestic support payments.

The October proposals of the US, the EU and the G-20 demonstrate the lack of engagement on this issue. The US proposal says that there should be no substantial change in the Green Box criteria, and no cap on the level of Green Box support. The EU proposal makes no mention of the issue at all, but presumably the European Union holds to its earlier view that the Green Box should remain in its present form and not be capped or subject to reduction. The EU had indicated in its earlier proposals that the eligibility of certain payments for animal welfare and environmental objectives as Green Box measures be confirmed, but it is not clear whether the EU is proposing to put this in the form of a revision to the Green Box criteria or leave it as a tacit understanding.

By contrast, the G-20 has been explicit about what changes it would like to see in the Green Box. Its ideas were first elaborated in a document entitled “Review and Clarification of Green Box Criteria” (G20/DS/Greenbox, 02/06/05). In the October proposal from the G-20 this document was referenced though no new suggestions were offered.

The main issues that have confronted negotiators in this area are (issues of monitoring and sheltering Green Box payments are dealt with below):

- Are the basic concepts behind the Green Box sound?
- Can the Green Box accommodate non-trade concerns?
- Can the Green Box accommodate developing country concerns?

Side issues that have emerged as a result of experience with the URAA include:

- Should the Green Box criteria specifically exclude payments dependent on keeping land in agricultural uses?
- Should the Green Box criteria restrict the updating of bases on direct payments?
- Should the Green Box criteria clarify the extent to which restrictions on production of other products affect eligibility?

The G-20 “Review and Clarification” paper supports changes that would address many of these issues. The paper expresses concern not so much with the concept of the Green Box as with its contents. From the G20 perspective, the major problem with the Green Box as currently defined is that it includes both “direct payments”

⁴ Paper prepared by Tim Josling, Professor, emeritus, at the Food Research Institute at Stanford University

used to compensate farmers for the removal of price supports, and “public good payments” that encourage farmers to provide benefits to society other than their marketed output. The G-20 argues that the direct payments are not truly production-neutral, and presumably should be in the Amber Box. But moving any Green Box payments into the Amber Box would be unacceptable to the EU and the US, as the policies of these countries have been geared toward moving into such policies. So the G-20 has focused on modifying the Green Box criteria to minimize the wealth and the insurance effect of direct payments even when they are not tied directly to price or output (Economic analysis suggests that such payments can have output-increasing effects. However, the magnitude of these effects is still debated and is likely to be very specific to the circumstances of a particular program and crop).

There is less controversy now than at the beginning of the negotiations to including subsidies designed to address non-trade concerns in the Green Box in part because those pushing for wider recognition of these concerns no longer advocate addressing them through border measures (Of course the provision for Sensitive Products and Special Products in the Market Access talks has provided a home for many of the non-trade concerns). The provision of public goods through Green Box measures does not contribute significantly to trade distortions, though some exporters still question the apparently open-ended nature of this provision (Ironically, the output effect of some subsidies designed to address non-trade concerns may be larger than those associated with wealth and other effects of decoupled policies. Joint production of the public and the private good is quite likely to be common). The EU’s intention to find space in the Green Box for payments aimed at helping farmers change their farming practices to be more animal or environment friendly has raised some concerns in this regard. But as the Harbinson draft (March 2003) included provision for these items, and because the G-20 has not suggested language that would exclude these items, it seems reasonable to assume that they will be incorporated in the Green Box.

The applicability of the Green Box to developing countries is an extension of the broader debate about a “development box,” a safe haven for development policies that might otherwise seem to violate WTO rules. But the G-20 paper restricts its suggestions to additions to the text of Annex 2 to make it clear that certain policy instruments common in developing countries (and not markedly trade distorting) are included. Such changes may well be agreed by developed countries as they do not change the reality of the situation greatly.

Regarding specific issues that have arisen based on the experience of the Uruguay Round implementation, the G20 paper suggests several changes of wording. These proposed changes would constrain direct payments by eliminating the requirement that land be kept in agricultural use and by preventing countries from modifying payments to farmers by allowing them to update the basis on which those payments are made. The first change is primarily an extension of the existing provision that “no production be required in order to receive [direct] payments.” The new provision would add the phrase that “land ... shall not be required to be in “agricultural use.” Though the logic behind this change is impeccable, its political acceptability is in doubt. The prospect of the desertification of agricultural regions and the abandonment of farming still concern governments, particularly in Europe. In that case one could argue that there is some “public good” benefit to subsidies that keep agriculture viable. So the rationale for a subsidy tied continued agricultural production could shift from farm income support to rural amenity provision and still be in the Green Box.

On direct support payments, the G-20 paper suggests that decoupled income support be targeted to low income farmers and be tied to a fixed and unchanging base period. The paper also proposes limits on direct payments where Amber Box and Blue Box payments exceed a percentage of the value of production (There would also be a provision added that precludes investment subsidies from being related to production in any year after the fixed and unchanging base year). The argument to fix the base is entirely within the spirit of the current rules and could prevent farmers from planting in anticipation of changes in government policies and payments. But any attempt to cap the Green Box is much less likely, and runs counter to the spirit of the WTO nomenclature. Such a change would make it more difficult for governments to undertake policy reforms that are less trade distorting, if the scope for shifting policies out of Blue and Amber Box subsidies were limited. Any capping of the Green Box would be seen as setting trade rules in contradiction to the broadly desirable trends in domestic agricultural policies in the past two decades.

The US Cotton Panel Report poses an additional challenge to those contemplating revisions to Green Box rules, raising questions about whether past US Green Box notifications should be challenged, and whether these rules needed to be clarified in the Doha Round (The EU has an interest in this issue, as a similar provision

is contained in direct payments under the CAP). The panel ruled restricting farmers from growing fruits and vegetables on acres eligible for direct payments was inconsistent with the Green Box definition, even though the direct payments themselves did not cause serious prejudice to other countries. The fruit and vegetable exclusion (used both by the United States and the European Union) is clearly a political decision to prevent land moving into those activities from arable crops (In effect it is an indirect subsidy to fruit and vegetable producers by restricting entry.) As such it does violate the strict definition of a system of decoupled payments and unrestricted production decisions. But if the panel decision is taken into account by governments in their notifications in the future, and if it is also taken as a guide by any future panels looking into domestic support challenges, no rule changes are needed. It seems unlikely that countries would agree to make such payments ineligible for the Green Box.

EXPORT COMPETITION

End Date⁵

“While concrete proposals have been made on the issue of an end date for elimination of all forms of export subsidies, there is at this stage no convergence. There are suggestions for the principle of front-loading or accelerated elimination for specific products, including particularly cotton.”

Export subsidies have been banned since the early days of the GATT because they are the most directly trade distorting. So, even though economic analysis indicates that the gains from eliminating export subsidies might be small, it is important not to underestimate the impact that elimination will have on the political dynamic of the negotiations. Because the GATT (WTO) have long banned export subsidies on non-agricultural goods, a strong argument could be made for a relatively rapid phase-out of these measures. At a minimum, there is a strong case for a down payment in export subsidy cuts, along the lines of that made for domestic subsidies in the July Framework Agreement. Such a down payment should be across all commodities—to spread the benefits and the costs most widely- but the down payment should be made from actual expenditures and actual volumes.

Export State Trading Enterprises⁶

“There has been material convergence on rules to address trade-distorting practices identified in the July 2004 Framework text, although there are still major differences regarding the scope of practices to be covered by any new disciplines. Fundamentally opposing positions remain, however, on the issue of the future use of monopoly powers. There have been concrete drafting proposals on such matters as definition of entities and practices to be addressed as well as transparency. But there has been no genuine convergence in such areas.”

In the July 2004 “Framework Agreement” there was a consensus that government financial support of export STE’s including the underwriting of losses and any direct export subsidies, should be phased-out, presumably over the same time frame as the phase-out of export subsidies. However, there was no agreement on whether the monopoly powers of export STE’s should also be eliminated.

Some countries have argued strongly that export STE’s with monopoly powers are inherently trade distorting and threaten to circumvent the export subsidy disciplines. Other countries have insisted, equally strongly, that the existing WTO right to market exports through a single desk mechanism be retained and there is no evidence to substantiate the claims that export STE’s have in fact engaged in trade distorting practices. Most countries are somewhat ambivalent about the issue but they are concerned that, if export STE’s retain their monopoly powers, they not be permitted to circumvent the export subsidy disciplines.

Discussions over the monopoly powers of export STE’s are at an impasse but a viable solution must be found if a comprehensive agreement on modalities is to emerge from the Hong Kong WTO ministerial meeting.

Disciplines on STE Practices

A major part of the concerns regarding export STE’s will be addressed through the phase-out of government financial assistance. What other disciplines are appropriate?

- (a) Transparency: It has been suggested that countries maintaining export STE’s should be obliged to provide any information a complaining country may request, including details on individual shipments. Clearly this raises concerns regarding normal business confidentiality. However, provided business confidentiality can be assured, there should be no objection to providing such information to a complaining party via the WTO. To ensure speedy resolution of potential complaints, an expedited review process would be needed.

