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Building on the July Framework Agreement: Options for Agriculture

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Preface

In January 2005, with funding from the William and Flora Hewlett Foundation and the German Marshall Fund, the International Food & Agricultural Trade Policy Council commissioned three papers from members of the International Agricultural Trade Research Consortium. These papers were intended provide negotiators and other interested stakeholders with an independent analysis of options for elaborating the July Framework Agreement, as it moves from a "First Approximation" in the summer of 2005, towards the development of concrete negotiating modalities at the Hong Kong Ministerial in December 2005.

In addition, the IPC convened three task forces, comprised of IPC members as well as other agricultural trade experts, to provide substantive input and a wider range of views into these three commissioned papers. The authors presented their analysis to the IPC task force at a meeting held in Washington, DC in March 2005 at the offices of the German Marshall Fund, as well as through an online forum throughout the spring of 2005. These commissioned papers were then presented and discussed at the IPC's plenary meeting in May 2005.

This Issue Brief draws heavily on the original commissioned papers, but has been condensed and supplemented by the views and opinions of task force and IPC members. As such, the papers and the executive summary reflect substantial input of both groups, but they have not been approved or agreed by members of the task forces or by members of the IPC. For those interested in the original commissioned papers, they will be published on the website of the International Agricultural Trade Research Consortium (IATRC), www.iatrcweb.org, in July 2005. The International Policy Council's issue brief is also available on the International Policy Council's website, www.agritrade.org.

The IPC would like to thank the authors of the commissioned papers (David Blandford, Penn State University; Tim Josling, Stanford University; Mario Jales and Andre Nassar, Institute for International Trade Negotiations (ICONE); and Linda Young, Montana State University) for writing and extensively revising these papers. The IPC would also like to thank Amee Patel, a summer intern from Davidson College, who has done yeoman's work in editing and preparing these papers for publication under an extremely tight deadline. In addition the IPC would like to thank Kari Heerman, former IPC Communications Director, Christin Cogley, Program Manager and Steve Shin, Intern, for their logistical support of the project. Finally, of course, the IPC extends its thanks to the Hewlett Foundation and the German Marshall Fund for their support of this project.

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Options for Domestic Support

Note: This paper draws heavily from a paper commissioned by the International Policy Council from David Blandford and supplemented with input from IPC and Taskforce members. Blandford is a professor of Agricultural Economics at Penn State University. The commissioned paper will be published by the IATRC in July at www.iatrcweb.org.

1. INTRODUCTION

The Doha Ministerial Declaration calls for "substantial reductions in trade-distorting domestic support" (WTO, 2001). The July Framework Agreement (WTO, 2004) specifies:

1. A substantial reduction in the overall level of trade-distorting support (defined as the sum of *de minimis* levels, Blue Box support, and the Total Aggregate Measure of Support – Total AMS) in developed countries with a strong element of harmonization, in which higher levels of permitted trade-distorting support will be subject to deeper cuts.
2. As part of the overall reduction commitment, a substantial reduction in the Total AMS and permitted *de minimis* levels, and a capping of Blue Box support at five percent of the average value of total agricultural production for an historical period. (Countries with high levels of Blue Box support at the outset are allowed to phase down support to five percent over the implementation period.)
3. Special and differential treatment (S&D) for developing countries to include longer implementation periods and lower reduction coefficients for all types of trade-distorting domestic support, with continued access to the provisions under Article 6.2 of the Uruguay Round Agreement on Agriculture (URAA), with exemptions of direct or indirect assistance for agriculture and rural development. The Least Developed Countries (LDCs) are not required to make any reduction commitments.

2. DOMESTIC SUPPORT: A BACKGROUND

At the outset, it is essential to clarify the basic approach used for WTO disciplines on domestic support. The final permitted Total AMS represents a commitment on the maximum amount of trade distorting support that a country can provide through the so-called Amber Box, calculated using conventions established in the URAA. Countries can provide up to the permitted level of support they agreed in the Uruguay Round, but the actual amount of support they provide may be less.

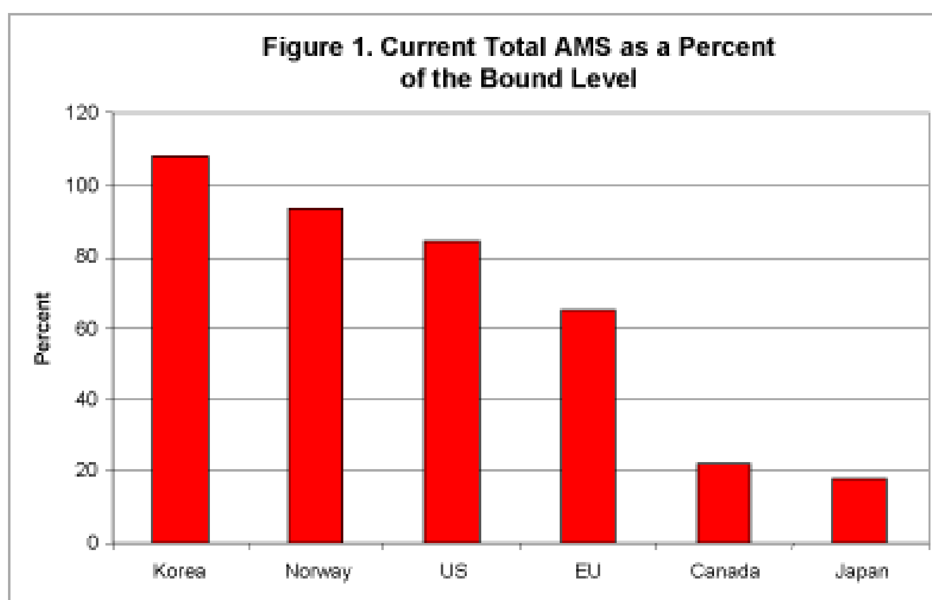
The Uruguay Round Agreement permits countries to provide "minimal" support to individual products and the agricultural sector as a whole through product and non-product specific *de minimis* provisions. As long as support under each of these provisions is less than five percent (ten percent for developing countries) of the value of production for that particular commodity (for product-specific *de minimis*) or the sector as a whole (for non-product specific *de minimis*), then none of that support counts against a country's Total AMS.[1] If however, support rises above five (ten) percent, then all of that support counts towards the Total AMS. The Total AMS plus the *de minimis* allowances can be interpreted as the total level of support each country is permitted under the WTO agreement.

3. DOMESTIC SUPPORT UNDER THE JULYFRAMEWORK AGREEMENT

As Figure 1 demonstrates, for a selection of countries, there is substantial variation in the use of the total AMS entitlement. Korea's current Total AMS exceeded its Bound Total AMS by an average of eight percent for 1998-2000. Norway and the United States were within ten percent and 20 percent of their Bound levels, respectively. The European Union had a 35 percent margin of difference. Canada and Japan were both substantially below their Total AMS entitlement.

Table 1 shows the substantial variability in the relative importance of the *de minimis* exclusions to different countries. Norway and Canada represent two extremes in this regard. Norway reported no *de minimis* exemptions in the base period. In contrast, Canada's total *de minimis* (product and non-product specific) was larger that its current Total AMS. Among the large countries in the WTO, the *de minimis* exemptions were particularly significant for the United States, with a *de minimis* level accounting for 45 percent of the current Total AMS. The *de minimis* is also significant for Korea, which benefits from the ten percent exemption rule for developing countries. Korea's *de minimis* exemptions equaled 65 percent of its current Total AMS. For two of the countries for which the *de minimis* exemptions are important, Canada and the United States, the non-product specific exemption is more significant. In Korea, the non-product-specific exemption is larger, but both exemptions are significant.

The Blue Box was very important for the European Union and Norway in the base period. The magnitude of Blue Box support in the EU was half the size of its current Total AMS. In Norway, it was equivalent to 70 percent of the current



Note: Data relate to most recent three years notified to the WTO. These vary from 1997-99 for Canada to 2000-02 for Japan.

Table 1. Domestic Support for Selected Countries, Base Data

	Canada 1997-99 Million $	**EU** 1999-01 Million €	**Japan** 2000-02 Billion ¥	**Korea** 1998-00 Bill Won	**Norway** 1999-01 Mill Kr	**US** 1999-01 Million $
Base data						
Bound total AMS (permitted)	4,301	67,159	3,973	1,490	11,449	19,103
Current Total AMS	983	43,607	717	1,602	10,593	16,026
Product-specific *de minimis*	205	110	15	598	0	102
Non-product specific *de minimis*	1,009	467	20	448	0	7,171
Blue Box	0	21,914	90	0	7,558	0
Green Box	1,788	20,812	2,472	5,342	4,076	50,159
Production value	29,705	241,159	8,978	31,499	17,430	190,919
Overall Trade Distorting Support	2,196	66,098	843	2,648	18,151	23,299
Actual OTDS as percent of production	7%	27%	9%	8%	104%	12%
Permitted OTDS as percent of production	29%	46%	59%	30%	119%	25%

Base data: The Bound Total AMS is the final value under the Uruguay Round Agreement. Other figures relate to actual averages for the period indicated (the base period). The calculated OTDS is current Total AMS + *de minimis* (product and non-product specific) + Blue Box

Source: Computed from data in country notifications to the WTO. Additional data on production values from the OECD PSE/CSE database (2004)

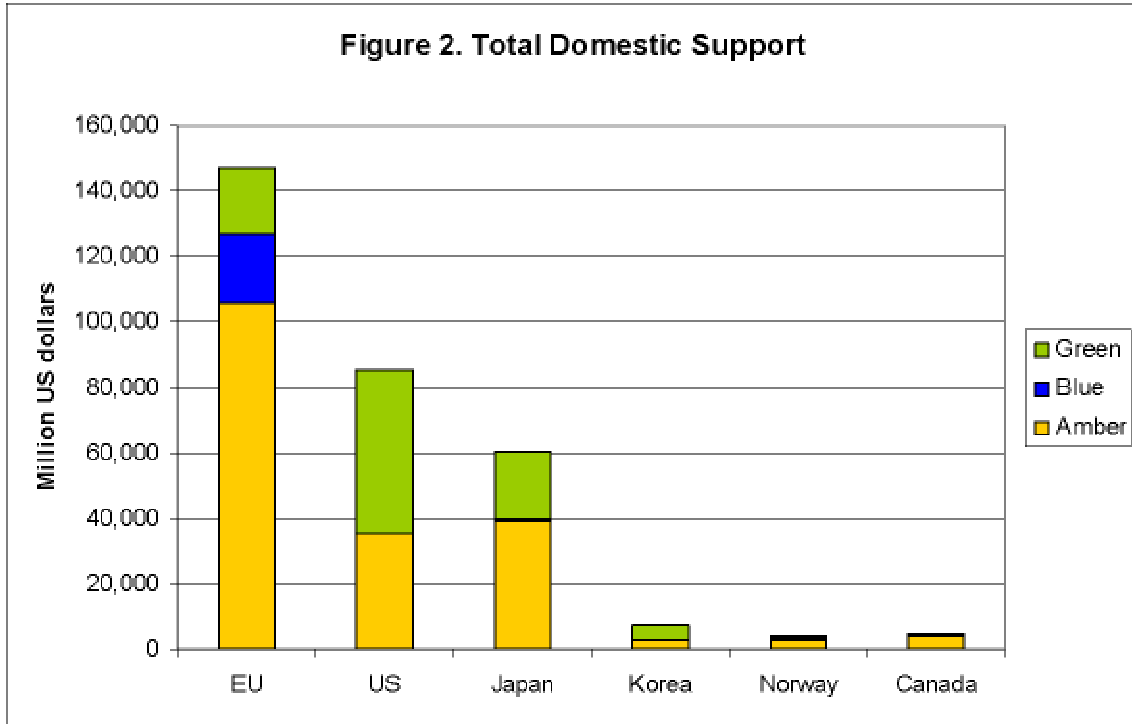
Total AMS. It is important to note that recent changes in policy will reduce the size of Blue Box support in the European Union and will increase it in the United States (under the new definition of the Blue Box).

The final category of support – the Green Box – is extremely important for several of the countries included in Table 1. The value of support under this category is more than three times as large at the current Total AMS for Japan, Korea and the United States.[2] It is relatively less significant in comparison to the current Total AMS for Canada, the European Union and Norway, although total Green Box payments exceeded the current Total AMS by more than 50 percent in Canada.

Figures 2 and 3 summarize the levels of domestic support and its composition for the countries in Table 1. Both graphs depict the three components of support:

1. Total Amber Box support (defined as the current Total AMS plus *de minimis*);
2. Blue Box support; and
3. Green Box support.

Figure 2 shows the components of support for each country expressed in US dollars, using exchange rates corresponding to the respective base periods for each country. The European Union has the highest total support, followed by United States and Japan. The United States has the second highest level of total support, due to high Green Box support.



Note: Data relate to most recent three years notified to the WTO. These vary from 1997-99 for Canada to 2000-02 for Japan. National currency values converted to US dollars at the average exchange rate applicable to the base period for each country.

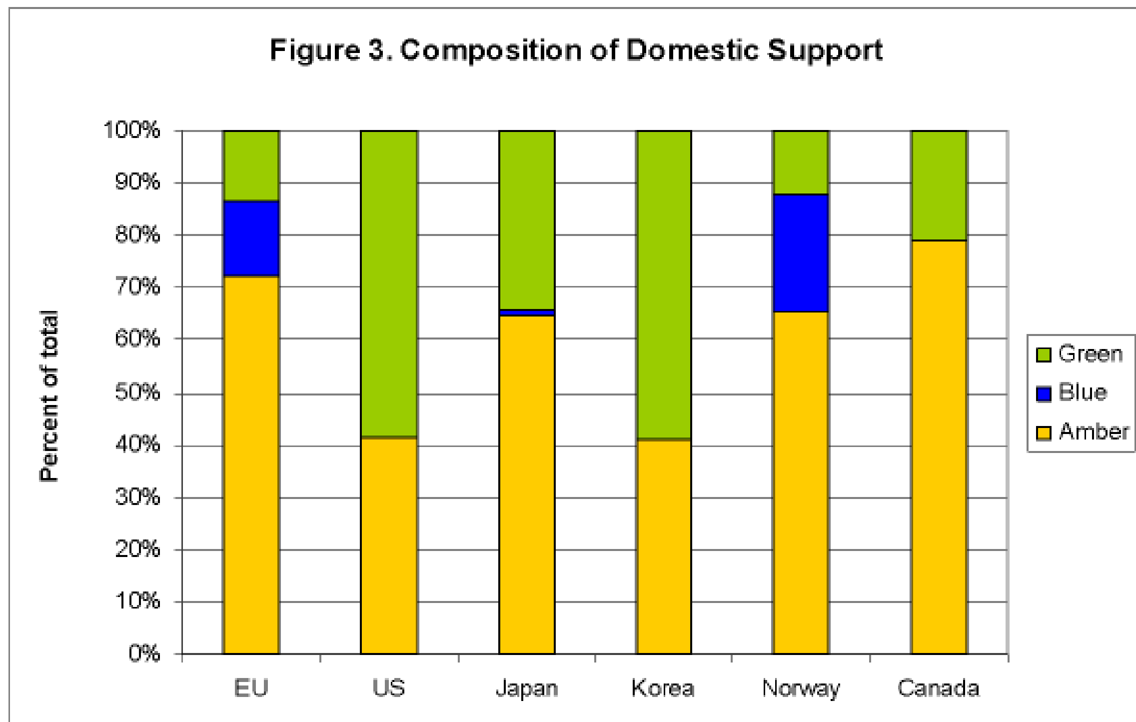


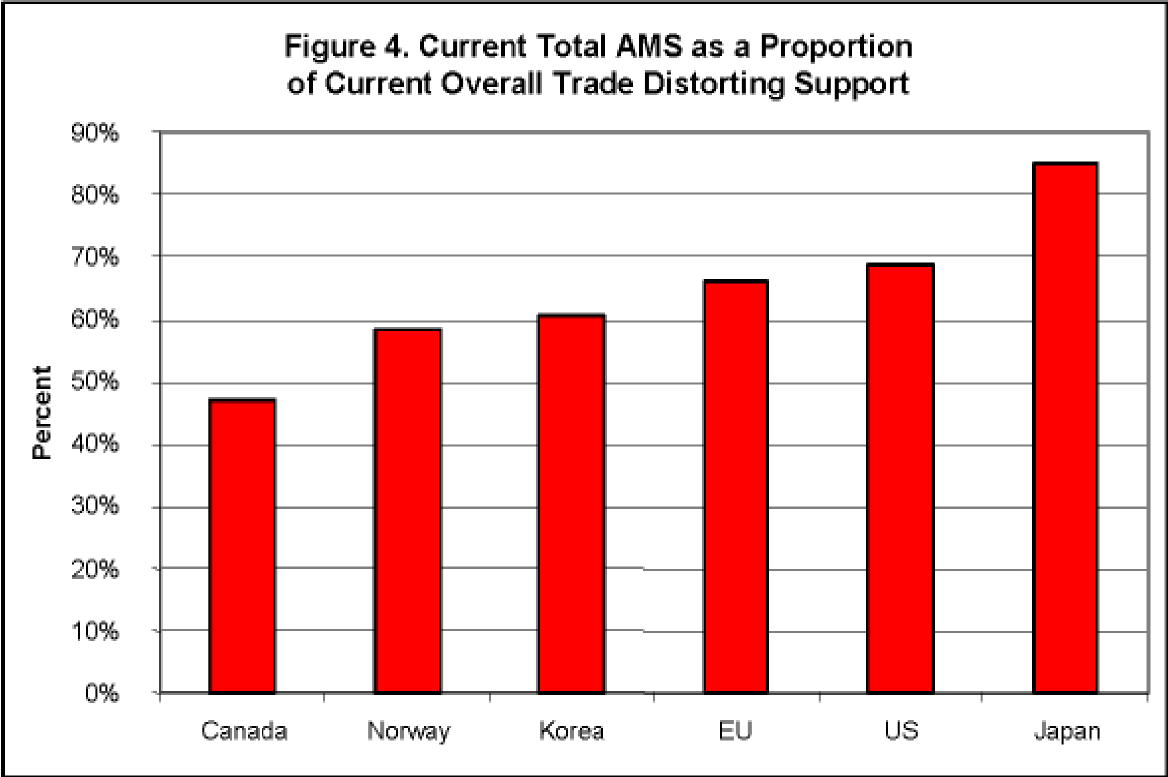
Figure 3 provides a clearer picture of the differing composition of support among the countries. It illustrates the importance of Green Box support in Japan, Korea and the United States, and the importance of the Blue Box in the European Union and Norway.

3. DOMESTIC SUPPORT UNDER THE URUGUAY ROUND AGREEMENT

The July Framework Agreement widens the support that is to be disciplined in the Doha Development Round beyond that counted in the Uruguay Round Agreement. The concept of the Overall Trade Distorting Support – the sum of the Total AMS, permitted *de minimis* and capped Blue Box support embodies this broader coverage. Under the new agreement, countries will undertake commitments on Overall Trade Distorting Support, as well as its individual components. Those commitments will be monitored based on the evolution of the actual Overall Trade Distorting Support. As a starting point to compare various options for reductions, the actual Overall Trade Distorting Support in the base period for each of the countries is shown in Table 1.

The size of the actual base period Overall Trade Distorting Support varies considerably among the countries relative to the value of production. The most startling case is Norway, for which the actual Overall Trade Distorting Support exceeds the value of production in the base period due to the relatively large amount of both Amber and Blue Box support provided to Norwegian agriculture (as depicted in Table 1 and Figure 3). With the exception of the European Union, whose Overall Trade Distorting Support represented 27 percent of the value of production in the base period, the other countries in Table 1 had ratios of Overall Trade Distorting Support to production of around 10 percent.[3]

The proposed disciplines on the Overall Trade Distorting Support in the current Round are very significant because they have the potential to exert greater pressure on the actual support provided by individual countries than did the Uruguay Round disciplines. The Uruguay Round only disciplined the individual components, and not the sum of those components, and the 'permitted' levels of spending in the Uruguay Round were much higher than countries' actual spending in some categories. Figure 4 demonstrates this by comparing the ratio of the current support subject to WTO disciplines under the URAA (as reflected by the current Total AMS) to the current Overall Trade Distorting Support. Other things being equal, the smaller the percentage in the graph, the higher the potential for greater discipline through the use of Overall Trade Distorting Support reductions. Whether that potential actually applies in practice will depend on the size of the cuts in Overall Trade Distorting Support and its components and whether these are actually binding.



The key elements of the July Framework Agreement on domestic support are:

1. Separate and complementary reduction formulas for the Overall Total Trade Distorting Support, Total AMS, and *de minimis*, with a five percent cap on Blue Box payments, except for those countries whose Blue Box payments are significantly above the five percent cap.
2. The reduction in Overall Trade Distorting Support will be the minimum required reductions, if the separate formulas for cuts in the Total AMS and *de minimis* imply a greater total cut in the Overall Trade Distorting Support. So required cuts in the individual components could result in greater reductions than might be required by a discipline on Overall Trade Distorting Support.

In discussing options under the current round of negotiations, it is important to distinguish between the permitted levels of the various elements of support that define allowable amounts of support and the actual support provided under each of those elements. The impact of potential reductions in the permitted level of Overall Trade Distorting Support cannot be determined without considering how the components of the Overall Trade Distorting Support will be treated and how that treatment relates to an individual country's actual use of its components.

In terms of the permitted level of Overall Trade Distorting Support, key factors are: the percentage reduction in the Bound Total AMS; limitations on the AMS for individual commodities (product-specific caps); the limits placed on support that can be excluded from reductions under the *de minimis* provisions; and limitations on Blue Box support. The impact of the rules established for each of these components on individual countries will largely be determined by how much countries actually use the various elements in supporting agriculture.

Because countries make different use of the different components of total trade-distorting support, opportunities for countries to behave strategically in reducing the Overall Trade Distorting Support may be great, depending on the nature of the individual reduction requirements for the components of the Overall Trade Distorting Support.

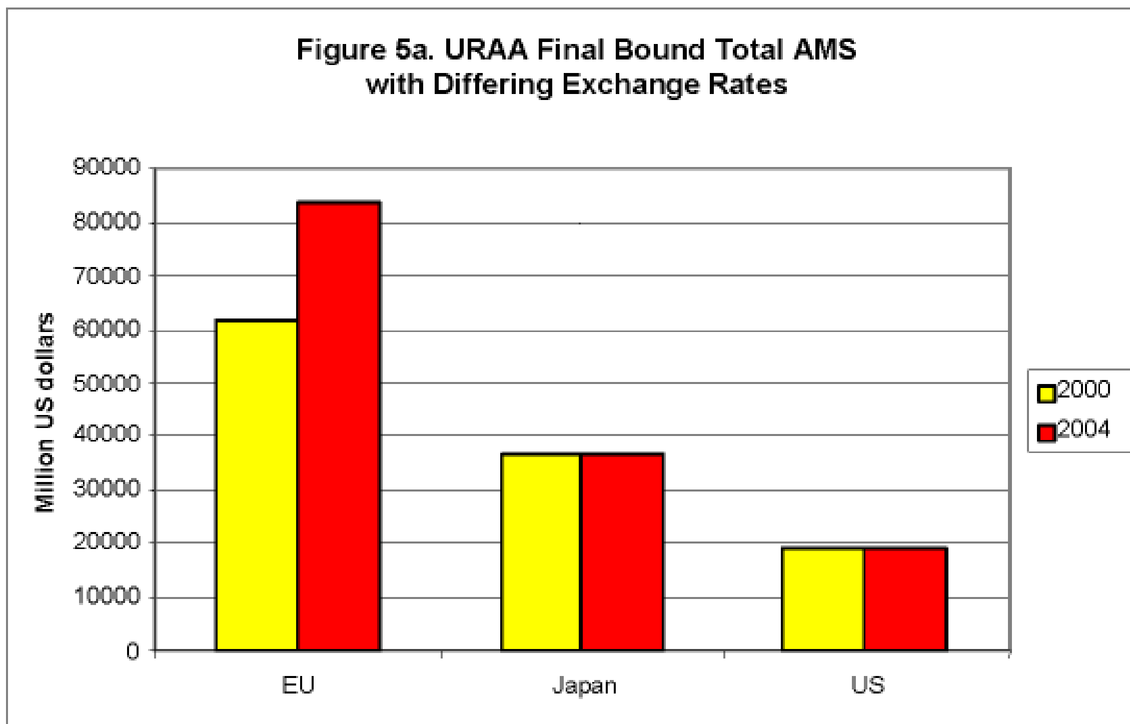
It is useful to recall that the reduction in Total AMS and the *de minimis* measures, together with the capping of the Blue Box, are the essential components of the Overall Trade Distorting Support discipline. Therefore, negotiators are likely to focus on these familiar components. In practice, the degree of reduction of the Overall Trade Distorting Support may then be derived from the reduction and/or the capping of the individual components. However, this does not seem to be the approach outlined in the July Framework Agreement. Consequently, our analysis begins with an assessment of reductions in the Overall Trade Distorting Support, which may lead to an adjustment of reductions in Overall Trade Distorting Support and *de minimis* support or a reduction in Blue Box support.

