



Biofuel and Biomass Subsidies and WTO Rules

This policy focus provides a brief overview of the key findings of IPC's September 2010 position paper, "Biofuel and Biomass Subsidies in the U.S., EU, and Brazil: Towards a Transparent System of Notification" by Tim Josling, David Blandford, and Jane Earley. For sources and references, please refer to the full paper, which can be found on IPC's website at: <http://www.agritrade.org/BiofuelSubsidiesUSEUBrazil.html>

IPC's latest Position Paper focuses on governmental subsidies provided to the biofuels sector: **the paper argues for greater transparency about the types and levels of these subsidies.**

- As trade in biofuels and their feedstocks increases, the likelihood of trade conflicts over the impact of subsidies on trade is likely to increase as well. In the absence of agreement as to where the impacts of such subsidies fall, such conflicts are probably going to be heated and disruptive.
- Taxpayers deserve greater transparency about subsidies in the energy sector more generally.
- Biofuels subsidies also deserve a specific look as they are derived from agricultural feedstocks, raising questions about whether they also constitute support to the agricultural sector.

There are a variety of ways in which governments channel support to the biofuels sector from support for the production of biomass, to support for biofuel production and distribution and support for the consumption of biofuels, and for research and development. Mandates for blending biofuels into vehicle fuels have been enacted in at least 17 countries. These targets are often accompanied by supporting mechanisms, such as subsidies and tax exemptions. Such measures are frequently supported by import tariffs to limit import competition in domestic fuel markets. **If all biofuel policies are taken into account, the OECD estimates that their total effect on coarse grain prices ranges from an increase of 10-17 percent and 6-9 percent for wheat and oilseeds.**

An important way to promote greater transparency about support to the biofuels sector is to clarify how WTO disciplines apply to biofuel subsidies, since such subsidies are relatively new on the scene and their place in the WTO rulebook is untested and sub-

ject to debate. There are two WTO Agreements that deal with subsidies: the Agreement on Subsidies and Countervailing Measures (ASCM) and the Agreement on Agriculture (AoA), and biofuel subsidies need to be in compliance with both of them in order to avoid challenges from other WTO members. **But the matching of subsidy policy with the appropriate WTO discipline is not always easy, and there are a number of questions to clarify:**

- **What type of product are biofuels?** The AoA characterizes ethanol as an agricultural product, whereas biodiesel is regarded as an industrial product. Yet, feedstocks used for the production of both ethanol and biodiesel are agricultural products, and the AoA would cover support that benefits producers of agricultural products.
- **Who receives the benefit of the subsidy?** Producers of biomass may receive a subsidy and thus provide a "downstream subsidy" to biofuel producers through lower feedstock prices. When a subsidy is paid to the ethanol producer, it can be passed "upstream" to the feedstock producer through higher prices for feedstocks. A subsidy provided to blenders may benefit the ethanol producers as well as the feedstock producer.
- **Do the benefits of the biofuel subsidy accrue to domestic producers or to all producers of the feedstock?** A standard concern about subsidies is that they serve to disadvantage competing producers, but in the case of biofuels subsidies, the negative impact of subsidies that raise the price of feedstocks, may fall on consumers rather than competing producers, as food costs rise throughout the world.
- **What about biofuel mandates?** In and of

itself, a mandate confers no benefit on the party that has to abide by it, but as it is often accompanied by subsidies or tax credits, would a WTO panel treat the two as part of the same policy and examine the two instruments together?

WTO Disciplines on Subsidies

The **ASCM** sets forth that a subsidy must entail a financial contribution; must be made by a government and must confer a benefit, all of which would apply to biofuel subsidies. Yet, a subsidy must be a “specific subsidy,” for the ASCM disciplines to apply, and the Agreement divides specific subsidies into those that are prohibited (i.e. export incentive subsidies contingent on export performance and local content subsidies granted for the use of domestic inputs over imported goods) and those that are “actionable,” potentially subject to challenge. A WTO member can initiate remedial action if it proves that non-prohibited actionable subsidies cause serious prejudice to its interests. Serious prejudice may arise when one or more of the following apply: imports into the market of the subsidizing country are displaced; exports to third country markets as a result of the subsidy are displaced; there is significant price suppression as a result of the subsidy, and there is an increase in world market share by the subsidizing country. In addition to a challenge based on serious prejudice, a subsidy can also be countervailed if it causes injury to domestic producers.

The **AoA** includes disciplines for “all domestic support measures in favor of agricultural producers,” but exempts “green box” support from reduction. The Aggregate Measure of Support (AMS) quantifies the level of support and is subject to ceilings set forth in national schedules agreed in the Uruguay Round. AMS support is defined as benefitting producers of “basic agricultural products,” “as close as practicable to the point of first sale,” again raising the question of how biofuels are to be classified. In addition to subsidies to feedstock producers, it might be argued that blending requirements, often combined with protection from imported biofuels, serves to increase the domestic demand for feedstocks and thus their price, providing support in favor of basic agricultural products. **The issue would be how to assess the magnitude of the subsidy for a particular basic product due to the fact that the subsidy accrues to the processor (blender) rather than directly to agricultural producers. If measures used to promote domestic production of biofuels are judged to fall under the AoA, it would appear on the surface that they should be treated as amber**

box support and included in a country’s estimate of its current total AMS, yet there are potential difficulties, i.e. it is difficult to calculate precisely the price support such measures provide.

Could biofuel subsidies fall under the Green Box?

Measures to support biofuels are generally publically funded – a key general Green Box requirement, but any benefits that producers receive from import restrictions (which serve to enhance the value of the tax credit) are not likely to meet this criteria, as there is arguably a consumer transfer involved and the measures to provide price support for producers.