It has been suggested that an export STE should not be able to export at a price below its acquisition cost plus normal marketing charges and/or it should be required to purchase at least a certain percentage of its supplies on a cash basis, as opposed to making an initial payment which is subsequently

⁵ From International Policy Council Options Paper, 2005

⁶ From International Policy Council Options Paper, 2005

supplemented to reflect the pooled returns at the end of the marketing year. Cash price and acquisition cost reporting should not raise business confidentiality concerns and therefore could be a normal reporting requirement.

- (b) Cross subsidization: The ad note to Article XVII indicates that STE's may price differentiate provided this is done for commercial reasons to meet conditions of supply and demand in export markets. Nevertheless, there is a concern that an export STE might abuse this right by using high returns from a protected domestic market to "cross-subsidize" its exports. The cross-subsidization concern could be minimized by requiring a country maintaining an export STE with monopoly powers to provide duty free access to its domestic market for the products the STE exports.
- (c) Relationship of the Government to the Export STE: While the governance of export STE's is likely to vary widely between countries, there should be a provision which requires the national government to ensure that the export STE operates in a manner which is in full conformity with the country's WTO obligations.
- (d) Periodic Review of the Operation of Export STE's: In a manner similar to the "Trade Policy Review" each WTO member is subject to on a periodic basis, there could be a requirement that a WTO Member maintaining an export STE with monopoly powers would be subject to a thorough review every [5] years by the Committee on Agriculture.
- (e) Mandated co-existence: If the monopoly power of State Trading Entities is found, in and of itself to be trade distorting, then mandating co-existence with private entities would be an appropriate response. This could be phased in over time, as was done in the Chinese accession to the WTO, and would allow the STE, the private sector and producers time to adjust to new marketing realities.

Food Aid⁷

"There have been detailed and intensive discussions, some of which have even been text-based, but not to a point where a consolidated draft text could be developed. This has been precluded by Members clinging to fundamentally disparate conceptual premises. For instance, one firm view has been an insistence that all food aid should be cash only. Another view has rejected this approach and, in turn, insisted that there should be a safe harbor for emergency food aid, and that the fulcrum of any discipline should be the distinction between emergency and non-emergency situations. Absent movement on the basics, it has proven impracticable to explore more productively certain elements and possibilities that are already on the table."

Within the WTO, food aid falls within the export competition pillar, alongside export subsidies and export credits. The Uruguay Round Agreement on Agriculture recognized that food aid could be used to circumvent export subsidy commitments, but did not provide an effective enforcement mechanism to prevent this from happening. Two of the three clauses referring to food aid are little more than guidelines (that the provision of food aid not be tied directly or indirectly to commercial exports, and that international food aid be distributed according to FAO principles, including Usual Marketing Requirements.) The third clause relies heavily on the effectiveness of the FAO Principles of Surplus Disposal.

A key element in the discipline of food aid is the notion of Usual Marketing Requirements. UMRs are established based on historic trade flows, and are written into the contract between the donor and the recipient country. UMRs are meant to limit distortion in international and in domestic markets that a large food aid donation might create. The UMR principles allow for exceptions due to emergency food aid donations. In practice, donor countries often classify food aid as "emergency" in order to circumvent these requirements.

Adherence to the Food Aid Principles is monitored by the FAO Consultative Committee on Surplus Disposal (CSSD). The CSSD has no enforcement powers, and its role is limited to a consultative forum for monitoring food aid and related policies and programmes. It has been relatively ineffective in disciplining food aid.

⁷Prepared by Fiona Cooper, Trade Strategy Manager, Fonterra, and from International Policy Council Options Paper, 2005

Since the July Framework Agreement has committed to ending export subsidies, it is important that appropriate disciplines are established on food aid, to prevent countries from using food aid as a means to continue to “subsidize” exports.

A recent document developed by the Committee on Agriculture’s Informal Technical Work provides an outline for effective disciplines on food aid. The proposal stipulates that food aid shall be:

- Based on a needs assessment.
- Based on effective targeting mechanisms
- Result in increased food consumption of the target population.
- Not be linked to market development objectives of the donor country
- Be in response to appeals from UN food agencies, other regional or international intergovernmental agencies, or the Red Cross/Red Crescent.

In addition, the practice of providing food aid through long term, concessional loans (PL480 Title 1) should be eliminated (or counted towards the disciplines under export credits). Food aid should be given only on a grant (free) basis. The link between food aid and market development should be severed (PL480 Title 1). Any monies expended toward market development objectives should also be counted towards a country’s export subsidy commitments.

These guidelines would minimize the potential disruption to genuine food aid. However, they will not address the most potentially disruptive food aid that “leaks” onto world markets through monetization. (Food aid that is sold on local or neighboring markets to raise funds for other development projects or to purchase non-donated food is “monetized”.) This allows donated food to disrupt local and international markets and this loophole must to be closed by reducing and over time eliminating the ability of donor countries to monetize food aid. Food aid is monetized both by governments and by private voluntary agencies. Ending the practice of monetizing food aid would not be terribly difficult for government-to-government food aid, but such a discipline would impose a hardship on many private voluntary organizations, which now finance their operations from the proceeds of monetized food aid. In order to allow these organizations to continue to provide needed social and other services, countries need to commit to replacing lost food aid revenues with financial assistance to these charity groups.

Finally, to increase transparency, all food aid donations should be notified in advance (or within one month in the case of emergencies) to the WTO Committee on Agriculture. Any donations found not to comply with the rules should be counted against the donor country’s export subsidy commitments.

In an ideal world, countries facing food emergencies should be provided aid in the most effective form possible. In some cases, this would be in cash, and in others, the most effective form of aid might be in kind. Clearly, the cost of providing in-kind food aid, particularly if the donor country requires the food to be drawn from national stocks and to be shipped on nationally flagged vessels, is far higher than the cost of acquiring food in local or regional markets. According to some sources, shipping in-kind food aid under these conditions doubles the cost of that food aid. If the justification for in-kind food aid is to provide support to private voluntary organizations or to overcome a lack of public support for foreign aid, rather than to do what is best from the perspective of the country in need, then it is difficult to argue that food aid is a development tool.

MARKET ACCESS

Tiered Approach:

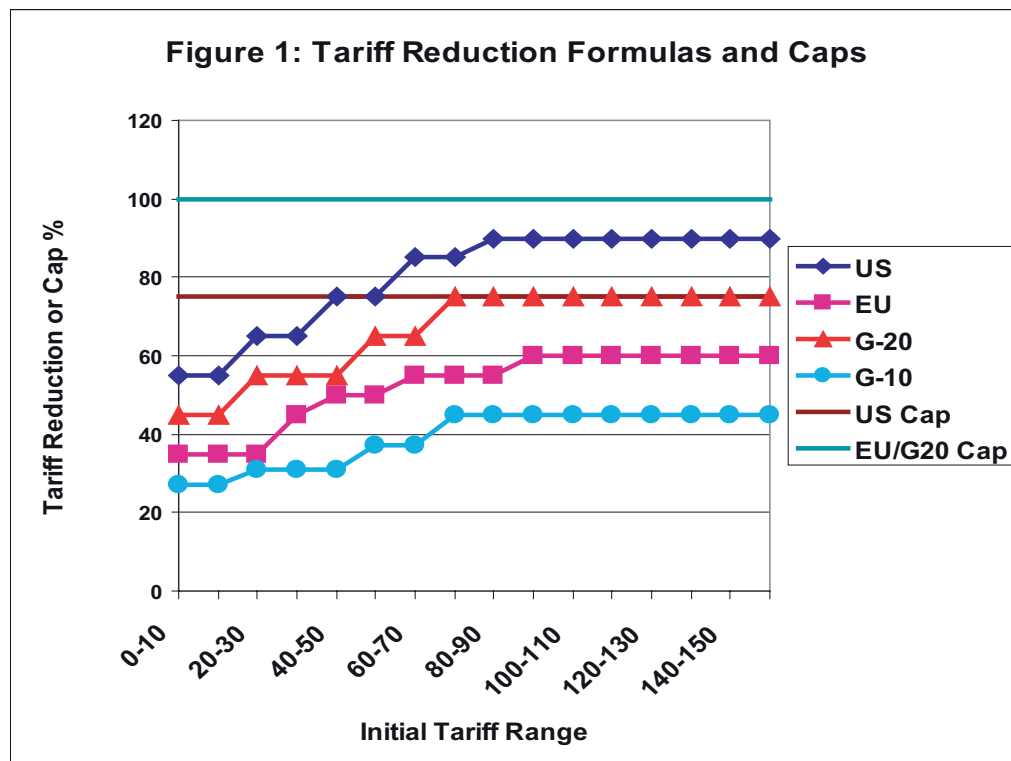
“We have progressed on the ad valorem equivalents. This has successfully created a basis for allocating items into bands for the tiered formula. We have a working hypothesis of four bands for structuring tariff cuts. There has been very considerable convergence on adopting a linear based approach for cuts within the bands. Members have, of course, by no means formally abandoned positions that are even more divergent. We need now to narrow the extent of divergence that remains. This will include whether or not to include any “pivot” in any band. Members have made strong efforts to promote convergence on the size of actual cuts to be undertaken within those bands. But, even though genuine efforts have been made to move from formal positions (which of course remain), major gaps are yet to be bridged. Somewhat greater convergence has been achieved as regards the thresholds for the bands. Substantial movement is clearly essential to progress. Some members continue to reject completely the concept of a tariff cap. Others have proposed a cap between 75% and 100%.”

