

Post-Conference Draft

## **ICTSD/IPC/IFPRI Conference on Revised Draft Agricultural Modalities:**

### **The Consequences for the European Union of the WTO Revised Draft Modalities for Agriculture**

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#### ***Introduction***

The EU has been playing a more active role in setting the agenda for the agricultural component of the Doha Round than it did in the Uruguay Round and in earlier GATT rounds.<sup>1</sup> The Commission, negotiating on behalf of Member States, has tried to avoid the defensive position that gave it little room to suggest changes in the rules that it would favor. In particular it wanted to avoid being isolated as the main defender of protectionist agricultural programs, and risk being blamed for resisting further progress in bringing agricultural trade rules closer to those in the non-agricultural sector.

This new position has indeed had a major impact on the conduct of the negotiations. Although transatlantic tensions still exist, often over issues such as regulations regarding biotech food and the use of place names for trademarks, the past five years has seen a noticeable convergence of EU and US positions on agricultural trade rules. The conflicts that are prolonging the Doha Round

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\* Thanks are due to Alan Swinbank and David Blandford for their collaboration with one of the authors in the IFPRI study upon which the domestic support calculations are based.

<sup>1</sup> We use the term EU for the collective position and interest of the European Union rather than the technically correct term EC, preferred in WTO documents.

agricultural talks are more often between the US and the EU on the one hand and developing countries on the other. Both the US and the EU have agreed that there will be significant cuts in tariffs, subject to partial exclusions for sensitive products, and major reductions in the allowable level of trade-distorting domestic support. The elimination of export subsidies is no longer a significant point of contention, although there are still differences in the area of food aid.

The main reason why the EU can be so much more positive in its approach to trade talks is in the progress it has made with domestic reform of agricultural policy. The MacSharry reforms of 1992 allowed the EU to agree to disciplines on domestic and export subsidies in the Uruguay Round Agreement on Agriculture (URAA), as well as resolving the oilseed controversy. Payments that were made in compensation for price cuts were placed in the Blue Box, and thus avoided mandated reductions. Support given through administered prices also declined, in part as a result of the use of fixed reference prices for the calculation of the subsidy element. So the partially-reformed CAP had no difficulty staying within the bounds of the EU's schedule of subsidy reductions over the past decade.

Further reforms have had a similar impact, lowering the level of trade-distorting subsidies and making it easier for the EU to contemplate and accept further restrictions on agricultural policies in the WTO. In this connection, the changes in 1999 (the Agenda 2000 reforms) and the subsequent significant changes in 2003 and 2004 attributed to the leadership of Commissioner Fischler have made the CAP significantly more consistent with the "tariffs and decoupled payments" model that underlies the URAA.

To what extent would a successful conclusion of the Doha Development Agenda (DDA), along the lines of the modalities in the Revised Draft Modalities paper of February 8, 2008, require further changes in the Common Agricultural Policy? Will those changes be made easier by corresponding disciplines on the domestic programs of other countries? How much increased market access is likely to be generated as a result of cuts in tariffs that would be required of the EU? Can the EU expect to expand its own exports of agricultural products as a result of the tariff cuts of others? Will the termination of the EU's use of export subsidies to balance its internal market have any significant impact on price levels and on world market conditions? And to what extent will the modification of the export policies of competitors help the EU to move away from export subsidies? What other issues will the EU insist on as it moves towards a package that is acceptable to Member States?

This paper attempts to address these issues, as a way of exploring the domestic and international implications of a Modalities agreement. The first section of the paper gives some background information on the nature of the CAP as it relates to the disciplines introduced in the URAA. This section is useful to give some perspective on the potential impact of the DDA as it relates to the recent development of the CAP. A second section reviews briefly the main "offensive" and "defensive" positions of the EU, so as to be able to evaluate the extent to which the modalities draft addresses these issues. This perspective is relevant to

the political reactions that will determine the acceptability of the Modalities. The next three sections discuss in more detail the implications of the domestic support, market access and export competition modalities, and give an interpretation of the WTO disciplines as a constraint on future policy developments. A final section attempts an overall assessment of the impacts of the suggested modalities on the EU and on its negotiating interests.

### ***1. The CAP and WTO Disciplines***

The level of farm support in the EU has historically been high relative to that of many other countries. The high level of that support has been criticized by trading partners, as has the nature of the support measures used. The CAP was introduced forty-five years ago, when agriculture in the original six members was still recovering from the devastation of the Second World War. Countries agreed on the need to offer secure markets within the EU through protection against imports and the purchase of surplus products for disposal abroad. Import protection was given by means of a levy that varied inversely with world prices (a variable levy) so that imports would enter the domestic market at a predetermined threshold price. On the export side, a subsidy (restitution) was paid that covered the difference between domestic intervention prices (at which supplies were purchased off the domestic market) and the world price.<sup>2</sup> Thus domestic prices were supported at a level that reflected a political decision by the (Agricultural) Council of Ministers meeting periodically, and were generally well above world prices.

The high level of target prices relative to world prices over much of the past thirty years has tended to isolate the EU internal market. With such a controlled market, the need for internal subsidies was minimal. Domestic (taxpayer funded) subsidies were the exception rather than the rule, being limited to products of mainly regional importance such as durum wheat and olive oil, to livestock grants paid to hill farmers, and to the crushers of EU-grown oilseeds, a contentious scheme that provoked a trade dispute with the US.

A succession of reforms in the past twenty years has changed the nature of the CAP and the policy environment in which EU agriculture exists. In 1992 a significant change was agreed that introduced direct payments in compensation for price cuts in cereals and beef; and the support arrangements for oilseeds were revised. These cereal and oilseed payments (COP), based on area grown, represented a major change in the instrumentalities used by the EU to support its farm sector.<sup>3</sup> The reforms reduced the reliance on intervention and the subsequent subsidizing of exports in the cereals market by cutting the domestic support price. The reduction of cereal prices and the consequent decline in the

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<sup>2</sup> Both the threshold price and the intervention price were linked to a target price that was intended to give an acceptable level of farm income. The system described here operated for cereals: other products had regimes of a broadly similar nature.

<sup>3</sup> The MacSharry reforms also increased, and extended, the range of headage payments for beef farmers, and brought those for sheep and goats into a comparable framework.

need for export subsidies allowed the EU to agree to restrictions on export subsidies in the GATT Uruguay Round, as embedded in the URAA.

Domestic subsidies were also constrained in the URAA, in particular those that were deemed to be most trade distorting. The extent to which these direct payments, related to past output and tied to quantitative restraints, should be disciplined was a major topic for negotiation at the Blair House meeting of November 1992, at which the EU and the US agreed on the main parameters of the URAA. The device of the Blue Box was introduced at that time as a way of placing the MacSharry compensation payments (and the US deficiency payments) in a category separate from the most trade distorting subsidies (as measured by the Aggregate Measure of Support (AMS)). The Blue Box payments were not subject to reductions, though they had to be limited (for crops, to a fixed area and yield, or paid on 85 percent or less of a base level of production) and support was not to exceed the 1992 levels. Thus the Blue Box represented the way in which the reformed CAP became consistent with the Uruguay Round constraints. The notifications by the EU to the WTO reflect this compromise, and provide the starting point for an analysis of the impact of the Revised Draft Modalities of the Doha Development Agenda.

By contrast, the level of border support, through tariffs and export subsidies, has been reduced by a lesser amount. Hence the exporters of farm goods still consider the EU market to be restricted, and still object to the use of export subsidies to clear the market. In this regard, the EU has to complement its domestic reforms with significant changes in market access. In addition, other countries would not consider a Doha Round that left export subsidies intact to be satisfactory.

## ***2. EU Negotiating Position***

The above developments shape the EU's negotiating position in the DDA. Relative to the US and the G-20, the EU has argued for a slower opening of markets, but has agreed to the elimination of export subsidies and a steep reduction of domestic support. The EU has also emphasized the importance of flexibility in the case of sensitive products.

The EU has tabled a market access offer including tariff cuts and a somewhat high tariff cap (100 percent), but wants exceptions for more "sensitive products". The EU has agreed to end export its subsidies only if other export programs used by US and Canada are curbed. The EU has laid out plans for significant cut in its own domestic support limits, and has indicated that it expects the US to make real cuts in its own support.

Negotiations have been ongoing in the Trade-Related Intellectual Property (TRIPS) Council, as mandated in the Uruguay Round, on the establishment of a multilateral register for wines and spirits. The EU has insisted on a link between these talks and the agricultural negotiations, and has indicated that it needs some concessions in this area before agreeing to a broader deal. The US, Australia and Canada are however, opposed to the concept of a mandatory register but

willing to agree to a voluntary list of GIs that countries can refer to when setting domestic regulations.

Discussions have stalled on the other GI issue of interest to the EU, that of extending the “enhanced” protection given in the TRIPS to wines and spirits to other food products. There is no agreement whether indeed these talks are mandated by the Doha Agenda. In this case, some developing countries have supported the EU in arguing for such an extension of protection. The Framework Agreement and the Chairman’s Revised Draft are silent on the resolution to this problem.