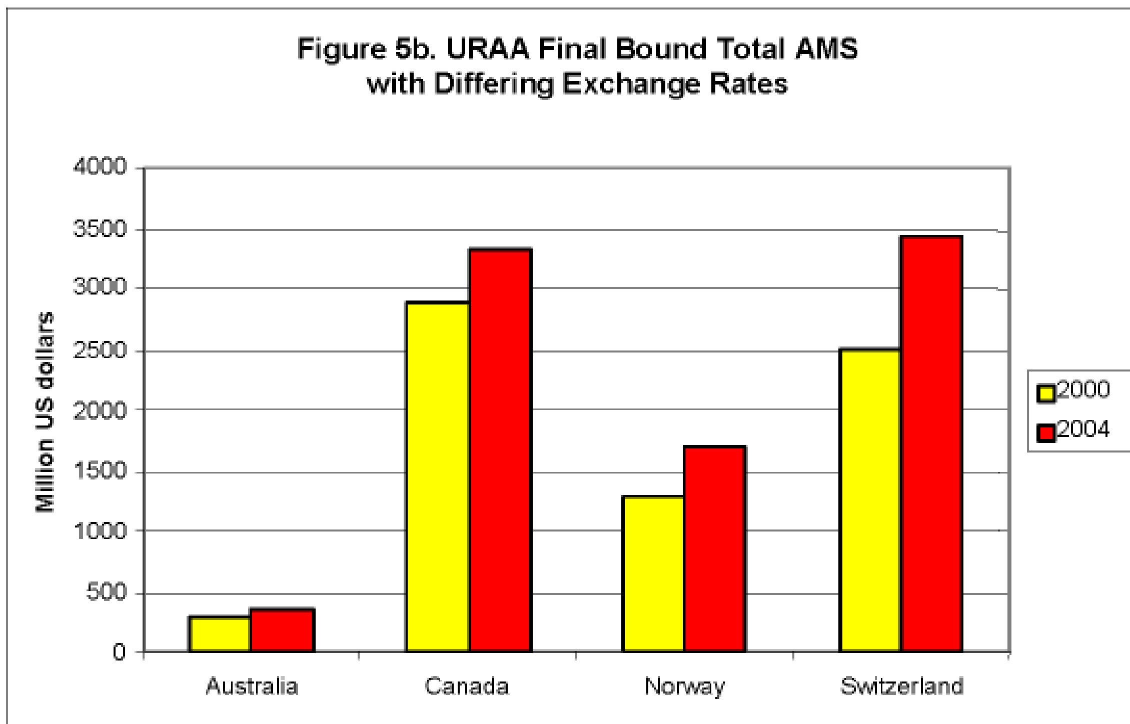
The Overall Trade Distorting Domestic Support

Overall Trade Distorting Support is the sum of the Final Bound Total AMS, plus permitted product and non-product specific *de minimis* and the Blue Box. In the Framework, the Blue Box is capped at five percent of the value of domestic production. However, there is a special (and important) provision for countries whose Blue Box payments are particularly large. The Framework is ambiguous on whether product and non-product specific *de minimis* will be treated as two separate commitments, or whether they will be combined into one commitment. This analysis assumes that countries will have access to both types of *de minimis* provisions at an agreed upon cap.

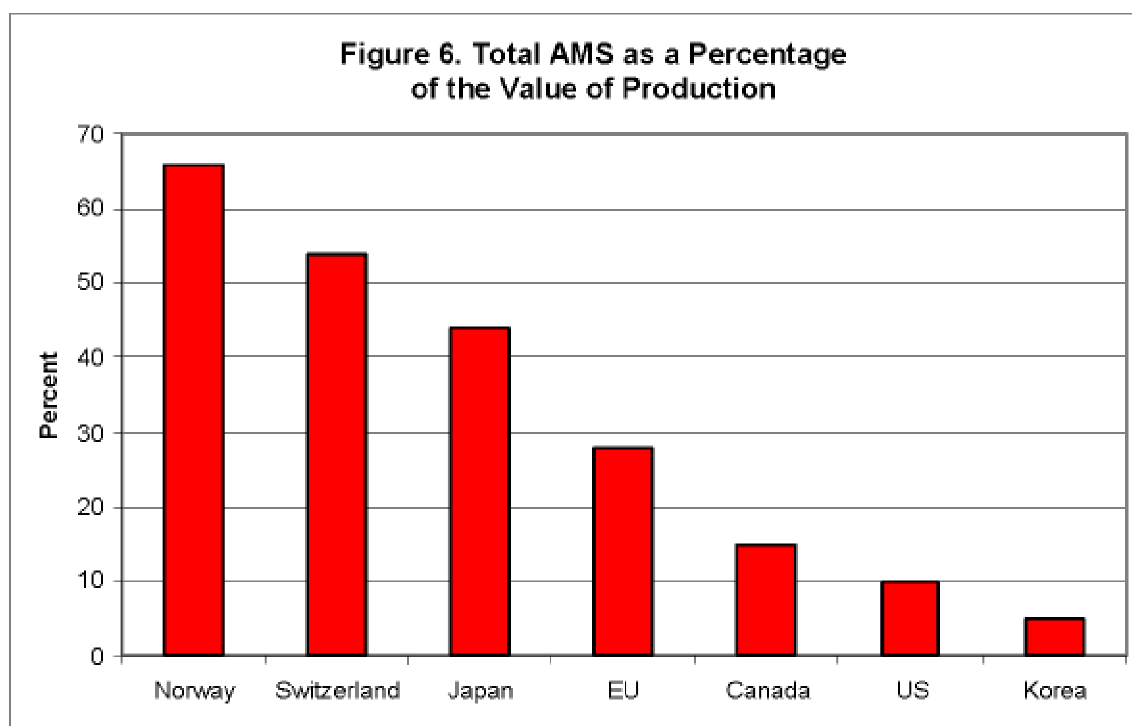
The Framework Agreement calls for "Members having higher levels of trade-distorting domestic support to make greater overall reductions in order to achieve a harmonizing result". This phrasing implies a tiered approach to the reduction percentage, with tiers based on the absolute level of support in a base period.

The first challenge is to agree on the level of Overall Trade Distorting Support across countries, which requires the use of a common currency (e.g., Euros or US dollars). The choice of currency may not be a simple issue from a political perspective, not only because of the sensitivity that might be associated with according a particular currency the status of a global numeraire, but also because of the implications of changes in exchange rates among the currencies of certain WTO members. It is not possible to conduct a simple analysis of the effects of currency variations and the choice of a base period for the Overall Trade Distorting Support because country notifications are relatively dated and it is difficult to make comparisons without a uniform base period. Nevertheless, the basic issue can be illustrated by comparing changes in the Final Bound Total AMS expressed in US dollars for recent years, as seen in Figure 5. Between 2000 and 2004, the value of the Final Bound Total AMS for the European Union rose by 36 percent in dollar terms, while Japan's had barely changed (Figure 5a). In dollar terms, the Final Bound Total AMS in the European Union was more that four times as large as that in the United States using the value of the dollar in 2004, compared to roughly three times as large using the value of the dollar in 2000.[4] The Total AMS of many other countries that have a lower absolute Total AMS has also increased (Figure 5b).





The second challenge is to decide whether to harmonize based on the absolute or the relative levels of Overall Trade Distorting Support. Based on the overall size of the Total AMS in the European Union, the relative magnitude of the difference between the next largest Total AMS, that of Japan, as shown in Figure 5a, it might be argued that the European Union should be in a class of its own when tiers for reductions in support are determined.[5] If one compares the Total AMS of each country to the average value of production, however, one might come to a different conclusion (Figure 6). Some smaller countries, such as Norway and Switzerland have a high Total AMS relative to the value of their domestic agricultural production. Under this comparison of the countries depicted in Figure 6, Japan has a high relative entitlement to support, followed by the European Union, Canada, and the United States.



If future reductions in support were linked to the current absolute level of support, countries with a larger total Overall Trade Distorting Support would be subject to a larger total (percentage) reduction. To the extent that a larger total value of support implies a larger absolute effect on trade, the emphasis on achieving the greatest reduction in support should focus on countries that, all other things being equal, account for the highest level of trade-distorting subsidies. This would imply that small developed countries, which do not contribute significantly to the absolute level of distortion in world trade, but which provide large amounts of trade-distorting support relative to the value of their domestic production (e.g., Norway and Switzerland), may be less affected, since they would be in a lower tier.[6] This would not necessarily mean that such countries would be less affected in practice, depending on the approach for reducing the domestic support entitlement. (It is also important to note that if all of a country's support is concentrated in one or two commodities, then even a relatively "small" country might have a disproportionate impact on that commodity's trade patterns. And, one can certainly question whether wealthy countries with high levels of trade-distorting support, who could shift much of that support into less-distorting Green Box measures should be subject to lesser disciplines.)

According to a recent proposal (Brink, 2005), the European Union would be in the highest tier (tier 1); and Japan and the United States would be in a second tier. Other developed countries could be in a third tier, with developing countries in a final tier, in line with the principle of (S&D). Even though in absolute terms (measured in any currency) the EU's Overall Trade Distorting Support is substantially larger than in any other country, it might prove politically difficult for Europe to be in a tier of its own. Equally, there are political pressures in the United States to "harmonize" the level of support allowed Europe and the United States.

The Final Bound Total AMS

The Framework calls for a tiered formula with greater reductions for larger values of the Total AMS to harmonize support levels. The Framework also allows for greater than formula reductions if necessary to achieve a given overall reduction in trade distorting support (i.e., to permit smaller cuts in Blue Box, since the Blue Box is not subject to an explicit reduction formula). The Framework also indicates that Members having a higher Total AMS will make greater reductions.

It is not clear whether the percentage reduction in Total AMS will differ from the percentage reduction in the Overall Trade Distorting Support. If the Total AMS percentage cut were to be larger than that for the Overall Trade Distorting Support, this would reduce the adjustment required in other components of the Overall Trade Distorting Support, particularly the Blue Box. It could mean that the reduction percentage in the Overall Trade Distorting Support would not be binding, i.e., that the reduction in Total AMS and *de minimis* would exceed the required reduction in the Overall Trade Distorting Support.[7]

Conversely, if the reduction percentage for the Total AMS were set lower than that for the Overall Trade Distorting Support, the latter reduction would be binding, forcing a country to reduce its actual Total AMS below the bound level

in order to meet the Overall Trade Distorting Support reduction commitment. The implications for future entitlements of separate reduction percentages for the various components of the Overall Trade Distorting Support and for the Overall Trade Distorting Support as a whole are relatively complicated. Their impact is further complicated by how these entitlements relate to the actual level of support provided and its composition.

The Product-specific AMS

The Framework specifies that the product-specific AMS will be capped at average levels to be agreed, with "reductions of some product-specific support". It is not clear if this relates to the aggregate of such support or that for each individual product category. The latter would seem to be more likely since the Harbinson Draft Modalities specified that the current AMS for individual products would not exceed average levels for 1999-2001. (Until November 1992, the Uruguay Round negotiations also included commodity by commodity reduction commitments. The Blair House Agreement in that month aggregated the commitments.) Capping product-specific AMS prevents an escalation of support for individual commodities. Countries whose current Total AMS is substantially less than the Bound level (Figure 1) have significant flexibility to increase the Amber Box support for individual commodities. Some of the complexities with product-specific caps can be illustrated by data for the United States.

Table 2 shows the average and the highest levels of AMS for key US commodities between 1999 and 2001. As the table indicates, there is substantial variation in the average value of the AMS across commodities ranging from 12 percent for corn (maize) and wheat to 57 percent for rice.[8] (By comparison, the average AMS for all supported commodities was 14 percent of the value of their production.) The data also point out the substantial year-to-year variability in the relative amount of support provided to some commodities. For example, the average AMS for cotton was 47 percent of the value of production for the three years, but it was as high as 74 percent in one of those years. Similarly, while the average AMS for rice was 57 percent, in one year it was 82 percent. The variation in the relative level of support, and whether a product is counted in the Total AMS or in product-specific *de minimis*, can be due to changes in the amount of support provided and/or in the value of production.

Table 2. Bindings on the Product-Specific AMS and Changes in *de minimis* for the United States

	Average AMS Million dollars	Average AMS Percent	Highest AMS Percent
Corn	2,193	12%	15%
Cotton	2,071	47%	74%
Dairy	4,738	21%	24%
Peanuts	364	38%	49%
Rice	607	57%	82%
Soybeans	3,358	27%	29%
Sugar	1,149	55%	57%
Tobacco	481	24%	39%
Wheat	670	12%	17%
Average non-product specific AMS	7,171	4%	
Average AMS on supported products		14%	
Average AMS 5% de minimis	16,026		
Average AMS 2.5% de minimis	23,273		

Note: Only selected commodities are shown. AMS percentages are with respect to the value of production. Based on 1999-2001 notifications.

Based on these figures, the United States would have great difficulty in complying with a cap on the product-specific AMS linked to the average AMS for all commodities that receive support. Imposing an overall product-specific ceiling of 14 percent would require a substantial reduction in support for many key commodities. Even the less restrictive requirement of individual commodity caps could be problematic. First, there is substantial variation in the percentage

AMS among commodities –setting individual caps would imply numerous individual rates. Second, policymakers might find it extremely difficult to stay within those individual caps.

Between 1999-2001 there was considerable policy instability in the United States. During those years various forms of emergency or special assistance were provided to US farmers. In 2000, net outlays of the Commodity Credit Corporation reached an all-time record of over $32 billion. Consequently, the variation illustrated by the US for this period may be atypical. It is possible, however, that even during periods of greater stability in agricultural policies, the United States and other countries would have difficulty living within rigid product-specific caps on the AMS, both because of variations in the value of support and variations in the value of production.

The use of fixed reference prices for the calculation of market price support has interesting implications for "large" countries – those whose production volumes can be expected to influence world prices, particularly when their production is subject to random fluctuations due to weather. The use of a fixed reference price is likely to overstate the actual amount of support in such countries if poor weather causes their domestic production to fall and world prices rise and to understate support if good weather causes production to rise and world prices fall. Since market price support is calculated as the difference between a domestic support price and a world reference price multiplied the volume of production eligible for support, both large and small countries could find that they breach a product-specific AMS cap without any change in the per unit support provided, simply because domestic production is higher than normal. This may add to the difficulty that countries may face in meeting their commitments with product-specific AMS caps.

Product-specific AMS caps could be defined based on historical averages for each commodity. The choice of the base period could be important in such a context. For example, as indicated above, a period that included the high support year of 2000 would be advantageous for the United States. Similarly, a reduction formula for each product specific AMS could be defined. In order to address this issue, a formula reduction requirement could be specified for each product-specific AMS. This would probably have to be similar in magnitude to the reduction percentages for Overall Trade Distorting Support or the Total AMS. The use of such an approach would ensure that trade-distorting support was reduced proportionately across the range of supported commodities.

It would also be possible to cap product-specific AMS using an approach similar to that devised for the Blue Box, by setting the initial value as a percentage of the value of production in a base period. It would then be possible to evaluate the annual product-specific spending against the capped percentage of the value of production for that commodity. This approach would provide more flexibility for countries to meet their commitments when the value of production varies year to year.

The use of product-specific caps and a product-specific reduction formula would limit the ability of countries to reallocate their AMS to protect more sensitive sectors, although it would not prevent this. Countries could still reallocate actual support to maintain the capped value on sensitive products, even if they could not exceed the cap. As we have seen with the AMS itself in recent years, fixing maximum values for support can create an entitlement mentality, which pressures policymakers to provide the full amount of the specified level of support (as was the experience with the 2002 US Farm Bill). The use of caps, therefore, may actually impede the process of policy reform. For example, there might be little incentive for US dairy or sugar producers to give up their capped AMS entitlement in the WTO even if less-distorting policies were on offer as part of a new Farm Bill. In fact, it could be argued that since the cap would be linked to actual levels of support, those countries that had refrained from providing support and consequently had a low product-specific AMS would be penalized, while countries with high product-specific AMS would be rewarded.[9] To some extent, AMS caps build in an entitlement on the basis of previous "bad behavior".

Certainly creating tighter discipline on the amount of support provided to individual commodities would be desirable, particularly from the perspective of producers in other countries trying to compete with subsidized production. Product-specific caps prevent the escalation of subsidies for individual commodities. However, as noted above, countries might violate such caps simply because of normal year-to-year fluctuations in prices or production. Establishing a discipline over which policymakers have no control might not make a positive contribution to the WTO process, unless one were to judge the value of that process in terms of the volume of litigation.

Finally, reductions in "some product-specific support" as specified in the Framework would be virtually inevitable if sufficiently high reduction percentages are specified for the Overall Trade Distorting Support and the Total AMS. This is particularly true for countries whose current total AMS is relatively close to the current bound level. The likelihood that broad reductions in actual support would be necessary is evaluated in subsequent examples. For countries concerned about imposing greater discipline on domestic support, the major priority might be to achieve meaningful reduction percentages in the Overall Trade Distorting Support and its components that would actually be binding on the amount of support that countries could provide.

The Product-Specific and Non-Product Specific de minimis

The July Framework Agreement calls for a reduction in *de minimis* levels, but does not specify an amount. It notes that greater than formula reductions should be allowed to meet an overall reduction requirement for trade-distorting support. The Harbinson Draft Modalities proposed that the five percent *de minimis* exemptions for developed countries be reduced to 2.5 percent in equal installments over a period of five years. Under Harbinson's proposal the 10 percent *de minimis* for developing countries would be maintained, with credit for negative product-specific support up to a maximum of 10 percent of the value of production for that commodity. The July Framework Agreement simply calls for negotiated reductions to take into account S&D and for an exemption for developing countries allocating almost all *de minimis* support to subsistence and resource-poor farmers. Of the countries analyzed in this paper, only Korea qualified for developing country status under the URAA. It is assumed that this will continue to apply, but that the *de minimis* for non-exempt developing countries will be reduced to five percent.

As noted earlier, there are two components to the *de minimis* – a product-specific component and a non-product specific component. The importance of these varies among countries, as illustrated by the data in Table 1. For most countries, a reduction in the *de minimis* cap is likely to be more significant for non-product specific support. Korea is the only country examined for which the actual support provided under the product-specific *de minimis* provision exceeded non-product specific support.

Under the URAA, separate *de minimis* calculations were applied to product and non-product specific support. This meant that, at the limit, a country could maintain a support level of at 9.99 percent (under five percent for each category of support) without such support being counted against its commitments. The Overall Trade Distorting Support approach seems to imply that a cap of 2.5 percent will apply to each *de minimis* category (with the exception of developing countries), meaning that the total level of support under the *de minimis* provision could be maintained at just under five percent. The use of a five percent cap for non-exempt developing countries would imply that the total level of support under this provision could be maintained at just under 10 percent.

Countries have greater flexibility to use non-product specific *de minimis* than the product specific category. Since the non-product specific *de minimis* is an aggregate of various forms of support, the composition of that support varies substantially within the capped level. The situation is different for product-specific *de minimis*, since the product-specific cap disciplines the amount of support that can be provided for each commodity. However, because product-specific support can rely on market price supports, which are consumer-financed, and non-product specific support must rely on taxpayers, it may not be easy for countries to switch from consumer to taxpayer-financed support . For the countries examined, the non-product specific *de minimis* exceeded 2.5 percent of the value of production for some commodities in some years (five percent for Korea). Unfortunately, the notifications do not permit a comprehensive analysis because production values are not provided for some years and some countries. However, Table 3 shows that relatively few commodities would be affected by a reduction in the *de minimis* percentage in the base period, and then only in certain years.

Table 3. Products Affected by a Reduction in the Product-Specific *de minimis* in the Base Period

Country	Product
Canada	Barley (*de minimis* in 1997-98, counted in the Total AMS in 1999) Oats (*de minimis* in 1997 only, counted in the Total AMS for the two remaining years)
Korea	Garlic, Maize, Other Cereals and Silkworm (AMS was 5 percent or more of the value of production in 2000)
United States	Barley (*de minimis* in 2001 only) Safflower (*de minimis* only in 1999, counted in the Total AMS in 2000, no support recorded for 2001) Sheep and Lamb (*de minimis* in 1999 and 2000, counted in the Total AMS in 2001) Wheat (counted in the total AMS in 1999 and 2000, *de minimis* in 2001).

The variability in the level of support in the United States during the base period, noted earlier in the discussion of caps on the product-specific AMS, is again apparent. Commodities move into and out of the *de minimis* category from year to year depending on the level of support and changes in the value of production.

One important implication of product-specific *de minimis* in the Overall Trade Distorting Support is an issue of "double counting" (Roberts, 2005). Double counting arises because the *de minimis* allowance relates to five percent of the total

value of production rather than to the value of production for those commodities for which a product-specific *de minimis* exemption is claimed. While the eligibility of each particular commodity for the exemption is evaluated with respect to its value of production of that commodity, thereby imposing some discipline on its use, the unused part of the total exemption provides some extra "padding" in the Overall Trade Distorting Support.[10]

The reduction in the *de minimis* from five percent to 2.5 percent imposes a greater constraint than under the URAA, but including two separate allowances for each category means that *de minimis* becomes a significant proportion of the base Overall Trade Distorting Support — more than twice the value of the permitted Blue Box level. Countries that do not use their *de minimis* exemptions may still benefit from their inclusion in the Overall Trade Distorting Support, since this may dilute the effective reduction required in other elements for any given reduction in the Overall Trade Distorting Support. Conversely, a meaningful reduction percentage for the Overall Trade Distorting Support could force additional reductions in actual *de minimis* support, regardless of the nominal entitlement.

The Blue Box

The Framework calls for capping Blue Box support at five percent of the average value of total agricultural production for an historical period. Countries with significantly higher Blue Box expenditures (i.e., the European Union and Norway) are allowed to exceed this cap during a transition period. However, the July Framework does not indicate any reduction formula for the Blue Box.[11] Therefore, in calculating the permitted level of Overall Trade Distorting Support, the Blue Box component will be the higher of existing payments in a representative period or the capped value. While the new Blue Box was intended for US programs now counted in the Amber Box, it is important to note that all countries, whether or not they currently use Blue Box payments, will be entitled to include the five percent Blue Box cap in their Overall Trade Distorting Support. This provides some additional padding in the Overall Trade Distorting Support for countries that do not use Blue Box payments. It is unclear whether countries that are forced to change existing policies because of reductions in their total AMS would modify existing programs to qualify for the Blue Box, taking advantage of the support entitlement under that category, but this certainly creates an opportunity for strategic behavior.