Preliminary Assessment of Recent Doha Round Proposals for Market Access⁸

Several countries have recently made proposals on tariff reduction formulas for agricultural products and for reductions in permitted levels of trade-distorting domestic support. This note provides a preliminary assessment of the implications of some of these proposals. The focus is on the implications for developed countries, particularly the European Union and the United States.

Tariff Reduction Formulas

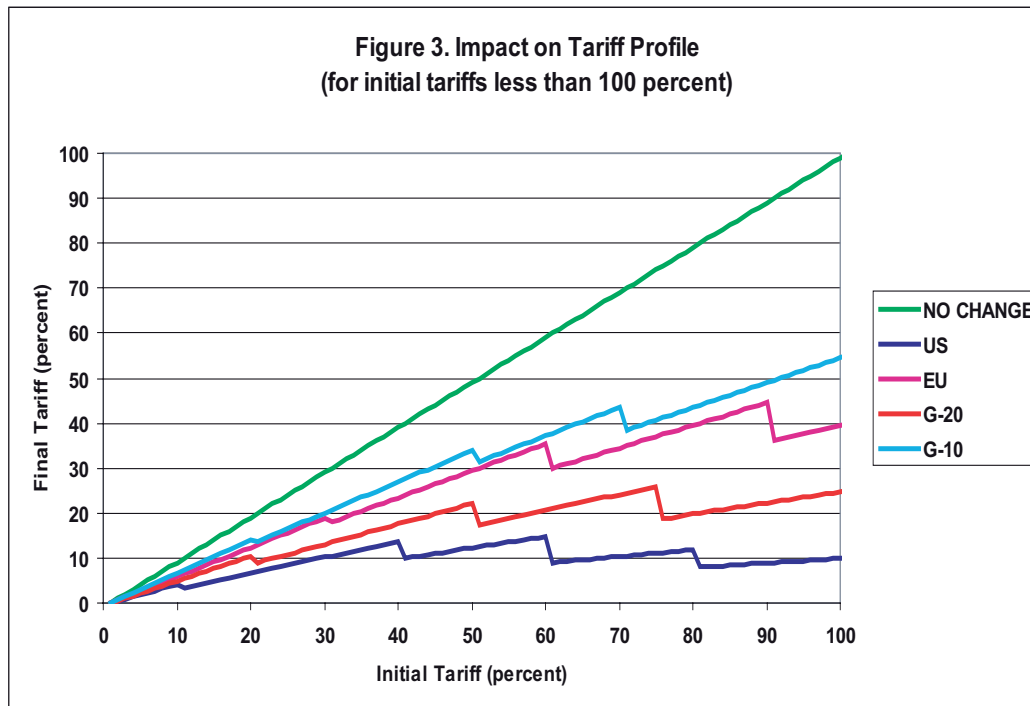
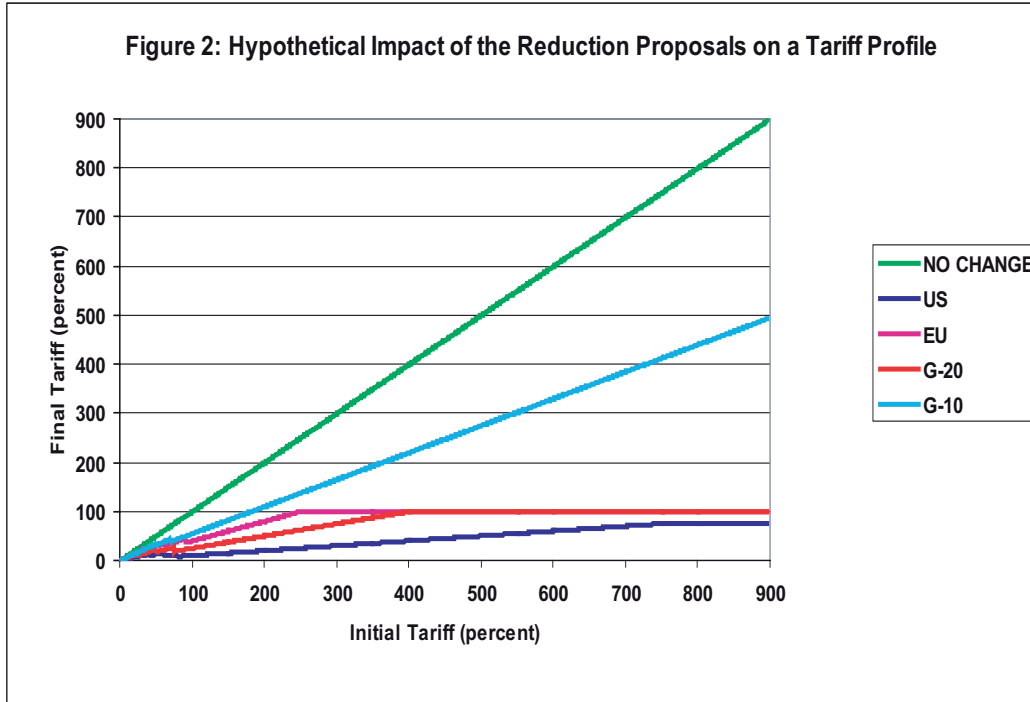
The G10 and the G20, as well as the European Union and the United States have proposed tariff reduction formulas. Some of these involve a cap on the maximum permitted tariff. The formulas are depicted in Figure 1.



⁸ Prepared on the basis of information assembled by David Blandford (Penn State Univ.), Tim Josling (Stanford Univ.), Ann Tutwiler, (IPC) and CEPII/INRA.

The most ambitious reduction formula is proposed by the United States, and the least ambitious is proposed by the G-10 group of countries. The G-20 proposal implies reductions that fall between the EU and US proposals.

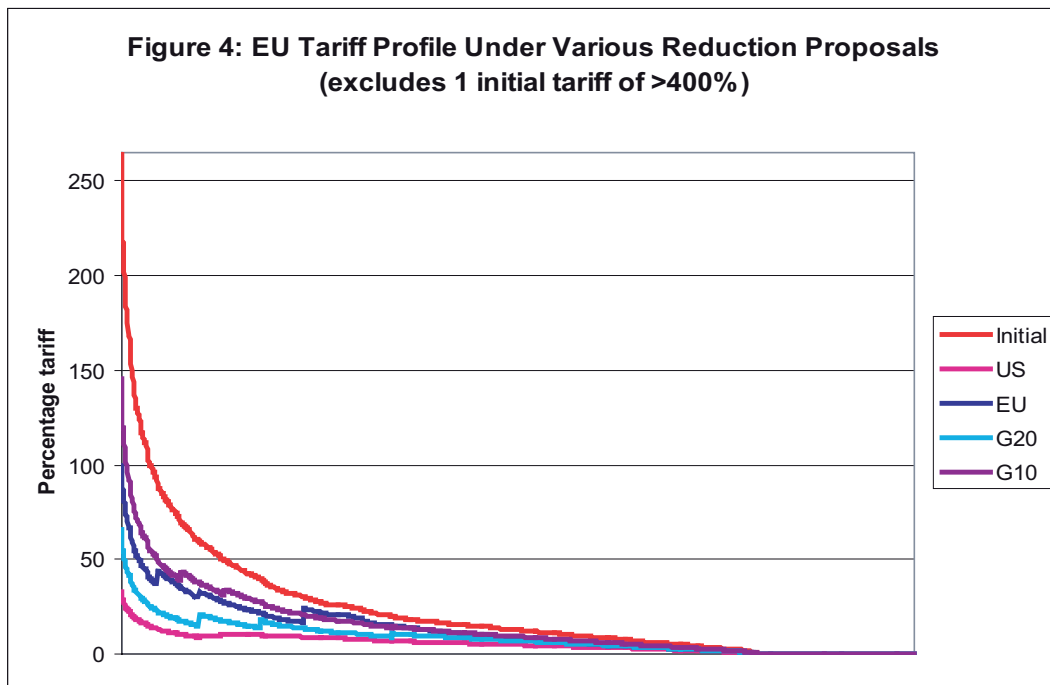
The hypothetical impact of these approaches on tariff profiles are demonstrated in figures 2 and 3. In both graphs the 45 degree line represents the status quo (no reduction in the initial tariff). Figure 2 shows the impact across the range of tariffs from 0-900 percent. Figure 3 shows the impact on tariffs that are initially less than 100 percent.



The G-10 reduction formula has the smallest impact on the tariff profile. All the remaining approaches result in substantially greater reductions, particularly for tariffs that are over 200 percent. The US proposal has the greatest impact on the tariff profile, resulting in a lower overall maximum and a sharper reduction in the tariff gradient. The differences are more pronounced at higher tariff levels (above 200%) than they are at lower tariff levels.

All the proposed reduction formulas create a stepped or “saw-toothed” pattern, because the proposed reduction percentages are increasing at each tariff band and a given reduction percentage is applied over a range of tariffs. At the lower limit of a new tariff range, the new reduction percentage has an exaggerated effect. The implication is that tariff reversal can occur with reductions. As a result, tariff reversal can occur with linear reductions based on fixed tiers. A product that had a initial tariff close to the upper end of a range may end up having a higher tariff than a product that was towards the lower limit of the next band.