In summary, the conditions for a package acceptable to the EU are now fairly clear, though the willingness of countries to agree to them is still elusive. These conditions include:

- **Market Access:** substantial improvements in access to developed and emerging markets are needed in order for European governments to retain domestic support for the deal. EU will need to reduce demands for wide sensitive product exclusion from tariff cuts. This might entail substantial market opening through TRQ expansion.
- **Domestic support:** real cuts in domestic support are required by the US and EU that have to be credible to developing countries. Ceilings must be lower than historical levels to avoid increases in domestic support in the future. The EU can satisfy this condition more easily than the US (see below).
- **Export subsidies:** all forms of export aids need to be eliminated in parallel, as conditionally agreed. The EU has put its own export subsidies “on the table: and the prospect of losing this concession is a significant pressure on other countries to complete a deal.
- **Balancing issues:** some progress will be needed in other areas, such as GIs, in order to “sweeten the pot” for those who would otherwise be seen to make the largest concessions. By the same token, a new Peace Clause could be necessary as a part of a final package to convince domestic politicians that policies will not be subject to endless legal challenge.

In addition, the EU is seeking an equal level of “ambition” in other areas of the talks, particularly Non Agricultural Market Access (NAMA) and Services, so that a broad package can be put together that all Member States can support.

### ***3. Domestic Support***

#### **Notifications**

The first notification of domestic support by the EU, in 1995/96, coincided with the final years of the implementation of the MacSharry reforms.<sup>4</sup> Direct

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<sup>4</sup> The compensation payments were introduced progressively in the marketing years 1993/94 – 1995/96.

payments (the area payments on cereals and oilseeds, and the headage payments on beef and sheep) were placed in the Blue Box, as they were associated with limits on production. As a result, the original notifications, from the 1995/96 marketing year, included a large AMS component (48 billion euro) and smaller but sizable Blue Box element (21 billion euro) and a relatively modest amount of Green Box payments (19 billion euro).<sup>5</sup>

The EU last notified its level of domestic support in December 2006. The period covered support up to the 2003/04 marketing year. Figure 1 shows the notifications from 1995/6 to 2003/04. The nature of the CAP reforms since 1995 is reflected in the notifications of domestic support to the WTO. The changes in policy show up as a major shift in the pattern of the notification among the different categories of domestic support. Support prices have been reduced for most of the major products, to close somewhat the gap between EU prices and those in world markets. Export subsidies have also been reduced in part as a result of the WTO constraints.

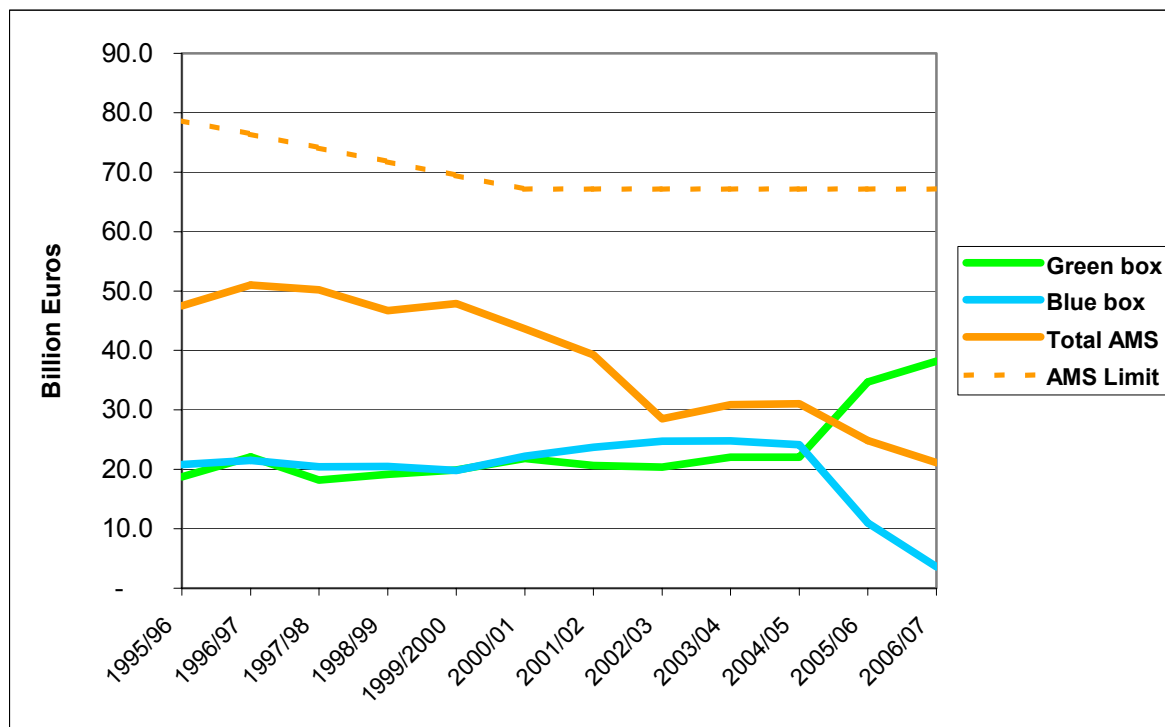
The “new” CAP, starting with the MacSharry reforms, places heavy reliance on direct payments to farmers based on past production patterns and broadly unrelated to current prices and output decisions. Thus the nine notifications from 1995/96 to 2003/04 show a marked reduction in price supports compensated by an increase in direct payments. Current Total AMS payments fell from around 50 billion euro in 1995/96 to 30 billion euro in 2003/04, a 40 percent decline. Blue Box payments rose over the period, from 20 billion to 25 billion euro, and Green Box payments rose from 18 billion to 22 billion euro.<sup>6</sup>

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<sup>5</sup> No estimate exists of what would have been the AMS notifications before 1995, had they been required. But it is likely that, in the eight years between the 1986-88 base and the first year of the URAA, trade-distorting support (as measured by the AMS) fell from about 80 billion to 50 billion euro. This was due in large part to the introduction of the MacSharry reforms and the placing of these payments in the Blue Box. Green Box eligible policies probably rose modestly over the same period.

<sup>6</sup> Though this might appear to suggest that about 10 billion euro in less trade-distorting support has replaced 20 billion euro of more trade-disruptive payments, it should be remembered that the much of the AMS is a calculation based on the difference between an administered price and a fixed reference price. So a drop in this support can be unrelated to either government payments or farm income.

Figure 1: EU Notifications of Domestic Support, 1995/96 to 2003/04 with Estimates to 2006/07



Source: WTO EU Notifications and Author's Estimates

The mix of policies in the EU changed relatively little from 1995 to 2000, as the reforms in the cereal and oilseed sectors were being assimilated. But budget pressures and the prospect of ten new members from eastern and central Europe led the EU to consider further reforms. These were incorporated in a decision known as the Agenda 2000 reforms that were agreed in 1999. These reforms had a noticeable impact on the EU domestic support notifications, maintaining the direction of the 1992 reforms but pushing somewhat further. Intervention prices were reduced by 29 percent for cereals (including a more substantial cut for rice) and, from 2005, they were to be reduced by 15 percent for butter and for skimmed milk powder, reducing the gap between these “administered” prices and the fixed reference prices.<sup>7</sup> The AMS fell from 48 billion euro in 1999/2000 to 29 billion euro in 2002/03. Changes in the beef regime also modified the notifications somewhat: to the existing subsidies for suckler cows and the special beef premium was added a slaughter premium and some supplementary payments, notified as Blue Box payments as they were limited to base levels of livestock numbers. Blue Box payments increased by 10 billion euros over this period.

<sup>7</sup> The Agenda 2000 package also agreed a new dairy premium from 2005, to compensate dairy farmers for the scheduled reductions in butter and skim milk powder intervention prices. In G/AG/N/EEC/17 the EU said it intended declaring these payments in the Blue Box.

Even more significant in their impact on the EU's domestic support notification have been the reforms enacted since that time, notably the 2003 Fischler Reforms, the changes in the regime for the Mediterranean crops in 2004, the reform of the sugar policy in 2005, and the reform of the fresh and processed fruit and vegetable policies in 2007. The introduction of a Single Farm Payment, the key ingredient of the 2003 Reform, further separates payments from current production. An estimate of the notifications for the years 2004/05 to 2006/07 are included in Figure 1.<sup>8</sup> The 2004/05 notification of domestic support will include some of these decoupled payments under the Fischler reforms, those that were made in 2004, but the main impact will be on the notifications from 2005/06 and 2006/2007, by which time many of the policy changes will have been implemented.

The result of these reforms is that a significant shift from Blue Box to Green Box is likely to occur in the next few notifications, as the Blue Box could be reduced to about 4 billion euro in 2006/07 from about 25 billion euro in the most recent notification, and the Green Box could expand from 22 billion euro to 38 billion over the same period (see Table 1). A significant further reduction could occur in the AMS, from 31 billion euros to 21 billion euros between 2003 and 2006, reflecting the changes in policy, as many payments that were previously linked to production are shifted to the Green Box. By 2006/07 the transformation of the CAP into a predominantly Green Box policy will be well underway, with a further increase in decoupled direct payments and a reduction of those in the Blue Box and the Product-Specific AMS (Blandford and Josling, 2007; Josling and Swinbank, forthcoming).