The Framework extends the definition of Blue Box payments from those made under production limiting programs to payments that do not require production (to be negotiated) or that are not paid on 100 percent of production. It also specifies that such payments must be made on "fixed and unchanging" areas or number of animals. This expansion of the Blue Box definition is intended to capture the Counter-Cyclical Payments (CCPs) introduced by the United States as part of the 2002 Farm Act.

The CCPs vary with current market prices, but not with current production.[12] They differ from the deficiency payments used by the United States prior to the 1996 Farm Act in one key aspect. Deficiency payments and the EU compensatory payments covered by the Blue Box required supply controls (i.e., compulsory set-asides) or payments based on a fixed number of animals (in the EU case). The rationale was that such restrictions could offset the potential production-enhancing effects of the payment. Even though such payments required production limitations, there is no actual requirement in the URAA that supply controls should actually be imposed or that the supply restriction actually offset the production-enhancing effect of the payment. Payments linked to a fixed number of animals would likely distort trade if there were farmers who were required to produce in order to receive the payment. Consequently, it is not clear whether such payments actually distort trade. (In some cases, Blue Box payments may have actually been negatively coupled, resulting in reductions in production levels beyond "market" levels.)

One might argue that the level of distortions created by various Blue Box payments is not important since the Framework will impose some discipline on Blue Box payments for the first time. As noted earlier, Blue Box payments are to be included in the Overall Trade Distorting Support and, while they are not subject to a specific reduction percentage, they are likely to be affected by a reduction requirement for the Overall Trade Distorting Support. In addition, they are subject to the five percent cap on the value of agricultural production.

From a US perspective there is a clear advantage in the expansion of the Blue Box definition to include CCPs, since otherwise they would have to be accommodated within the Total AMS ceiling of $19.1 billion. At five percent of the value of production, the separate Blue Box provision adds an additional $9.5 billion of support entitlement for the United States (see Table 1). Expenditures on CCPs in 2002-03 averaged around one percent of the value of total agricultural production in the United States.[13] Subsequently, the application of an aggressive Overall Trade Distorting Support reduction percentage could substantially reduce the flexibility open to the United States in using CCPs.

The five percent cap would affect countries in different ways. For Japan, the cap does not seem to be much of an issue if recent policies continue, since in the base period its Blue Box payments only amounted to roughly 20 percent of the capped value. On the other hand, EU payments were more than 80 percent above the capped value. The EU is in the

process of changing its policies, which should switch much of the support previously provided under the Blue Box to the Green Box.[14] And, as the European Union adds more member countries, without increasing its Blue Box spending, the percentage of spending compared to the overall value of production will naturally decline. Norway faces the greatest challenge. Its Blue Box support was more than eight times the five-percent production cap in the base period. The Framework allows for some flexibility in cases where an exceptionally large percentage of trade-distorting support is in the Blue Box to avoid "a wholly disproportionate cut". If this category of support were going to continue to be of importance for Norway, it would appear that some relaxation of the five percent cap, even at the end of the transition period, might have to be granted.

The Blue Box is the only element of trade-distorting support for which no formula reduction is proposed. Perhaps such payments are viewed as proportionately less distorting than those in the Amber Box. In any event, the Blue Box appears to be subject to more degrees of freedom than other components. Because countries may have to reduce the Overall Level of Trade Distorting Support by more than the sum of the cuts in each component of trade distorting support, there is some uncertainty concerning much future Blue Box payments might be disciplined.

A modest Overall Trade Distorting Support reduction, in particular, would relieve any pressure to reduce the Blue Box below the five percent cap. Alternatively, countries could reduce their final bound total AMS or the *de minimis* components below the levels implied by formula reductions in the Overall Trade Distorting Support, rather than reduce Blue Box payments (providing that such payments do no exceed the five percent production limitation). While the overall level of Blue Box support will be capped and the payment will be fixed, payment rates can still be varied to alter the distribution of payments across commodities, as there is no proposal to cap product-specific payments under the Blue Box. Thus if CCPs are included under the Blue Box, this will allow considerable flexibility in *ex post* income stabilization on a product-by-product basis.[15] The problems of imposing a product-by-product cap on Blue Box payments (which is not called for in the July Framework Agreement) parallel those associated with product-by-product caps on the AMS discussed earlier.

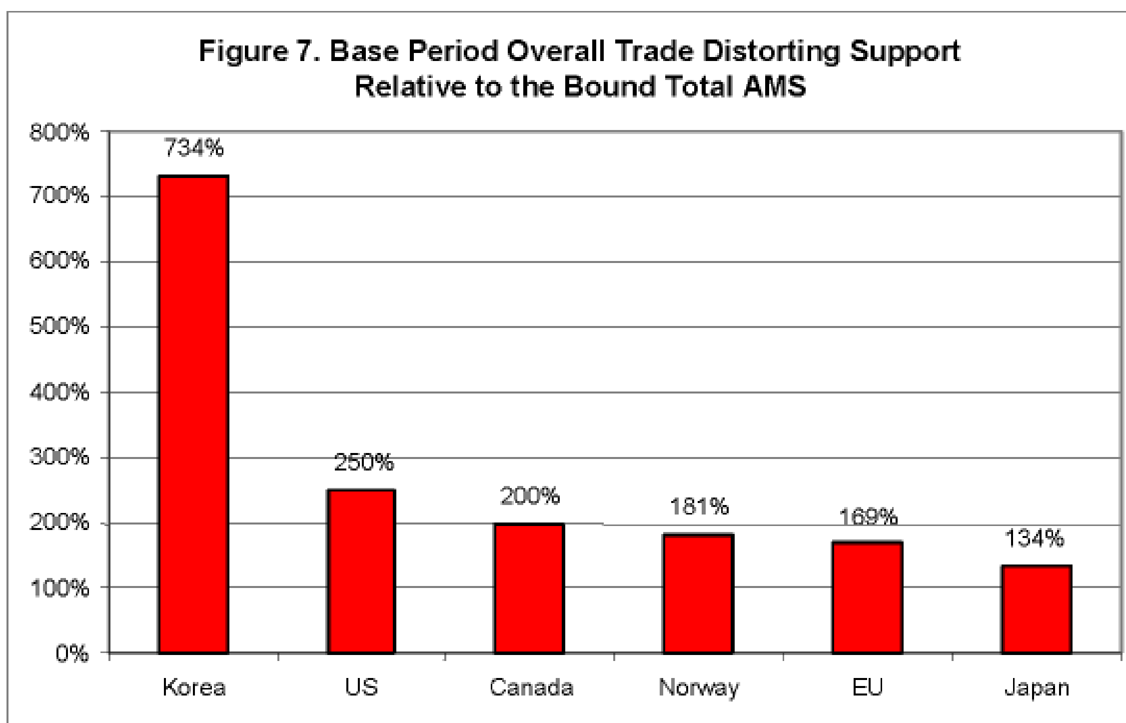
Finally, criteria for payments to be included in the Blue Box have been tightened. They must now be based on "fixed and <u>unchanging</u>" areas, yields or number of animals. This is presumably to stop updating of payment bases (which occurred under the 2002 US Farm Act). Updating payment bases has limited farmers' production response, as farmers keep more of their area in supported crops to maintain their future entitlement to payments. The new requirement will introduce some discipline into the distribution of payments (although payment rates for different commodities could presumably be varied), but if the payments are only a transitional measure "in promoting agricultural reforms" (as indicated in the Framework), perhaps this is not a grave concern.[16] The Framework indicates that "additional criteria" will be negotiated (to take account of the balance of WTO rights and obligations, and will not have the perverse effect of undoing ongoing reforms), but it is unclear exactly what this will involve.[17] It might be possible to tighten the rules that apply to payments linked to production restrictions, to ensure that the restrictions are binding, and are sufficient to offset any production-enhancing effect.

5. SCENARIOS FOR REDUCING OVERALL TRADE DISTORTING SUPPORT AND ITS COMPONENTS

Basing reductions on a country's Overall Trade Distorting Support significantly increases the amount of support subject to cuts. For example, a developed country would be permitted to provide support equal to five percent of the value of its total agricultural production in the Blue Box, plus a five percent product and non-product specific *de minimis*. If one assumes that each country is entitled to use each of the components up to the limit allowed means that Korea's level of support permitted in the base period increases more than six fold. In the United States, including *de minimis* and Blue Box allowances mean that the support entitlement more than doubles from URAA levels. Figure 7 shows that Japan faces the smallest impact of the switch from the Total AMS to the Overall Trade Distorting Support, but it is also least likely to be affected by required reductions in the Overall Trade Distorting Support.

Table 4 contains two examples that illustrate some of the issues involved.[18] The first example, an "undifferentiated approach", provides a point of reference for the tiered example. This approach assumes that each country would be required to reduce its Overall Trade Distorting Support and its total AMS by 60 percent. It assumes that the *de minimis* components would be reduced from five to 2.5 percent of production, with the exception of Korea whose *de minimis* falls from ten to five percent. The Blue Box included in the base Overall Trade Distorting Support is five percent of the value of production, except for the European Union and Norway, where it is the actual value of Blue Box payments in the base period (the Framework requires the base Overall Trade Distorting Support to include the higher of five percent of the value of production or actual Blue Box payments). In both the European Union and Norway, Blue Box payments exceeded five percent of the value of production in the base period.

Under the Framework Agreement, if the reduction in the Overall Trade Distorting Support is greater than the sum of the reduction in various components, then the proposed reduction in Overall Trade Distorting Support is binding. In the



first scenario where each country reduces its support by 60 percent and where the Total AMS is also reduced by 60 percent, the cuts required in the Overall Trade Distorting Support are greater than the sum of permitted AMS, Blue Box and *de minimis* support. For example, Canada would have to reduce its permitted Overall Trade Distorting Support from C$8.757 billion to C$3.503 billion, but the sum of Canada's permitted Total AMS, product and non-product specific *de minimis* and Blue Box spending is C$1.188 billion higher than its permitted Overall Trade Distorting Support. Canada, in this example, could find these additional "cuts" by shifting this support to its under used AMS (C$737 million), or its underused Blue Box (C$1.485 billion). The European Union would have to reduce its overall support from E112.087 billion to E44.835 billion. But, adding up the permitted component parts, the EU would still need to find an additional E6.145 billion in cuts, mainly in Amber and Blue Boxes. In this case, the EU could shift some support into product and non-product specific *de minimis*. Norway would find itself in a different situation. The reduction in the Overall Trade Distorting Support, from NKr18.151 billion to NKr8.3 billion would be very painless for Norway. However, the limits on permitted Total AMS (NKr6.013 billion) and the limit on Blue Box (five percent in the final year of implementation) would be drastic. Norway would have to reduce its Total AMS from NKr10.593 billion to NKr4.58 billion and its total Blue Box from NKr7.558 billion to NKr872 million.

For the Overall Trade Distorting Support reduction to be potentially binding , its reduction percentage must exceed those applied to the Total AMS. If that is not the case, the Overall Trade Distorting Support reduction merely allows countries to shift support from Total AMS into "underused" *de minimis* or Blue Box spending. The sequencing of reductions in the Overall Trade Distorting Support (i.e., the suggested 20 percent reduction in the first year of the Framework) could accelerate reductions in total AMS and *de minimis*, but the final Overall Trade Distorting Support reduction percentage is likely to have no additional impact on them. It is important to point out that if the Blue Box is truly less trade distorting than the Amber Box, then allowing countries to shift support from Amber to Blue may in fact be positive from the point of view of the international trading system.

One way to "measure" the success of an across the board cut of 60 percent in Overall Trade Distorting Support and in the Total AMS in harmonizing the levels of support across countries is to measure the level of permitted Overall Trade Distorting Support relative to the value of production in the base period versus after the 60 percent cut. In the base period, Canada's "permitted" level of Overall Trade Distorting Support relative to the value of production was 29 percent, after a 60 percent cut its permitted Overall Trade Distorting Support relative to the value of production was 12 percent, The EU's permitted level of support fell from 46 percent to 19 percent, while the US level fell from 25 percent to 10 percent. While still not completely "harmonized" these figures are clearly moving towards greater harmony.

The second block of figures in Table 4 present a tiered approach to the reduction in the Overall Trade Distorting Support and total AMS. In this scenario, the reduction percentage of 60 percent for both components is maintained for the European Union, Japan and the United States. A reduction percentage of 50 percent is applied for Canada and

Table 4. Domestic Support for Selected Countries, Potential Reduction Formulas

	Canada	EU	Japan	Korea	Norway	US
	1997-99	1999-01	2000-02	2000-02	1999-01	1999-01
	Million $	Million €	Billion ¥	Bill Won	Mill Kr	Million $
Equal Reductions Across Countries/Components (60% cut)						
Permitted Overall Trade Distorting Support	3,448	44,835	2,128	3,746	8,300	19,096
Permitted Total AMS	1,720	26,864	1,589	596	4,580	7,641
Permitted Product-Specific (2.5% others)	720	6,029	224	1,575	436	4,773
Permitted Non-product (2.5% others)	720	6,029	224	1,575	436	4,773
Permitted Blue Box (5% Korea)	1,440	12,058	449	1,575	872	9,546
Additional Cuts to Meet Permitted OTDS	1,152	6,145	359	1,575	-1,977	7,637
Additional Cuts to Meet Permitted Total AMS	-787	16,743	-872	1,006	6,013	8,385
Percentage Cut in AMS required	0%	62%	0%	37%	43%	48%
Additional Cuts to Meet Permitted PS	-537	-5919	-209	-977	-436	-4671
Additional Cuts to Meet Permitted NPS	148	-5,562	-204	-1,127	-436	2,398
Additional Cuts to Meet Permitted Blue Box	-1,440	9,856	-359	-1,575	6,686	-9,546
Permitted OTDS/Production	12%	19%	24%	12%	48%	10%
Tiered Reductions Across Countries/Components	**50% Cut**	**60% Cut**	**60% Cut**	**40% Cut**	**50% Cut**	**60% Cut**
Permitted Overall Trade Distorting Support	4,310	44,835	2,128	5,619	10,375	19,096
Permitted Total AMS	2,151	26,864	1,589	961	5,725	7,641
Permitted Product (5% Korea, 2.5% others)	720	6,029	224	1,575	436	4,773
Permitted Non-product (5% Korea, 2.5% others)	720	6,029	224	1,575	436	4,773
Permitted Blue Box (5%)	1,440	12,058	449	1,575	872	9,546
Additional Cuts to Meet Permitted OTDS	720	6,145	358	67	-2,907	7,637
Additional Cuts to Meet Permitted Total AMS	-1,218	16,743	-872	641	4,869	8,385
Percentage Cut in AMS required	0%	62%	0%	60%	54%	48%
Additional Cuts to Meet Permitted PS	-537	-5,919	-209	-977	-436	-4,671
Additional Cuts to Meet Permitted NPS	148	-5,562	-204	-1,127	-436	2,398
Additional Cuts to Meet Permitted Blue Box	-1,440	9,856	-359	-1,575	6,686	-9,546
Permitted OTDS/Production	15%	19%	24%	18%	60%	10%
Assumptions						
Maximum Permitted OTDS (base period)	8,757	112,087	5,320	9,365	20,750	47,741
Value of Production	1,485	12,058	449	3,150	872	9,546

The undifferentiated approach assumes a reduction of 60 percent in Overall Trade Distorting Support and Total AMS and a *de minimis* of 2.5 percent (5 percent for Korea) for each of product and non-product specific

The tiered approach assumes reductions of 60 percent in Overall Trade Distorting Support and total AMS for the EU, Japan and US; 50 percent for Canada and Norway and 40 percent for Korea, with a *de minimis* of 2.5 percent (5 percent for Korea) for each of product and non-product specific

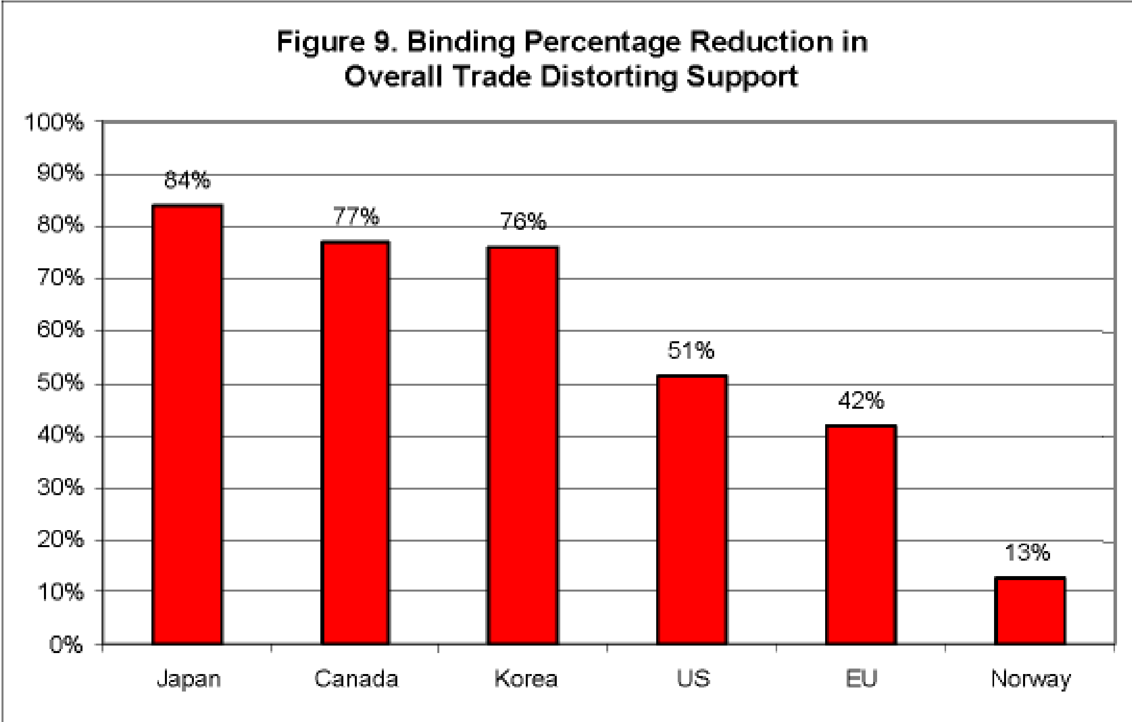
Assumptions: The maximum Overall Trade Distorting Support is the Bound Total AMS plus a *de minimis* of five percent (10 percent for Korea) for each of the product and non-product specific components, and Blue Box cap of five percent of the value of production in the base period, except for EU and Norway where it is actual Blue Box payments in the base period.

Source: Computed from data in country notifications to the WTO. Additional data on production values from the OECD PSE/CSE database (2004)

Norway, and Korea has a 40 percent reduction. As this analysis illustrates, a tired reduction formula somewhat increases the flexibility that countries have, mainly because the required cuts in the Total AMS are reduced, save for the US, the EU and Japan.

It is also important to point out that Canada, Japan, and Korea the level of Overall Trade Distorting Support allowed under this tiered reduction formula remains higher than the Total AMS for these countries in the base period (and Norway is very close). This means that they would not have to make any further reductions, unless required by the reduction formulas for the components of trade distorting support. Canada would have to cut non-product specific support by C$289 million; Norway would have to reduce its Total AMS by NKr4.869 billion. The United States and the European Union would both have to make substantial cuts in their total AMS (62 percent and 47 percent respectively), and the EU would have to reduce its Blue Box by 55 percent at the end of the implementation period.

Figure 9 demonstrates the percentage reduction in the base Overall Trade Distorting Support entitlement required before actual reductions in the current levels of overall support would be necessary. In other words, it shows when those reductions would actually become binding on the provision of support to agriculture. The graph illustrates clearly the policy flexibility that countries like Japan, Canada and Korea have compared to countries like Norway. A reduction of roughly 13 percent in the bound Overall Trade Distorting Support would become binding in Norway, whereas a reduction of more than 80 percent would be required in Japan before cuts in actual spending occurred. In Europe, a cut of 40 percent would become binding, while in the United States a cut of 50 percent would be required. As in the URAA, the initial starting conditions (i.e., the level of permitted support) that apply to each individual country are crucial in determining whether an agreement is likely to have any effect on the levels of support actually provided to agriculture.



Because Table 4 is based on historical data, the effects of the reductions might be overstated. The future evolution of domestic support policies could affect the actual adjustments required by a new WTO agreement. To evaluate this would require assumptions about the future impact of policy changes on the variables in Table 4. While this paper does not derive such projections, an analysis of reductions in the Overall Trade Distorting Support across four country tiers – Tier 1 (EU) 90 percent; Tier 2 (Japan and US) 80 percent; Tier 3 (Canada) 70 percent; Tier 4 (Brazil[19]) 60 percent – indicates that cuts of this magnitude would constrain the European Union and the United States' ability to increase trade-distorting support, but it would not require major changes in existing policies (Brink 2005).[20] The European Union and the United States could reduce their permitted Overall Trade Distorting Support by 76 percent without having to change their policies significantly in the future.

Brink's projections take into account the changes in the EU agricultural programs under the Mid-term review, in particular the shift from Blue Box to Green Box payments, and the continuation of the current U.S. Farm Act beyond 2007 (with CCPs being included in the Blue Box). Using market price projections developed by the US Department of

Agriculture, Brink concludes that the European Union and the United States could absorb 72 percent and 61 percent cuts, respectively, in their total AMS commitment without a significant change in policies. These results support the conclusion reached through an analysis of recent historical data for this paper, that very large reduction percentages in the total AMS and Overall Trade Distorting Support would be required in order to generate the need for significant changes in support policies in these countries.

The Green Box

The URAA exempted certain types of payments from reduction if they meet "the fundamental requirement that they have no, or at most minimal trade-distorting effects or effects on production." Policy-specific criteria and conditions are specified in Annex 2 of the URAA. Green Box payments are of considerable significance for a number of countries (Table 1). The Framework indicates that these criteria will be reviewed and clarified to ensure no, or at most minimal, trade-distorting effects or effects on production and to provide for improved monitoring and surveillance of Green Box payments. The Draft Modalities suggested amendments to Annex 2 of the URAA. These included clarifying payment characteristics for income insurance and safety net programs; disaster payments; structural adjustment assistance; and payments under environmental programs (with these to be extended to include animal welfare payments). There are clearly concerns that payments currently declared as Green Box may indeed by trade distorting.

This discussion is complicated by difficulty of developing specific criteria for what is "trade distorting". For example, there is empirical evidence that US decoupled payments have had some impact on production even though the estimated impacts are modest in comparison to conventional price supports. Fixed direct payments, also included in the Green Box, have a wealth effect that may be at least as important for production decisions. The current thinking in the WTO classifies payments directly linked to current prices or production as trade distorting, but some decoupled expenditures that are clearly in the Green Box (such as for research) arguably can be more distorting over the long run, because of their impact on productivity.

The future of some Green Box payments is currently uncertain because of the recent ruling under the Cotton Case in the WTO. In that case, Brazil brought a complaint against certain aspects of the cotton policies of the United States. A key aspect of this complaint, relevant to the Green Box, was the panel's finding that US direct payments and the legislative and regulatory provisions which establish and maintain the direct payment program do not fully conform to the conditions set out in Annex 2 of the URAA.

Brazil challenged the contention that US direct payments had no impact on production. Annex 2 of the URAA states that the amount of decoupled income support payments in a given year shall not be related to the type or volume of production undertaken in any year after the base year used in establishing the payments. The panel concluded that since the payments forbade producers to plant certain commodities (specifically fruits and vegetables) on the land upon which payments were based, and that producers were penalized if they chose to do so, there was indeed a link to production decisions after the base period. This is an important decision not only for the United States, but also for the European Union, whose single farm payment (SFP), currently being introduced as a result of the Mid-term review in 2003, involves a similar requirement. One might conclude that a simple solution to this problem would simply be to relax the restriction on the ability of producers to devote their land to other crops, and that may indeed be the case.