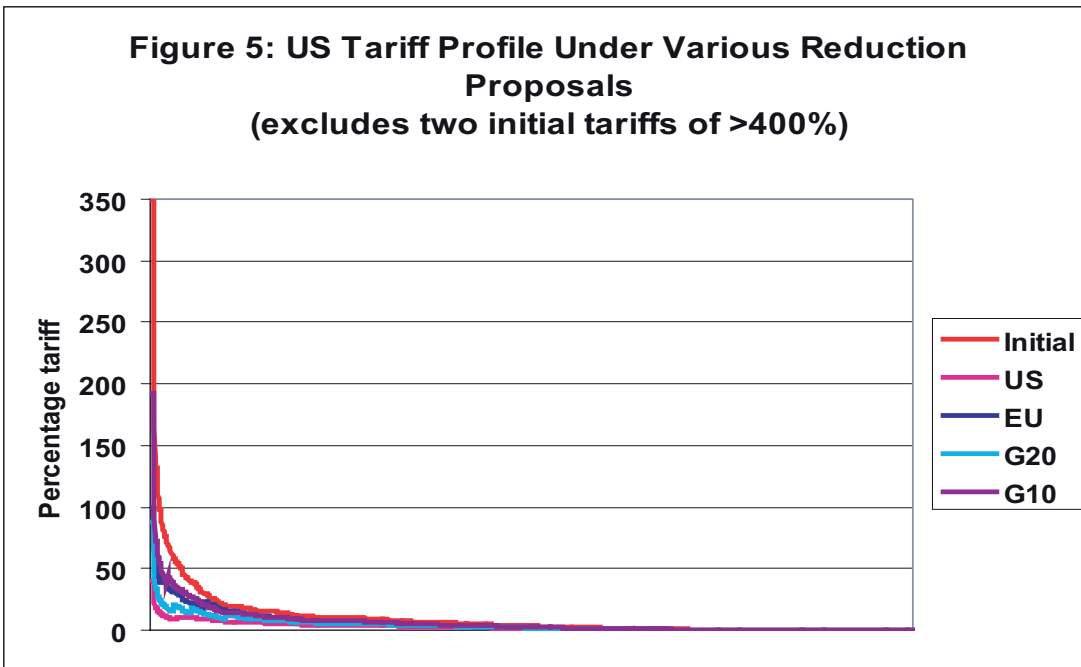
Estimates have been derived of the impact of the various proposals on the existing profile of tariffs for agricultural products in the European Union (Figure 4) and the United States (Figure 5) computed at the HS6 level. The profiles include estimates of the *ad valorem* equivalent of specific tariffs using the formula agreed by the member countries of the WTO. The actual profiles used in making final commitments may differ slightly, but the overall pattern is unlikely to be affected. These estimates do not take into account lower reductions in tariffs for “sensitive” products. Sensitive products will tend to be products with high tariffs; they would reduce the effects of the various reduction formulas on the tariff profile.



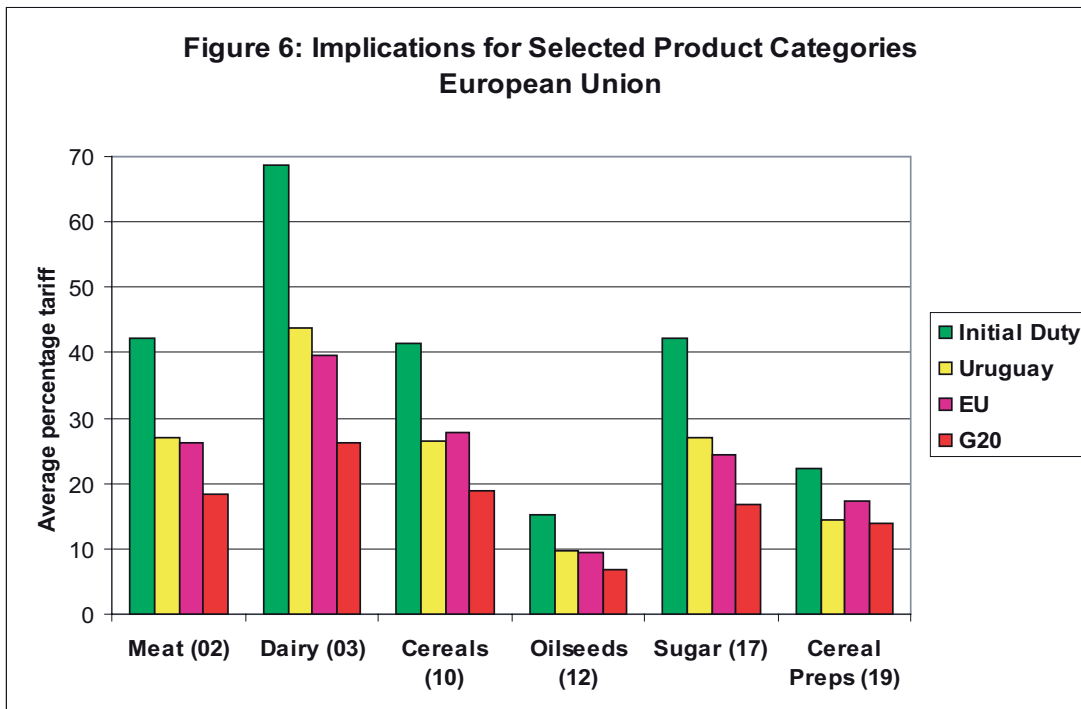
(In preparing Figure 4 one tariff in excess of 400 percent was omitted in order to improve the readability of the chart. Two tariffs in excess of 400 percent have also been removed from the US profile for the same reason.)

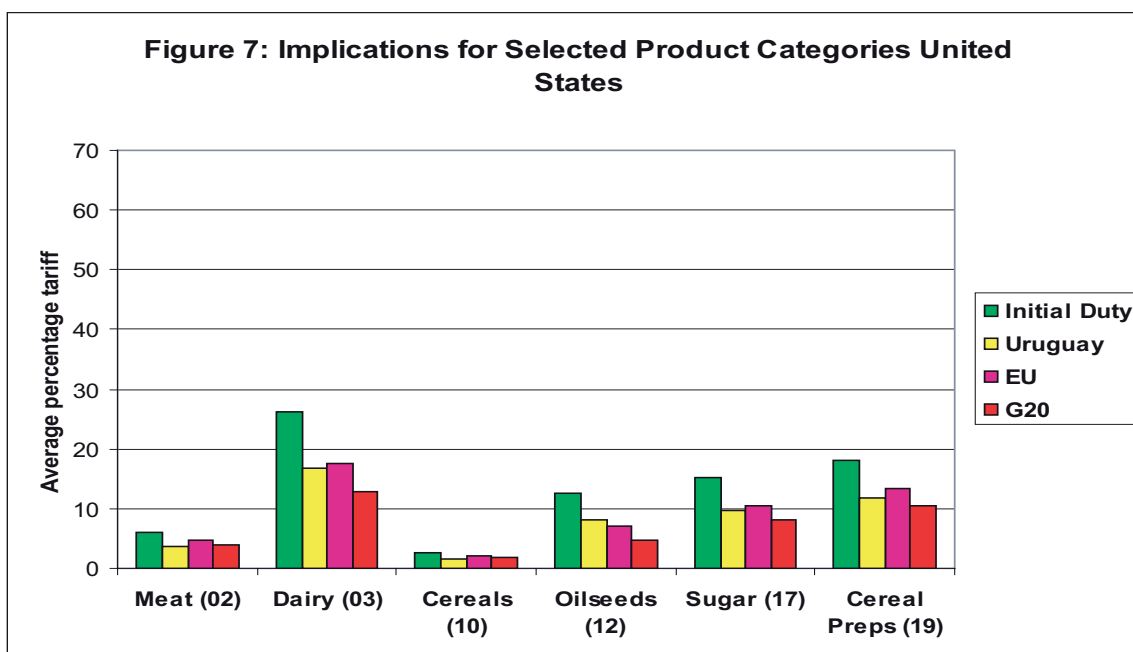
The saw-tooth effect of the reduction approaches with their associated tariff reversals are apparent in Figure 4. The EU’s own reduction proposal provides an example. At a tariff level of 90 percent, the percentage reduction under the EU proposal increases from 55 to 60 percent. As a result, in the EU schedule more than 50 products (tariff lines) would have post-reduction tariffs that are higher than the previous top tariff in the adjacent lower band.

The current US tariff schedule has a limited number of high tariffs (350 percent or more) but the overall tariff structure is lower than that in the European Union. As a consequence, the impact of all the reduction formulas on the tariff profile is less pronounced. The greatest impact on the US tariff schedule is created by the US reduction proposal.



Examining the impact of the proposals on the average tariffs for selected groups of products provides additional insight. Figures 6 and 7 for the European Union and the United States compare the effects on average tariffs (unweighted) at the HS2 level of the EU and G20 proposals. For comparison, we have included an implementation of the Uruguay Round Agreement formula.





