International Food & Agricultural Trade Policy Council

IPC Policy Focus

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Should the Green Box be Modified?

The push towards minimally trade distorting domestic support is crucial for domestic agricultural policy reform. However, some have claimed that current Green Box criteria permit trade-distorting effects, and that they are not flexible enough to allow for a full range of legitimate programs. This IPC Policy Focus raises salient questions on the need to modify the Green Box to better meet the needs of developed and developing countries.

Why, the reader may ask, does IPC address an issue that has not been at the forefront of the difficult Doha Round agricultural negotiations, when there are more important differences that have to be bridged? Why, you may wonder, further muddy already sufficiently muddied waters? We answer these questions at the outset: as a group that has argued for the benefits to developed and developing countries alike from an ambitious Doha Round outcome, we must also sometimes take a longer term perspective and address issues we believe will be crucial in the future. Moreover, since a Doha Round conclusion may well require agreement on a built-in agenda for Green Box issues, we believe it is important to examine the issues at play.

It is also important to state at the outset our view that the concept of non- or minimally trade distorting domestic support, introduced in the Uruguay Round, has been and continues to be crucial for domestic policy reform which offers better targeting of support and reduced surplus production and is much more consistent with open international markets. At the same time, however, we believe that it is important to address concerns raised by some countries that current Green Box criteria can nonetheless have significant trade-distorting effects, and by others that they are not sufficiently flexible to incorporate a full range of legitimate programs.

We refer the reader to the full IPC Discussion Paper by David Blandford and Tim Josling for a detailed overview of Green Box issues.[1] In this Policy Focus, however, we zero in on what could usefully be addressed within a Doha Round and which issues require a longer-term work program. We also address Green Box issues at play in the 2007 Ffarm bill debate presently underway, and in the EU's CAP reform.

Green Box Criteria Agreed to in the Uruguay Round

The URAA (Annex 2) identifies domestic support payments exempt from reductions. The Annex includes both general criteria that all exempt payments must satisfy, and specific criteria for individual payment types. The overarching requirement is that Green Box payments should have "no, or at most minimal trade-distorting effects or effects on production" (paragraph 1). Two general criteria are specified:

1. support should be provided through a publicly-funded government program and should not involve transfers from consumers; and
2. the measures should not provide price support to producers.

The restriction that a payment be publicly funded reflects the need to exclude transfers generated through the market, by raising output prices or reducing input costs. This is consistent with a move from coupled to decoupled policies.

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The types of government programs specified under the Green Box are grouped under eleven payment/expenditure headings:

- general services for agriculture;
- public stockholding for domestic food security;
- domestic food aid;
- decoupled income support;
- income insurance and income safety net programs;
- disaster relief (including crop insurance);
- producer retirement;
- resource (land) retirement;
- investment;
- environmental programs; and
- regional assistance.

The first of these is the broadest, including many of the programs that governments in both developed and developing countries have operated for decades to assist growth and development of the agricultural sector. No government has suggested that expenditures on such programs be limited. The next heading refers to stockholding and food aid, and includes programs that are not usually considered "distorting" to international trade. Payments identified under the next three headings are directly related to farm income goals, including protecting against fluctuations. These categories are the most contentious. The next three relate to payments designed to improve sectoral structure and performance. Payments under environmental programs are presumed to have broader benefits to society rather than just producer incomes. The final category is designed to address the problem of economically disadvantaged regions.

Although the intention of the specific criteria is to prevent increased production, there is recognition that payments may be associated with the provision of public goods. The balance between public good aspects and trade distortions is difficult to determine conceptually, and even more difficult to achieve in practice.