In the URAA limits were put on trade-distorting domestic support. In particular, the Current Total AMS had to be within a ceiling given by the 1986-88 base level reduced over six years by 20 percent. The base period AMS as calculated by the EU (and agreed by other countries) was to be reduced by the year 2000 to 67.2 billion euro.<sup>9</sup> These commitments continue until a revised set of limits is agreed, as would be the case if the Doha Round arrived at a conclusion.

The EU is well within the limits set by the Agreement on Agriculture, in part because of the high AMS recorded in the base period and in part as a result of the steady progress of reform, moving away from price support toward direct payments. Figure 1 shows the Current Total AMS in relation to the negotiated

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<sup>8</sup> For the details behind these forecasts see Josling and Swinbank (forthcoming).

<sup>9</sup> The EU (at that time the EU12) declared a base period AMS of 73.53 billion euro, which with a 20% reduction would have given an AMS commitment in 2000 equal to 58.82 billion euro. However, a 'credit' of 2.38 billion euro was negotiated, and this led to a Final Bound Total AMS of 61.20 billion euro being agreed (see Supporting Table 9a in the EU notification). Enlargement to the EU15 necessitated some changes. The initial AMS figure of 78.7 billion euro mentioned in the text was the EU15 limit in the first year of implementation. The revised Final Bound Total AMS was fixed at 67.2 billion euro for the EU15. No limit has been agreed for the EU of 25 or of 27: for the purposes of this chapter we will assume that the EU15 limit is continued.

AMS limit. In the latest official notification, the AMS stood at 30.9 billion euro, and our estimated notification for the year 2006/07 shows the level at 21.2 billion euro. Projected notifications for the years beyond 2006/07 indicate that one can expect the level of AMS payments to drop to about 20 billion euro with the full impact of the CAP reform, and to be stable after 2009 (Josling and Swinbank, forthcoming). This situation gives the EU considerable scope for agreeing to reductions in the ceiling for the AMS as a part of a Doha Round agreement.

Table 1: EU Notifications of Domestic Support, and Composition of Support, 1995/96 to 2003/04 and Estimates to 2006/07

	1995 /96	1996 /97	1997 /98	1998 /99	1999 /2000	2000 /01	2001 /02	2002 /03	2003 /04	2004 /05	2005 /06	2006 /07
€ billion												
Green Box	18.7	22.1	18.2	19.2	19.9	21.8	20.7	20.4	22.1	22.1	34.7	38.2
Blue Box	20.8	21.5	20.4	20.5	19.8	22.2	23.7	24.7	24.8	24.2	11.0	3.6
Current total AMS	47.5	51.0	50.2	46.7	47.9	43.7	39.3	28.5	30.9	31.1	24.9	21.2
PS de minimis "used"	-	-	-	-	-	-	-	-	-	1.5	1.2	0.9
NPS de minimis "used"	0.8	0.7	0.5	0.3	0.3	0.5	0.6	0.9	1.1	1.0	1.0	1.0
Total Support	87.9	95.4	89.3	86.7	87.9	88.3	84.2	74.6	78.8	79.8	72.7	64.9
Share of Total Support												
Green Box	21.3%	23.2%	20.3%	22.1%	22.7%	24.8%	24.5%	27.4%	28.0%	27.7%	47.7%	58.9%
Blue Box	23.7%	22.6%	22.9%	23.6%	22.5%	25.2%	28.2%	33.2%	31.5%	30.3%	15.1%	5.6%
Current total AMS	54.1%	53.5%	56.2%	53.8%	54.5%	49.5%	46.6%	38.2%	39.2%	38.9%	34.2%	32.6%
De Minimis	0.9%	0.8%	0.5%	0.4%	0.3%	0.6%	0.7%	1.3%	1.3%	3.1%	3.0%	3.0%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
URAA AMS Binding (billion euro)	78.7	76.4	74.1	71.8	69.5	67.2	67.2	67.2	67.2	67.2	67.2	67.2
Share of Binding	60.4%	66.8%	67.8%	65.1%	68.9%	65.0%	58.5%	42.4%	46.0%	46.2%	37.0%	31.5%

Source: WTO EU Notifications (1995/96 – 2003/04) and Author's Estimates (2004/05 – 2006/07)

## The Revised Draft Modalities for Domestic Support

The Doha Round is at present considering a number of changes to the URAA that would have an impact on the constraints on EU policy from WTO obligations. In February 2008 Ambassador Crawford Falconer, the chair of the WTO's Committee on Agriculture, released a revised set of draft modalities for agriculture that included detailed proposals for future disciplines on domestic support (WTO, 2008). The Falconer Revised Draft Modalities paper was an attempt to frame the parameters of such increased restraint so as to enable countries to converge on a single document. The EU has indicated that it would be willing to accept a conclusion within the range of the Falconer draft, provided that other countries respond with satisfactory offers in other areas.

The Falconer proposals, as they would apply to the EU, are summarized in Table 2. The proposals would place a limit on overall trade-distorting support (OTDS). The base period OTDS would comprise the Final Bound Total AMS, ten percent of the 1995-2000 value of agricultural production (the current *de minimis* allowances), and the higher of the average Blue Box payments and 5 percent of the value of agricultural production in the base period. This OTDS limit would be subject to reductions over the implementation period of the agreement. There would also be reductions in the limits for the total AMS from the final values applying under the Uruguay Round Agreement as well as in the *de minimis* percentages. The Blue Box would have limits imposed based on the percentage of the value of production. Limits would also be imposed on the product-specific AMS and on product-specific Blue Box support, as described in the table.

The implications for the EU of these proposals are summarized in Tables 3 and 4. The Base OTDS, from which reductions would be measured, would be 110.3 billion euro. Thus the range for the Final Bound OTDS would be from 16.5 to 27.6 billion euro. This corresponds to an estimate of 24 billion euro for the Current Total OTDS in the year 2013/14.<sup>10</sup> Thus the more restrictive limit would appear to bind and impose further policy changes of a nature consistent with developments since 2003. The AMS limit would be reduced from the current level of 67.2 billion euro to 20.1 billion euro (augmented minimally by allowance for the enlargement of the EU). The estimated Current Total AMS for the year 2013/14 is 20.0 billion euro, indicating no significant restraint on EU policies if they continue on their current course. The overall picture is shown in Figure 2. The year 2013/14 is the only year when policy options are likely to be significantly constrained – and that is the year when a new budgetary cycle starts in the EU at which time the funding for the CAP could well be trimmed for internal reasons.

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<sup>10</sup> In order to examine the impact of these changes on future notifications we assume that new WTO support commitments are implemented over the period from 2010-2014, so that all new reductions and bindings apply fully in 2014. Our assumptions about the evolution of agricultural policy in the EU are that progressively more of the direct payments can be notified as Green Box, as the "Health Check" solidifies the changes in the 2003 Reforms.

Table 2: Main Domestic Support Provisions of the Revised Draft Modalities  
(February 2008) as applied to the EU

<b>Item</b>	<b>Initial Values</b>	<b>Reduction</b>
<b>Overall Trade-Distorting Domestic Support (OTDS)</b>	Base OTDS=Final Bound Total AMS+10 percent of the value of production in the base period (1995-2000)+average Blue Box payments in base period (a)	Base level reduction of [75] [85] percent. Initial reduction of 1/3 in first year: remaining reductions in five equal steps
<b>Total Aggregate Measure of Support (AMS)</b>	Base level is Final Bound Total AMS (from Uruguay Round schedules)	Base level reduction of 70 percent. Initial reduction of 25 percent in first year: remaining reductions over five years.
<b>Product-specific AMS</b> <i>De minimis</i>	Base level is average of 1995-2000 Base level is five percent of value of production for non-product specific support and five percent of the value of production of products that receive product-specific support	Base period levels not to be exceeded (b) Reduction of [50] [60] percent [from the start of the implementation period] [in five equal steps].
<b>Blue Box</b>		Capped at 2.5 percent of value of production in base period (1995-2000) applied from start of implementation period.
Product-specific Blue Box Cotton AMS		Product specific caps at average value in 1995-2000 period (c). Reduced by 74.29 percent in two years, with a 25 percent reduction in the first year

Source: Author's summary based on WTO (2008)

Notes: (a) Blue Box payments exceeded 5 percent of value of production in base period.

(b) Qualifications apply where product-specific AMS amounts above *de minimis* levels have been introduced since the base period (para 21) and where the product-specific AMS was below the *de minimis* level during each year of the base period (para 25). In the former case, the two most recent (notified) AMS levels may be taken as the base: in the latter case, the *de minimis* level may be used.

(c) Qualifications apply when Blue Box support was not provided for the whole of the base period (para 41) and where there is a corresponding one-for-one reduction in the AMS for a product (para 43). In the first case the EU can use the average of three years Blue Box payments and for the second the "transferred" support may exceed the Blue Box limit for that product.