In many cases, the European Union’s tariff reduction proposal would result in a lower average reduction in tariffs than by simply repeating the Uruguay Round approach. Admittedly the current approach does do more to address the relatively few tariffs that are currently set at high levels. The G-20 approach generally has a larger impact on average tariffs than the Uruguay Round formula. Since the U.S. reduction approach is the most ambitious, it reduces average number of tariffs the most.

These graphs demonstrate that there is less difference between the Group of Ten and the Group of Twenty on proposals than might be assumed on the face of it, and equally that there is less difference (particularly at low tariff levels) between the United States and the European Union proposals than is commonly anticipated. At higher tariff levels, the differences between the proposals becomes more telling, and to the extent that the objectives of the Round are to bring down peak tariffs, then the United States and the European Union formulas provide greater reductions in these highest tariffs. However, when looking at key product sectors, the European Union proposal (in most cases) is only slightly more ambitious than the Uruguay Round formula, and in some cases, is actually less ambitious than the Uruguay Round formula approach.

Sensitive Products⁹

“Members have been prepared to make concrete-albeit conditional- proposals on the number of sensitive products. But in a situation where proposals extend from as little as 1% to as much as 15% of tariff lines, further bridging of this difference is essential to progress. The fundamental divergence over the basic approach to treatment of sensitive products needs to be resolved. Beyond that there needs to be convergence on the consequential extent of liberalization for such products.”

In exchange for a formula approach to tariff reduction, each Member will be allowed to designate a number of products as “Sensitive” that will be subject to different market access rules. As the negotiations over the tariff reduction formulas, bands and caps continue, the designation and treatment of Sensitive Products becomes a critical issue. The key issues for the negotiations are how many tariff lines or what proportion of trade will be allowed special treatment? And what treatment will be allowed these products?

Commodities likely to be designated as Sensitive contribute a great deal to the net loss in overall global welfare from food and agricultural subsidies and tariffs generally. For example, rice accounts for 35% of the total welfare lost from agricultural protection, beef and sheep meat for 18% of the total cost, and sugar 8%. (Anderson, de Gorter and Martin) Put simply, protection in these three product categories alone account for 61% of the overall costs of agricultural protectionism to global welfare. Therefore, how these products are treated within the context of Sensitive Products will have tremendous implications for the overall benefits of trade liberalization, regardless of the ambition of tariff cuts.

⁹Prepared by M. Ann Tutwiler, IPC Chief Executive

How Many and Which Products?

In Zurich, the United States proposed that each country be allowed to designate 1% of their tariff lines as Sensitive. The European Union, also in Zurich, proposed that up to 8% of a country's tariff lines be designated as Sensitive. Other countries, including Switzerland and Japan have indicated they would like to designate over 15% of their tariff lines in the Sensitive category. Analyses by the World Bank and others of "realistic" Doha outcomes indicates that even treating 2% of developed country tariff lines as Sensitive eliminates nearly 2/3 of the gains from market access. (The World Bank's analysis does not factor in the possibility that there could be expanded TRQs for Sensitive Products, therefore the total loss might be smaller than indicated. However, it is unlikely that expansion of TRQs alone would overcome the loss to welfare caused by designating a large share of tariff lines as Sensitive, as there are many problems with quota fill and quota administration that would limit the effectiveness of TRQs in increasing actual trade.) Since developing countries are the major beneficiaries from market access gains overall, then they would benefit from having the smallest percentage of tariff lines designated as Sensitive.

The July Framework Agreement allows countries to designate a certain number of tariff lines as Sensitive. Designating a percentage of tariff lines, rather than a percentage of trade, runs a risk that countries will select tariff lines that represent a disproportionately larger share (or potentially a large share) of trade than would be indicated by the share of tariff lines. However, calculating the value of trade involves significant technical difficulties that might make such an approach too difficult to implement. For example, many over quota tariffs are prohibitive, so the value of actual trade flows over the quotas would be nil, while the value of in-quota trade might not reflect actual trade either, depending on the level of the in-quota tariff. Using a share of trade modality would also involve discussions of base periods, proxy data where data is not available and a debate over whether the share is to be across all trade, all trade in a particular chapter, etc.

Using tariff lines, instead of products, could reduce the share of trade covered under a Sensitive designation. For example, sugar might be considered a "product" but sugar is classified under many tariff lines, depending on its level of processing involved. If Sensitive Products were designated on the basis of tariff lines, countries would have to make some choices about the exact products (and the level of processing) they want to protect.

It is equally unclear whether the designation of Sensitive Products would be a certain percentage of all tariff lines (presumably at the six-digit level) or only of the non-zero tariff lines. This makes a difference: for example, Canada has 1346 tariff lines, but only 863 carry duties. A two percent designation could therefore apply to 27 tariff lines or to 17 tariff lines. A further complication is the substantial variation across countries in the number of tariff lines. The European Union has, for example, 2200 tariff lines, the United States 1777, Japan 1800, Philippines 802, Thailand 774, Brazil 959 and India 692. This means that a modality designating a specific percentage of lines as Sensitive will have widely different impacts across countries.

The importance of these issues is illustrated by recent analysis by Jean, Laborde and Martin (July 5, 2005) Using the tariff bands suggested by Harbinson, selecting Sensitive Products on a "political economy" basis (that countries will attempt to protect products with the highest tariffs), and assuming that Sensitive Products were subject to only a 15% tariff reduction, the average applied tariff cut falls from 16% to 9.5%. If two percent of tariff lines are selected as Sensitive, the average applied tariff cut falls from 6.7% to 2.6%. (If five percent of tariff lines are Sensitive, the average applied tariff cut falls to two percent.) In other words, *the loss of ambition in a jump from two to five percent is relatively small—the bigger loss of ambition comes in the jump from designating zero tariff lines as Sensitive to designating two percent of tariff lines as Sensitive.*

The Average Applied Tariffs after Designating Two and Five Percent SPs

	Baseline	Tiered Reduction	2% SP	5% SP
WTO	16.3	9.5	13.7	14.4
Developed	14.6	6.9	11.7	12.6
Developing	18.6	13.2	16.5	16.8

(Note: Harbinson's proposal had inflexion points at 15% and 90% for developed countries, with tariff cuts ranging from 40% to 50% to 60%. For developing countries, inflexion points were at 20, 60 and 120 percent, with cuts at 25%, 30%, 35% and 40% respectively. This analysis is based on six digit tariff levels, which can significantly underestimate the number of sensitive tariff lines.)

If the designation of Sensitive Products is based on the percentage of trade, the average applied tariff cuts are larger. This is because a large and variable amount of trade can be sheltered under a single tariff line. Designating two percent of trade as Sensitive results in an average applied tariff cut of 5.3%; designating five percent of trade as Sensitive results in an average applied tariff cut of 4.2%—or almost double the average cuts if the selection is based on tariff lines.

For most countries, the designation of Sensitive Products either at the two or the five percent level does not affect the average level of tariff cut. But where it does have an impact, that impact tends to be quite significant—for example Canada, the EU, Japan and Korea all see sharp reductions in their average tariff cuts depending on the share of products classified as Sensitive.

Clearly, the more lines are designated as sensitive, the less ambition will result in the final agreement. If countries insist on designating more than a few tariff lines as sensitive, one way to ensure market access is to require additional TRQ access as the percentage of sensitive tariff lines increases. For example, if a “normal” minimum TRQ access for sensitive products is 7% of recent consumption, then this could increase to say 9% if the number of sensitive products exceed is between 2% and 5% of total tariff lines. This would rise to 11% if the number of sensitive products is between 5% and 10%.

In one negotiating document, it was suggested that countries only be allowed to designate products with TRQs as Sensitive. While it is not true that all products with TRQs are Sensitive—or should be designated as Sensitive, given that TRQs cover approximately 50% of all OECD trade—it is likely true that most products countries wish to designate as Sensitive were covered by TRQs created during the Uruguay Round. It also seems to be somewhat unlikely that countries would wish to, or in fact, should be allowed to designate a product as Sensitive if it is a major exporter of that product into world markets.

How Should Sensitive Products Be Treated? There are two issues here. The first is what level of tariff cut should be imposed on Sensitive Products. And the second is whether and how market access should be increased for products designated as Sensitive, given that most of these will have very high tariffs. The EU proposed that the level of tariff cut for Sensitive Products be linked to the tariff band in which the product lies. This seems to be a sensible proposal, conceptually. Rather than negotiate an entirely different set of formulas and bands for Sensitive Products, it seems useful to accept that the tariff cuts for Sensitive Products be some proportion of the tariff cut agreed for that particular band.

In the Uruguay Round, market access was achieved both by reductions in tariffs, and in some cases by the creation of tariff rate quotas for products where initial tariffs were high and where political sensitivities meant that these high tariffs could not be reduced enough to create real market access. In its proposal the United States, suggested that Sensitive Products with existing TRQs be subject to increased TRQs over the implementation coupled with a tariff reduction. The US proposed to reduce in-quota tariffs to zero. For products without a TRQ, the United States offered three suggestions. The first would be to introduce a safeguard that would impose higher tariffs if an import surge occurred. The second option would be to allow for a longer implementation period for tariff cuts, and the third would be to “back-load” the cuts.