What Has Been Proposed

The Cairns Group has argued that structural aids, safety net programs and certain direct payments should be shifted to the Amber Box, thus essentially limiting the Green Box to public good payments. Canada would even like to see a cap on such public good payments. Both the US and EU argue that such changes would hinder ongoing positive movement towards decoupled support; the EU would like to see payments to promote animal welfare, environmental and rural support programs be included in an expanded Green Box. The G-20 wants to prevent "box-shifting," and argues that Green Box payments that compensate for the removal of price supports should be constrained as they are not production neutral, and that the criteria be modified so as to minimize wealth and insurance effects of direct payments. The G-20 proposes that direct payments no longer be linked to a requirement to keep the land in agricultural use, that such payments be targeted to low income farmers and tied to production in a fixed and unchanging base period and be capped when Amber and Blue Box payments exceed a certain percentage. There are also calls to make the Green Box criteria more development friendly. A full resolution of all the issues currently on the table will be difficult if a swift conclusion is to be reached in the Doha Round, and a hasty attempt to do so runs the risk of creating more problems than solutions. It is therefore necessary to distinguish between what can usefully be addressed in the "review and clarification" of Green Box criteria as asked for in the July 2005 Framework, and what is more usefully postponed to a designated period following the conclusion of the Round.

What is Feasible in the Doha Round?

Timely and binding requirements for notification, monitoring and surveillance of Green Box payments – along with all elements of domestic support – should absolutely be agreed to in the Doha Round. Since Green Box criteria were formulated largely with developing countries in mind, it would also be help-

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ful to clarify that certain developing country policy instruments, which are not markedly trade distorting, are to be considered Green Box.

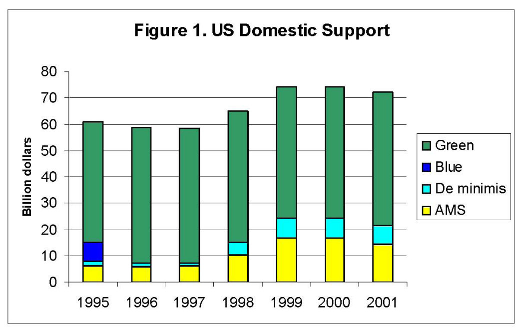
Important Issues to Address Post Doha

While it makes sense to call for the elimination of the requirement for direct payment recipients to keep land in agricultural use, its political acceptability is in doubt, since many rich countries are concerned by the prospect of rural depopulation through the abandonment of farming. Nonetheless, a longer term review and clarification process may usefully explore how to evaluate output effects of apparently decoupled farm income payments, through the impact on wealth, capital constraints, expectations of future payment eligibility and the reduction of uncertainty and whether to minimize such effects through restricting the method or size of payments to farmers. It would also be useful to see whether clarification is required on payments for the provision of public goods (i.e. environmental services) when these are associated with private goods (farm products). The provision of public goods, such as recreational and scenic amenities, may be related to the type and method of production of private goods, such as agricultural crops. Stimulating economic activity might be a legitimate aspect of rural development. Direct payments and targeted subsidies can meet some objectives, while others may require particular farming activities. Hence, there is an underlying tension between the use of subsidies to achieve domestic goals and the possible impact that these subsidies can have on producers in other countries. Currently, such subsidies could be challenged as not conforming to Green Box criteria, even if they are the most effective way of achieving legitimate environmental objectives. One such challenge could be made to payments for environmental services that do not simply compensate for compliance costs or income foregone, but reward producers for adopting environmentally-friendly practices.[2] These payments could be actionable under the SCM if they caused "serious prejudice" to other WTO members, but are more vulnerable to the charge of non-compliance with Green Box criteria. The challenge, then, is to find rules that will allow "legitimate" objectives to be followed with minimum disruption to other countries.

U.S. Farm Policies

Green Box payments are an important component of the support provided to U.S. agriculture. The annual average of US$50 billion of support provided under this category was 75 percent of total support notified to the WTO for 1995-2001. Domestic food aid, in particular the Food Stamp program, accounted for 70 percent of total notified support under the Green Box.

The United States notified direct payments provided to producers under the 1996 Farm Act as Green Box. These payments replaced the Blue Box deficiency payments of the former legislation, as reflected in the composition of support in Figure 1. The URAA limits the total AMS for the United States to a maximum of just over US$19.1 billion. If the direct payments



Source: WTO notifications.

that have previously been included in the Green Box were required to be included in the calculation of the total AMS because of the WTO ruling on cotton, the United States could exceed this limit, even more so if the Doha Round of negotiations ultimately results in a reduction of allowable trade distorting support (the sum of total AMS, de minimis and Blue Box payments).