<b>Table 3: OTDS, Total AMS, <i>de minimis</i>, and Total Blue Box Commitments for the EU under Revised Draft Modalities</b>	
	Million euro
URA Final Bound Total AMS (million euro)	67,160.0
Value of Production (million euro)	222,576.5
10% value of production (1995-2000) (million euro)	22,257.7
5% value of production (1995-2000) (million euro)	11,128.8
Blue Box (in excess of 5% value of production) (a)	20,887.9
<b>Base OTDS</b>	<b>110,305.6</b>
<b>OTDS (85% reduction) (million euro)</b>	<b>16,545.8</b>
<b>OTDS (75% reduction) (million euro)</b>	<b>27,576.4</b>
<b>DDA Final Bound Total AMS (70% reduction) (million euro)</b>	<b>20,148.00</b>
AMS/production 1995-2000 (b)	21.5%
<b>Total Blue Box</b>	
<b>2.5% value of production (1995-2000) (million euro)</b>	<b>5,564.41</b>
Average Blue Box relative to Base OTDS (c)	19%
<b>Cotton</b>	
<b>Base AMS for cotton (million euro)</b>	<b>752.7</b>
Cotton AMS reduction (assuming 70% total AMS reduction) (d)	<b>74.29</b>
Note a: tests for Para 1 condition, picks up Blue Box when above 5% of production value	
Note b: this tests for application of paragraph 15, less than 40%, additional effort does not apply	
Note c: test for para 39: less than 40 percent so no phased reduction allowed	
Note d: Application of cotton reduction formula paragraph 55 for AMS	

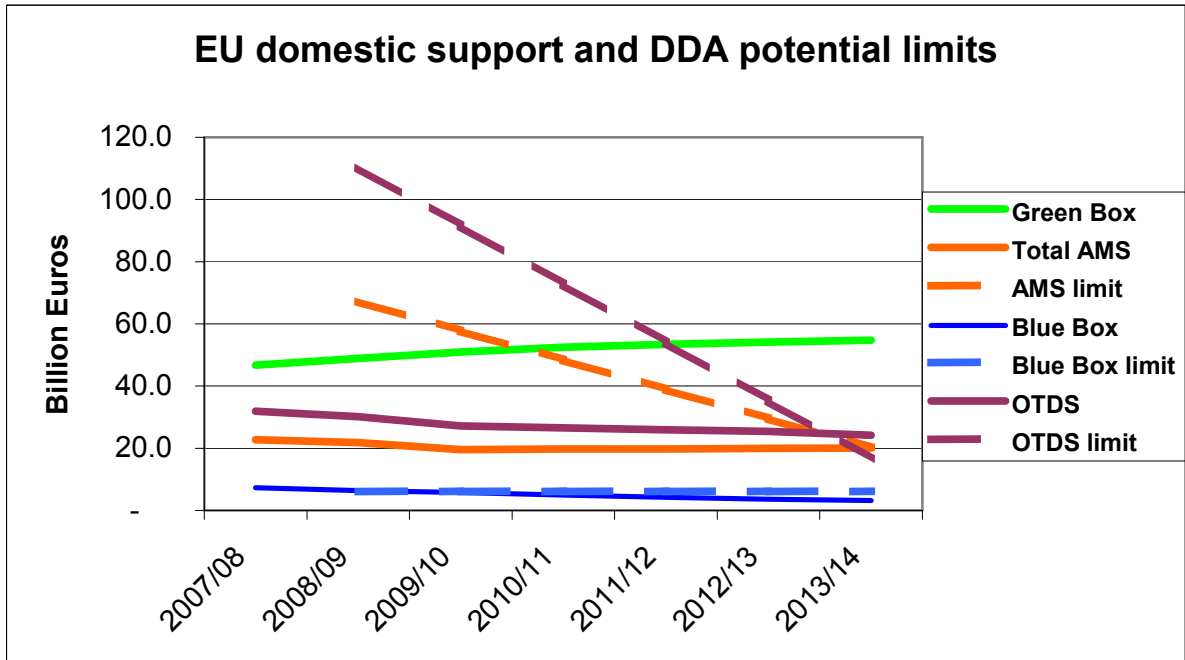
Source: Author's calculations based on WTO (2008)

**Table 4: Phased Reduction of OTDS and AMS, and *de minimis* limits, EU, under Revised Draft Modalities**

	Immediate	Year 1	Year 2	Year 3	Year 4	Year 5
<b>Reductions</b>						
Proportions of the base OTDS to be cut						
OTDS (85% reduction) (a)	0.33	0.43	0.54	0.64	0.75	0.85
OTDS (75% reduction) (a)	0.33	0.41	0.50	0.58	0.67	0.75
AMS (25% initial; 70% total reduction)	0.25	0.34	0.43	0.52	0.61	0.70
Cotton AMS (25% initial, 74.29% total) (c)	0.25	0.74	0.74	0.74	0.74	0.74
<b>Scheduled Limits</b>						
OTDS (85% reduction) (million euro)	73,904.7	62,432.9	50,961.2	39,489.4	28,017.6	16,545.8
OTDS (75% reduction) (million euro)	73,904.7	64,639.1	55,373.4	46,107.7	36,842.1	27,576.4
AMS (25% initial; 70% total reduction) (million euro)	50,370.0	44,325.6	38,281.2	32,236.8	26,192.4	20,148.0
Cotton AMS(25% initial; 74.29% total) (million euro) (d)	564.6	193.6	193.6			
<b>De minimis</b>						
50% immediate reduction <i>de minimis</i>	2.5%					
60% immediate reduction <i>de minimis</i>	2.0%					
50% phased (5 year) reduction <i>de minimis</i>		4.5%	4.0%	3.5%	3.0%	2.5%
60% phased (5 year) reduction <i>de minimis</i>		4.4%	3.8%	3.2%	2.6%	2.0%
Note a: Initial reduction of one third, with remainder phased-in in five equal steps (paragraph 5)						
Note b: Initial reduction of 25%, with remainder phased-in in five equal steps (paragraph 15)						
Note c: two year phase in period for cotton, with higher total reduction percentage						
Note d: Implementation period for cotton specified as one-third of the general period.						

Source: Authors' calculations based on WTO (2008)

Figure 2: EU Domestic Support Levels and DDA Proposed Limits



In addition to the constraints on total AMS and Blue Box support, the Revised Modalities Draft also proposes restrictions on product-specific AMS and Blue Box amounts (see Table 2 for details). The implications of these restrictions are shown in Table 6 (for the AMS limits) and Table 7 (for the Blue Box limits). These constraints might well be binding in specific instances. The Revised Draft suggests caps on product specific AMS payments at the 1995-2000 levels. Increases in administered prices are effectively restricted by this constraint. Changes in fixed reference prices are not envisaged in the URAA, and would presumably have to be negotiated. But variations in the level of “eligible production” for both the products where the market price support is calculated and for those where an equivalent measure of support is used could well lead to AMS limits being violated.

Blue box limits at a product specific level are also likely to have some impact. Though the total Blue Box spending may be decreasing, as payments move to the Green Box, those for individual products cannot increase to make use of that “slack”. Although these payments are currently tied to fixed yield, areas and head of livestock, the restriction implies no possibility of any re-basing of such payments that would violate the limits.

<b>Table 5: Product-specific AMS bindings, EU, under Revised Draft Modalities</b>	
<b>Product</b>	<b>Average AMS 1995-2005</b>
	million euro
Common wheat	2,783.58
Durum wheat	0.00
Common wheat, maize, barley, rye, triticale, grain sorghum	0.00
Barley	2,509.05
Maize	904.92
Rye	297.28
Oats	9.93
Sorghum	19.53
Triticale	211.38
Rice	463.68
White sugar	5,852.03
Skimmed milk powder	1,561.52
Butter	4,287.62
Milk	0.00
Beef	13,154.75
Pigmeat	0.03
Dried fodder	304.73
Chick-peas, lentils and vetches	69.77
Olive oil	1,909.92
Tobacco	962.37
Bananas	225.97
Apples	2,155.00
Pears	622.15
Apricots	123.80
Cherries	136.12
Peaches/Nectarines	439.47
Table grapes	247.12
Plums	76.58
Lemons	359.17
Clementines	188.13
Mandarins	48.20
Satsumas	31.57
Oranges	389.50
Cucumbers	567.67
Courgettes	152.48
Artichokes	184.87
Tomatoes	3,146.40

<b>Table 5: Product-specific AMS bindings (contd.)</b>	
<b>Product</b>	<b>Average AMS 1995-2005</b>
	million euro
Wine	1,711.12
Ethly alcohol of agricultural origin	0.00
Seed for sowing	99.65
Hemp	14.47
Flax fibre	101.27
Silkworms	0.37
Hops	14.60
Cotton	752.73
Cauliflower	2.83
Aubergines	0.00
Fruit and vegetables not mentioned in R2200/96	0.25
Asparagus	0.00
Citrus fruit for processing	150.10
Lemons for processing	37.17
Tinned pineapple	4.32
Peaches for processing	68.72
Plums for processing	32.60
Pears for processing	32.18
Figs for processing	5.37
Tomatoes for processing	340.52
Grapes for processing	60.97
Potatoes for processing to starch	0.00
<b>Total product-specific AMS</b>	<b>47,825.50</b>