The Cotton Panel decision appears to open up a broader set of issues, however.Both the European Union and the United States want to link income support for agriculture to specific uses of land. The conditions for the Single Farm Payment, for example, involve a definition of arable land that involves land cultivated for crop production or under set-aside be maintained in good agricultural and environmental condition. Although the implication of these particular conditions was not considered in the cotton case, such requirements might be interpreted as linking the provision of payments to agricultural activity (i.e., to production). To the extent that such a requirement directly increases agricultural output, the requirement might be challenged as not satisfying the condition of minimally production and trade distorting. While this may appear to be rather extreme, one could imagine cases where this might be a concern. The broader implications of the Cotton Case for the provision of income support to agriculture remain to be determined, but may question any support that is linked to the continuance of agricultural activities.

A separate element of the Green Box appears to legitimize such a linkage in environmental programs. Annex 2 acknowledges that governments may require producers to meet certain environmental conditions relating to production methods or inputs in exchange for receiving direct payments. But Annex 2 specifies that the amount of any payment made must be limited to the extra costs or loss of income involved in complying with the conditions of the program. Governments may provide payments to secure the supply of environmental benefits associated with agriculture's use of the land, but it is unclear whether some of the environmental programs under consideration would conform to the Green Box conditions. These rules cover programs that compensate producers for the private costs of complying with environmental regulations, but they do not allow subsidies that reward producers for the social value of those services.

The underlying assumption behind multifunctionality (agriculture as a source of both commodities and non-commodity outputs), seems to be that the optimal supply of agriculture's non-commodity outputs, such as landscape, wildlife habitat, biodiversity, and cultural heritage can only be guaranteed by providing farmers a sufficient economic incentive to provide those attributes. To be effective, that incentive may need to cover the opportunity costs faced by farmers (their potential earnings in non-agricultural activities or use of the land for alternative purposes), not just the additional costs that environmental programs may impose due to their impact on specific agricultural or land-use practices. Payments established through competitive bids, such as US Conservation Reserve Program, may satisfy the income foregone condition of the URAA, since it can be argued that farmers' individual bids will be related to the opportunity costs of the use of their land, i.e., to income foregone (Blandford and Boisvert 2005a).

However, it is by no means clear that incentive payments set by governments for environmental benefits, or direct income payments with environmental conditions attached, would conform to current Green Box rules. Even though the WTO rules governing the Green Box has no opinion on the rationale for the payments, the rules set forth on the amount of allowable compensation may make it more difficult for countries to shift payments from trade distorting Amber Box subsidies to minimally trade distorting Green Box supports. It is important that these the level of support allowed under conservation or other forms of environmental programs be clarified.

A more general and difficult issue with the Green Box, as currently defined, is that some categories of payments may, of necessity, affect production. This may be true for environmental payments and the proposed animal welfare payments. These are often designed to help support a particular production process or level of output in order to generate positive externalities or public goods. While considerable confusion exists in the policy debate on these issues, there is little doubt that the correction of market failures associated with agriculture (where they exist) will affect land use and production, either positively or negatively (Blandford and Boisvert, 2005b). Such payments may become a new mechanism for supporting otherwise agriculturally uncompetitive activities under an environment of freer trade. Green Box payments may create equity problems in countries using them, and such payments may generate "subsidy envy" among countries that cannot afford them. Again, these programs may be less trade distorting than the programs they are replacing. The issue is to make sure the rules governing Green Box payments are clear and unambiguous.

Clearly, the current Green Box includes many different types of payments, some of which are likely to be more distorting than others. Some of these payments are likely to have the greatest impact on production (in particular, those relating to direct income supports, income insurance and income safety-net programs, and crop insurance). Some have argued that these payments be moved into a Box subject to reduction or capping– perhaps into the Blue Box.[21] As noted earlier, so-called decoupled payments may indeed have an impact on production that cannot be justified on the basis of correcting for market failure. These issues raise important concerns that seem to support the call in the July Framework for a "review" of criteria for Green Box programs and payments.

Even with a clearer elaboration of the characteristics of Green Box payments, it will be difficult and perhaps counterproductive to impose greater discipline on these payments. First, the URAA refers to payments not programs – there is considerable flexibility to change payment names and forms (i.e., the changes in US payments between the 1996 and 2002 Farm Acts) while keeping the fundamental instruments the same.

A final issue is how to improve monitoring and surveillance, as called for in the Framework. One option would be to have a formal WTO review process for new payments or policies with a panel to review their conformity with the minimally distorting requirement. In such a process the responsibility would rest on the country proposing to create a new program to demonstrate that it is minimally distorting (Blandford, 2001). If it were judged not to be so, the support under such a program would be counted against the Overall Trade Distorting Support.

Special and Differential Treatment

The Framework Agreement calls for special and differential treatment (S&D) for developing countries to include longer implementation periods and lower reduction coefficients for all types of trade-distorting domestic support and for continued access to the provisions under Article 6.2 (the exemption of direct or indirect assistance for agriculture and rural development). LDCs will not be required to make any reduction commitments.

The Draft Modalities included amendments to Article 6.2 of the URAA, clarifying the forms of assistance to encourage agricultural and rural development in developing countries that would be exempt from domestic support reduction commitments. It also proposed a 10-year implementation period for commitments, compared to a five-year period for developed countries.

The Framework specifies that *de minimis* negotiated reductions should take into account S&D, with an exemption for developing countries that allocate almost all *de minimis* support to subsistence and resource-poor farmers. It is not clear exactly how (if at all) that will be determined as part of a final agreement. The Draft Modalities proposed that the

10 percent *de minimis* for developing countries be maintained, with credit for negative product-specific support up to a maximum of 10 percent of the value of production for that commodity.

As indicated in the earlier analysis for Korea, the approach to reductions in support proposed under the Framework may not have much impact on the ability of developing countries to support agriculture, even if they have a bound total AMS. Countries that have no such commitments will find themselves in a truly preferential position. For example, the absence of a total AMS binding for the Peoples Republic of China provides substantial flexibility, should China decide to support its agricultural sector in the future (Brink 2005). The substantial and rapid economic growth of China and a number of other developing countries raises the question whether such countries should be granted the same special and differential treatment as poorer developing countries. In particular, should all developing countries that are required to reduce non-exempt support be placed in the same (lowest) tier for reductions and subject to the lowest reduction percentage?

6. OTHER ISSUES

There are some other issues relating to the treatment of domestic support that are relevant to components of a final agreement. Presumably the choice of the base period or periods used in capping or determining reductions in domestic support will not be independent of base periods in the parts of a final agreement relating to market access and export competition. As has been noted above, variations in the base period may have differing implications for key countries in the negotiations.

Finally, the implementation periods for reductions in domestic support are likely to be linked to other elements of the agreement. There will be a shorter implementation period for concessions by developed country members of the WTO and a longer period for the developing country members. The Draft Modalities foresaw an implementation period of five years for the former and ten years for the latter.

7. CONCLUSIONS

The introduction of the Overall Trade Distorting Support in the current WTO negotiations appears to be a positive development for those who would like to see reduced distortions in international agricultural trade created by domestic agricultural policies. The Overall Trade Distorting Support will include forms of support that were previously exempt from reduction commitments, specifically *de minimis* and Blue Box support. Questions still remain over the future of the Green Box – at the very least there will need to be a significant improvement in the monitoring and surveillance of payments made under that category of support. Questions also remain over the treatment of support in developing countries and, in particular, the way in which special and differential treatment will be handled for the higher-income developing countries.

The implications of a formula approach to the reduction of permitted support are complex. As has been illustrated, the final effects of a reduction formula will depend on the initial permitted levels of support and how these relate to the actual support provided, as well as on the percentages applied. One of the major conclusions from an analysis of data from recent country notifications is that reduction percentages of at least 60 percent will be required in the Overall Trade Distorting Support and total AMS if an agreement is to translate into reductions in the actual level of domestic support provided to agriculture in many countries. In the absence of such an approach, such countries will be able to conduct their agricultural policies on a “business as usual” basis. It that happens, reductions in trade-distorting support may result in much progress on paper, but relatively little in practice.

8. REFERENCES

For complete list of references, see the commissioned paper on the IATRC website, www.iatrcweb.org

Endnotes

[1] The amount of support for an individual commodity, as calculated under the provisions of the URAA may differ from the actual amount of support provided for that commodity because the URAA used fixed world prices for the period 1986-88 to calculate market price support for commodities for which domestic/international price comparisons can be made. Because the base period reference prices may not correspond to actual world prices in the current year, the calculated level of support for the AMS can differ from the actual level of support provided.

[2] The figure for Korea includes expenditures under development programs that are exempt under special and differential treatment. These were roughly one percent of the total (Green + S&D exempt).

[3] Since the value of production includes all commodities, whether or not these receive government support, a country that provides support to most of its agricultural commodities, such as Norway, is likely to have a higher Overall Trade Distorting Support ratio than countries in which parts of their agricultural sectors receive relatively little support, such as the United States. This partly explains some of the differences in the percentages.

[4] A comparison based on Euro would yield a decline in the value of the Total AMS in Japan and the United States. The qualitative conclusion of a widening gap between the Total AMS of these countries and that of the European Union would still hold.

[5] This is the assumption made by Brink (2005). Presumably a final determination on the countries to be included in the tiers would be based on the Overall Trade Distorting Support rather than the Total AMS, on the assumption that the relevant data were made available by the Member countries to the WTO.

[6] A mixed approach (with absolute and relative support criteria) could be adopted in which countries whose current Overall Trade Distorting Support exceeds some critical proportion of production, for example, 50 percent would be placed in a higher reduction tier. The tiers for the Total AMS reduction could also be determined using such an approach.

[7] The actual outcome would depend on the relative reduction percentages for the Overall Trade Distorting Support and the Total AMS, and the relative size of the current Total AMS and *de minimis*. A key factor is the proposed fixed reduction in the *de minimis* exemptions of 50 percent.

[8] As noted subsequently in the discussion of product specific *de minimis*, wheat actually qualified for a *de minimis* exclusion in one year of the base period.

[9] This criticism might also be leveled at the original Total AMS entitlements under the URAA.

[10] This is only the case if the Total AMS is non-zero. In the limit, if the Total AMS were reduced to zero, all product specific support would be *de minimis*, the support for each product would not exceed the allowable *de minimis* percentage, and total support would be less than the permitted percentage of the value of total production. It is not clear whether Roberts is suggesting that the aggregate value of production used in determining the total product specific *de minimis* in the Overall Trade Distorting Support should be variable, rather than fixed, but that would mean that the bound level of product-specific *de minimis* would have to change through time in line with changes in the value of production for products included in the Total AMS. Such a provision might be difficult to implement.

[11] This is in contrast to the Draft Modalities, which proposed that Blue Box payments be capped at their most recent notified level and reduced by 50 percent in equal installments over a period of five years; with a 33 percent reduction for developing countries.

[12] They are linked to historical production. The level of payments for an individual producer is unaffected by variations in current output, unlike conventional price support programs.

[13] Figures obtained from the OECD's PSE/CSE database.

[14] See the Green Box section of the paper on the current uncertainties created by the recent Cotton case in the WTO for future EU and US policies.

[15] From the perspective of trade distortions, this is only an issue if the expectation of receiving the payments influences production decisions significantly. As indicated above, this is still an open question.

[16] Skeptics might argue that the transitional period might turn out to be of infinite duration.

[17] Some of the possibilities could include capping the support for individual commodities; restrictions on the provisions of multiple forms of support linked to prices; and greater transparency in the setting of payment rates.

[18] The commissioned paper only analyzes linear reductions. Other more aggressive approaches are possible conceptually, although their acceptance may be less likely politically. Brink (2001) analyzed the application of an aggressive harmonization of domestic support based on the Swiss Formula.

[19] He notes that China, which has no AMS commitment would maintain a very large Overall Trade Distorting Support entitlement if this method were to be applied – 2.5 times larger than that for the US and almost twice as large as that for the EU by the end of the reduction period.

[20] The US could face problems in low-price years through expanded loan deficiency payments and counter-cyclical payments. This could require discretionary adjustments in loan rates and payment rates by the Secretary of Agriculture. Note also that Brink's analysis is for the EU15; there may be potential implications for future payments resulting from the recent enlargement of the Union, or from potential future enlargement.

[21] This is the suggestion made for direct income payments by de Gorter et al (2003).

Options for Export Competition

Note: This paper draws heavily from a paper commissioned by the International Policy Council from the International Agricultural Trade Research Consortium (IATRC) member Linda M. Young and supplemented with input from IPC and Taskforce members. Young is on the faculty at the Department of Agricultural Economics and Economics at Montana State University. The commissioned paper will be published by the IATRC in July at www.iatrcweb.org.

1. INTRODUCTION

The Doha Ministerial Decision called for a "reduction of, with a view to phasing out, all forms of export subsidies." The July Framework Agreement, currently guiding the development of specific negotiating modalities for the Hong Kong Ministerial in December 2005 calls for the parallel elimination of all forms of export subsidies and disciplines on all export measures with equivalent effect by a credible end date.

This paper evaluates potential disciplines under the export competition pillar of the agricultural negotiations, addressing export subsidies, food aid, state trading enterprises and export credits. This paper also discusses differential export taxes, even though they were not specifically included in the export competition pillar of the July Framework Agreement. This paper focuses on potential proposals for the disciplines called for in the July Framework Agreement. Some topics, such as state trading entities and food aid, are treated more comprehensively than others because there has been less discussion of these issues in the negotiations, and addressing them in a parallel form to export subsidies and export credits is relatively complex. This does not necessarily reflect their relative importance in political or economic terms, however.

2. DIRECT EXPORT SUBSIDIES

URAA on Export Subsidies

In the Uruguay Round Agreement on Agriculture (URAA) negotiated from 1986–94, 25 contracting parties with a history of export subsidies (see Table 1) agreed to reduce the volume of export subsidies by 21 percent over six years from a 1986–90 base period level (14 percent over a ten year period for developing countries). They also agreed to reduce the value of export subsidies by 36 percent over six years from a 1986–90 base period level (24 percent over ten years for developing countries). Countries with no history of export subsidies agreed not to initiate them. According to Article 9.4 of the URAA, however, developing countries were allowed to use export subsidies to support marketing, handling, upgrading and international transport as long as doing so did not evade reduction commitment responsibilities.

Table 1. Who Subsidizes Exports?

Australia (5)	Iceland (2)	Slovak Rep (17)
Brazil (16)	Indonesia (1)	S Africa (62)
Bulgaria (44)	Israel (6)	Switzerland-Liechtenstein (5)
Canada (11)	Mexico (5)	
Colombia (18)	New Zealand (1)	Turkey (44)
Cyprus (9)	Norway (11)	United States (13)
Czech Rep (16)	Panama (1)	Uruguay (3)
EU (20)	Poland (17)	Venezuela (72)
Hungary (16)	Romania (13)	

( ) indicate number of products for each country
Source: WTO 2004b

The Use of Export Subsidies by WTO Members

WTO members must give notification of all *direct* export subsidies where there are reportable public expenditures and reduction commitments. There are currently no obligations to report other programs that can mimic export subsidies, such as marketing loans or loan deficiency payments. The European Union accounts for 92 percent of export subsidies by value, with expenditures of $29.3 billion over the 1995–2000 period. Over this same period, Switzerland and Norway spent $1.8 billion, and the United States spent $487 million. Another 23 countries cumulatively spent less than $1.5 billion over those five years. This group includes several developing countries, six of which (India, Korea, Morocco, Pakistan, Thailand and Tunisia) did not make reduction commitments in the URAA (Abbott and Young 2003).

WTO notifications document whether national commitments have been met or violated, including both commitments on value and volume. Table 2a and b show the share of value and volume commitments, respectively, for 11 countries from 1995 to 2000. The European Union used from 50 to 82 percent of its budgetary commitment and 65 to 107 percent of its volume commitment during the time period – being beyond its volume commitment in one year but never above its value commitment. From 1995–98, Columbia was often near its volume commitment, but spent only 15–20 percent of its budgetary commitment, and, in 1999 and 2000, showed no expenditures. In 1999, the United States and

Table 2a. Share of Value Commitments used for Direct Export Subsidies (in %), 1995–2000[1]

Member	1995	1996	1997	1998	1999	2000
Canada	59	8	0	0	0	
Colombia	15	20	17	22	0	0
European Communities	54	61	51	69	82	50
Hungary	58	31	20	73	114	
Israel	44	31	13	9	13	0
Norway	68	44	83	65	184	
Slovak Republic	12	23	32	29	46	54
South Africa	15	51	35	28	48	39
Switzerland-Liechtenstein	70	73	45	65		
Turkey	47	92	71	66	61	70
United States	22	56	50	74	185	

Table 2b. Share of Volume Commitments used for Direct Export Subsidies (in %), 1995–2000[1]

Member	1995	1996	1997	1998	1999	2000
Canada	58	5	0	0	101	
Colombia	59	76	125	152	0	0
European Communities	65	85	82	91	107	74
Hungary	23	22	18	21	37	
Israel	69	63	20	15	33	0
Norway	69	45	94	78	170	
Slovak Republic	32	28	56	56	71	62
South Africa	15	52	45	3	4	2
Switzerland-Liechtenstein	81	81	34	55		
Turkey	71	89	72	70	71	72
United States	35	50	70	73	199	

[1] Simple average use of export subsidy commitment levels across all relevant product groups in percent (excluding zero-use notifications).
Source: WTO, TN/AG/S/8, 2002a

Norway exceeded both their value and volume commitments. Other violations of export subsidy commitments are extremely rare.

Table 3a and b show the percentage of value and volume commitments used by the European Community, the world's largest export subsidizer, for several commodities from 1999 to 2001. While both value and volume commitments for wheat and wheat flour have decreased over the time period from 34 to 0.7 percent and 100 to 11 percent, respectively, sugar and various dairy products continue to use a high share of the European Community's commitments.

Export subsidies are harmful to efficient producers, including unsubsidized exporters and import-competing producers. In fact, export subsidies were deemed to be so antithetical to the interests of trade liberalization that they were banned for all products, except agriculture, in the early days of the GATT. Elimination of export subsidies is particularly important to developing country exporters who cannot afford to compete with the treasuries of the United States and the European Union. A few developing country exporters have reluctantly used export subsidies solely to compete with other export subsidies. For example, Mexico has needed export subsidies in sugar to compete in the world market (de la Calle 2005).

Despite extensive criticism, export subsidies persist because they are a necessary complement to domestic agricultural policies that increase domestic production. Elimination of export subsidies will make it more difficult for countries to adopt domestic policies that require export subsidies to dispose of surplus production. Export subsidies have, in fact, fallen in recent years due to domestic policy reforms in the European Union and the United States.

According to some analysts, the elimination of export subsidies will account for two percent of the total gains from potential agricultural policy reforms, in part because the level of export subsidies is relatively low compared with earlier periods (Anderson and Martin 2004). A 2001 study by the Economic Research Service of the US Department of Agriculture estimated that elimination of export subsidies would account for 13 percent of the total gains from agricultural policy reform. While it may be true that the gains from the elimination of export subsidies are smaller than the removal

Table 3a. Share of Value Commitments for the European Community by Commodity, 1999–2001[1]

Product	1999	2000	2001
Wheat and wheat flour	34	8	0.7
Coarse grains	63	18	11
Sugar	86	75	97
Butter and butter oil	32	36	34
Skim milk powder	112	9	13
Cheese	60	70	55
Other milk products	119	59	58
Pig meat	115	18	10
Poultry meat	75	63	66
Eggs	30	19	14
Wine	61	60	58

Table 3b. Share of Volume Commitments for the European Community by Commodity, 1999–2001[1]

Product	1999	2000	2001
Wheat and wheat flour	100	71	11
Coarse grains	161	65	39
Sugar	73	69	83
Butter and butter oil	46	49	49
Skim milk powder	146	47	32
Cheese	89	95	87
Other milk products	110	91	80
Pig meat	150	29	16
Poultry meat	101	91	81
Eggs	97	85	81
Wine	99	99	99

[1] Notes: Percent of commitment is reported after both volume and value measures.
EU data for 2002 not included in WTO report for January 2005.
Sources: WTO, TN/AG/S/8/Rev.1/Add.1, 2005; WTO, TN/AG/S/8, 2002a

of all barriers to imports and all domestic subsidies, for some industries and commodities these gains will be significant (i.e., dairy products). Moreover, since the elimination of subsidized export competition may be the one pillar where concrete results are visible, econometric models may understate the political and economic impact of their elimination.

The July Framework Agreement calls for phasing out all forms of subsidized export competition by a credible date. Accomplishing that objective for direct export subsidies is more or less straightforward, but achieving a "parallel" phase out in other forms of subsidized export competition is more complicated.

Potential Disciplines in Direct Export Subsidies

Timeframe. Because export subsidies are highly trade-distorting and countries have committed to eliminate them in all forms, an argument could be made for a relatively rapid phase-out, such as over five years. Since many developing countries object to opening their markets to subsidized imports that might undercut their domestic producers, a rapid phase-out of export subsidies is more likely to result in greater market access. Yet because export subsidies are a necessary counterpart to domestic subsidies that encourage excess production, it might not be possible to mandate a shorter timeframe than is allowed for market access or domestic support.

Initial down payment. Some countries argue for an initial down payment, and then further elimination of export subsidies. They argue that the URAA negotiators envisioned a continuation of export subsidy cuts beyond 2001. As these reductions never occurred, export subsidies have not been further reduced over the past five years. An initial down payment would also bring export subsidy reductions in line with the down payment proposed for the domestic support

pillar. Some have argued for a six percent annual reduction per year, from the end of the Uruguay Round, or approximately 42 percent (which would continue the pace of cuts mandated in the URAA), others argue for a 20 percent down payment, which would mirror the down payment in the domestic support pillar.

After the down payment, reductions in export subsidies could be made in equal increments until they are eliminated. A down payment would make it possible to realize a large portion of the gains from reducing export subsidies quickly. The political argument is perhaps more compelling, however. A significant down payment in export subsidy commitments would be a good faith gesture, indicating to developing and developed countries who do not subsidize their exports that members using export subsidies are willing to make significant changes in their agricultural policies. It would be important to find similar “down payments” in the other forms of subsidized export competition to satisfy the mandate of the July Framework for parallel reductions in all forms of export subsidies.

Table 4 provides three scenarios for reductions in the EU, using wheat, skim milk powder and beef meat as commodity examples.