If the SSG is retained for developed countries, the first alternative would be redundant. Back-loading tariff cuts may seem politically palatable now, but experience with the recent removal of the Multi Fiber Agreement as well as the implementation of the NAFTA indicates that few countries will undertake measures to facilitate adjustment until the last minute, risking a protectionist backlash. The preferable method would be to allow for a longer implementation period for Sensitive Products without existing TRQs and in the lower tariff bands.

The EU also offered a different suggestion that links the size of the required tariff cut to the size of any required quota increase. This concept, first vetted by staff at the FAO, would allow individual countries to balance lower tariffs with increased market access via a TRQ—the smaller the tariff cut, the larger the tariff rate quota. This concept would imply that products falling within the same band might be subject to different combinations of tariff cuts and TRQ expansions depending on the mix chosen by the individual country. This concept would also imply that new TRQs might be created where none now exist.

Approximately about 50% of OCED trade is already covered by TRQs (Anderson, de Gorter, and Martin) so trade in these products is not trivial. Many of these quotas are not filled, so simply reducing over-quota tariffs will have limited impacts on trade. To expand effective market access in these products (whether or not they are sensitive) would require a zero duty within the quota, as well as effective administration.

There is considerable concern about creating new TRQs where none now exist. TRQs were a necessary mechanism to increase market access in the URAA, but they bring many distortions, not least in how they are administered. And, moderately high in-quota tariffs can prevent trade as much as high out-of-quota tariffs, as can poor administration. But, where initial tariffs are prohibitively high and where even deep reductions in bound tariffs will not affect trade, TRQs can provide minimum market access, especially if the in-quota tariffs are set at zero or a low level. This might be a better mechanism for dealing with Sensitive Products with high initial tariffs (those in the top band, for example) than allowing for a longer implementation period for tariff reductions as has been proposed by the United States.

Role of a Tariff Cap: A tariff cap would help reduce the losses in overall economic benefits created by the designation of Sensitive Products as well as the diminished impact of cuts from bound, as opposed to applied tariff levels. A World Bank Trade Note suggests that if only 2% of tariff lines are designated as Sensitive, welfare gains from trade reform drop by 2/3. If a tariff cap is imposed at the same time, then the welfare gains drop “only” to 1/3. (World Bank Trade Note, June 2, 2005) The United States, the European Union and the Group of Twenty have all called for a tariff cap in the range of 75% to 100%. However, the notion of a tariff cap remains anathema to Japan and other members of the Group of Ten. In question is how a tariff cap—if agreed to by WTO members—would be applied to Sensitive Products. Exempting Sensitive Products from a tariff cap completely would defeat the major objective of the cap: to bring down extremely high peak tariffs. However, it is unlikely that countries will be willing to subject their Sensitive Products to a tariff cap immediately. One option would then be to impose a tariff cap on these products at the end of the implementation period, rather than to impose the cap on these products immediately.

If a product is sensitive, a country could have the option of not applying a tariff cap (although a minimum reduction commitment would be required) but the price for not applying the tariff cap would once again be additional TRQ access. Allowing countries to expand TRQs to offset deviations to the general formula may be more realistic than suggesting delaying a tariff cap until the end of the implementation period.

Sources:

Anderson, Kym and Will Martin. Agricultural Market Access: The Key to Doha Success. World Bank Trade Note, No. 23, June 27, 2005.

Jean Sebastien, David Laborde and Will Martin. Sensitive Products: Selection and Implications for the Agricultural Trade Negotiations. Draft, July 5, 2005.

Inside US Trade, various issues, October 2005.

International Food & Agricultural Trade Policy Council, Building on the July Framework Agreement. June 2005.

Special Products¹⁰

“Regarding designation of Special Products, there has been a strong divergence between those Members which consider that, prior to the establishment of schedules, a list of non-exhaustive and illustrative criteria based indicators should be established and those Members which are looking for a list which would act as a filter or screen for the selection of such products. Latterly, it has been proposed (but not yet discussed with Members as a whole) that a developing country Member should have the right to designate at least 20 percent of its agricultural tariff lines as Special Products, and be further entitled to designate an Special Product where, for that final product, an AMS has been notified and exports have taken place. This issue needs to be resolved as part of modalities so that there is assurance of the basis on which Members may designate Special Products. Some moves toward convergence on treatment of Special Products have been made recently. Some Members had considered that Special Products should be fully exempt from any new market access commitments whatsoever, and have automatic access to the Special Safeguard Measure. Others had argued there should be some degree of market opening for these products, albeit reflecting more flexible treatment than for other products. In the presence of this fundamental divergence, it had clearly been impossible to undertake any definition of what such flexibility would be. It is to be hoped that further convergence will now be facilitated by a new proposal for tripartite categorization of Special Products involving limited tariff cuts for at least a proportion of such products.”

The concept of Special Products originated within the context of the Development Box. Even though the Development Box concept did not survive, the July Framework Agreement created a category of Special Products for use by developing countries to take account of their food and livelihood security needs. However, the July Framework Agreement did not specify how these Special Products were to be selected, what limits might be imposed on their selection, and how they were to be treated under the Market Access Pillar.

Selection of Special Products: The July Framework Agreement suggests that there will be criteria for Special Products (unlike for Sensitive Products, which have no objective criteria imposed). There are several options:

Food Security: Special Products selected to enhance or protect food security would be allowed to maintain higher tariffs than other products in a similar tariff band. While this argument has intuitive appeal, higher tariffs act as a tax on consumers—raising their food prices—and undermine the interests of the urban and rural poor. Ensuring economic access to food may be more important to these consumers than physical access, and higher tariffs would defeat that purpose. Lower tariffs may do more, in this case, for food security, than higher tariffs. Nevertheless, one starting point to develop a food security criterion is to assess the relative weight of products in the national food consumption basket combined the country’s self-sufficiency in the products at the top of the list. Setting a benchmark for self-sufficiency in these important foodstuffs could be possible, but it is hard to imagine setting such a benchmark across a wide array of very diverse countries. (There are other technical problems, including the selection of a base period and determining the country’s financial capacity to import.)

Livelihood Security: Livelihood security may be a better rationale for the selection of Special Products, given the large proportion of small and subsistence farmers employed in agriculture. The question is how to take this concern into account in fashioning a criterion. One possibility would be to use the share of the value of the product in the total value of agricultural output, which would be a proxy for the level of employment dependent on that product. Again, it would be difficult to fix one level that would be appropriate for all developing countries, and a national ranking would miss situations where employment related to a specific product was very localized within a country.

Rural Development: The difficulties of developing a criterion to reflect a country’s rural development concerns are similar to those posed by criteria based on livelihood security. Finding an appropriate benchmark across countries would be next to impossible, as their conditions vary so much.

¹⁰Prepared by M. Ann Tutwiler, IPC Chief Executive

Self-Selection: Given the difficulties of finding criteria that can be used across developing countries, it may be most appropriate to allow developing countries to self-select those products to designate as Special. In this case, it would be necessary to establish an appropriate share of trade, or percentage of tariff lines, as is proposed for Sensitive Products. As developing countries will have access to the Sensitive Product designation, in addition to the Special Product designation, countries may not need as much additional leeway as has been proposed by some Members for the latter category. The level could be a function of the overall level of ambition in the agreement. If the agreement is successful in reducing OECD subsidies and opening OECD markets (since the existence of these distortions is one of the main arguments behind the need for Special Products), then perhaps fewer products would need to be placed in the Special Product category. A lower level of ambition might be traded-off for a higher level of Special Products.

Treatment of Special Products: The July Framework Agreement did not specify how Special Products would be treated, only that they would be eligible for more flexible treatment than would otherwise be provided under Special and Differential Treatment. Some countries argue that Special Products should be exempt from tariff reductions, but to completely exempt products in the context of a negotiation to increase market access seems counterintuitive to the objectives of the WTO. Exempting Special Products from tariff cuts would likely come at a big cost in terms of other demands from developing countries. Since developing countries will also have access to Sensitive Products and to normal Special and Differential Treatment (reduced tariff cuts and longer implementation periods), it probably does not behoove them to ask for complete exemption for Special Products.

Flexibility could be provided through the tariff reduction formula. Already, it appears that developing countries will face 2/3 of the tariff cut applied to developed countries, undertaken over a longer timeframe. In addition, developing countries will have access to the Sensitive Product category, where access will be provided through some combination of tariff cut and quota expansion. It seems to make sense to allow Special Products a lesser cut than that faced by other products, perhaps 1/2 of the cut for other developing country products—or 1/3 of the cut required for developed country tariffs. An alternative, proposed by Stuart Harbinson, would be to subject any Special Product to a uniform reduction, regardless of the height of the initial tariff.

Another option, proposed by FAO staff, would assign countries a certain number of “points.” It would be allowed to deviate from the negotiated tariff formulas by assigning these points to individual products until all the points are used. Each country would be free to designate any number of products as Special, and could distribute its points to products as it desired. Each percentage point reduction from the negotiated tariff cutting formula would cost one point. It would be necessary to prevent countries from increasing their tariffs beyond their bound levels with such an approach. (Presumably such an approach could work for Sensitive Products, as well.)