The importance of the ability to provide payments under the Green Box would increase if there is a successful outcome of the Doha Round. The United States, for example, has proposed a 60 percent reduction in its total AMS limit (to US$7.64 billion).

If that limit had been in place for 1995-2002, the United States would have exceeded the limit in every year shown, with the possible exception of 2004. This indicates that some additional changes will be required in future U.S. farm legislation if the United States is to stay within negotiated limits for trade-distorting domestic support.

Perhaps in recognition of the potential challenges created by WTO issues, there is an increasing amount of discussion about a reorientation of U.S. agricultural policies to permit a larger proportion of government support to be notified as Green Box

Services to Increase Competitiveness

An increase in expenditures on basic and applied research leading to increased productivity is permissible under the Green Box, even if research programs are oriented towards specific products. Investment in infrastructure is also permitted, providing that on-farm facilities are not subsidized. It would therefore be possible to subsidize a general upgrading of transportation facilities (e.g., locks on the Mississippi river) or other types of infrastructure (e.g., broadband internet networks) providing that farmers' marginal costs of using the infrastructure were not subsidized through preferential user charges. As currently specified, expenditure on extension and training activities could also be increased, even if these were primarily targeted to increasing farm profitability rather than productivity.

Income Insurance and Safety Net Programs

The term "safety net" can be used in a number of different contexts. Under the Green Box, the term is taken to apply to programs that provide income insurance. The amount of compensation that can be provided is limited and payments cannot relate to the type and volume of production or to prices. It should be noted that the Green Box conditions relating to insurance do not include the qualifier that this linkage should not solely apply to years after a base period (as is the case for decoupled income support) – the lack of linkage appears to be an absolute requirement.

Under the current federal program, approved insurance companies provide crop insurance to producers. These policies provide coverage for a loss in yield or revenue for over 350 commodities (USDA 2006). In some states, whole-farm gross revenue policies are also available. Current U.S. crop insurance programs do not satisfy the conditions set out in Annex 2. Consequently the United States has notified these as non product-specific support and this has been included in total AMS calculations.

Proposals exist to increase expenditures on revenue insurance as an alternative to current price-based support (e.g., AFT 2006; NCGA 2006). These proposals include compensation for reductions in revenue on an individual crop basis rather than a whole-farm basis. This is consistent with the way in which other U.S. payments (direct and counter-cyclical, for example) have been structured. However, revenue stabilization schemes that are linked to individual crops appear to be inconsistent with the criteria set out in Annex 2. Consequently payments under this approach would seem to be open to challenge if notified as Green Box.[3] A switch from current price-based and other programs that fall in the Amber Box by alternative programs that would also fall in the same category would seem to be feasible only if the new programs would be expected to lead to lower expenditures. This would be particularly important if reductions in the total AMS binding are eventually agreed.

Environmental Payments

Environmental programs relating to soil conservation have been a feature of U.S. agricultural policy since the 1930s. The 1985 Agriculture Act represented an extension of policy to broader environmental concerns, such as the protection of environmentally sensitive land and the preservation of wetlands. The trend was continued in the 1996 Act through the establishment of several new programs, including the Environmental Quality Incentives Program (EQIP). This program encourages farmers and ranchers to adopt farming practices that reduce environmental damage associated with production. The pressure to increase expenditure on conservation (agri-environmental) programs is evident in the debate on the 2007 Farm Bill.

The Annex 2 criteria governing payments under environmental programs appear to be quite restrictive and may pose questions for the Green Box compatibility of several current U.S. agri-environmental programs.

The likelihood of challenge to the Green Box compatibility of U.S. agri-environmental programs centers on the following issues:

1.The extent to which the requirement that payments be part of a clearly-defined environmental or conservation program is met;
2.Whether or not payments include an incentive component above and beyond compensation for additional costs incurred or income loss; and
3.The extent to which payments made are linked to the production of marketable agricultural production.

If payments that are justified on environmental grounds are to increase significantly, the compatibility of programs with these conditions is likely to come under increasing scrutiny, with pressure to have these counted as Amber Box.