Table 4. Possible Timeframe for Phasing Out all Export Subsidies (wheat, skim milk powder and beef meat)

		Wheat and wheat flour		Skim milk powder		Beef meat	
		tonnes	*Million Euros*	*tonnes*	*Million Euros*	*tonnes*	*Million Euros*
		Marketing (1July - 30 June)	Financial (16 Oct/15 Oct)	Marketing (1 July - 30 June)	Financial (16 Oct/15 Oct)	Marketing (1 July - 30 June)	Financial (16 Oct/15 Oct)
	Year	14,438,000	1,289.70	272,500	275.8	821,700	1253.6
1.Equal reductions five years	1	11,550,400	1,032	218,000	221	657,360	1,003
	2	8,662,800	774	163,500	165	493,020	752
	3	5,775,200	516	109,000	110	328,680	501
	4	2,887,600	258	54,500	55	164,340	251
	5	0	0	0	0	0	0
2. Equal reductions ten years	1	12,994,200	1,161	245,250	248	739,530	1,128
	2	11,550,400	1,032	218,000	221	657,360	1,003
	3	10,106,600	903	190,750	193	575,190	878
	4	8,662,800	774	163,500	165	493,020	752
	5	7,219,000	645	136,250	138	410,850	627
	6	5,775,200	516	109,000	110	328,680	501
	7	4,331,400	387	81,750	83	246,510	376
	8	2,887,600	258	54,500	55	164,340	251
	9	1,443,800	129	27,250	28	82,170	125
	10	0	0	0	0	0	0
3. Downpayment 50%, then equal reductions five years	1	7,219,000	645	136,250	138	410,850	627
	2	5,414,250	484	102,188	103	308,138	470
	3	3,609,500	322	68,125	69	205,425	313
	4	1,804,750	161	34,063	34	102,713	157
	5	0	0	0	0	0	0

Product Treatment. There are several options to be considered regarding the treatment of specific products. Export subsidies for all products could be phased out over a specified time period in equal increments. One practical reason for supporting the first option, a single date for all products, is that if countries insist on strict parallelism in commitments, it would avoid the problem of determining different dates for different products across the four forms of export competition–export subsidies, export credits, state trading enterprises and food aid–addressed in the July Framework Agreement. Alternatively, export subsidies could be eliminated over a relatively short timeframe for most commodities, with a limited number of commodities given a longer transition period due to difficulty in making adjustments to domestic policies. Countries could be allowed to voluntarily self-select which products would be subject to a shorter or a longer timeframe. This would allow for a rapid phase out of some export subsidies, and would facilitate progress in a key area of the negotiations. This mean that a single (the quicker the better) end date will normally apply for export subsidy

cuts. However, in the case of sensitive products a longer end-date would be permitted, provided there was offsetting compensation. A third option would be to accelerate the reduction for commodities with higher levels of subsidies. This would address the most trade-distorting subsidies first, although it would be difficult to implement politically.

Volume and Value Disciplines. Continuing value and volume commitments, as in the URAA, is vital; the dual commitments constrain export subsidies in times of both high and low prices. When world prices are low, the value limit becomes the constraint because the wedge between the domestic support price and the world price becomes larger. Volume limits prevent export of excess supply when domestic prices are low. When world prices are high, the value constraint becomes less binding, but the volume constraint can still be effective. Therefore, value and volume limits together weaken the ability of export subsidies to maintain fixed internal price supports.

Rollovers and Standstills. The modalities for December's Hong Kong Ministerial Conference should also clarify that unused commitments from one year cannot be carried forward to subsequent years. While this issue was raised during the Uruguay Round implementation, when the European Union wanted to credit unused subsidies in one year to a subsequent year, it will become more important as subsidies are further reduced. Countries that have had the right to use export subsidies for a product during the URAA, but have not used export subsidies, should also forego that right.

Special and differential treatment for developing countries. A wide variety of proposals have been made for special and differential (S&D) treatment of export subsidies. But, few developing countries have export subsidy reduction commitments because few developing countries could use them. In the URAA, developing countries were given ten years to reduce the value of their export subsidies by 24 percent and the volume by 14 percent. These countries could be given a longer transition period than that given to developed countries for elimination of their remaining export subsidy commitments. Some developing countries advocate for the ability to use export subsidies beyond the activities allowed in Article 9.4. There is considerable disagreement over this proposal, however. Additionally, developing countries have expressed concern over increased food import bills both during negotiations for the URAA and since the implementation of the agreement. Proposals to address this concern will be discussed in Section 5.

3. FOOD AID

The July Framework Agreement focuses on food aid disciplines to prevent commercial displacement. Commercial displacement occurs when purchased food imports are reduced by food aid. The fact that "market development" is a central objective of some US food aid and that much of this food aid must be "purchased" by recipient countries with low interest loans contributes to concerns that food aid is in fact undermining commercial imports. The extent of this displacement is not clear. As Figure 5 reflects, food aid constitutes a small share of the commercial market for grains, implying that there will not be much of a price impact from reform of food aid programs for that commodity. Recent empirical work estimated that substantial reform of food aid would result in price changes for grains of only +/- 2 percent, although the impact on skim milk powder may be large in some years (OECD, von Lampe 2004). Therefore, while food aid may not have a major impact in global markets overall, it does have relevant impacts on specific commodities and countries.

In addition to displacing commercial imports, food aid can also depress local production if it increases the supply of food on a domestic market and reduces farmer's expectations of future prices. The extent to which food aid displaces local production depends on the size of the economy in question, its openness to trade and the level of price transmission in the economy. Food aid levels tend to rise when prices are low and are often sourced from surplus stocks, leading to concerns that it is provided when it is least needed and most likely to disrupt local markets.

In some cases food aid can create additional demand, if it leads to consumption that would not have otherwise occurred. The level of this "additionality" depends on the design of the food aid program and the nature of the donated commodities. Food aid targeted to the poor has high additionality, because the poor are very sensitive to the price of food and food aid allows them to consume food they would not have been able to otherwise. Studies have found that food aid enables some additional consumption (Barrett, 2002) and does reduce malnutrition. Programme food aid, however, has been shown to provide less additional consumption than either project or emergency food aid.

URAA on Food Aid

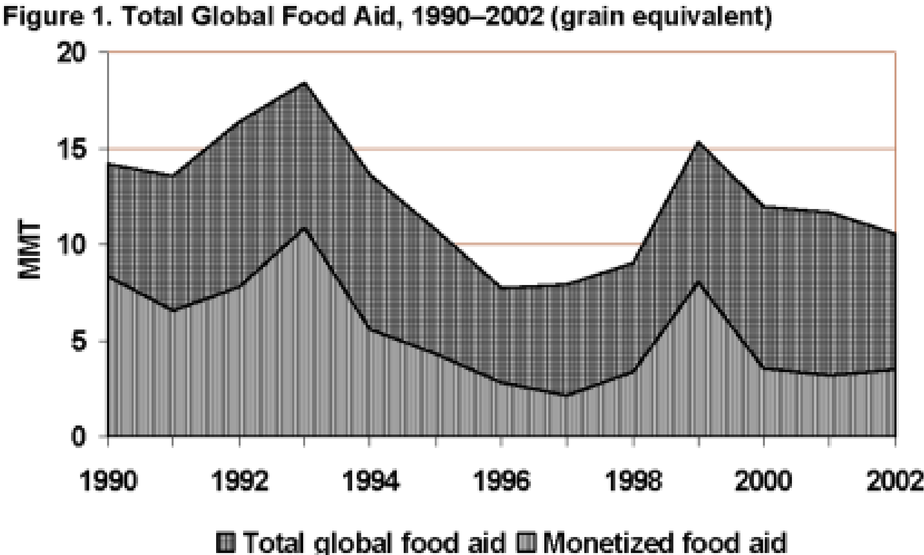
The URAA attempted to balance concern over the trade-distorting impacts of food aid with arguments for its contribution to the food security of developing countries. Disciplines included prohibitions on food aid as a blatant export subsidy made reference to the rules governing food aid under the Food and Agriculture Organization's "Principles of Surplus Disposal and Consultative Obligations." Concerns over food security were recognized in the Ministerial Decision on Measures Concerning the Possible Negative Effect of the Reform Programme on Least Developed and Net Food

Importing Developing Countries (NFIDC Decision). This decision committed the WTO to review the level of food aid guaranteed by the Food Aid Convention of 1986 to ensure that the legitimate needs of developing countries were met. However, in the 1999 renewal of the Food Aid Convention, the first since the URAA, donor commitments dropped to their lowest level in 33 years.

Food aid has historically been divided into three categories. Emergency food aid is given to victims of natural disasters and conflict. Project food aid is given to non-governmental organizations (NGOs) and private voluntary organizations (PVOs) to support development projects. Programme food aid, given on a government-to-government basis, is sold on local markets with the proceeds supporting the recipient government's objectives, such as food security, health care and education. The selling, or "monetizing", of food aid on local markets has stirred controversy with its potential to compete against domestic production and reduce the demand for imports.

Food Aid Donations by WTO Members

Figure 1 shows total global food aid, and the share of monetized food aid, from 1990–2002. Both are given in million metric tons (MMTs). The United States is the largest food aid donor, providing 63 percent of global food aid in 2002 and accounting for 55 percent of food aid over the 1990s. Box 1 provides a breakdown of the various international food assistance programs provided by the United States. Donations by the European Commission are variable, accounting for 8 to 29 percent of global food aid donations during the 1990s. The World Food Programme (WFP) of the United Nations delivered 42 percent of global food aid in 2001, including nearly 70 percent of emergency aid and 27 percent of project aid. WFP food aid originate from bilateral donors, such as the United States or European Union, and are intended to reduce the political motivations behind food aid distribution. Figure 2 shows food aid deliveries by major donors from 1994-2003.



NGOs and PVOs play an important role in delivering food aid from both bilateral donors and the WFP. In the 1990s, NGOs and PVOs delivered between 60 to70 percent of global food aid. These agencies finance their activities by selling, or monetizing, donated food in recipient (or neighboring) country domestic markets. The funds from sales of food aid are then used to cover overhead costs of distributing food aid and to provide a wide variety of projects on maternal and child health, childhood immunizations, water conservation and agricultural productivity, and micro-credit enterprises.

The WFP no longer allows food aid to be monetized, and requires donors to provide cash to cover distribution costs. The US is the only donor country that allows project food aid to be monetized. In 2002, the US monetized project food aid accounted for 43 percent of total global project food aid. And as Figure 3 shows, monetized project food aid as a share of total US project food aid is growing. US programme food aid is mostly monetized and recipient country governments use the funds for a variety of purposes.

Potential Food Aid Disciplines

Most proposals for disciplining food aid exempt emergency food aid, so as not to encumber the speed or the size of the international response to crises. This analysis assumes that emergency food aid would not be disciplined in the Doha Development Round.

BOX 1. US International Food Aid Programs: Basic Descriptions

US Programs	Agency	Purpose
P.L. 480: Title I	USDA	Concessional commodity sales through long-term loans.
Title II	USAID	Development and emergency relief programs in partnership with PVOs, NGOs, WFP and government-to-government (emergency only).
Title III	USAID	Government-to-government commodity donations to least developed countries, linked to policy reforms.
Food for Progress Act of 1985	USDA	Commodity donations offered for emerging democracies and developing countries making commitments to introduce or expand free enterprise elements in their agricultural economies. Agreements may be with governments, PVOs, NGOs, private entities, cooperatives, intergovernmental organizations.
Agriculture Act of 1949: Section 416b	USDA	Surplus commodities to PVOs, NGOs, WFP, Government-to-Government, donated to accomplish foreign food aid objectives.
Bill Emerson Humanitarian Trust	USDA/USAID	A four million MT reserve that can be tapped to meet emergency humanitarian food needs in developing countries.

Source: US Agency for International Development, "US International Food Assistance Report 2002," 2004, p. 34.

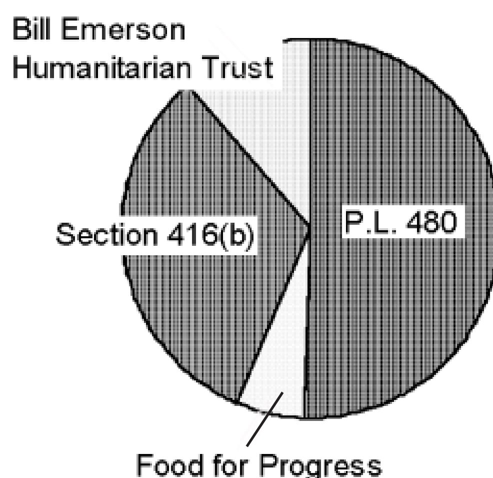


Figure 2. Food Aid Deliveries by Main Donors in 1994-2003 (in million metric tons)

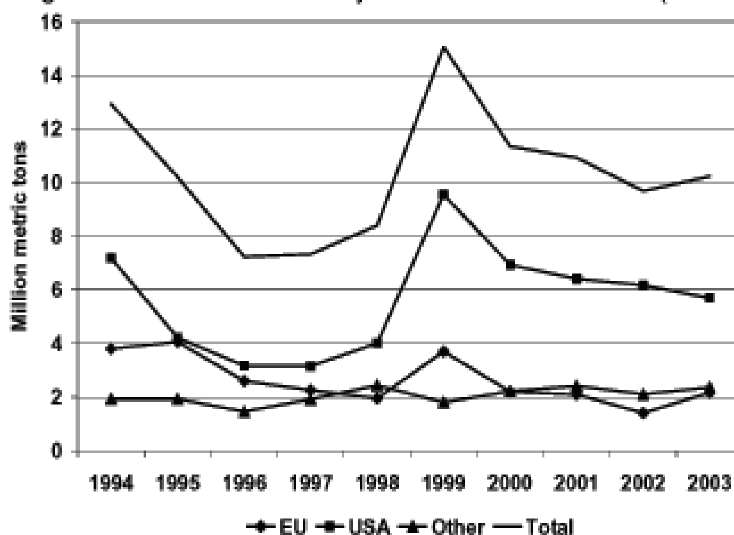
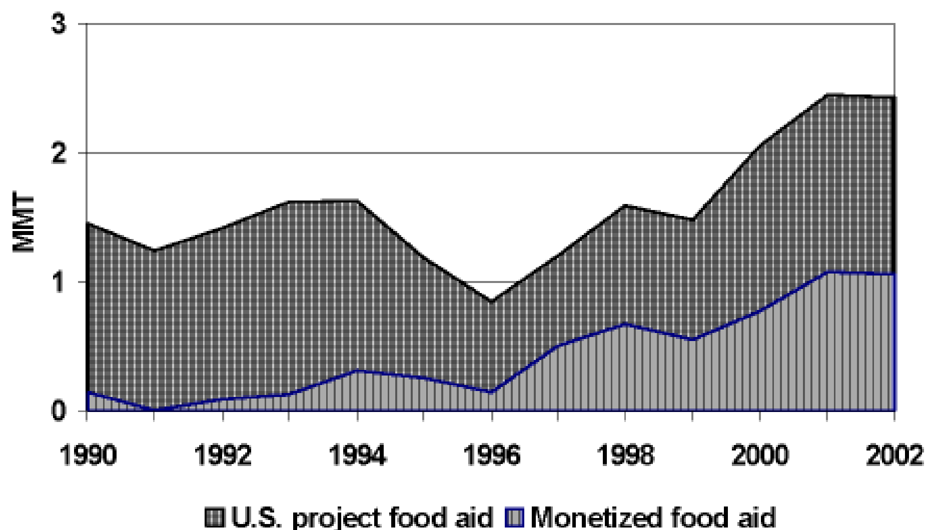


Figure 3. US Project Food Aid, 1990–2002 (grain equivalent)



From the perspective of the WTO, it is critical to write rules that are specific enough to eliminate the undesirable aspects of current and future programs, but broad enough to prevent commercial displacement in current and future programs. Disciplines can be fashioned in a variety of ways. For example, categories of food aid or eligible recipients can be restricted. The terms and purpose of food aid programs can be proscribed. Finally, food aid programs can be disciplined by restricting the agencies that can implement them.

Clarify role of emergency food aid. No restrictions on emergency food aid have been discussed in the WTO. The Harbinson Draft Modalities (WTO 2003) included language to clarify dimensions of emergency food aid, which could be included in the Doha Development Round Agreement on Agriculture.

> …in the case of food aid to meet or relieve emergency or critical food needs arising from natural disasters, crop failures or humanitarian crises and post-crisis situations, such aid is provided on the basis of pledges and commitments to, or in response to appeals from, specialized United Nations food aid agencies, other relevant regional or international intergovernmental agencies, non-governmental humanitarian organizations and private charitable bodies, or in response to an urgent government-to-government ministerial request for assistance in meeting food needs in the immediate aftermath of a natural disaster; (WTO 2003, p. 23)

Give food aid on a grant basis. About 12 percent of US food aid is provided through low interest loans to low-income countries. Loans are seen as potentially larger and more stable sources of development assistance than would be available on a grant basis. However, the economic rational for providing loans for food, a consumable, is not as strong as the argument for providing loans for investment goods. The Harbinson Draft Modalities proposed that food aid provided through loans be prohibited, and that all food aid be donated (WTO 2003). This discipline is explicitly mentioned in the July Framework Agreement and is targeted at US PL 480 Title I, the only food aid program that provides long-term concessional loans to countries for "purchases" of food aid. This proposal is also in line with the Food Aid Convention (FAC), which states that all food aid for Least Developed Countries should be given on a grant basis. It would also conform to the NFIDC Decision, which directed the WTO to ensure that an increasing percentage of basic foodstuffs be provided in grant form and/or on concessional terms.

Discipline market development programs**.** A primary goal of US PL 480 Title I is to develop future markets for US exports. Language disallowing market development objectives for food aid programs could be included in Article 10.4. Monies expended for these programs could be counted against a country's export subsidy commitments (Harbinson 2003). If combined with a requirement that all food aid be provided on a grant basis, these two disciplines would mean that the US PL 480 Title I program would have to be discontinued, or that it would count against US export subsidy commitments.

Many WTO members believe that market development objectives are inappropriate for food aid programs and support language prohibiting the explicit use of food aid programs for that purpose. Given the relatively small size of these programs at the current time (a half a million metric tons for Title 1 in 2002), it is not likely that US interest groups

Table 5. Government-toGovernment Food Aid, 2000

	Emergency	Project	Programme	Total
	------- metric tons, grain equivalent -------			
Australia		49,500		49,500
Canada	10,000		51,577	61,577
EU	33,000			33,000
France		57,805	79,905	137,710
Italy	6,328	13,507	10,969	30,804
Japan		37,109	112,346	149,455
United States	149,686	350,512	2,103,231	2,603,429
Total	199,014	508,433	2,358,028	3,065,475

would be adamantly opposed to their removal. Also, WTO proposals on food aid by developing countries indicate some (but not universal) support for this discipline.

Prohibit government-to-government food aid**.** The Harbinson Draft Modalities provided a list of acceptable categories of food aid, in which government-to-government food aid was excluded. This suggests an implicit discipline to eliminate it. The real intent is to discipline programme food aid, which is given on a government-to-government basis and is largely monetized and least additional. Table 5 shows the large share of food aid that is attributed to programme food aid in several developed nations. For the US, government-to-government food aid can be given through all three titles of PL 480, Food for Progress and Section 416b programs (refer to Box 1 for descriptions of these programs). This discipline may also target cases where food aid has been criticized as surplus disposal.

Excluding government-to-government food aid from legitimate food aid might prevent donors working with recipient country governments on development programs. It would also prohibit donors from working with recipient governments as they become more responsive and efficient and prevent recipient governments from using food aid as a tool to meet their food security goals.

Eliminate the surplus disposal aspect of food aid. The relationship between food aid and domestic agricultural policies of some donors, where stocks growing out of domestic price support are “disposed” of as food aid, has been extensively criticized (Lowder 2004; Barrett 2002). This criticism has been directed at US food aid programs since their inception in the 1950s and at European food aid programs before reforms ensured that EU food aid programs were independent of the Common Agricultural Policy.

One concern about disposing of stocks through food aid is that food aid should be given purely in response to need without being linked to domestic agricultural policies, even though food aid from stocks may be used to meet legitimate humanitarian needs. Prohibiting food aid donated from stocks is likely to reduce the humanitarian achievements of these programs. On the other hand, stocks, and hence food aid, tend to be higher in times of low prices, when food aid is less needed. Mandating higher levels of guaranteed food aid through the Food Aid Convention could address this problem, although the Food Aid Convention has not carried much weight in the past.

Limiting surplus disposal would target US Section 416b, in which stocks held by the Commodity Credit Corporation are “disposed of” as food aid. However, stocks from 416b are also donated to the WFP in amounts not easily dismissed in times of need. Additionally, as a result of an unexpectedly high level of food aid emergencies in a given year, food aid may be transferred from projects to emergency relief, with stocks from 416b used to meet emergency needs in these circumstances.

Distrust of food aid drawn from stocks is accentuated by the political motivations attributed to their use. A potential discipline could mandate that food aid from stocks be channeled through the WFP, so that this food aid would not be given from donor governments directly to NGOs or recipient governments. This would minimize the possibility of political gain by donor governments while ensuring the beneficial use of stocks. It is worth noting that a discipline addressing food aid from stocks would require careful drafting to hit the target, both now and in the future.

Channel all food aid through the WFP. The WFP provides food aid, particularly in emergencies, (mostly) free of the political motivations of bilateral food aid. It would be possible to eliminate some or all categories (emergency, project and programme food aid) of bilateral food aid, so that all donations in those categories would be given through the

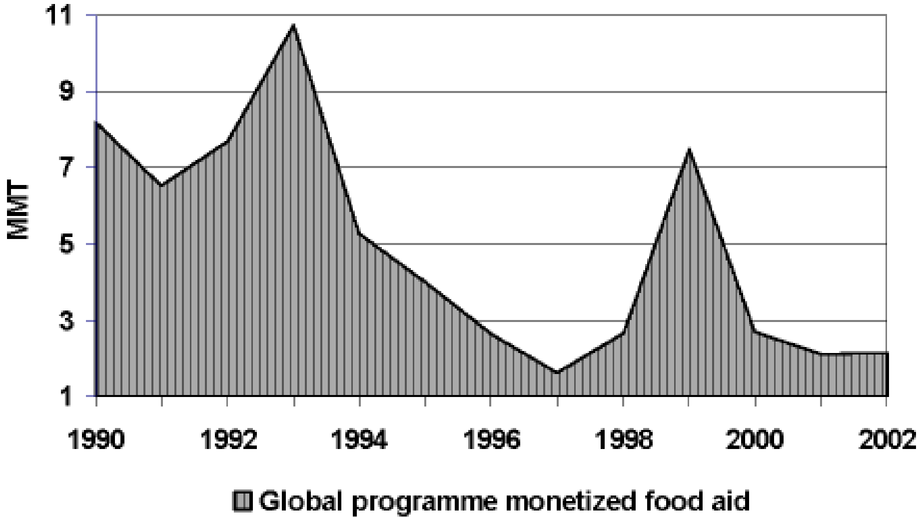
WFP. Advocates of this option believe that the WFP filters out political concerns, resulting in better targeting. Another result may be gains in efficiency, as coordination between numerous national food aid agencies can be problematic.

This discipline may undermine donor motivation, however, resulting in lower levels of food aid overall. Many analysts argue that the current level of food aid given by the United States results from the carefully crafted coalition of interests that lobby for food aid. If donations can only be given though the WFP, this coalition and the support for development assistance may evaporate. In addition, credible and effective bilateral aid programs might be dismantled without clear benefits. While the European Union has begun moving away from in-kind food aid and towards financial assistance, this discipline would eliminate any remaining in-kind food aid from the European Union. Additionally, giving all responsibility for food aid to one agency could be problematic if the agency suffered from inadequate leadership or difficulty in reaching a compromise between donors' competing concerns.

Enforce usual marketing requirements (UMRs). Food aid recipients are currently obligated to import under UMR, which is simply a moving average of past imports. This obligation is rarely monitored or enforced, however. Many food aid recipients (including Least Developed Countries) have experienced increasing imports, and food aid usually makes up only a small fraction of domestic production shortfalls (Abbott 2005; FAO 2003). As a result, food aid recipients can meet this requirement most of the time, making this discipline not binding. However, enforcing UMRs in light of liquidity constraints, or lack of domestic demand in the recipient country, could require a recipient government to adopt distorting trade policies. For example, the requirement to increase imports could lead the government to lower the domestic price of a good, reducing incentives for domestic production.

Eliminate programme food aid**.** There are several concerns about programme food aid. Programme food aid is extremely variable, as Figure 4 illustrates, making it an unreliable resource. Programme food aid donations tend to be large relative to project food aid donations and are generally monetized, resulting in more disruption to local markets. In addition there is anecdotal evidence that programme food aid is sometimes ineffective due to misuse by recipient country governments. Finally, governments frequently fund programme food aid by stocks arising out of domestic support policies.