Sources:

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Preference Erosion¹¹

The fundamental tenet of the multilateral trade system, that countries must treat all their trading partners as well as they treat their most-favored trading partners (known in the WTO as the MFN principle) originally applied to all WTO members. In 1965, a new article on trade and development (Article XXXVI) introduced the concept of non-reciprocity between developed and developing countries. The “Enabling Clause” of 1979 solidified the concept of special and differential treatment and legitimized preferential tariff treatment for the exports of developing countries within the Generalized System of Preferences (GSP).

The Doha Ministerial Declaration of 2001 and the Framework Agreement of 2004 reaffirm the provisions for special and differential treatment. The Framework Agreement recognized the importance of long-standing preferences and indicated that they would be addressed in the negotiations. The Framework Agreement also

¹¹Prepared by David Blandford, Professor of Agricultural Economics, Penn State University

indicates that developed countries, and developing country members of the WTO that are in a position to do so, should provide duty-free and quota-free access to the least-developed countries (LDCs).

Although empirical evidence is limited, it appears that preferential arrangements have not had a major impact on economic growth and development, particularly in low-income countries that face internal constraints in taking advantage of enhanced market access. The economic effectiveness of preferences is also limited because they are an extremely inefficient means of transferring income from developed to developing countries. According to some studies, only \$1 of every \$6 spent on preferences actually reaches the intended developing country farmers. Much of the rest is absorbed by traders and shippers.

Nevertheless, preferential arrangements are important to some developing countries, in some products, and they can play a role in integrating them into the global economy. Moreover, the erosion of preference has become a political issue that must be addressed in the negotiations. The key challenges are how to mitigate the impact of preference erosion from a political point of view, and how to make preferential arrangements more effective in stimulating growth and development, particularly in the poorest countries.

Measuring the Impact of Preference Erosion

There has been limited analysis of the effects of preference erosion changes, particularly the erosion of existing preferences through a general reduction in MFN tariffs. Studies indicate that significant preference erosion is likely to be confined to a small group of commodities and countries. The effects are likely to be largest for bananas, meat and sugar and for textiles and apparel. The countries most likely to be affected are in the Caribbean and Sub-Saharan Africa.

One study (Subramanian 2003) examined the impact of a 40 percent reduction in tariffs facing the least-developed countries (LDCs) for agricultural and manufactured goods exported to the United States, the European Union, Japan and Canada. The estimates were based on optimistic assumptions about the current gains accruing to LDCs from preferences, in particular, that the rules applying to preferential trade do not restrict their exports to these four countries. Under these generous assumptions, preference erosion would reduce the value of total LDC exports less than two percent. However, five LDCs face losses in excess of five percent of the value of their exports – Malawi (12 percent), Mauritania (9 percent), Haiti (6 percent), Cape Verde (6 percent) and Sao Tome and Principe (5 percent). In absolute terms, the largest losers were Bangladesh (US\$222 million), Cambodia (US\$54 million); Malawi (\$US49 million), Mauritania (US\$40 million) and Tanzania (US\$29 million). On the basis of these estimates Malawi and Mauritania could face significant losses in both absolute and relative terms.

A second study, (Alexandraki and Lankes 2004) extended the analysis to middle-income developing countries. This analysis concluded that the impact of preference erosion in these four countries would be heavily concentrated in a limited number of products—namely bananas and sugar. The countries most affected by a 40 percent reduction in the preference margin (in descending order of impact) are Mauritius, St. Lucia, Belize, St. Kitts and Nevis, Guyana and Fiji and Dominica. These countries are estimated to lose 5 percent or more of the total value of their exports. The dollar amounts of losses are not given in the study, but in percentage terms they range from 12-24 percent of the total value of exports, depending on the responsiveness of exports to the reduction in prices.

A third study (Wainio and Gibson 2004) assessed the impact of lower tariffs on US preferential programs. It concluded that only those countries shipping over 80 percent of their total exports under preferential arrangements to the United States would be net losers from the erosion of preferences.

A fourth study (Bouët et al. 2005) found that the effective margin of preference (worldwide average difference between preferential rates and MFN rates) is greatest for three sets of agricultural products: meat (Lesotho, Uruguay and Vanuatu); sugar (Aruba, Croatia, Suriname and the former Yugoslavia); and bananas (mainly Caribbean countries). Key non-agricultural products include textiles and apparel. Their empirical analysis of tariff reductions supports the earlier studies cited, namely that the impact of preference erosion is limited, with the exception of a handful of products and countries. Most of the countries likely to be affected are in sub-Saharan Africa and the Caribbean. On average, there would be a small loss in economic welfare for Sub-Saharan Africa (0.03 percent) as the result of the loss of preferences and deterioration in the terms of trade under a Doha agreement modeled on the Harbinson draft modalities. (Bouet, et.al. 2003)

Shortcomings in Existing Preferential Arrangements

Preferential arrangements can create dependence on preference-granting markets, locking the economies of preference-receiving countries into patterns of production that are unsustainable over the longer term. These effects are intensified when preferences are granted on a limited range of products. In recent years, there have been attempts to broaden preference schemes, particularly for the LDCs.

Some studies have examined the impact of expanding preferences through schemes similar to the EU's Everything But Arms (EBA) to the United States, Japan and Canada. Under such a scheme, the margin of preference provided to LDCs would be increased by eliminating any remaining tariffs and removing any limitations on the volume of imports. The results of these studies (Achterbosch et al. 2003) suggest that broadening and deepening preferences in the four developed country markets would increase the export potential of LDCs by 3-13 percent, primarily through the impact on textiles and clothing in Canada and the United States, and agricultural products in Japan.

One reason these broader preference schemes are so effective is because tariff peaks have a disproportionate effect on LDC exports since such peaks tend to be concentrated in agricultural products (sugar, cereals and meat) and in labor-intensive products such as apparel and footwear. (Hoekman, 2001) If the export potential created by stronger preferences were to be exploited by the LDCs, this would increase their economic welfare by 1-2 percent. Unfortunately, there is little analysis on extending preferences for LDCs to a broader range of importing countries, for example, middle income developing countries, but it is likely that such an expansion could also help to increase the export potential of LDCs.

There are a number of ways that existing preference schemes do not achieve their objective for developing country recipients.

Eligibility: Various preference schemes differ in terms of which countries are eligible for preferential access. While several countries follow generally accepted conventions on countries eligible for preferential treatment, such as the list of LDCs compiled by the United Nations, this is not always the case.

Product coverage: Product coverage and preferential rates of duty differ significantly among agreements, even for the poorest countries.

Rules of origin: There are substantial differences in rules of origin in preferential arrangements. Some of these rules discriminate against the integration of agricultural industries among developing countries and limit the opportunities for adding value to imported products that are subsequently re-exported. An Agreement on Rules of Origin was part of the Uruguay Round Agreement, but this was oriented towards the harmonization of non-preferential rules of origin. Member countries are merely required to notify the rules of origin that they apply under preferential agreements.

Certainty of commitments: The certainty of future market access differs considerably, both in terms of the length of time to which agreements apply and whether countries can lose their eligibility. Countries that provide preferential access for developing countries have the option of using safeguards if the volume of imports threatens to undermine prices in their domestic market.

Number of schemes: The number of countries that apply the generalized system of preferences for developing countries is limited. In addition to the GSP schemes operated by the Quad countries, a further 12 schemes have been notified to the UNCTAD secretariat.

Policy Options

Provide financial assistance: Developed countries should make additional resources (financial and technical) available to countries affected by preference erosion, preferably on a multilateral basis, to help them to adjust to the change in their competitive position. Funding should be targeted to facilitating economic adjustment and diversification. For example, the European Union will assist ACP countries affected by the reform of its domestic sugar policies. The scheme, which will extend over eight years, will provide funds to promote restructuring of the sugar industry in affected countries and to diversify their economies.

For the few countries that may experience significant pressure on their balance of payments as a result of preference erosion, short run assistance could be provided through the IMF's Trade Integration Mechanism. This is not a special lending facility and does not provide additional resources that are specifically oriented to the adjustment process in affected countries. It is designed to increase the predictability of resources provide to affected countries under existing lending arrangements.

Increase the scope and number of schemes: An expansion of duty free/quota free access to all LDC exports by developed countries could offset the erosion of narrower tariff preferences. In order for the poorest countries to take advantage of the opportunities for growth in exports to other developing countries, middle-income developing countries should expand preferential market access for the poorest countries, as well. Negotiations under the Global System of Trade Preferences for developing countries (GSTP) should be given renewed emphasis and oriented towards the expansion of preferential access for LDCs.

Strengthen the legal status of broad based preferential schemes: Preferential schemes have a fragile legal status because they are created and managed on a unilateral basis by each preference granting country. The terms of schemes vary considerably among countries. Rules for preferential schemes should be brought under the GATT/WTO framework with the aim of establishing greater certainty and stability of access, providing unrestricted duty-free access for all LDC exports, and simplifying schemes to reduce transactions costs and actively encourage the development of value-added processing in the poorest countries.