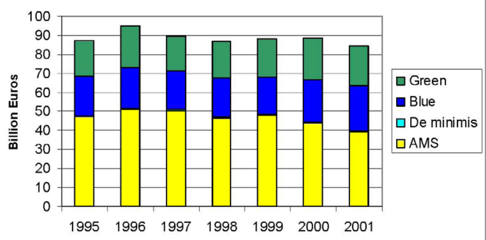
Bio-energy Programs

Recent increases in the price of energy and concerns about dependence on imported energy supplies have led to heightened interest in bio-energy programs. There may be pressure to increase payments to farmers to produce crops that can be used as a feedstock for ethanol or to produce bio-diesel. Direct subsidies for the production of feedstock would almost certainly be classified as Amber rather than Green. An incentive for the supply of ethanol is currently provided by a reduction of 51 cents per gallon in the federal excise tax compared to that imposed on gasoline. Although the exception does not discriminate between domestically produced and imported ethanol, there is also an import duty of 54 cents per gallon. As a result of the two measures, the excise tax reduction could be perceived as a subsidy to domestically produced ethanol and could be seen as a pass-through subsidy for corn. A key issue in this case is whether feedstock for ethanol is considered a marketable agricultural product.[4] If this is indeed the case, then the subsidy could be counted under the Amber Box.

Green Box and the CAP

Prior to recent changes in the Common Agricultural Policy (CAP) the Green Box was a less important component of the support provided to EU agriculture than in the United States. The annual average of €20 billion of support provided under this category represented 22 percent of the total support notified to the WTO for 1995-2001 (Figure 2). The three leading categories of support were general services,

Figure 2. EU Domestic Support



investment aids and environmental payments—each of which averaged from €4.5 to €5.5 billion per year. Regional assistance was the other significant category, averaging roughly €2.5 billion annually.

Because of the lack of more recent notifications, recently published data do not show the likely effects of the significant changes in the CAP since 2003. The introduction of the single farm payment (SFP) scheme in 2005 would probably result in a substantial increase in the amount of decoupled income support that would be notified to the WTO. It is difficult to estimate the exact impact, but a rough indication of an order of magnitude can be derived from the notifications. Over the period 1995-2001, roughly 24 percent of the support notified to the WTO was in the Blue Box. If roughly 80 percent of the support provided under the SFP would qualify for the Green Box, then this would have roughly doubled this category of support over the notification period to around 42 percent of the total.[5]

In the future, Green Box support may become even more significant for the EU as a result of the following:

1.Reform of the sugar regime in which a reduction in the support price for white sugar is being replaced by a decoupled payment;
2.The potential adoption of direct payments for other commodities, particularly wine, fruit and vegetables; and
3.Possible replacement of remaining coupled components of direct payments made to commodities covered by the 2003 reforms.[6]

The future status of payments that the EU may wish to modify as Green Box is open to question. The SFP involves a number of restrictions on land use that could be interpreted as involving a linkage to current production (European Communities 2003) and could open the SFP to a challenge on the basis of Green Box compatibility. These are:

1.Land upon which an SFP is made may not be used for the production of fruit and vegetables (Article 51) – this parallels the condition applied to direct payments in the United States, which were ruled by the WTO panel not to be in conformity with Green Box rules in the case of cotton.
2.Member states are required to ensure that areas under permanent pasture, upon which payments are based, remain in that use (Article 5). To the extent that this increases the marketable production of livestock or livestock products, it could be subject to challenge.
3.There is a requirement that land upon which payments are based should be kept in good agricultural and environmental condition (Article 5). The general criteria (Annex IV) used to define these include several elements relating to land management practices than could be interpreted as linked to current production. The most obvious of these is a criterion for minimum stocking rates for livestock.

Also, producers receiving the SFP must respect a range of statutory management requirements (Article 3) relating to environmental conditions; public, animal and plant health; and animal welfare. To the extent that these are production linked, they are likely to constrain production, rather than increase it, and are therefore unlikely to be challenged.
As in the United States, a lot of attention has been directed recently to increasing the supply of bio-energy in the European Union. Under the 2003 changes to the CAP, €45 per hectare is offered to farmers who produce energy crops. A maximum of 1.5 million hectares of eligible area was originally specified, but there are proposals to increase this to 2 million hectares. There is also a proposal to allow member states to provide investment subsidies for up to 50 percent of the costs of the establishment of multi-annual energy crops. Whether these would be included in the Amber Box would depend on whether the crops are considered agricultural or not.[7]

Although payments under bio-energy schemes are yet to be notified to the WTO, it seems likely these will primarily fall under the Amber Box rather than the Green Box. As in the case of U.S. policies in this area, it seems unlikely that production-linked aids for marketable agricultural crops used in the production of bio-energy will be eligible for inclusion in the Green Box.