Source: Author's calculations based on WTO (2008)

Table 6: Product-Specific Blue Box bindings, EU, Revised Draft Modalities	
	Average 1995-2000
<b>Payments- fixed area and yields</b>	million euro
Maize payments	1,206
Other cereals	9,404
Oilseeds payments	2,126
Pulses payments	548
Flaxseeds payments	147
Set-aside compensation	1,640
Durum supplements	1,020
voluntary set-aside payments	0
silage payments	10
rice payments	60
<b>total crop payments</b>	<b>16,161</b>
<b>Livestock payments - fixed number of head</b>	
Suckler cow premium	1,876
Special beef and veal premium	1,352
Slaughter premium	82
Beef supplemental payments	25
Deseasonalization premium	22
Ewe and goat premium	1,370
<b>Total livestock payments</b>	<b>4,727</b>
<b>TOTAL BLUE (notified)</b>	<b>20,888</b>

Source: Author's calculations based on EU notifications

Although it would appear that the EU can continue to run the CAP in the face of cuts of 70 percent for the AMS limit and the introduction of a cut of 85 percent in overall trade-distorting support, these results should not be interpreted as an indication that the WTO constraints introduced by the Doha Round, will not affect EU policy. In order to stay within the new limits changes would have to be made to ensure that direct payments can continue to be notified as Green Box without being challenged by other countries. The extent to which the SPS are truly compatible with the Green Box has been raised by some commentators. (Swinbank and Tranter, 2005, and Swinbank, 2007). Were they to be notified in the AMS or Blue Box, under current WTO constraints, the impact would not be great. The limit of 67.2 billion euro for the AMS would not be approached, and the Blue Box is not limited.<sup>11</sup> However, the situation would be drastically changed if the Doha Round were to be completed along the lines of the Revised

<sup>11</sup> Inclusion in the Blue Box of new or modified subsidies however could be challenged, but these subsidies could be transferred to the AMS without violating the AMS limit. The AMS limit itself will be somewhat higher than 67.2 billion euro, to take into account the allowable limits of new members.

Modalities. In all cases except where the direct payments are notified in the Green Box (where no limit exists) the new WTO constraints would be violated by the year 2013/14. If direct payments were to be notified in the Blue Box, the total would far exceed the limit of 5.6 billion euro suggested in the Revised Draft. Up to 28 billion euro would have to be notified in the AMS and this would well exceed the limit of 20.1 billion euro suggested in the same draft. *A fortiori*, if all the direct payments were to be notified in the AMS, the limit of 20.1 billion euro would again be violated. Perhaps more relevant is the effect on the OTDS of any decision to place direct payments outside the Green Box. The OTDS limit of 16.5 billion euro suggested by the Draft would be less than the level of direct payments alone, leaving all other support to be cut or changed to Green Box compatible payments.<sup>12</sup>

#### **IV. Market Access**

Market access liberalization in the European Union is among the stumbling blocks of the whole Doha Round negotiation. The size of the European market (the largest for developing countries), combined with a significant level of initial border protection, explains its special interest for trading partners. Meanwhile, market access liberalization faces harsh resistances in the EU. The principle of intervention prices, aimed at maintaining domestic prices above a given level, is still key to EU's Common Agricultural Policy, even though its importance has been considerably reduced by successive reforms. Such interventions require border protection to be maintained above the level corresponding to the gap between world and domestic prices. Liberalising border protection would thus not only increase, in some cases dramatically, the extent of foreign competition faced by European farmer, it would also put into question the nature and scope of agricultural policies.

European border protection is highly uneven across products, and serious concerns focus on a handful of sectors. Given the different importance of agriculture and agrofood industries across member countries, as well as the different sectoral specialization, market access liberalization is also a source of internal conflicts in the EU. Countries with still large and relatively powerful agricultural sectors, like France, Spain or Poland, have repeatedly expressed their opposition to liberalizing above the initial European proposal whose ambition lies far below the revised draft modalities. Other member countries, like the UK, Germany or the Netherlands, see in agricultural market access liberalization a powerful leverage to obtain further concessions from their partners on issues like non-agricultural market access and services, where offensive interests clearly dominate for the EU.

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<sup>12</sup> However, another source of uncertainty is less of a problem in the EU. Unlike the situation in the U.S., relatively little of the support provided to farmers in the EU is subject to increases if market prices fall.

The existence of numerous and widespread preferential trade agreements complicates further the problem. Countries benefiting from bilateral agreements (including recently signed or still negotiated Economic Partnership Agreements), from the GSP+ or from the Everything But Arms initiative, face little protection in acceding the European market; their main concern lies in the erosion of their preferential margin. Non-European developed countries and developing countries in East Asia and Latin America, in contrast, consider EU's border protection and preferential access as a major obstacle to the development of their agricultural and agro-food exports.

The situation is evolving, however. By reducing the scope and depth of price support, successive reforms have reduced the intensity of the problems potentially posed by market access liberalization. Unfavorable rulings in WTO panel against EU's policies on banana and sugar have required further reforms for these two products, among the most sensitive. And lastly, the recent surge in world prices of many agricultural products has potentially opened new room of maneuver.

EU agricultural border protection is complex, and the revised draft modalities include a number of different (and not always simply applied) provisions. The assessment proposed here mainly aims at making clear what the actual consequences of the modalities might be for market access in the EU.

## **EU's current agricultural tariffs**

Before asking what the impact of liberalization could be, assessing in detail the starting point is in order. In so doing, we take 2004 as the reference year and use the WTO rule to compute the ad-valorem equivalent (AVE) of specific tariffs (TN/MA/20). Even though no agreement has been reached so far on the computation of AVEs for the sugar sector, we use the general rule for this sector.

Summarizing protection requires choosing a weighting scheme. Much has been written on this important issue, and using theoretically sound aggregators is beyond the reach of this paper. Unless otherwise specified, we will use in what follows import weighted averages. Such computations are widely used, and provide useful information, in particular as far as market access is concerned (Anderson and Neary, 2007). Still, they are also known to suffer from an endogeneity bias: imports tend to be lower on highly protected products –and zero for prohibitive tariffs-, inducing an understatement of the true extent of protection. But import-weighted averages are also sensitive to the presence of tariff rate quotas (TRQs). This protection instrument typically allows substantial imports in highly protected sectors; when only the outside-quota tariff rate is accounted for, as is the case here, this leads to an upward bias in the average.

We use in some cases as additional information the un-weighted average across tariff lines. This metric is easily calculated and widely used, but it does not account for the relative trade importance of tariff lines. This is why we also report in this section averages weighted by exports of WTO partners as a group,

toward a reference group of industrialised importers ("reference-group weighted averages", see Bouët et al., 2008 for details). Such calculation limits the extent of the endogeneity bias, while taking into account the respective importance of tariff lines in terms of potential imports.

Unless otherwise specified, calculations are based in what follows on data from the TARIC, the Integrated Community Tariff database, harmonized at the HS6 level following the MACMapHS6 methodology (Bouët et al., 2008). Even though EU tariff schedule is defined using an eight digit nomenclature and applied at the ten digit level (with four additional codes), working at the six digit level facilitates cross-country comparisons. Moreover, in spite of the desire to promote transparency in the WTO negotiations, several key elements needed in order to perform detailed analysis at the tariff line level are still restricted to negotiators, for instance the mapping table between Uruguay Round schedule nomenclature and the current applied tariff schedule or the official AVEs computed by each delegation. While 2004 is used as a base year, the data is updated to consider the consequences of the poultry cases initiated by Brazil and Thailand (WT/DS269 and WT/DS286) in 2003 against the EU, which induced the EU to increase its bound tariffs for several tariff lines in 2006.

The average bound duty for agricultural products in the EU was 22.9% in 2004 when weighted by imports, and 23.4% un-weighted (Table 7). Weighted by reference group exports, the average amounts to 29.5%. This protection is markedly heterogeneous, as reflected in the import-weighted standard deviation of 42%. High protection is largely clustered in a handful of chapters, in particular sugar (chapter 17, import-weighted average bound duty of 129%), cereals (chapter 10, 78.4%), meat and edible meat offal (chapter 2, 67.5%), dairy produce (chapter 4, 55.9%) and products of the milling industry (chapter 11, 44.4%). In each case, these high levels of protection mainly result from specific duties. For fruits and vegetables, seasonal tariffs and entry prices increase the difficulty to compute *ad valorem* tariff with precision; we cannot exclude the possibility that protection in the corresponding chapters (7 and 8) is underestimated in our calculations.

In contrast, bound protection is zero in textiles of agricultural origin (agricultural products in chapters 41, 43, 50, 51, 52 and 53), in vegetable plaiting materials (chapter 14), in "other products of animal origin" (chapter 5), and it is less than 5% in a few other chapters, including important tropical products (cocoa, coffee, tea), as well as oil seeds and oleaginous fruits (chapter 12).