Increasing export capacity: Many poor countries face considerable challenges in mobilizing domestic resources to take advantage of export opportunities. Some of these challenges are due to natural disadvantages created by geography, limited natural resources or population. Barriers to export development can be overcome through a combination of appropriate domestic policies that stimulate investment in export-oriented industries, the development of the labor force and the acquisition and application of knowledge and information. An expansion of technical assistance, which has been increasingly emphasized by international organizations that work with LDCs, should be assigned a major priority.

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OTHER ISSUES

Monitoring and Surveillance¹²

“A proposal has been made, but there is no material advance at this point.”

The introduction of a continuous process for monitoring of the compliance of countries with their obligations under the URAA was a major innovation. The Committee for Agriculture has been a useful body to allow for discussion of the operation of the URAA and a way of identifying and discussing areas where the Agreement could be improved. Experience with the Committee has certainly helped in the current negotiations, from the early papers tabled in the analysis and information phase to the use of the Committee meeting in Special Session to act as the negotiating body. However, in the area of monitoring the picture is less satisfactory. Notification by countries has been dilatory in the past few years and the scrutiny of the notifications has been less than thorough.

The July Framework attempts to improve the situation. It includes the statement that:

Article 18 of the Agreement on Agriculture will be amended with a view to enhancing monitoring so as to effectively ensure full transparency, including through timely and complete notifications with respect to the commitments in market access, domestic support and export competition. The particular concerns of developing countries in this regard will be addressed.

Few of the proposals for the current negotiations have addressed the issue of monitoring. An exception is the G-20, who have developed a paper on the subject. The G-20 paper sets out their concerns about the current system of notifications and suggests some improvements. Specifically, the G-20 have suggested the setting up of a sub-group of Agriculture Committee, the Subcommittee on Notification and Surveillance, which would significantly increase the timeliness and transparency of the notification process and would generate conclusions and recommendations on the adequacy of compliance with the (modified) URAA. Though the G-20 paper emphasizes that the monitoring should be improved in all areas, including export competition and Special and Differential Treatment, it is in the area of domestic support that the benefits of such improvements are likely to be most apparent.

In particular, strict rules on monitoring and surveillance should be established in order to guarantee that new Blue Box payments are less trade distorting than Amber Box payments. Monitoring and evaluation should take place both ex ante and an ex post. Member countries should be required to notify programs prior to implementing them. To be eligible for Blue Box status, payments must conform to a set of criteria (ex ante evaluation). Payments should also undergo scrutiny after implementation, to determine if product specific caps and other requirements were respected (ex post evaluation).

In addition, the WTO should authorize analyses into whether certain types of Green Box measures are more trade distorting than commonly believed. While such analysis will not play a formal role in the Doha negotiations, it could inform the debate as countries continue to reformulate their agricultural policies, and for the next Round of negotiations, which may be able to focus more attention on Green Box measures. Many economists and developing country Members believe that any level of support provided to farmers distorts trade, by its very nature. Evaluating whether all non-trade distorting supports are created equal would help resolve potential disputes and also direct countries into the least trade distorting subsidies possible.

Improved timeliness and completeness of notification is a necessary if not sufficient step in the improved monitoring of domestic support. This is clearly evidenced by the confusion at the present in the extent to which CAP reform has changed the level of trade-distorting support and hence the impact of further limits on support levels. Article 18 of the URAA already stipulates that members should notify promptly “any new domestic support measure, or modification to an existing measure, for which exemption from reduction is claimed.” So merely adhering to current rules would resolve some of the problems. But adding some structure to the process could help. A subcommittee dedicated to the overview of the monitoring process could be constructive, if that body were adequately supported by information collected by the Secretariat. This could be coordinated with the process that is used for the Trade Policy Reviews. Advance notification of significant policy changes should not be a problem, as they are typically the subject of lengthy debate and legislative procedures.

¹²Prepared by Tim Josling, Professor, emeritus, at the Food Research Institute at Stanford University

The question of evaluation of the compatibility of domestic measures with the URAA could also be referred to the subcommittee. However, the limits of such evaluation need to be made clear. It is not obvious that the Committee on Agriculture, or any subcommittee thereof, could decide on the compatibility of any policy with other aspects of the WTO, such as the Agreement on Subsidies and Countervailing Measures (SCM). The legal issues will continue to be the province of the dispute settlement process. But the discussions in the Committee on Agriculture could well influence the decision of countries as to whether to pursue litigation.

The G-20 proposal also includes a call for annual reports from the Committee on the progress of reform in agricultural trade policies, and a report coordinated with the World Bank, the IMF and other institutions that would review the coherence between trade and development objectives. The process of reform is being monitored by other institutions including the OECD and the FAO, and the WTO should probably restrict its activities to providing up-to-date information to these bodies. High level debate on policy coherence would be constructive, and the WTO should be closely involved, but the analytical work and the compilation of a report would seem to be best left to the Washington institutions.

Peace Clause¹³

The Peace Clause (Article 13 of the URAA) expired in 2003. The Clause may have been responsible for the relative lack of challenges to domestic policy instruments over the period since 1995. It was considered at the time of the Uruguay Round to be a necessary part of the bargain that introduced disciplines of domestic support policies. However, little time has been so far spent on the question as to whether it should be brought back. The Framework Agreement was silent on the issue of the re-introduction of a Peace Clause (Article 13 of the Uruguay Round Agreement on Agriculture, known as the Peace Clause, protected agricultural subsidies from the operation of the Subsidies and Countervailing Measures Agreement (SCM). It expired in January 2004). The October papers from the EU and the G-20 also made no mention of this issue.

The silence was broken by the US proposal of October that called for the establishment of a peace clause “to protect farm programs if a country keeps trade-distorting support below agreed levels.” It is not clear how extensive such litigation protection would be or whether it would be permanent. As one may assume that the G-20 will be less enthusiastic about the return of the peace clause, there is likely to be considerable discussing over the limits of its coverage if reinstated.

The argument in favor of the peace clause is that it keeps the sensitive issues of domestic policy reform in the “political” rather than in the “legal” arena. Members can negotiate limits on domestic support and then set up a system for notification and counter-notification. The notifications come from the countries concerned and the counter-notifications are essentially strategic decisions to challenge or accept. But the acceptance, tacit or even explicit, does not represent a legal decision. Members can still be held accountable through the dispute settlement process for actions that conflict with WTO rules. The Peace Clause attempted to make more difficult such challenges by narrowing the application of general rules on subsidies to agricultural programs. Without this shelter it is possible for challenges, under such provisions as “non-violation nullification or impairment” and “serious prejudice” to trading partners, to proceed regardless of the decisions in the Committee for Agriculture. And, by implication, the distinction between Green and Amber boxes, and indeed between export and domestic subsidies, would become irrelevant to the question of multilateral accountability. If such a situation were to emerge then the WTO dispute settlement process would become in effect a substitute for negotiations in constraining domestic support.

Is the argument for a new peace clause is stronger if it is restricted to Green Box measures, as is sometimes argued. Trade-distorting support, at least by the large countries, is by definition potentially actionable under the SCM. Green Box measures are less likely targets. So restricting the Peace Clause to Green Box measures is in effect to remove its impact. It would become a backup shelter for subsidies that are not constrained by agreement and could otherwise be challenged by competitive exporters and those countries with low support levels. Panels would need to establish through a series of cases those policies that are truly trade-neutral. A case can be made that the Green Box not be sheltered (Indeed, the US proposal only mentions that trade-distorting support be protected).

¹³Prepared by Tim Josling, Professor, emeritus, at the Food Research Institute at Stanford University

The decision on whether to restore the Peace Clause will ultimately be a part of the final package. Countries that wish to shelter their domestic support policies from challenge will have to accept deeper cuts in those policies. Those that are seeking deeper cuts will have to factor in the loss of legal remedies if those policies provoke trade disputes. Developing countries, especially those that do not provide subsidies, will be loathe to accept a new Peace Clause, as they view the right to challenge agricultural subsidies to be a major benefit of the WTO itself. However, reviving the Peace Clause could prove an acceptable price for real and significant constraints on trade-distorting support.

Linkages

These three aspects of domestic policy are likely to be linked in the final package. A generous Green Box will require extensive and intensive monitoring to allay the fears of countries who are concerned that trade distorting policies can be clothed in Green Box guise. These countries will not be eager to lose the ability to challenge such Green Box policies through the use of panels. So the price of an accommodating Green Box may be more monitoring and litigation. Tightening the criteria for the Green Box also will call for more monitoring and surveillance, in order to ensure compliance, but less need for a Peace Clause if the monitoring is successful.

The improvement of the process of monitoring and surveillance is constructive regardless of changes in the Green Box criteria, but is crucial if significant changes are made. The inability to agree on such an improvement in monitoring and surveillance could seriously undermine the confidence of countries and lead to litigation as an alternative compliance mechanism. This could have serious implications for the acceptability of the WTO by domestic politicians.

The restoration of the Peace Clause would appear to be desirable mainly to the extent that it may be necessary in order to achieve higher cuts in domestic support. It would be undesirable if the process of monitoring remains inadequate and particularly problematic if changes in the Green (and Blue) Box criteria was seen as a way for the developed countries to escape disciplines on their trade-distorting programs. So the emergence of this issue as a factor in the final stage of the talks is appropriate. It can only be judged in the context of the whole agricultural package.