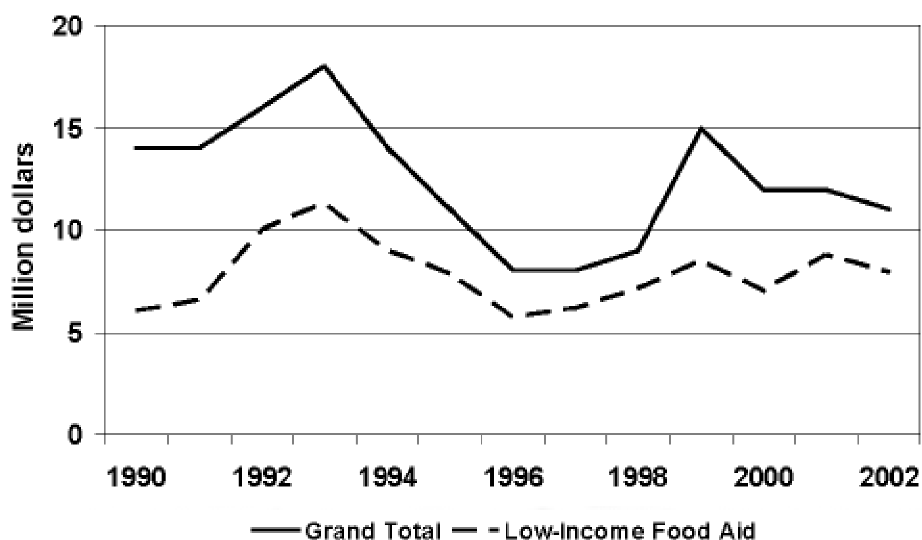
Figure 4. Global Programme Food Aid, 1990–2002 (grain equivalent)



Programme food aid is seen as most disruptive to international markets. However, several arguments in favor of programme food aid need to be considered. As food aid is less fungible than cash, it ensures that more food is available at lower prices on domestic markets than if food aid were not available. This may be particularly important for vulnerable populations, including the poor and elderly, who suffer due to their inability to purchase adequate food. Also, if programme food aid is eliminated, it is unlikely that other forms of aid replace it. (It should be pointed out, however, that donating cash is far more efficient than transporting food around the world, and would ensure that assistance would reach needy countries more quickly.)

It may be possible to limit the size of programme donations, curtail its use as a political tool and limit its possible market impact. None of these guarantee that commercial displacement or the disincentive effect will be eliminated, however. It might also be possible to limit programme food aid to low-income countries, with appropriate language including higher-income countries facing unusual financial events or conflict. This would allow the benefits of programme food aid to continue being available, while limiting market displacement as well as its use as a political tool. Limiting

Figure 5. Food Aid to Low-Income Countries and Total Food Aid, 1990–2002



food aid to Least Developed Countries does not, however, address the concern over the potential disruption to recipient country markets.

Eliminate all monetized food aid. Eliminating all monetized food aid risks eliminating development projects funded by this food aid. While monetizing programme food aid tends to be disruptive because of the sheer size of the donations, there is slightly less concern about monetized project food aid. If these funds would not be available under other types of development programs, the elimination of all monetized food aid may reduce the overall amount of foreign assistance provided to developing countries, in particular by the United States.

Institutional issues. It might also be possible to draft rules for food aid limiting trade distortions and to create innovative institutional procedures to resolve disputes. Because food aid can have an impact on trade, the WTO should be responsible for enforcing any agreed disciplines. This might involve quick evaluation by a standing WTO dispute panel or appellate body, which could evaluate the legitimacy of the questioned food aid transaction. It should be made clear, however, that the WTO is not the appropriate institution to manage food aid beyond disciplining its trade effects.

A new institutional home to manage and monitor food aid would be beneficial, as current institutions are outdated, disjointed and ineffective. A new institution with a balanced representation of donors and recipients could be charged with advising the WTO on appropriate disciplines, but should remain operationally independent of the WTO (see Barrett and Maxwell 2005).

4. STATE TRADING ENTITIES

Exporters use state trading entities (STEs) for a variety of reasons: to implement domestic agricultural policy, support producers, subsidize consumers, improve marketing systems, and exercise market power in both domestic and international markets. A number of concerns have been expressed about STEs. Market activities by state traders may not be transparent. State traders may be able to disguise export subsidies and thereby exceed export subsidy commitments so countries using STEs can evade their WTO commitments. State traders also enjoy government underwriting and preferential tax treatment, which enables them to offer attractive financial terms to buyers. Finally, STEs may not behave like private firms in international markets and may violate the non-discrimination and equal treatment provisions of the WTO.

The definition of STEs is hotly debated and important because it determines which agencies fall under WTO disciplines. Three issues arise in establishing a definition — who owns the STE; what special privileges it has; and whether the state trader must make purchases and sales of the commodity (Ackerman and Dixit 1999). Differences of opinion exist about whether certain institutions are state traders. The United States initially notified the Commodity Credit Corporation as a state trader in 1995, yet withdrew the notification when it stopped using the Export Enhancement Program (EEP), although many argued that it continued to act as a state trader due to other programs such as the Dairy Enhancement Incentive Program. Some observers have argued that the European Union's control of agricultural markets constitutes state trading, but since no public entity physically handles commodities, it has never been notified as a state trader (Sorenson 1991).

State Trading Under the URAA

State trading is explicitly permitted under current WTO rules. State traders have historically been required to notify the WTO of their existence. Until the URAA, these reporting requirements were minimal and many countries failed to notify agencies that were clearly state traders. Article XVII of the URAA established a working party to address state trading issues, which adopted stricter notification requirements. The URAA continued to explicitly permit state trading, as long as STEs fulfilled certain obligations, including:

- Nondiscrimination: commonly referred to as Most Favored Nation (MFN) treatment;
- No quantitative restrictions;
- Preservation of tariff concessions;
- Transparency; and
- Sales in accordance with commercial practices.

Governments are also obligated to report subsidized exports by STEs under their export subsidy commitments. Many WTO members believe that these notification requirements do not go far enough in disciplining STEs, and that the relevant WTO articles need to be rewritten.

The Prevalence of State Trading Entities

The prevalence of STEs has been declining since the 1970s, but is still important in some commodities. While nearly 90 percent of both rice and wheat trade in 1970s were handled by state traders (Schmitz et al. 1981; Falcon and Monke 1979-1980), that share fell to between 33 and 50 percent by the end of the 1990s (Abbott and Young 1999; Young 1999). The decline in STEs is largely due to requirements of structural adjustment programs. The redistributional objectives of these agencies were costly, both in terms of domestic resources and foreign exchange, and were factors behind the macroeconomic imbalances that led to structural adjustment programs. Cost and external pressure from international institutions prompted reform of these institutions more often than changes in domestic agricultural policy goals. For example, many Asian countries avoided structural adjustment programs imposed by the World Bank and the International Monetary Fund through better management of debt and foreign exchange and so less reform occurred in that region.

Because STEs are used to implement domestic policy and some countries question the role of the private sector in food trade and distribution, countries have resisted elimination of state traders. In many cases, however, countries have permitted private trading entities to coexist with public agencies, with importing STEs managing lower quality products for poor consumers and private agents handling trade for the higher quality products. Reform of STEs has also been accomplished through privatization of existing entities, making STEs autonomous from government. These agencies mimic producer cooperatives and may be required to operate without government subsidization. A list of export STEs notified to the WTO in 2003 are given in Table 6.

Issues Surrounding State Trading Entities

Market Power

The power held by state traders in domestic and international markets is of concern to many governments and private companies. State traders may regulate domestic prices, enact supply controls, and regulate procurement and domestic marketing. The ability of state traders to distort trade derives from a combination of control over domestic markets and power in international markets (Dixit and Josling 1997; Ackerman and Dixit 1999; Veeman, Fulton, and Larue 1999).

Since market conduct may be difficult to assess, contestability is one criterion for judging whether an STE's market power is of relevant concern (Veeman, Fulton, and Larue 1999). Markets are contestable when the possibility of market entry precludes the exercise of market power, even though market share might suggest that market power exists. Contestability and other criteria can be used to classify state traders into green, amber and red categories, with a higher level of disciplines, largely in the form of increased reporting requirements, in the red category (Veeman, Fulton and Larue 1999).

In many ways, STEs serve the same purpose as agricultural cooperatives, which enable individual producers to come together in buying or selling to increase their market power vis-à-vis private corporations. For example, "…under US rules agricultural cooperatives have special privileges with respect to cooperation and coordination. The rationale for marketing cooperatives is to allow farmers to band together to obtain *higher* commodity prices and compete *more efficiently* in the market. Coops allow farmers to achieve scale and scope economies in marketing initiatives, quality control and reputation, and branding. Such cooperatives maximize returns to their members and enhance demand for its members' (and other competitors) commodity production, exactly the rationale for and effect of the CWB" (Summer

Table 6. Agricultural Export STEs as Notified to the WTO, June 2003

Country	——Grand Total — -Low-Income Food Aid Agency/Commodity	Item
Developed		
Australia	Australian Dairy Corporation	Butter, butter oil, blends
		Cheese
		Skim milk powder
		Whole milk powder
	Australian Wheat Board	Wheat
	Queensland Sugar Corporation	Raw cane sugar
	Grainco	Barley
	New South Wales Grains Board	Sorghum
		Oilseeds
	Grain Pool WA	Lupins
		Rapeseed
	NSW Rice Marketing Board	Rice
	NSW Grains Board	Oats
	Australian Barley Board	Oats
Canada	Canadian Dairy Commission	Butter and other fats and oils derived from milk
	Canadian Wheat Board	Wheat
		Barley
	Ontario Bean Producers Marketing Board	White pea beans
Israel	Israel Groundnuts Production and Marketing Board	Groundnuts
	Fruit Board of Israel	Non-citrus fruit
	The Vegetable Production and Marketing Board of Israel	Vegetables
	Canadian Freshwater Fish Corporation	Freshwater fish
New Zealand	New Zealand Dairy Board (elimination has occurred but has not been reported)	Butter and butter oil
		Skim milk powder
		Cheese
		Other milk products
		Casein and caseinates
	State Trading: Enza Limited	Apples
		Pears
	Zespri Group	Kiwifruit
	New Zealand Hop Marketing Board	Hops
Developing		
Barbados	Barbados Dairy Industries Limited	Unclear
	Barbados Agricultural Development Corporation	Sugar (raw)
China	China National Cereals, Oil and Foodstuff Import and Export Co. (Group)	Rice
		Corn
	China National Textiles Import and Export Co.	Cotton

Country	Agency/Commodity	Item
Cyprus	Cyprus Potato Marketing Board	Potatos
	Cyprus Carrot and Beetroot Marketing Board	Carrots
		Beetroot
	Vine Products Commission[d]	Raw grape alcohol
		Raisins
	Cyprus Olive Products Marketing Board[e]	Olives
		Olive oil
Dominca	Dominica Banana and Marketing Corporation	Bananas
Fiji	Fiji Sugar Marketing Company	Sugar
India	Various State Level Cooperatives	Gum karaya
	Various State Level Cooperatives	Niger seeds
	Various State Level Cooperatives	Onions
Indonesia	Badan Urusan Logistik (Bulog)	Rice
Jamaica	The Cocoa Industry Board	Cocoa
	The Coconut Industry Board	Coconuts
	The Coffee Industry Board	Coffee
	The Banana Board	Bananas
	The Sugar Industry Authority	Sugar
Korea	Korea Ginseng Cooperative Federation	Ginseng
Mauritius	Agricultural Marketing Board	Tea
Namibia	Meatco[h]	Meat and meat products from cattle, sheep and goa
Philippines	National Food Authority[i]	Rice
Taiwan	Council of Agriculture, Executive Yuan	Brown rice
	State Trading: Taiwan Provincial Fruit Marketing Cooperative	Banana
	State Trading: Taiwan Salt Industrial Corporation	Salt
	Taiwan Sugar Company	Sugar[j]
Trinidad and Tabago	Cocoa and Coffee Industry Board of Trinidad and Tabago	Cocoa beans
		Coffee beans
	Caroni	Sugar
	National Flour Mill Limited	Soya oil
		Soya meal
Tunisia	National Edible Oils Board	Olive oil

a. Australia Dairy Corporation trades internationally on a competitive basis with private Australian traders in these products.
[b]Australia Dairy Corporation has exclusive rights to specified markets.
[c]Total quantity exported may differ from quantity exported by STE due to different reporting periods used by Statistics Canada and the CWB.
[d]Insufficient production for exports.
[e]No exports due to high domestic prices.
[f]Sole exporter to countries outside of the Caribbean.
[g]Bulog maintains the right to intervene in the market when necessary.
[h]Meatco exists to export to the EU.
[i]National Food Authority did not engage in the export of rice and corn in 2001 due to domestic shortages.
[j]Taiwan Sugar Company only exports sugar to the United States according to quota allocation.

Source: Compiled by authors from country notifications to the WTO in the document series G/STR/N on the WTO website http://www.wto.org.

and Boltuck, p. 14-15).The legal and financial basis for STEs and cooperatives is quite different, however, which some would counter is precisely the reason that STEs are qualitatively different from farmer cooperatives. Unlike STEs, cooperatives must compete in the private market for capital and business.

In many cases, the absence of functioning markets has been a rationale for the existence of STEs. Countries have also used the existence of export subsidies, such as the Export Enhancement Program, the Dairy Export Incentive Program and the European Union's export restitution scheme, to justify the need for STEs. This rationale would no longer be valid, however, if export subsidies are to be eliminated in the Doha Development Round.

State trading could be considered under WTO discussions on competition policy, where the appropriate goal would be that STEs operate in contestable markets (Josling 1998a, 1998b).STEs have traditionally been exempted from competition policy discipline (Abbott, 1998), however, and competition policy is not being discussed under the Doha Development Round. For non-agricultural commodities, the trade-off between market power and competition has been resolved by permitting competition to be compromised when the public interest is served, suggesting that competition policy, even if further developed by the WTO, may not be rigorously applied to agricultural STEs.

Transparency

Lack of transparency is the most common concern with STEs. A public agency handling imports or exports can potentially disguise the level of export subsidies to avoid reduction commitments. While disguised protection generates rents equivalent to tariff revenue, export subsidies require government budgetary support, cross-subsidization or price discrimination for its financing.

The WTO could require that STEs provide additional information to insure that a country's commitments are met. At present, the WTO requires a substantial degree of notification, including description of the STE's operation and annual data, including yearly average import prices, representative domestic sales and procurement prices, mark ups, export prices, as well as volume information. More detailed reporting would make it easier to determine whether an STE engages in price discrimination, dumping or cross-subsidization of commodities. Requiring STEs to regularly report the transactions level data necessary to detect these practices would greatly exceed the level of notification currently required in other areas, and would place STEs at a disadvantage (Veeman, Fulton and Larue, 1999).

Until now, a balance between the needs of STEs to protect market information and concern over their ability to circumvent their GATT commitments has been met through the WTO dispute resolution system. Given the length of time needed to press a WTO complaint, however, market damage may be done long before any relief is granted.

Pooling and Price Discrimination

Pooling occurs when a state trader purchases commodities from a farmer at an undetermined price and returns net revenue to producers at a later time, after sales have occurred, allowing pooling of receipts to all farmers across multiple sales. With pooling, cross-subsidization can occur over time and across commodities. When state traders handle multiple commodities, and especially when state traders control joint products, as in the case of dairy (butter, skim milk powder, cheese) prices can be altered for each product to maximize net profit of the board or achieve whatever objective the STE is pursuing. Pooling and cross-subsidization enable greater "discretionary pricing" by state traders than is possible by private firms.

Price discrimination can occur at planting time, with aggressive pricing to discourage competitors from planting, or by denying sales in a tight market to protect the STE's domestic economy at the expense of foreign customers. Discrimination can also occur if an STE targets a particular competitor's traditional customers or provides free services that private firms must provide for a fee.

STEs can also price discriminate by selling exports to countries at different prices. In a case filed against the CWB, the United States argued that WTO provisions impose three separate, if related, obligations on export STEs: to avoid discriminatory behavior; to act in accordance with commercial considerations; and to provide the enterprises of other contracting parties adequate opportunity to compete. Canada argued that the primary obligation to avoid discriminatory behavior is qualified if discriminatory behavior is justified on commercial considerations.

The Panel found no basis for concluding that the CWB had an incentive to discriminate between markets by selling in some markets and not others on the basis of non-commercial considerations. The Panel "saw nothing in the legal structure of the CWB, its mandate or its privileges which would create an incentive for the CWB to discriminate between markets for reasons which are not commercial. Nor have we seen any evidence of such sales behavior by the CWB." It therefore concluded that the United States had not established that the CWB export regime necessarily results in non-conforming export sales.

The CWB dispute established that the primary discipline imposed by the WTO is the prohibition on discriminatory behavior, unless justified on commercial considerations. Thus an export STE cannot offer commodities at below-market rates in support of government foreign policy objectives or refuse to supply on political considerations. Other than this, the WTO does not prevent an export STE making use of any of its exclusive or special privileges to maximize its return from export markets.

Pooling and price discrimination need to be treated as somewhat independent problems. It is possible to price discriminate in the absence of pooling, and pooling does not automatically imply price discrimination. Pooling is principally intended to help farmers cope with risk. Since the founding of many STEs, other institutions have emerged to help farmers cope with risk, including domestic support policies, future markets and insurance schemes. Even under the CWB, alternatives to price pooling have emerged (such as the fixed-price contract) for farmers who are willing to bear more market risk. In the absence of state mandates, price pooling may not prove a commercially viable risk management strategy.

Control Over the Domestic Market

Some STEs have monopoly control over domestic markets. If there are effective barriers to imports, STEs can charge domestic consumers higher than they charge foreign customers, leaving consumers to subsidize the operations (Scluep and de Gorter 2000). For example, the Canadian Dairy Commission set high domestic prices for milk and uses a combination of import barriers and supply management to restrict milk supply. In 2002, a WTO panel found that the Canadian Dairy Commission's market segmentation resulted in an export subsidy, as processors could buy milk from producers at a price lower than the government determined domestic price (WTO 2002b). A WTO panel also required Canada to make adjustments in the CWB's operation to ensure openness to grain imports, including changes to the entry authorization permit system; Canada's system of grain segregation; and its rail revenue cap.

Consideration of Disciplines for State Trading Enterprises

Eliminate government financing, underwriting of losses and export subsidies**.** The July Framework Agreement states that government financing, loss underwriting and export subsidies provided by STEs will be eliminated by an agreed end date, presumably over the same time frame as the elimination of direct export subsidies. An argument can be made that government underwriting and financing should be reduced over the same timeframe as domestic subsidies, as export STEs are a different policy tool for assisting agricultural producers. Given that STEs are in the export competition pillar, however, it is more likely and logical that all export competition measures will be phased out in tandem.

Design new terms and conditions**.** The WTO rules could be revised to require that STEs offer duty-free access to their domestic market for the goods they manage. This would put a cap on the price wedge that an STE would be able to create and defend, but it would not eliminate the possibility that the domestic market could serve as a high-priced haven used to subsidize exports. Such duty-free access would not eliminate the distortions STEs can introduce between exports of raw commodities and value added products.

Expedite Dispute Settlement. The WTO could also expedite the dispute settlement process to determine if an STE has engaged in "trade-distorting practices." In this process, a trade dispute panel would have the right to acquire transaction specific data from the defending country and would evaluate whether trade-distorting practices had occurred. Such a mechanism could be used for harassment, however, and appropriate guidelines would need to be developed. Moreover, a quicker process might not meet standards of due process. Many of the potentially discriminatory practices mentioned above would be difficult to discipline through even an expedited dispute settlement process, because they are endemic to the operation of an STE.

Mandate co-existence. While the major issues of concern surrounding State Trading Entities speak to STE's behavior in markets, rather than to their existence, the July Framework Agreement states that the future use of monopoly powers will be subject to further negotiation. The July Framework also states that STEs in developing member countries that preserve domestic consumer price stability and ensure that food security will receive special consideration for maintaining monopoly status.

The United States has been a leading advocate of mandated co-existence with private companies. Previously, the Harbinson text proposed that developed country governments with STEs allow private enterprises to purchase agricultural goods for export and engage in exporting. This provision would remove the monopoly status of export STEs and mandate coexistence with the private sector, with an implementation plan to be included in each member's schedule. (A similar mechanism was used in China's accession agreement with respect to import STEs.)

In very few cases do STEs currently coexist with the private sector entities. Examples mostly occur when export STEs fulfill export quotas. There are no cases of co-existence in which an export STE and private traders maintain viable market shares over a substantial period of time. Where governments do enact real co-existence, it may be difficult for the STE to fulfill its mission through the realization of economies of scale in marketing, since the intent of co-existence is precisely to eliminate that market power.

If WTO reforms eliminate the monopoly power of STEs, imperfectly competitive private actors may replace them (this may be more common outcome in developing countries than in developed countries). If STEs are eliminated, some analysts argue that private firms may capture rents instead of producers. It is far from clear, however, that such an outcome would occur. Rents from monopolies tend to go to the monopolist and not to producers or to consumers. Some have argued that it is preferable to have STEs pass on possible rents to producers rather than have them secured by private firms (Young, Abbott and Leetma). It is far from clear that STEs do a better job for producers than private firms.

Moreover, the competitive nature of global grain trade—where numerous private firms have failed over the past 35 years—demonstrates that typical oligopolistic behavior is impossible in commodity businesses, where the rapidity of price changes leaves little room for “signaling” and where traders are both buyers and sellers, with differing and changing market positions (Caves, Richard). Moreover, excess capacity typical in the grain-handling industry drives returns toward variable costs, and publicly accessible markets for commodities, transportation, handling services, and risk insurance eliminate barriers to entry.

5. EXPORT CREDITS

Officially supported export credit programs create implicit export subsidies when loan terms are better than would occur under private market transactions, and with interest rates that do not reflect the risks of those loans. The OECD (2000) estimated the subsidy component of existing official export credit programs, comparing the difference between actual interest rates charged under these programs and estimates of corrected market based interest rates (Hyberg et al. 1995). Determining the subsidy component is difficult since comparable short-term loans are not common and country rates may underestimate the risk of these transactions, especially if importing country governments are not involved. The extent of subsidy also depends on other loan terms including down payments, grace periods, term lengths and program fees. For example, the longer the term, the greater is the subsidy component of a loan at a given interest rate differential.

While the OECD methodology gives a good first approximation, it may not capture the implicit subsidies to importers facing “liquidity” constraints. The subsidy component of a program would be much greater when liquidity constraints are binding.

WTO Members’ Use of Officially Supported Export Credits

According to the OECD $6–8 billion of agricultural exports benefit from official credit programs annually. Almost half of these agricultural exports are from the United States, with the European Union, Canada and Australia accounting for about equal shares of the rest. Figure 6 shows that virtually all officially supported export credit transactions longer than one year come from the US, which is also responsible for 88 percent of the total subsidy component of export credit programs (see Figure 7). The use of these programs varies somewhat with market conditions, with the Asian financial crisis stimulating much greater use in 1997–98. A surprisingly small fraction of these transactions involve LDCs or Net Food Importing Developing Countries (NFIDCs).

Surprisingly, the OECD study concluded that the subsidy element of these transactions is quite small. The longer-term US programs resulted in a subsidy of 6.6 percent in 1998, with even lower components for the European Union (1.9 percent), Canada (1.2 percent) and Australia (0.3 percent). The subsidy element appears small because these programs break liquidity constraints, which are hard to measure. The increased use of export credits during the Asian financial crisis enabled credit and trade flows that would not otherwise have occurred. If liquidity constraints matter, elimination of these programs could put at risk over $500 million in imports per year by those countries.

Using a very different methodology, the General Accounting Office (GAO) found a subsidy component of 9 percent based on expenditures used to cover losses from defaults. That suggests that interest rate premiums determined by the OECD underestimate the underlying risk and is more indirect evidence that these programs relieve liquidity constraints. The OECD also argued that these programs could not be justified on development grounds since only a small fraction of transactions involve LDCs and NFIDCs.