Table 7: Initial bound protection level in the EU (base year 2004, AVE in %)

<< Insert Table 7 Here >>

*Source: Authors' calculations based on MACMap-HS6 version 2 and TARIC (European Commission).*

*Note: Unless otherwise specified, import-weighted averages are reported. The binding overhang is computed as the difference, in percentage points, between bound and applied duties.*

Little difference remained between EU's bound and applied MFN duties after the Uruguay Round. Still, the seasonality of protection in vegetables, fruits and cereals is a source of significant binding overhang (4.4% for vegetables, 6.0% for fruits, and 3.5% for preparations thereof). Last, the unilateral liberalization of applied MFN duties for wheat, except barley, has created an additional, important source of binding overhang, averaging to 42.8% for the chapter.<sup>13</sup>

In practice, the border protection level applied by the EU differs significantly from the MFN duties described so far, due to the large number of reciprocal and non-reciprocal preferential trade agreements signed by the EU. As a result, the trade-weighted average of preferential duties was 16.2% in 2004, when only the outside-quota tariff rate is taken into account for TRQ products.<sup>14</sup>

Table 8: Distribution of European tariff lines by band (number of tariff lines, 8 digits)

<< Insert Table 8 Here >>

*Source: Authors' calculations based on TARIC (European Commission).*

*Note: Chapters with no dutiable products (i.e. chapters 5, 14, 41, 43, 50-53) are not reported. Tariff lines are defined here at the eight-digit level of the Combined Nomenclature.*

## **Assessing the tariff-cutting impact of the formula**

The revised draft modalities include a number of complementary provisions for liberalizing market access. In this section, we focus on the core element of these modalities, the tariff-cutting formula, without taking into account the specific treatment associated with sensitive products or TRQs.

As a preamble to assessing the impact of the revised draft modalities, it is also useful to examine how tariff lines are spread across the bands upon which the tariff cutting formula is based. Among the 2204 eight-digit level agricultural tariff lines in the EU, 1569 exhibit an AVE bound duty less than or equal to 20% (i.e. are not dutiable or pertain to the first band –see Table 8). 352 tariff lines belong to the second band (AVE between 20 and 50%), 134 to the third band (50 to 75%), and 149 to the fourth band (above 75%). Not surprisingly, the bulk of tariff lines in the last two bands are clustered in the above-mentioned high-protection sectors. The importance of cattle products is especially noteworthy, with chapters 1, 2 and 4 jointly accounting for almost two-thirds

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<sup>13</sup> In addition, EU tariffs on cereals include discrimination based on the entry point in Europe. For example, the same product, on a specific day, will face a different tariff if it enters by trains (land) or by boat (sea), going through the Suez channel or not.

<sup>14</sup> Computing the AVE of a TRQ is cumbersome, since it is often difficult to know to what extent the quota is actually binding, and who benefited from the corresponding rent. According to our calculations, accounting for inside-quota tariff rates would lower the average duty by only 0.9 percentage points.

the number of tariff lines in the fourth band, and more than half the tariff lines in the third band. A significant number of products belonging to these two bands are also found in cereals and the milling industry (chapters 10 and 11), in the sugar sector (chapter 17), in preparation of fruits and vegetables (chapter 20) and in residues and waste of the food industry<sup>15</sup> (chapter 23).

The percentage cuts involved in the proposed tiered formula are still being negotiated, as reflected in the bracketed numbers in the text. In each case, we use as a proxy the mean of the two bracketed numbers. The tiered formula used here thus entails cutting by 50% bound duties with AVE below 20%, by 57.5% duties between 20% and 50%, by 63.5% duties between 50 and 75%, and by 69.5% duties with AVE above 75%. As before, the calculations rest on the agreed computation of AVEs of specific tariffs, extended to the sugar sector. For TRQ products, only the OQTR is accounted for.

Applying without any exception the core tiered formula to the EU would cut its (import-weighted) average bound duty from 22.9% down to 8.5% (8.9% in un-weighted average, 10.8% in reference-group weighted average –see Table 9). This would represent a 63% cut in the average bound duty, whatever weighting scheme is used. As is logical for such a progressive formula, the cut in the average bound duty would be even higher for highly protected sectors such as sugar (-68%), food residues (-68%), cereals (-67%), meat (-66%) or dairy produce (-64%). The standard deviation of bound duties across products would accordingly fall by a factor of three, from 42% down to 14%, i.e. by more than the average. After such tariff cuts, the highest sectoral average bound duties would be found in the sugar sector (41.2%), cereals (26.2%), meat (23.0%) and dairy produce (20.1%).

As part of the special and differential treatment granted to developing countries, additional provisions are proposed to ensure "fullest liberalization of trade in tropical and diversification products", by requiring larger cuts for these products (§ 140-141). Since the corresponding list of products concerned is still being negotiated, we base our assessment of these provisions on the Uruguay Round's list of tropical products. These provisions are found to reduce the average bound duty by an additional 0.6 percentage point, down to 7.9 percent. At the HS chapter level, their impact is mainly significant on products of the milling industry, oils and fats, plants, fruits and their preparations, and cocoa.

In order to gain a comprehensive appreciation of the potential impact of the tariff-cutting formula, provisions aimed at addressing tariff escalation (§ 80-86) must be taken into account. We find that these provisions have little impact here: the only chapter significantly impacted is food residues (-1.3 percentage points), and the average bound duty is further reduced by 0.2 percentage point only. Outside this sector, tariff escalation is actually not widespread in the EU, even though many processing industries benefit from domestic support through

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<sup>15</sup> Protection is high for some products in this sector because it includes downstream products, or byproducts, of highly protected industries such as cereals, sugar or meat.

input subsidies instead of border protection (cf. tomato based products, until recently subsidized butter for cookies industries), allowing them to remain competitive on the world market despite high domestic prices on some inputs. The limited effect of tariff escalation provisions is also related to the restrictive coverage of the draft modalities list, which for instance excludes orange juice and chocolate products.

Table 9: Impact of the tariff-cutting formula and associated provisions on European bound duties (in % AVE)

<< Insert Table 9 Here >>

*Source: Authors' calculations based on MAcMap-HS6 version 2 and TARIC (European Commission).*

While this does not show up in the calculations, the provisions concerning tariff simplification (revised modalities, § 98-104) would also entail substantial changes in European protection since the highest protection levels generally result from specific duties, or from the specific component of complex duties. This provision will change MFN bound and applied tariffs but also the GSP scheme since, in the EU, GSP preferences for sensitive products are mainly granted through the elimination of the *ad valorem* component of compound tariffs. Moreover, it is noteworthy that protection in the fruits and vegetables sectors involves a large number of complex tariffs, often including provisions linked to the entry price of imports. The AVE of such tariffs is difficult to compute, and it remains unclear at this point how they may be adapted to comply with the proposed modalities.

Given the extent of trade preferences in the EU market, the implications of the formula for applied duties are worth investigating, in order to evaluate how changes in bound duties are actually transmitted to applied preferential duties, and what the implications are in terms of preferential margins. This assessment should be interpreted with caution, though, insofar as it is unclear how applied duties may be adapted to liberalized bound duties. We make here the conservative assumption that applied duties are set at their initial level or at the new bound duty level, whichever is lower. Another issue is the market access conditions available to ACP countries (still negotiating Economic Partnership Agreements for many of them) when the formula is applied. The conditions prevailing in 2004 are taken here as a basis (except for EBA, the implementation of which is assumed to be completed).

Our calculations show that the average applied preferential duty would be cut by approximately the same proportion as bound duties, from 16.2% down to 6.2% (Table 10). Since applied duties are weighted by bilateral imports instead of total imports from WTO partners, however, this result is difficult to interpret in terms of preferential margin.

We therefore compute average preferential margins as the difference between MFN applied duties and the lowest preferential tariff the exporter is eligible to, weighted by total imports from WTO partners. This calculation shows that the average preferential margin, initially equal to 3.5 percentage points, is reduced to 1.0 percentage points, i.e. by approximately three quarters. This is substantially more than the average percentage cut, illustrating the reality of preference erosion. This is no surprise, and the provisions concerning long-standing preferences and preference erosion (§ 142-144) are largely meant to address the problems posed by the erosion of European preferences, in particular with regards to ACP countries. Averaging across all partners as is done here for the sake of consistency and brevity makes it difficult to assess the issue in detail, but sugar appears as the chapter where the problem is by far most acute; the erosion of preferential margins is also significant for fruits and vegetables (with the outstanding issue of bananas), for cereal products and for tobacco. Preferential margins by partners are provided in Table 11.

Table 10: Impact of the tariff-cutting formula and associated provisions on European applied preferential duties

<< Insert Table 10 Here >>

*Source: Authors' calculations based on MAcMap-HS6 version 2 and TARIC (European Commission).*

*Note: "After formula" refers to duties once the tariff-cutting formula is applied, including its additional provisions concerning tariff escalation and tropical products, but without any exemption concerning sensitive products. Chapters with no dutiable products (i.e. chapters 5, 14, 41, 43, 50-53) are not reported. The average preferential margin is computed as the average across all partners and all products of the difference between the MFN and the effectively applied rate, in percentage points.*

Table 11 Preferential margins by partner before, and after formula implementation.