In summary, it appears likely that the EU will continue to shift the structure of support towards decoupled direct payments, and that these will be linked to some extent to production practices. The future Green Box compatibility of these payments will be a major issue for the EU to satisfy more stringent constraints on Amber Box payments.

Conclusion

The fact that the Green Box rests on the concept of decoupling is both its strength and weakness. The notion of decoupling has considerable merit in providing a framework for moving from price supports to direct payments. The latter are likely to be less trade-distorting because they are less output-enhancing and do not reduce consumption. But decoupled payments are not always adequate for satisfying competing demands for the redirection of subsidies.

The granting of payments to compensate for previous price supports may require one set of criteria; payments that are tied to environmental benefits may require another. In the latter case, the effectiveness of a subsidy may be more important than its impact on production. What may be missing is the notion of "least trade-distorting" ways to achieve particular objectives.

As a consequence, the core of the debate over the Green Box should now shift from whether the Green Box has helped with the reform of domestic policies (which it has) to:

- Does the Green Box adequately address the provision of public goods? Though many aspects are covered, the problem remains of how to pay for the production of public goods (environmental services) if these are associated with private goods (farm prod-

- Does the Green Box ignore the output effects of apparently decoupled farm income payments, through the impact on wealth, capital constraints, expectations of future payment eligibility, and the reduction of uncertainty? Should one restrict the method or size of payments to farmers so as to avoid these output effects? Should one establish a separate category for income payments and subject them to additional disciplines?

Direct and environmental payments need to be firmly in the Green Box if they are to be a satisfactory alternative to current programs. Effective environmental programs that are minimally trade-distorting should be encouraged. Payments used as a substitute for price supports but not made for the provision of environmental or other services need to be monitored to ensure that the movement to less trade-distorting policies is not compromised.

The resolution of these Green Box issues will be extremely difficult if a swift conclusion is to be reached to the Doha Round. In the short run, steps should be taken to improve timely notification, monitoring and surveillance of Green Box payments (in line with more timely notification of all elements of domestic support). Ad hoc modifications or extensions of the existing conditions that are made in haste, however, run the risk of creating more problems than solutions. The only practical option is to postpone the full review and clarification of Green Box criteria to a designated period following the conclusion of the Round, for adoption at a specified date in the future. Given the other critical issues on which closure is needed, an agreed process of future review and clarification that addresses the interests of both developed and developing countries would seem to be the best way forward.

Endnotes

1This IPC Policy Focus is based on a more thorough discussion published in an IPC Discussion Paper, "Should the Green Box be Modified?" by David Blandford, Professor in the Department of Agricultural Economics and Rural Sociology, Pennsylvania State University, and IPC Member Timothy Josling, also senior fellow at the Spogli Institute for International Studies at Stanford University.
2 In the absence of some other form of direct personal gain or altruistic behavior, it is difficult to see why producers would participate in environmental programs without an incentive component.
3 Other elements of the proposals may be inconsistent with Annex 2, for example, the definition of a revenue shortfall that triggers payments and the amount of compensation provided.
4 As laid out in an IPC Discussion Paper, "WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace," by Robert Howse, the HTS lists ethanol as an agricultural good, but biodiesel as an industrial good.
5 This is probably a conservative estimate of the impact of CAP reform on the composition of EU support, since it will also have affected the size of the AMS.
6 EU members were allowed to retain a limited proportion of direct aids as coupled. There is no explicit requirement that these be changed in the future. However, a further review of the CAP to take place in 2008 may well result in pressures to reduce the use of coupled payments.
7 As mentioned above, if the feedstock has no agricultural use, its subsidized production on retired land should not run afoul of Green Box rules.
8 This is central to the Sanitary and Phytosanitary Measures and the Technical Barriers to Trade Agreements.

About IPC

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