Figure 6. Share of Total Export Credits with Length of One Year or More among Participants to the OECD Export Credit Arrangement, 1998

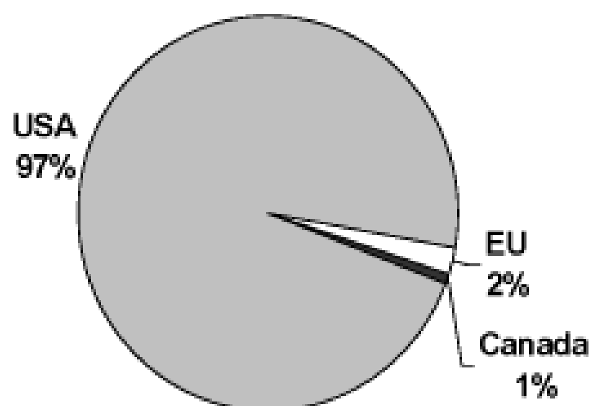
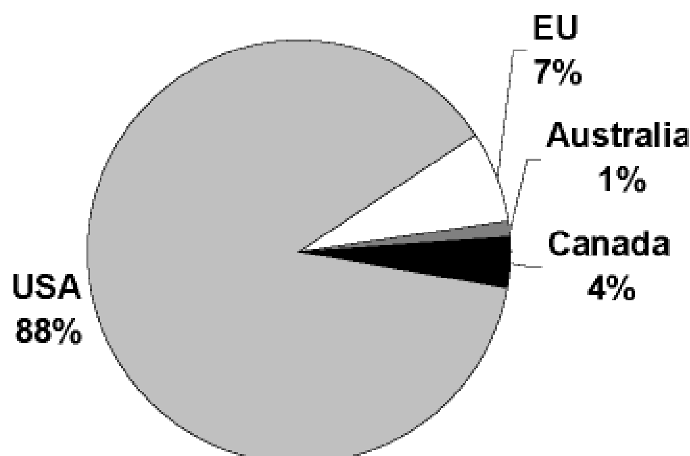


Figure 7. Share of Total Subsidy Element in Export Credits among Participants to the OECD Export Credit Arrangement, 1998



Export Credits Under the URAA

The URAA recognized the potential for officially supported export credits to act as implicit export subsidies, but referred the debate to the OECD, where negotiations focused on reducing the term lengths of these programs to one year or less, thus limiting but not eliminating the subsidy component of these programs. Negotiations broke down at the end of 2000 over the treatment of credit transactions by state traders. The export credit issue was also raised in the NFIDC Decision, asking that appropriate provisions be included for special and differential treatment in favor of LDCs and NFIDCs.

With the failure of the OECD negotiations, and based on the implementation concerns of developing countries, export credits are again being discussed in the Doha Round under the export competition pillar. While the export credit issue is largely seen as a US problem, which is responsible for the lion's share of the subsidies, the value of US subsidies for export credits is much less than the value of direct export subsidies, certainly by the European Union and possibly even in the United States.

The results of Brazil's case against United States cotton subsidies provides further impetus to export credit reforms. Brazil argued that US export credits programs for cotton, including GSM 102, GSM 103 and the Supplier Credit Guarantee Program, were export subsidies that violated US commitments. The WTO Panel and the Appellate Body found that "the United States export credit guarantee programmes – GSM 102, GSM 103 and SCGP – constitute a *per se* export subsidy under the Subsidies and Countervailing Measures Agreement". In addition, the Panel found that these export credit guarantee programs are export subsidies under the SCM Agreement and were inconsistent with

several WTO Articles. The panel concluded that the US export credit programs were not structured to avoid a net cost to the government, and that program premiums did not cover long term costs (WTO 2005, p. 254). Finally, the panel established that expenditures on export credit programs fall under a member's commitment on export subsidies.

Potential Disciplines for Export Credits

The July Framework Agreement calls for the elimination of programs offering export credits for more than 180 days. It further calls for disciplines to address the "payment of interest, minimum interest rates, minimum premium requirements, and other elements which can constitute subsidies or otherwise distort trade." The negotiations have used the Harbinson Draft Modalities as a basis for negotiations. The Harbinson text proposed specific disciplines, including:

1. Maximum repayment term of 180 days;
2. Minimum cash payments by importers of specified percentage of the amount of the contract value by the starting point of the credit;
3. Provisions specifying the payment of interest;
4. Minimum interests rates, with members to use Commercial Interest Reference Rates as published by the OECD plus appropriate risk-based spread;
5. Premiums based on risk, and adequate to cover long-term operating costs and losses.

Establishing premiums covering operating costs and losses appears to be the most critical discipline to be adopted at this point (as the repayment period has been established). It is important that this discipline be accompanied by adequate reporting requirements on member program long-term operating costs and losses to allow countries to monitor adherence to this discipline.

Eliminate programs with more than 180 days for repayment. The July Framework Agreement states that such programs will be eliminated. Negotiators need to establish the length of the transition period and the variable to be reduced over the transition period. Expenditures on the targeted programs could be reduced, however expenditure data is not readily available. The data on the dollar value of transactions covered by US programs is readily available. While reducing the dollar value of transactions covered is not a perfect solution, as expenditures are at the heart of the discipline, this might provide an adequate basis for program elimination over a transition period.

Create a special program for developing countries. To the extent export credit programs alleviate illiquidity and facilitate transactions that would not have otherwise occurred, they could be beneficial in certain circumstances. Proposed disciplines would significantly reduce this potential benefit of export credit programs. Yet credit constraints are tightest for developing country members, who did not historically receive a significant portion of export credits. NFIDCs received only 9 percent of export credits and LDCs two percent during the period studied by the OECD. An export credit program designed to eliminate liquidity constraints faced by developing countries could assist the WTO in meetings its stated food security goals. A multilateral institution could operate such a program. The Compensatory Financing Facility of the IMF has not been widely used due to extensive conditionality requirements (WTO 2002c). The IMF's recently established Trade Integration Mechanism might help member countries meet balance of payments difficulties arising from trade liberalization. Alternatively, national governments could be allowed to continue current programs without budgetary restrictions for designated recipients, perhaps NFIDCs and LDCs. These programs could allow subsidized credit in addition to longer repayment periods.

6. DIFFERENTIAL EXPORT TAXES

Differential export taxes (DETs) are among the issues listed in the July Framework as "issues of interest but not yet agreed." Export taxes applied at a uniform rate are often used by developing countries to raise revenues and to reduce exports in times of domestic shortfalls. While differential export taxes may serve these two functions, they are not needed to achieve either. Their primary goal is to discourage exports of primary products and encourage the production and export of value-added processed products. There are many examples of DETs, although no study analyzes them systematically. Argentina has a 23.5 percent tax on soybeans, and a 20 percent tax on soy oil and soy cake. Malaysia maintains a 16 percent tax on crude palm oil, but levies no tax on exports of processed palm oil (Jank 2005).

As such, DETs act as an export subsidy to value-added industries. Members using DETs argue that they are a necessary complement to tariff escalation by importers, but this rationale is less compelling, as the Doha Development Round will address tariff escalation under the market access pillar and as DET come into existence independently of tariff escalation. Differential export taxes differ from export subsidies in two ways: they are a source of government revenue, not expenditure, and the producers of the primary product (farmers) are disadvantaged by DETs, not advantaged as they are by direct export subsidies. But, in either case, DETs distort trade and world market prices. The studies for Argentina demonstrate that total supply of the grain and byproducts complex are lower than what they would have

been without export taxes including differential export taxes; so the rest of the world's exporters benefit from higher prices from the grain and byproducts complex.

7. CONCLUSION

The Framework calls for "the parallel elimination of all forms of export subsidies and disciplines on all export measures with equivalent effect by a credible end date." While this is a useful political goal if it facilitates agreement on disciplines by members, it is problematic to achieve due to differences in the nature and the consequences of the policies. Eliminating direct export subsidies would be beneficial, has broadly-based political support, and is a goal worth working for*. To facilitate the elimination of direct export subsidies, parallelism can best be achieved by writing simple rules that eliminate the use of government funds for direct export subsidies, export credit programs and STEs and disciplining food aid over time.* However, the notion of strict parallelism may be impossible to achieve.

8. REFERENCES

For complete list of references, see the commissioned paper on the IATRC website, www.iatrcweb.org

Options for Market Access

Note: This paper draws heavily from a paper commissioned by the International Policy Council written by Mario Jales and Andre Nassar of the Institute for International Negotiations (ICONE); Ann Tutwiler, chief executive of the International Food and Agricultural Trade Policy Council; and Tim Josling, professor at Stanford University's Food Research Institute. This paper is also supplemented with input from IPC and Taskforce members. The commissioned paper will be published by the IATRC in July at www.iatrcweb.org.

1. INTRODUCTION

The negotiation of improved market access in agriculture is crucial to the success of the Doha Round. Without significant tariff cuts in agricultural import markets, it is improbable that significant liberalization will occur in other areas of trade. The depth of tariff cuts will be the main indication of the level of ambition of the agricultural talks and hence the Round as a whole, because the countries with the most to gain from lower agricultural tariffs are the most reluctant to move on other areas of the trade negotiations (such as services and non-agricultural market access), and the countries most reluctant to reduce their tariffs stand the most to gain from services and non-agricultural market access. Though it is possible that the negotiations could still survive with modest ambitions, such as cuts of 20-30 percent, the likelihood is that the political support for such an agreement would quickly fade because the size of the gains in agriculture would not be enough to justify reforms in other areas. By contrast, cuts of the order of 50-60 percent would indicate a serious attempt to bring agriculture under the relatively liberal trade regime enjoyed by manufacturing sectors since the Kennedy Round almost 40 years ago, making the overall package more attractive.

Market access is also among the most sensitive of the agricultural issues. Whereas export competition is of considerable interest to competitive exporters, the use of export subsidies and equivalent measures is confined to a handful of countries. Domestic support is also concentrated in a small number of developed countries, and probably has less impact on developing countries than the policies that they themselves pursue. But the negotiation of improvements in market access affects all countries, whether exporters or importers of agricultural goods, and the scheduled reduction of tariffs is likely to be closely scrutinized by domestic interest groups.

Reductions in agricultural tariffs are vital, because agricultural tariffs remain five times higher than tariffs in industrial goods, and account for the bulk of the distortions in agricultural trade. As a recent analysis demonstrates (Anderson and Martin) the major gains from trade liberalization come from reducing tariffs and other market access barriers. Their analysis indicates that 92 percent of the global gains from trade liberalization in agriculture result from removing market access barriers. Rhetoric aside, most of the gains to developed countries come from reducing their own tariff barriers, not from gaining access to developing country markets. Similarly, developing countries gain proportionately more from reducing their own barriers, largely because of the growing importance of South-South trade.

Of the three pillars of the agricultural negotiations, market access is also the least developed in the Framework Agreement. While the modalities for reductions in total trade-distorting domestic support and the date for elimination of export subsidies and parallel measures have yet to be decided, the Framework is quite explicit on many of the aspects of these two pillars. By contrast, many gaps still remain in the market access talks and the way in which these missing pieces are put in place will have a major impact on the success of the talks. Most important perhaps is that the level of ambition on the formulas and bands for tariff reductions will be intricately related to the designation of Sensitive Products. It will be difficult for countries to know what they can concede on tariffs if they don't know the flexibility they will have on Sensitive Products.

2. MARKET ACCESS IN THE JULY FRAMEWORK AGREEMENT

The July Framework Agreement reaffirms the objective of substantial improvements in market access. This is to be accomplished by a single approach, applicable to all countries except Least Developed Countries (LDCs), with different tariff cuts, bands and time periods for developing countries. The impact of such an approach on real market access depends on the magnitude of the cuts and the negotiated exceptions to such cuts. Hence the agreement on the modalities of the tariff reduction formula and of the provision for Sensitive and Special Products is central to the market access component of the talks. Other aspects are likely to fall into place once this has been settled.

Tariff Reduction Formula

The Framework Agreement mandates a tiered formula, with tariffs above a certain threshold being subject to the highest cuts and lower tariffs being subject to lower cuts. This was preferred to the cafeteria (or blended) approach where countries place commodities in different categories each using different tariff-cutting methods. The tiered approach

ensures some degree of harmonization of tariff levels, whereas the blended approach gives countries the possibility of avoiding such harmonization. Language allowing countries to select Sensitive Products that would not be subject to the formula approach has, however, reinserted some degree of flexibility. And even the tiered approach requires decisions on which formula to use within each band. If too many exceptions are granted, the Doha Round will not deliver on the goal of substantial improvement in market access for all products.

The choice of overall tariff reduction methods is broadly between: (a) a linear cut or (b) a Swiss Formula cut. The advantage of a linear cut lies in its straightforwardness. The benefit of the Swiss Formula is that it brings down high tariffs at a much greater rate. But, as the tiered approach performs the same function, it is doubtful whether a series of Swiss Formula cuts specific to each band makes much sense. It would leave tariffs grouped around certain levels determined by the coefficient used in the formula. Hence, a series of percentage cuts increasing with the height of the initial tariff may achieve the same objective.

However, a Swiss Formula on the highest level of tariffs, say above 100 percent, could potentially be useful. It would deal with the wide range of the levels of peak tariffs. Yet many of these products are likely to be designated as Special or Sensitive, so even a Swiss Formula for the highest cuts would have less bite. A Swiss Formula approach to the lowest tier of tariffs could also be defended, as it could act the same way as an elimination of tariffs below a certain level. However, the lowest tariffs are unlikely to be the subject of much controversy.

The FAO recently analyzed various tariff-cutting formulas for four Asian countries (Indonesia, Pakistan, Sri Lanka and the Philippines). The FAO assumed a linear cut of 15 percent on Sensitive Products combined with either a 30 to 40 percent linear cut on non-sensitive products, a 50 percent Swiss Formula cut, or a 25 percent Swiss Formula cut. The analysis indicates that because many countries maintain high bound tariffs, they could reduce tariffs with a 50 percent Swiss Formula cut, with virtually no impact on trade.

The choice of formulas is critical to the ambition of the Round. Many countries maintain bound tariffs high above applied tariffs. Because tariff cuts in the WTO are from bound levels, substantial tariff cuts will be needed to have any impact on trade. As shown in Table 1, the difference between the bound and the applied rates (known as the tariff overhang) is over 100 percent in some countries, meaning that over a 90 percent tariff cut would be required to have any impact on actual trade flows.

In many countries, applied tariffs are high above the level actually needed to prevent trade at world market prices. Even to reduce this difference, known as "water" formula reductions would have to be fairly large to have any impact on actual trade, because applied rates are often higher than they "need" to be, given world market prices. As shown in Table 2, the European Union maintains a tariff of 91 percent on bovine meat, when a tariff of 80 percent would be sufficient to prevent any bovine meat imports.

The July Framework Agreement requires the tiered formula to take into account the different tariff structures of member countries. The tariff reduction method should reflect the intrinsic characteristics of the different types of tariff distribution. Figures 1 and 2 and Table 3 demonstrate that tariff structures in developed countries are substantially different from tariff structures in developing countries. While the tariff distributions of developed countries shown in Figure 1 follow a curved path, those of the developing countries shown in Figure 2 are either a straight line or a set of consecutive straight lines in a "staircase" format.

Table 1. Tariff Overhang in Selected Products and Developing Countries

Product	Market	Applied Rate	Bound Rate	Tariff Overhang	Equivalent Cut
Raw Sugar	India	100%	150%	50%	33%
	Nigeria	10%	150%	140%	93%
	Brazil	16%	35%	19%	54%
White Sugar	India	100%	150%	50%	33%
	Nigeria	10%	150%	140%	93%
	Brazil	16%	35%	19%	54%
Ethanol	India	30%	100%	70%	70%
	Brazil	20%	35%	15%	43%
Soybean Meal	India	30%	100%	70%	70%
	Brazil	10%	35%	25%	71%
Bovine Meat (chilled boneless cuts)	Chile	6%	25%	19%	76%
	Mexico	20%	45%	25%	56%
	Philippines	10%	35%	25%	71%
	Brazil	12%	55%	43%	78%
Poultry Meat (frozen boneless cuts)	South Africa	5%	82%	77%	94%
	Indonesia	6%	25%	19%	76%
	Egypt	32%	60%	28%	47%
	Brazil	10%	35%	25%	71%
Swine Meat (frozen boneless cuts)	South Africa	15%	37%	22%	59%
	Mexico	20%	45%	25%	56%
	Romania	20%	115%	95%	83%
	Brazil	10%	55%	45%	82%
Rice (milled)	Mexico	20%	45%	25%	56%
	Nigeria	10%	150%	140%	93%
	India	70%	100%	30%	30%
	Brazil	12%	55%	43%	78%
Powder Milk	Egypt	12%	20%	8%	40%
	Brazil	27%	55%	28%	51%

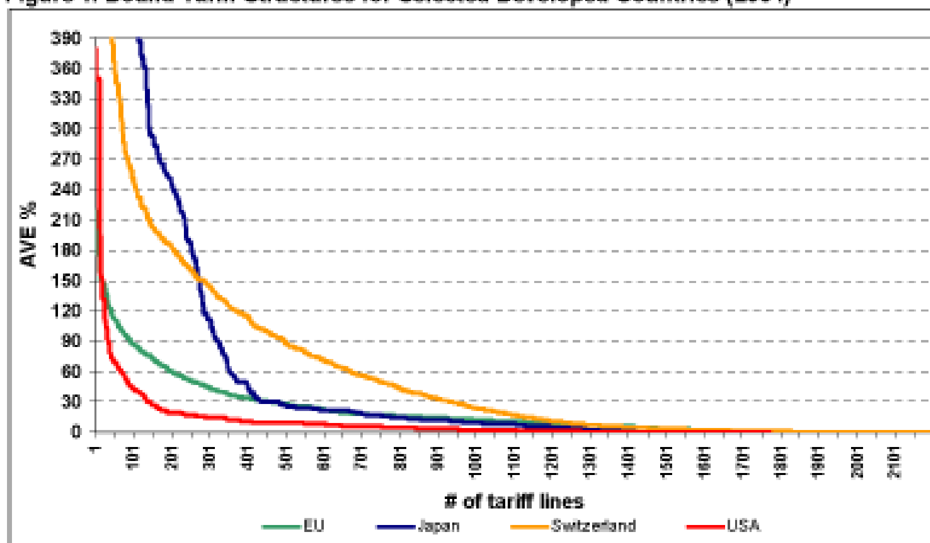
Source: Institute for International Trade Negotiations (ICONE).

Table 2. Applied Tariffs Higher than Necessary

Product	Market	Representative Domestic Prices (US$/ton-€/ton)	Tariff Duty	Import World Prices (US$/ton-€/ton)	EAV (according to world prices)	Effective Rate	Water
Bovine Meat (chilled boneless	EU	6,943	12.8% + 3,034 €/ton	3,856	91.5%	80%	11.4%
Raw Sugar	EU	505	339 €/ton	198	171.0%	155%	16.1%
	USA	409	338.7 US$/ton	186	181.6%	119%	62.6%
White Sugar	EU	646	419 €/ton	252	166.4%	157%	9.8%
	USA	425	357.4 US$/ton	237	150.9%	79%	71.5%
Rice (milled)	EU	546	€ 416/ton	332	125.4%	65%	60.7%

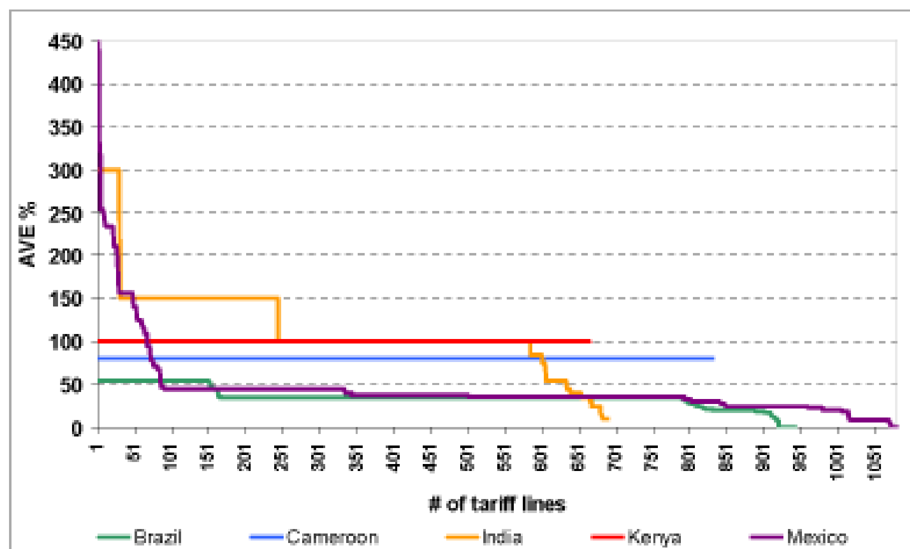
Source: Institute for International Trade Negotiations (ICONE).

Figure 1. Bound Tariff Structures for Selected Developed Countries (2004)



Source: Institute for International Trade Negotiations (ICONE).

Figure 2. Bound Tariff Structures for Selected Developing Countries (2004): Brazil, Cameroon, India, Kenya and Mexico



Source: Institute for International Trade Negotiations (ICONE).

Table 3 shows that developed countries such as the United States and the European Union have a significant number of high tariffs and a considerably larger number of low tariffs. As a result, they have a high degree of tariff dispersion. In contrast, tariff structures in developing countries are generally characterized by low tariff dispersion. Nonetheless, there is significant diversity in tariff structures among developing countries. While Brazil has low mean and median tariffs, India has high mean and median tariffs. The case of Kenya is particularly interesting: all agricultural tariffs were bound at the same level. Therefore, the country's tariff structure has no dispersion and a very high mean tariff rate.

Table 3. Bound Tariff Structures for Selected Countries (2004), Key Statistics

	DEVELOPED COUNTRIES			DEVELOPING COUNTRIES			
	United States	European Union	Japan	Brazil	Mexico	Kenya	India
Mean tariff	11.9	20.5	80.1	35.6	44.4	100.0	116.0
Median tariff	3.8	10.9	12.0	35.0	36.0	100.0	100.0
Minimum tariff	0.0	0.0	0.0	0.0	0.0	100.0	10.0
Maximum tariff	378.7	218.5	2,553.6	55.0	450.7	100.0	300.0
Std. deviation	33.0	29.4	203.3	11.2	42.1	0.0	52.5
Coef. variation	2.8	1.4	2.5	0.3	0.9	0.0	0.5
# of tariff lines	1,769	2,200	1,806	942	1,080	665	690

Source: Institute for International Trade Negotiations (ICONE).

Regardless of the tariff reduction method adopted, a practical issue is to determine (1) how many bands to select (2) where to place thresholds, and (3) how progressive to make the band-specific reductions. Tariff dispersion should be one of the criteria considered for the elaboration of the tiered formula. A high coefficient of variation indicates that the tariff structure must undergo harmonization in order to minimize the effects of tariff peaks. In the tiered formula approach, harmonization will be obtained through progressive reduction rates in different bands. Countries that have a high degree of dispersion – indicated by a coefficient of variation above one – should be subject to a greater number of bands. The higher the levels of dispersion, the higher the number of bands should be. The more bands used, the more "smooth" will be the harmonization. However, too many bands would add little to the outcome and merely complicate the process of verifying schedules, whereas too few bands would not harmonize tariffs in the way intended by the JFA. Four bands may be necessary for most developed countries to address their more highly dispersed tariff structures, while three bands is probably sufficient for most developing countries flatter tariff schedules. Countries with a high degree of variation in their tariff structures should have four or more bands.