<< Insert Table 11 Here >>

## **Sensitive products: likely selection and consequences**

Sensitive products are increasingly considered as one of the focal points of the Doha Round negotiation. This is especially true for the EU, where the unevenness of border protection and potential conflicts with price support in

some sectors, make this issue important from the point of view of both European farmers and trading partners.

The selection of sensitive products is constrained by a set of specific rules, but left to the discretion of policy makers. Guessing which products may be selected as sensitive is therefore inevitably hazardous. Nevertheless, the elaboration of trade policy has already been scrutinized in depth in the literature, allowing well-grounded simulations to be made.

We assume that sensitive products are selected according to the political economy criterion described in Jean, Laborde and Martin (2008). This criterion is based on the assumption that the political economy motivations that led to the present trade policy pattern are still valid; in this context, the political economy benefit of selecting a given product as sensitive can be shown to be proportional to the squared initial tariff, to the squared proportional cut implied by the formula, and to the level of imports. Those products for which this political economy benefit is highest are therefore deemed to be most likely selected as sensitive.

The allowed number of sensitive products is still being negotiated. The calculations presented here are based on the assumption that 5% of tariff lines can be treated as sensitive, and that they are allowed two-third the cut entailed by the formula (one third and one half are also considered in the draft modalities, with corresponding different options for compensation through TRQs). The analysis is carried out at the HS6 level, which entails significant simplification compared to the tariff line level at which the EU's lists should actually be established.

The results of this systematic procedure must be considered with caution. They should be thought of as a best guess based on trade and protection information, but the calculation does not account for cross-product specific relationships (complementarity between co-products, substitutability between differentiated products, etc.) nor for interactions with domestic support policies, which may also influence the choice.

Table 12 shows the fifteen HS6 products coming up as most likely to be treated as sensitive by the EU. This indicative list includes products widely recognized as sensitive, such as sugar, bananas and bovine meat or dairy produce. The list also features other meats (sheep, fowl), vegetables (manioc, garlic) and cereals and related products (maize residuals, rice, residues of starch).

Table 12: Highest-ranking products in terms of sensitivity criterion in the EU

<< Insert Table 12 Here >>

Source: Authors' calculations based on MAcMap-HS6 version 2 and TARIC (European Commission).

Note: "Post-formula" refers to MFN duty once applied the formula, including its additional provisions concerning tariff escalation and tropical products.

Columns 4 refers to the share of initial imports actually entering in quotas; it is an assessment based on available information about quotas and imports, based on simplifying assumption, since this information is not provided as such by the EU. Assessed TRQ creation, in column 5, is computed based on the hypothesis that it amounts to 4% of domestic consumption (3% in the case of sheep meat), consistent with the hypothesis that 2/3 the formula cut is applied to sensitive products.

A broader analysis by chapter confirms that meat and meat products (chapter 2), dairy produce (chapter 4), cereals (chapter 10), food residues (chapter 23) and sugar (chapter 17) are the most likely to be concerned with sensitive products exemptions, together with olive oil in chapter 15.

The impact of sensitive product exemptions on average protection is summarized in Table 13. According to our calculation, the 5% tariff lines selected as sensitive account for 18% of EU imports. Based on the formula including provisions for tropical products and tariff escalation, the corresponding flexibility reduces the cut in the import-weighted average bound duty from 66% to 51%. From 7.7% without flexibility, the final average is enhanced to 11.2%.

Table 13: Assessed impact of sensitive products exemption on EU market access liberalization

<< Insert Table 13 Here >>

*Source: Authors' calculations based on MACMap-HS6 version 2 and TARIC (European Commission).*

However, import-weighted averages are somewhat misleading for sensitive products, because most of them are covered by TRQs. In this case, the duty is assumed to be equal to the (often very high) OQTR, and imports are frequently large. Protection in these products is thus arguably over-weighted in this calculation, which does not account for the lower protection faced by in-quota imports. As a matter of fact, un-weighted calculations provide a less dramatic picture about the impact of sensitive product exemption: from 64%, the proportional cut is found in this case to be reduced to 59%. This corresponds to a final average tariff level of 9.5%, instead of 8.4% without sensitive product exemptions.

It may be argued that these un-weighted calculation in turn underweight sensitive products, since policy makers have incentives to designate as sensitive products with above-average trade importance, insofar as restrictions are only expressed in terms of number of tariff lines. The bottom line is that these two calculations can be considered as lower and upper bounds of the impact of sensitive products. The un-weighted cut in the average bound duty (60%) also shows that, accounting for sensitive products treatment (under the assumption that two-third the formula cut is applied to them), the EU would not be

constrained by the 54% minimum threshold set in the modalities. Meat, sugar, cereals and their by-products in chapter 23 are the sectors most strongly impacted by sensitive product exemptions.

In any case, this lesser liberalization should be accompanied by significant TRQ creations or expansions. This clause may influence significantly the choice of sensitive products, and the actual market access impact of implied deviations from tariff-cutting formula. These TRQ creations are difficult to assess, notably because they should be set in proportion of domestic consumption, about which figures are not always available at the same level as trade and protection information. Still, an illustrative calculation is possible for some products. Based on the assumption that TRQ creation should amount to 4% of domestic consumption (or 3% when the initial TRQ is large enough, consistently with the application of two-third the formula cut), the corresponding assessments are reported in column 5 of Table 12. TRQ creations would vary largely across products, and they are found to amount to one fifth or more of initial imports in half of the cases.

## Tariffs facing EU Exporters

Even though access to the EU market is the most heated issue, agricultural market access liberalization will also mean for EU's producers enhanced access to export markets. On average, the implementation of the full formula would reduce applied tariffs faced by EU exporters by 36%, from 18.2% to 11.7% (Table 14). Applying the complete formula would originate substantial gains for European exporters in other OECD markets, where the average applied cut would reach 53%. As is logical given the special and differential treatment, the gains in developing countries (excluding SVEs, RAMs and LDCs) would more modest, with the average tariff faced cut by one-fifth.

These gains must be revised downward when flexibilities for sensitive and special products are accounted for. The global average cut is then reduced by one-third, with *in fine* an average rate faced of 14.2%; this would represent a cut in average duty faced by 22%. In this case, developed markets would reduce their barriers towards EU exporters by 36%. This is significantly less than the 53% mentioned above, but it is certainly more more than during the Uruguay Round, since at that time dirty tariffication ended up in keeping applied protection nearly unchanged.

How provisions concerning special products would be applied for developing countries is difficult to devise. Absent any better selection rule, we assume here that they are selected by policy makers following to the same criterium as sensitive products. In this case, the combination of sensitive and special products for developing countries is found to neutralize much of the tariff reduction on products of interests for the EU exporters, with an average rate of reduction falling to 7% in these markets. This reflects the fact that the cumulation of sensitive and special product exemption grant developing countries with significant flexibility in applying the liberalization modalities. While protection

faced by EU exporters was initially similar on average across developed and developing markets (0.2% of difference), the gap would rise up to 5.7%.

Table 14 Protection faced by EU exporters, by partner.

<< Insert Table 14 Here >>

Table 15 provides sectoral information regarding EU offensive interests. Export opportunities should arise in meat industries, beverages, vegetables and live trees sectors. Flexibilities for sensitive and special products would strongly reduce potential gains in meat, beverages and cereals, and appears critical for EU dairy exporters since nearly 60% of the promised effects of the formula will disappear. In practice, however, the evolution of each productive sector will result from the new market equilibrium emerging as a result of the reform, which is far more complex to devise. Beyond the aspects mentioned so far, it will also depend in some sector upon the removal of export subsidies.

Table 15. Protection faced by EU exporters, by chapter.

<< Insert Table 15 Here >>

## ***V. Export Competition***

The EU is the major user of direct export subsidies, accounting for about 90 percent of such subsidies over the period since 1995.<sup>16</sup> The level of subsidies by product is shown in Table 16, for the year 2002/03 – the latest year for which an export subsidy notification has been made by the EU. Major beneficiaries of export subsidies are the grains, dairy products, beef and poultry, sugar, wine and fruits and vegetables. Though high quality products in these categories find ready markets, subsidies help to clear domestic supplies and maintain domestic prices. Products where the quantity exported with a subsidy has been close to the agreed limit have included butter and other dairy products, rice, poultry, alcohol (from agricultural raw materials) and products that incorporate higher-priced domestic inputs such as sugar. Quantities of cereals and sugar are donated as food aid, also reported to the WTO along with export subsidies.

Other exporters support export sales by means of subsidized credit, food aid that is designed to dispose of unwanted surpluses and develop markets for later commercial sales, or privileged treatment of single-desk exporting parastatals

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<sup>16</sup> By contrast the US has notified only between 1 and 2 percent of the total of notified export subsidies.

by the government. The EU has consistently taken the view that it is willing to eliminate the direct export subsidies if other exporters cut in parallel these other forms of export assistance. The Framework agreement of July 2004 included such a commitment and the date of 2013 was agreed at the Hong Kong Ministerial. The Revised Modalities draft elaborates these agreements and sets out a timetable for the reduction and elimination of direct export subsidies as well as the parallel elimination of other forms of subsidy to exports. These provisions are summarized in Table 17, below.