WTO Notifications of Biofuels Support Measures

Both the ASCM and the AoA require notifications of national subsidies. Under the ASCM, any specific subsidies must be notified to the SCM Committee no later than June 30 each year, and notifications must be sufficiently detailed “to enable other Members to evaluate the trade effects and to understand the operation of the notified subsidy programs.” The AoA is much less demanding with respect to the notification of agricultural support; it set up a Committee on Agriculture to monitor compliance with obligations but is less precise as to how to relate support to trade implications of subsidies. In fact, the distinction between subsidies and market access in the AoA acts to confuse rather than inform the significance for trade. The diverse coverage of biomass subsidies in these notifications further illustrates the unsatisfactory nature of the agricultural notifications.

WTO notifications provide little insight into the magnitude of biofuels subsidies. In both the agricultural support and industrial subsidies contexts, US, EU and Brazilian notifications of biofuel support have fallen far short of their potential in terms of coverage, timeliness and transparency.

The Global Subsidies Initiative (GSI) estimated that some \$5.9-7.2 b were provided as US subsidies to liquid biofuels in 2006. That year, the US notified a total of \$2.7b biofuels subsidies to the SCM Committee. The U.S. notified non-exempt payments for corn, sorghum and wheat under a bioenergy program and for livestock and soybeans under a biodiesel program for 2000-2005; the total was about \$150 million in 2002 and 2003. This total would arguably be significantly larger had the impact of all biofuels programs been included, depending on how the price-enhancing effect of current policies (mandate, tax credit and import tariff) would have been estimated.

One estimate finds that corn prices would be 6-7 percent lower on average for 2011-2017, if US ethanol policies were not in place and this would translate into an addition to the notified total AMS of roughly \$3b. Using a WTO notifications simulator, projected total AMS for 2015 without ethanol subsidies ranges from roughly \$3.5 to \$7b, and with the subsidies, would be \$6.5 to \$10b, and thus would not impact the US' ability to meet its existing ceiling AMS commitment of \$19.1b. **Yet the potential inclusion of (at least some) ethanol subsidies in the total AMS could be significant for the US if agreement is finally reached in the Doha Development Round negotiations and the US total cap on AMS would go from \$19.1b to just over \$7.6b.** Under existing Doha modalities, the US would exceed a product specific cap on AMS for corn, and possibly also for its total AMS.

The EU's latest SCM notifications cover 2007-2008, and the only specific notification relating to biofuels is the Energy Crops Scheme with \$13.5 m in 2004 and \$54 m in 2006 notified. Notifications for 2007 and 2008 mention the amount (45 euro per hectare) but not the total costs. These payments are also reported in the agricultural notification for those years under the Blue Box of quantity limited subsidies. The EU no longer gives specific aid for energy crops. EU member states can grant investment subsidies for on-farm investments in bioenergy and these are notified to the WTO as green box payments. **However, the main schemes to encourage the uptake of biomass for energy purposes are not reported by the EU as agricultural subsidies.** Some estimate that if the EU had to declare its biofuel support as amber box support, then it could account for about 16 percent of its total AMS. Clearly, if new Doha constraints were to apply, and the EU had to declare its support for biofuels, this could represent a serious challenge.

Brazil has not provided any notifications under Article 25 of the ASCM. While this is understandable given the relative absence of specific subsidies in Brazil, it leaves open the question as to whether some producers of biomass and ethanol may benefit significantly from the range of measures taken to keep ethanol competitive with petroleum? Under the AoA, Brazil's last notification of domestic support measures covered 2004/05 and 2006/07 years. For 2004/05, Brazil records a payment in favor of sugar cane producers of some \$8.25 m under the market credit equalization program for ethanol, which amounts to only 0.15 percent of the value of sugar cane production. Brazil maintains to the WTO that it does not provide agricultural export credit programs, with the majority of lending to the

sector coming from private non-bank sources such as domestic agribusiness and international lenders. The WTO Secretariat noted in its 2009 Trade Policy Review for Brazil that "although the value of assistance to agriculture in Brazil is low compared with the average in OECD countries, the interventions in both the credit and agricultural domestic markets are distorting forms of support." However, it does not seem likely that alternative forms of notification would have a major impact on Brazil, as the level of support would not be greatly affected, even with the implementation of a successful Doha Round.

Conclusions and Recommendations

- If oil prices stay sufficiently high, the production of biofuels could one day be possible without a subsidy. In the meantime, the mandates for biofuels use are likely to remain elusive without public financial support and the trade conflicts over the impact of subsidies are likely to increase.
- There is a disturbing lack of transparency in how biofuel subsidies are notified and treated in the WTO. Under both the ASCM and the AoA, lacking or insufficiently detailed notifications do not allow an estimate of the trade impact of subsidies. The SCM Committee has not been able to persuade WTO members to report all subsidies in enough detail to allow analysis. The Agricultural Committee seems to have been content to ignore subsidies to biofuels through mandates even though a case can be made that these should have been reported. Until the information is available on a comparable basis over time, the question of who benefits and who loses from biofuel support policies will remain unanswered.
- If a recognizable stream of additional income is generated for producers of biomass, subsidies would fit under the AoA, and the question of where in the AoA they should be notified would be very relevant, in particular if constraints on agricultural subsidies are enhanced by a Doha Agreement.
- **The time is ripe for an initiative to clarify both the status and magnitude of biofuels subsidies in the WTO rules, and the magnitude of these subsidies, which could involve the OECD, the International Energy Agency and others with an interest in the monitoring of policies.**