The constraints on the other forms of export subsidies have been one of the main requests by the EU: parallelism in improving export competition is the necessary condition for export subsidy elimination. The EU has argued for self-financing rules for export credit guarantees, for the elimination of the single-desk selling parastatals, and for the move toward cash-based, untied food aid. The Revised Draft has captured this parallelism in a way that should allow the EU to sell the loss of export subsidies to domestic constituents. Indeed, this is one area where the EU has played the unfamiliar role of “demandeur” in the agricultural talks: the food aid rules in particular fit in well with both current practice and desired developments as seen by the EU. It is the US that will have to change its food aid policies, and remove a source of conflict by reducing those parts of the food aid program that are most closely identified with surplus disposal and with market development. The EU will also be satisfied with additional constraints on state trading exporters, though it is unlikely that the removal of the monopoly powers of such traders will be possible on this occasion.

<b>Table 16: Export Subsidy Outlays and Quantities Exported with Subsidies: Amounts Notified and WTO Ceiling Commitments, and Food Aid Quantities, 2002/03</b>					
<i>Product</i>	<i>Outlays (million euro)</i>	<i>Commitment (million euro)t</i>	<i>Quantity (thousand tons)</i>	<i>Commitment (thousand tons)</i>	<i>Food Aid (thousand tons)</i>
Wheat and wheat flour	141.2	1289.7	12055.3	14438.0	406.0
Coarse Grains	167	1046.9	6259.3	10843.2	86.5
Rice	24.9	36.8	127.7	133.4	42.3
Rapeseed	0	27.7	0	103.8	0
Olive Oil	0	54.3	0	115	0
Sugar (a)	292.5	499.1	600.5	1273.5	16.7
Butter and butteroil	545.1	947.8	292.0	399.3	0.3
Skim milk powder	163.0	275.8	220.2	272.5	0
Cheese	267.7	341.7	317.0	321.3	0.6
Other Milk products	596.2	697.7	833.4	958.1	0.6
Beef	285.1	1253.6	358.6	821.7	8.6
Pigmeat	14.6	191.3	61.0	443.5	0
Poultry	90.5	90.7	247.4	286.0	0
Eggs	5.1	43.7	59.5	98.8	0
Wine	17.9	39.2	2096.0	2304.7	0
Fresh F&V	15.3	52.8	711.0	753.4	0
Processed F&V	3.1	8.3	66.9	143.3	0
Tobacco (raw)	0	40.2	0	110.8	0
Alcohol	90.4	96.1	850.0	1147.4	0
Incorporated products	413.6	415.0	-	-	18.8

Source: G/AG/N/EEC/52

Table 17: Summary of Main Provisions of Export Competition Revised Draft Modalities

Item	Agreement	Implementation
Export Subsidies	Eliminate remaining scheduled export subsidies by end 2013	Budgetary outlays reduced by 50 percent by end 2010 in equal installments, and reduced to zero in equal installments by end 2013  Quantities eligible for subsidy [reduced in equal installments] [applied as a standstill over implementation period at lower of current levels or bound levels reduced by 20 percent]
Export credits	Terms and Conditions	Maximum repayment term for export financing 180 days (a);  Export credit guarantee, risk insurance, and other risk coverage programs to be self-financing;  Least Developed and Net Food Importing Developing Countries allowed a repayment term of 360 days for the acquisition of basic foodstuffs
Food Aid	Guidelines for food aid and additional monitoring: classification of different types of food aid	Food Aid to be (i) Needs-driven; (ii) given in grant form; (iii) not linked to exports or market development; and (iv) not re-exported.  In-kind food aid needs to take into account local market decisions.  Emergency food aid follows declaration of emergency and an assessment of needs: no monetization of such food aid.  Non-emergency food aid should be based on a needs assessment and minimize commercial displacement: monetization of non-emergency food aid would be [prohibited] [restricted].
Exporting State Trading Enterprises	Eliminate trade distorting practices by exporting STEs	Eliminate export subsidies, government financing and government underwriting of losses provided by or to STEs;  [and eliminate the use of export monopoly powers by STEs by 2013]  (Note: No such STEs notified by EU)

(a) implemented from the date of the agreement or the end of 2010 if earlier.

Source: Author's summary based on WTO (2008)

## **Conclusion**

The revised draft modalities would imply deep liberalization of agricultural market access in Europe. The progressive nature of the tariff-cutting formula means that the handful of highly protected sectors would experience large falls in their average bound duties, with potential deep implications for European producers. The flexibility allowed for sensitive products changes somewhat the picture, but our calculations suggest that liberalization would remain important even in the most concerned sectors, like sugar or meat products.

At this point, it remains unclear whether this proposal is likely to be deemed palatable by European representatives. The proposed liberalization clearly overcomes the initial European proposal, recently again claimed by Member Countries' officials to be a "red line". But a negotiation entails bargaining, and agricultural market access liberalization is clearly for the EU a *sine qua non* condition to obtain concessions in other domains.

Finally, while this analysis focuses on the direct consequences of tariff-cutting provisions, it should be kept in mind that other provisions may also matter. This may be the case in particular of the provisions concerning safeguard measures. As a result of the Uruguay Round, the EU notified 31 eight-digit tariff lines as being potentially concerned by the Special Agricultural Safeguard (SSG). Limiting to 1.5 per cent of scheduled tariff lines (i.e. 33 eight-digit tariff lines for the EU), as suggested in the draft modalities, would thus considerably limit the scope for such safeguard. Together with other restrictions in the application of these safeguards, as well as in the Special Safeguard Mechanism (SSM), this should also be an important dimension of a potential agreement.

The export competition part of the agricultural modalities would not be particularly problematic for the EU to adopt. The elimination of export subsidies has been on the domestic agenda for some time, as it becomes increasingly difficult to justify spending scarce funds to subsidize consumers (or industrial competitors) in other countries. As prices fall to levels closer to those on the world market, the need for such subsidies is reduced. The unpopularity of such subsidies in a global context, where virtually all other countries want these policies removed leaves the EU with a high political cost if it chose to maintain them.<sup>17</sup>

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<sup>17</sup> On the other hand, if they are on their way out for domestic reasons, the negotiating benefit of offering to give them up is reduced.

### **Annex: The Use of Split Notifications in Domestic Support**

If part of a direct payment is fully decoupled and part is not, a question arises as to how the EU will notify the expenditure. We have assumed that the expenditure can be split between the Blue and Green boxes, allocating only that amount paid without the need for any current production to be in the Green Box. Without the ability to split the notification of certain subsidies, the EU would presumably have to notify all payments under the blue box whenever the degree of decoupling was less than 100 percent. That would make any restrictions on the size of payments under the Blue Box, such as those being discussed in the DDA, much more restrictive.

The problem stems primarily from the fact that the implementation of the new policy instruments is largely in the hands of the Member States. For example, France has retained 25% of its national ceiling for arable crops (the total direct payments allowable) to pay as coupled aid – in order to avoid the abandonment of farmland. This is in accord with the flexibility given to members in the 2003 Reform. In 2005 France's total IACS payments (i.e. those monitored by the common accounting system) on arable crops was 5,198 million euro.<sup>18</sup> So an amount equal to 1,299.5 million euro was spent by France on coupled support in that year. This latter figure will presumably appear in the Blue Box in the appropriate notification, and the rest of France's direct payments on arable cropland will appear in the Green Box.

To take this into account, we have allowed for the notification of direct payments to be split between blue and green boxes. The allocation is to a certain extent arbitrary, as there is no convenient way to aggregate up to the EU level the actual implementation decisions taken by the 27 members. But the EU regulations themselves generally define a limit to the amount of coupled aid that can remain. So the allocation between Blue and Green boxes in our shadow notifications is based initially on these maximum amounts but assumes also that over time these coupled payments are replaced by decoupled payments as they are incorporated fully into the SPS.

Another assumption we have made is that all SPS payments are equally eligible for inclusion in the Green Box. This again is a necessary simplification. Countries have had to choose one of three methods by which to pay direct decoupled payments. The Single Payment System can either be based on historical yields of the farm concerned or on the average yields of a region. Alternatively, the Single Area Payment System allows countries in the first few years after accession to pay on a uniform basis for all agricultural land qualifying for such payments. In all cases, the national ceiling for such

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<sup>18</sup> See details at [http://ec.europa.eu/agriculture/fin/index\\_en.htm](http://ec.europa.eu/agriculture/fin/index_en.htm)

payments is agreed at the EU level.<sup>19</sup> We make the assumption that the method of calculating the payments per farm are not relevant to the notification of the payment, so long as it is not tied to current yield/production or to price.

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<sup>19</sup> Some countries have indicated that they will adopt a historic basis in some regions and a regional basis in others. Moreover, there may be changes over time away from an historic toward a regional basis for payments.

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