Appropriate thresholds for each individual band are sensitive since they can have disproportionate effects on different countries given the diverse nature of tariff structures. The exact point where bands begin and end can make a big difference for a country such as Kenya, where all agricultural tariffs are bound at the same level. If the highest band (the one with highest cut) begins at a threshold of 100 percent, Kenya's tariff reduction effort will be significantly greater than if it starts at 101 percent. The number of bands and the thresholds for defining bands can be balanced by the magnitude of cuts. For tariffs close to the threshold, reductions in the higher band may result in final tariffs lower than tariffs in the lower band. To address this incongruity, it may be useful to adopt an approach similar to progressive income taxes.

Ad Valorem Equivalents

To implement these formula reductions, specific tariffs (such as 10 cents/litre) must be converted to ad valorem equivalents (such as 10 percent). The conversion of specific and compound tariffs to ad valorem equivalents (AVEs) was controversial. After nearly eight months, countries agreed to:

- Convert the final bound non-ad valorem duties into their AVEs using the unit value method based on the Integrated Database (IDB) import data for the 1999-2001 period.
- If the IDB data for the tariff line concerned is either (i) missing, contains errors, or is lower than US$2,500 on average for 1999-2001 or (ii) the IDB-based AVE cannot be considered to reflect the true level of tariff protection afforded by the non-ad valorem tariff an alternative method will be used.
  - o For the tariff lines that fall into category (i) above, there are four possible alternative methods:
    - – Extend the base period 1999-2001 by up to two years at either end;

- -- Use the IDB import unit value of a closely related tariff line;
- – Use the IDB import unit value of the tariff line at issue of a near country;
- – Use the United Nations Commodity Trade Statistics Database (COMTRADE) unit value.

o For tariff lines falling into category (ii) above, the “40/20 Filter” has been developed. The alternative method that applies to tariff lines captured by the 40/20 Filter varies according to the chapter of the Harmonized System (HS):

- – For chapters 1 to 16 (which cover primarily bulk and lightly processed commodities), and the products in Annex 1 of the Agreement on Agriculture in the HS chapters beyond chapter 24, a 82.5 / 17.5 (COMTRADE / IDB) weighting will apply;
- – For HS chapters 17 to 24 (which include more highly processed products), a 60 / 40 (COMTRADE / IDB) weighting will apply;
- – For all tariff lines for raw and refined sugar, world prices will apply, with prices to be agreed.

Table 4 presents the total number of specific tariff lines and the number of tariff lines captured by the 40/20 filter in some selected countries. Table 5 provides examples of AVEs calculated using the methodologies explained above. With the exception of raw sugar in the United States and ethanol in the United States and the European Union, all other products in Table 5 were captured by the 40/20 Filter.

Once a formula for converting specific tariffs into ad valorem tariffs was agreed, the issue arises of how to bind such converted tariffs. Should tariffs be bound in the form they are specified in the tariff schedule or should they be bound in the AVE? Given the steady resistance from some countries, binding specific tariffs as done in the Uruguay Round,

Table 4. Impact of the 40/20 Filter on Selected Countries

Country	# of specific tariff lines	# of lines captured by the 40/20 filter
Switzerland	1,940	483
European Union	1,010	280
Norway	975	33
United States	757	86
Canada	477	22
Japan	494	268
Mexico	90	18
India	2	0
Brazil	0	0

Source: Institute for International Trade Negotiations (ICONE)

Table 5. AVEs Based on the Agreed Methodology: Selected Products and Countries

Product	Market	Tariff Line	Specific Tariff Duty	Resulting AVE
Bovine Meat (chilled boneless cuts)	EU	02013000	12.8% + 3,034 €/ton	85%
	Switzerland	02013099	16,012 US$/ton	195%
Swine Meat (frozen boneless cuts)	EU	02032955	869 €/ton	26%
	Japan	020329021	4,217 US$/ton	136%
Poultry Meat (frozen boneless cuts)	EU	02071410	1,024 €/ton	91%
	Canada	02071422	238.3% ou 1,170 US$/ton	420%
Rice (milled)	EU	10063021	€ 416/ton	97%
	Japan	100630090	2,980 US$/ton	778%
Raw Sugar	EU	17011110	339 €/ton	189%
	USA	17011150	338.7 US$/ton	134%
White Sugar	EU	17019910	419 €/ton	184%
	USA	17019950	357.4 US$/ton	151%
Ethanol	EU	22071000	192 €/m³	42%
	USA	22071060	2.50% + 142.7 US$/m³	57%

Notes: 1. Specific tariff duties were converted into US Dollars using the average exchange rate of the 1999-2001 period. 2. Sugar AVEs were calculated using world prices (NYBOT Contract 11 for raw sugar and LIFEE Contract 5 for white sugar). An additional US$20 per ton was considered in order to express the value on a c.i.f. basis.
Source: Institute for International Trade Negotiations (ICONE).

would seem to be more realistic; it is difficult to envisage any country agreeing to bind a level of protection that varies as a result of events beyond the control of the government.

Tariff Cap

The issue of whether to impose a tariff cap on peak tariffs was left undecided in the July Framework Agreement. Tariff caps can reduce tariffs that are so high that they are little different from an import ban. If the cap is set at a low level, real trade improvements may follow. But the likelihood is that the cap would not be set at a level that would encourage much change in trade patterns. Table 6 indicates the total number of tariff lines that would be captured by a cap set either at 50 percent, 100 percent or 150 percent.

Table 6. Agricultural Bound Tariff Peaks in Selected

Country	Total # of tariff lines	# of tariff lines >=50%	# of tariff lines >=100%	# of tariff lines >=150%
Developed Countries				
European Union	2,200	259	**69**	16
Japan	1,806	395	**307**	272
Switzerland	2,168	798	**498**	316
United States	1,769	84	**29**	16
Developing Countries				
Brazil	959	148	-	-
Cameroon	831	831	-	-
India	690	633	**584**	243
Kenya	665	665	**665**	-
Mexico	1,080	84	**67**	48

Source: Institute for International Trade Negotiations (ICONE).

In any case, Sensitive and Special Products will be exceptions to the cap. So the cap can only be evaluated in the context of the exceptions. A tariff cap acts as a somewhat drastic "formula" cut for tariffs above that level. It therefore has to be considered as a part of the formula for the tiers, in essence a top tier. One possibility therefore may be to delay its implementation until the end of the transition, thus allowing Members to anticipate the cap at their own pace. A tariff cap of 100 percent, for instance, could be introduced in the tenth year of the agreement, allowing countries a long time period over which to reduce peak tariffs. A tariff cap could also be blended in with the operation of Tariff Rate Quotas (TRQs): Members could request consultations with principle suppliers to establish TRQs in lieu of the tariff cap for Sensitive (or Special) Products.

Capping products should prove valuable to developing countries, whose products often face extremely high tariffs once the impact of specific, compound and mixed tariffs are figured (ABARE). Peak tariffs in OECD countries are 40 times higher than average tariffs, while in Africa peak tariffs are five times higher than average tariffs. Developing countries must also decide whether to accept such disciplines on their own tariffs. Given the great distortions high tariffs create, if indeed they allow any trade at all, it is not clear why developing countries would not also accept a tariff cap, knowing that this might increase their influence over the height of the tariff cap for developed countries.

Sensitive Products

In exchange for a formula approach to tariff reductions, the July Framework Agreement specifies that each Member identify a number of products that will be treated as "Sensitive Products" and subject to different market access rules. The questions therefore are (a) how to select the products and (b) how to treat them once selected.

The selection of Sensitive Products will be a matter for individual countries. They will reflect the internal politics of each country and the domestic vulnerabilities of each sector. The main question then is how many to allow? Should there be a limit on the number of products selected? Or should the limit reflect the significance of the products to trade? Or should it be related to production or consumption? Probably some combination of criteria for limiting the use of the

Sensitive Product designation will be acceptable. One such combination could be that Sensitive Products could not exceed a certain percentage of total production or trade. This would ensure that the category is not used for widespread protection. It is important to recognize that even exempting two percent of tariff lines from formula-based cuts would substantially reduce the expected gains from market access improvements.

The European Union, members of the G-10 and some large developing countries (such as India and Mexico) are strongly interested in the concept of Sensitive Products. If one assumes that products with tariffs above 100 percent are "sensitive" then, the European Union may claim that more than 5 percent of the total tariff lines should be considered Sensitive Products. Japan would probably claim that more than 15 percent of agricultural tariff lines as Sensitive. India and Mexico, the number of Sensitive Products would be respectively 5 percent and 10 percent of total agricultural tariff lines. On the other hand, for the US and Brazil 2 percent and 1 percent would cover products with tariff peaks above 100 percent. (While the Framework Agreement allows countries to designate a certain number of products, most econometric analyses are based on the number of tariff lines. There is not a direct correlation between these concepts, but the impact of exempting a certain share of tariff lines is indicative of the likely impact of widespread use of the Sensitive Product designation.)

Ideally, an agreement on tariff-cutting formulas should be reached before the definition of conditions for Sensitive Products. The level of ambition on tariff reduction would determine the flexibility on Sensitive Products. One possible solution to minimized the number of tariff lines in the Sensitive category is to conceive reduction formulas with some degree of in-built flexibility, as outlined above.

Tariff Rate Quotas

The more products labeled as sensitive, the more important it will be to agree modalities that will ensure "substantial improvement" in market access for these products. The Framework specifies that market access be improved for all products including Sensitive Products through a combination of TRQ increases and tariff cuts.

For those Sensitive Products already subject to TRQs, these could be increased by a percentage of domestic consumption annually over the implementation period. For Sensitive Products without a TRQ, one could be established at the certain level of domestic consumption, increasing by a percentage over the implementation period. Countries could also reduce above-quota tariffs for Sensitive Products, although by less than the amount required for the tiered formula.

A direct link could be made between a country's willingness to trade off expanded TRQs for lower cuts in over-quota tariffs. One proposal would be to calculate the difference between the formula-based requirements for tariff cuts and the tariff cut imposed on Sensitive Products, and require the TRQ be increased by that amount. For example, if the required tariff cut were 20 percent and a country chose to implement only a 15 percent reduction (or 75 percent of the commitment) on a Sensitive Product, then it would have to expand its quota by 25 percent over and above the minimum quota increase.

For Sensitive Products already subject to TRQs, the TRQs could simply be increased by a certain annual percentage over ten years. For Sensitive Products for which a TRQ does not exist, one could be established at the level of five percent of domestic consumption and increased by a specified percentage for ten years. The measurement of the level of domestic consumption is a very important technical issue. In the Uruguay Round, some countries fulfilled the requirement set at 5 percent of the domestic consumption by assigning quota volumes that were not as significant as if domestic consumption had been measured through an agreed methodology. The new market access opportunities through quota expansion and creation will depend on the correct measurement of the domestic consumption. (In some cases, the level of domestic consumption has declined since the Uruguay Round Agreement on Agriculture (URAA). In those cases, the base consumption level should be updated to reflect current consumption patterns.)

But countries would also have the obligation to cut above-quota tariffs on Sensitive Products as well as increasing TRQs. These tariff cuts could, for instance, be at the rate appropriate to the next lowest level of tariffs on non-sensitive goods.

The Framework Agreement only refers to TRQ expansion when it addresses Sensitive Products. However, some of the products currently subject to TRQs under the URAA might not be categorized as Sensitive Products. Many would consider this a serious "gap" in the Framework, unless products subject to TRQs under the URAA would be subject to meaningful tariff cuts that would allow increased market access.

Within-Quota Tariffs

The issue of cutting or eliminating within-quota tariffs is introduced in the Framework as a way to "give the flexibility required to reach a final balanced result." This implies that the elimination of such tariffs is still possible, but may have

to be “purchased” by less ambitious tariff cuts or TRQ expansion. Given that the level of within-quota tariffs largely impacts the distribution of quota rents between governments and traders, there may not seem to be much advantage gained by such tariff elimination. On the other hand, as quotas increase over time, the impact of tariff-free access will also be enhanced. Moreover, as internal prices fall due to policy reforms in some markets, the level of protection offered by within-quota tariffs rises above low levels, making it important to include in-quota tariff reductions in formula cuts.

TRQ Administration

Since 1995, 1,400 TRQs have come into effect as a result of the URAA. TRQs are a second-best option for liberalization because they are closed and inefficient ways to increase market access. However, during the URAA they were necessary to convince some countries to reduce their tariffs on politically sensitive products, and they are likely to remain a fixture of the Doha Development Round Agreement. Therefore, improving the administration of TRQs and reducing in-quota tariffs are both important objectives for the DDRA.

No specific provisions were approved in the URAA governing administration of quotas, although relevant WTO rules for import quotas do apply. There is considerable scope to improve the efficiency and transparency of quota regimes.

Approximately half of all quotas are administered with applied tariffs, where no quota shares are allocated, and imports are permitted at unlimited quantities at the within-quota tariff rate. Of the remainder, most are governed by License on Demand, where import licenses are allocated in relation to the quantities demanded and requests are reduced by a *pro rata* amount if the total request exceeds the quota volume. This system is inefficient because it treats all firms equally, regardless of their cost structures and competitiveness. This system also tends to result in under-filled quotas. Other forms of TRQ Administration include First Come-First Served, historical shares, state trading enterprises (STEs), Lottery and Auction. Many of these options are wasteful, inefficient and result in substantial quota-underfill. (World Bank Trade Note Sept 10, 2003, De Gorter, et.al.)

Some general guidelines for the administration of TRQs could include

- Auctioning quotas to the highest bidders. This would ensure that companies with the lowest costs (and hence the capacity to offer higher bids for the right to trade) gain this right, and that quotas are filled.
- Allowing quotas and import licenses to be traded among firms. This would have the same advantage as an auction, but might be more practical and easier to administer.
- STE importers could also be disciplined to ensure that their activities are transparent and that they, over time, begin to compete with private entities in their home market.

It is unlikely that negotiators would agree to mandate a uniform method of administration of TRQs. Improvements could best be achieved by establishing a register of administration procedures that are acceptable. Countries could also agree on a mechanism for encouraging the full use of the market access represented by TRQs.

TRQ administration could also be geared in part to encourage exports from developing countries. Within-quota tariffs could be set to zero for developing countries, though this would require a modification of the notion emphasized in the Framework Agreement that TRQs be MFN-based.

Tariff Escalation

Tariff escalation, the application of higher tariffs on processed goods than on the raw and semi-processed commodities that compose those processed goods, denies countries the ability to add value to their raw products. While this is largely a concern for developing countries, even developed countries face such tariff escalation. The rationale for tariff escalation is to protect the domestic processing industry by adding a tariff for this industrial protection on top of the tariff for the agricultural commodity itself (in some cases, such as the European Union, tariff escalation has compensated manufacturers for higher domestic input prices. One can also argue that Differential Export Taxes act as a mirror image, providing protection to domestic processors in countries that normally might be exporting raw commodities.

To an extent, the progressive tariff reductions explicit in the tiered approach will tend to reduce tariff escalation. But the issue has become an important one for a number of developing countries and will have to be dealt with explicitly. Table 7 illustrates tariff escalation in the soybean sector in five different countries. It shows that the tiered formula alone would not be enough to address the escalation problem in this sector, given that the tariffs on soybeans and crude soybean oil would most likely fall in the same band of the tiered formula.

The Framework Agreement confirms that the issue “will be addressed” by a formula to be agreed. There would appear to be merit in making such a formula simple and avoid commodity-by-commodity negotiations or the complication of

Table 7. Tariff Escalation in the Soybean Sector (bound tariffs)

Product	Canada	China	European Union	Japan	United States
Soybean	0.0%	3.0%	0.0%	0.0%	0.0%
Soy oil (crude)	4.8%	9.0%	6.4%	25.6%	19.1%

Source: Institute for International Trade Negotiations (ICONE).

addressing tariff escalation in the case of Sensitive Products. The Harbinson Draft Modalities paper contained a suggested method for reducing tariff escalation, ensuring in the specification of tariff reduction schedules that tariffs on processed goods are reduced by some multiple (1.3) of the reduction for raw materials. Whether this amount is too much, too little or just right will probably vary from country to country, and commodity by commodity, but it is unlikely that each country or commodity would be treated differently, so a uniform multiple should probably be agreed.

Tariff escalation could, for instance, be handled through a provision that requires that the reduction in tariffs on processed goods be one-third greater that that of the principal raw materials incorporated in those goods. The complications would arise in cases where the link between raw and processed products is unclear, such as when a number of inputs are combined to produce a final good. Representation by principal suppliers to importers at the time of scrutinizing draft schedules may be the only way to solve such specific problems.

Special Agricultural Safeguards

Special Safeguard for Agriculture: Countries that converted their non-tariff barriers into tariffs during the Uruguay Round were allowed to impose a Special Agricultural Safeguard to restrict imports if they exceeded certain volume or price triggers. According to the Framework, the continued use of the Special Safeguard for Agriculture (SSG) by developed countries "remains under negotiation." Supporters of the continuation of the SSG argue that it allows reluctant importers to tolerate tariff cuts that would otherwise expose domestic producers to low prices or a surge in imports. It also can allow countries the flexibility to smooth the path of domestic policy reforms. But continual use of such a safeguard in order to protect domestic producers thwarts the objective of improved market access and isolates farmers from long-run changes in world prices and competitive markets. Some limitations may need to be introduced if the safeguard is to be continued under the new agreement.

One approach would be to allow the SSG to continue over the period of tariff reductions for developed countries. The use of the SSG would be limited to products so identified in the Uruguay Round schedules. Restrictions should also be imposed on the frequency of use, so as to prevent countries from using SSGs as a permanent protection against imports. The Committee on Agriculture could then monitor the use of such safeguards and recommend any changes in procedures that may be warranted.

Some have argued that the principle of "standstill" could apply to SSGs. The fact that a country has reserved the right to impose an SSG does not guarantee that it should be allowed to use it during the implementation period. They argue that if a country did not use an SSG on certain products, it should not be authorized to introduce such SSGs during the Doha Round implementation period. However, new tariff cuts will expose different products to the possibility of import surges, so it may be politically impossible to impose a "standstill" on SSGs. Another approach would be to limit safeguards to products with tariffs below some threshold based on bound tariffs.

An alternative approach would be to allow all countries to use SSGs on any products subject to tariff cuts, (as long as they do not also use the SSM mentioned below). This would require that the reference prices for the price triggers be linked more systematically with world price movements, rather than be determined based on the country's own price levels or calculations. One question facing negotiators is whether the SSG (and the Special Safeguard for SSM) should offset the entire price depressing effect, or only part of the price-depressing effect. One could argue that allowing some of the price-depressing impact (when the impact is due to competitive pressures, as opposed to subsidized competition) could be beneficial for consumers, who would benefit from lower prices, and also to producers, who would be exposed to competitive pressures that could encourage efficiencies.

Special and Differential Treatment: The Framework Agreement, in accord with the Doha Declaration, emphasizes that Special and Differential Treatment (SDT) is to be an integral part of the market access outcome. However, there is some disagreement as to how to balance aspects of SDT that reduce the obligations of developing countries with the aspects of favorable treatment that developed countries give to developing countries. The "reduced obligation" aspect of SDT in the context of market access is primarily through the pace and extent of liberalization; the "favorable

markets" aspect of SDT is implemented through reducing developed-country tariff cuts on products of export interest to developing countries. In general, the latter is likely to be the more economically constructive while the former may be more politically necessary.

Under the Framework Agreement, developing countries are entitled to a longer transition period and lower tariff cuts. But if tariff cuts are limited or phased in over a long implementation period, developing countries will lose much of the potential benefit and will have difficulty integrating their economies into the global economy, continuing to place a heavy burden on their own consumers.

One simple way to balancing these two considerations would be to allow developing countries to choose between implementing the entire tariff reduction required of developed countries, but over a longer timeframe or to require two-thirds of the tariff reduction required of developed countries, but implemented on the same timeframe.

Special Products: Developing countries, under the Framework Agreement, can specify a number of products as Special Products, based on criteria of food security, livelihood and rural development needs. Tariff reductions for Special Products might only need to be one-half that for other agricultural products. Several criteria have been proposed.

- The product should contribute more than ten percent of calories or essential nutrients; over ten percent of the farmers in a country produce the product as the major part of their farming activities; and programs recognize and encourage the production of this product for rural development purposes.
- The product should be produced primarily by farmers earning less than $2 per day; or products grown in areas where poverty is concentrated due to lack of natural resources or access to infrastructure; or products grown mainly by small holders.
- The products could be selected based on the relative contribution of each to the national economy either as a function of its contribution to national GDP, employment or the size of its total productive area in the country. These products should also play a prominent role in the national diet.
- The products could be selected based on the share of the product in total agricultural production (a proxy for rural development); the share of the product in total agricultural consumption (a proxy for food security) and the contribution of the product to total agricultural employment (a proxy for livelihood security). However, these objectives are not easily quantifiable, and even if they were, determining the acceptable threshold levels for each of the objectives is not simple either.
- The products could be those with low tariffs (and therefore susceptible to import disruptions); products for which the country is a net food importer; or products for which the country has a small share of the international market. But these criteria may not capture products that are vital to a small region or group of producers. These criteria also do not capture products that are not traded (e.g. cassava) that may be a local staple that could be displaced by an imported substitute, such as wheat flower.

Special Safeguard Mechanism: Because the creation of the SSG was linked to tariffication, very few developing countries have had access to the measure. According to the FAO, only 22 developing countries have access the SSG, and only six have made use of it. Instead, most developing countries have simply raised applied tariffs close to their bound rates when threatened with import surges. The Framework Agreement endorses the creation of a Special Safeguard Mechanism (SSM) for developing countries.

An SSM is seen as both politically necessary, particularly if there are sharp reductions in bound tariffs, and of potential economic benefit. Small, open economies are particularly vulnerable to changes in world market prices. A simple, transparent mechanism for temporary levies would give countries the security they need to stabilize domestic market without the temptation to protect inefficient sectors in the longer run.

Several issues are still under discussion with respect to the operation of the SSM. One is the width of the commodity coverage. From the developing country perspective, there would seem to be a benefit from a wide coverage, but this could come at a cost in negotiating terms. Developed countries will see too wide a range of commodities covered by the SSM as a way of avoiding any market penetration, depending on where triggers were set. Even for some developing countries, wide coverage could be a problem, as intra-developing country trade is 50 percent of all developing country trade.

The current volume triggers on the SSG are complex and opaque. Moreover, according to the FAO, the current triggers are biased against developing countries where there is a lower degrees of openness; consumption that is increasing; and consumption statistics that are missing. In this case, basing the volume trigger on import levels removes these

sources of bias, and ensures a simpler, more transparent mechanism. There should also be a limit on the length of time the SSG or SSM is in place, to prevent this method of protection from becoming permanent.

To avoid SSMs becoming an additional import restriction, it may be advisable to stipulate that developing countries could only make use of this whenever their bound tariff levels had been reduced by a total of one-third of the level in 2005.

One benefit of the SSM is that it essentially takes the place of the "price band" systems that are in place in several South and Central American countries. Such bands, which trigger additional tariffs, have been ruled contrary to the WTO. A WTO-consistent and reasonably uniform agricultural safeguard would simplify trade decisions and lower costs.

Some have suggested that the product coverage of the SSM be linked to Special Products, to smooth the effects of price shocks and import surges. Others have suggested that countries only protect products subject to deep tariff cuts with SSM, as an incentive to undertake deep reductions. Still others have suggested that the number of products eligible for an SSM be limited to a handful, but it would hard to impose this discipline on developing countries if similar disciplines were not placed on developed countries. FAO figures indicate that subsidized products are more subject to import surges, so the SSM could be provided for products that are highly subsidized in international markets, to counterbalance the impact of artificially low prices. SSMs could also apply to domestic products characterized by high import penetration.

Tropical and Alternative Crops

The Framework calls for efforts to liberalize tropical products and those representing alternatives to the growing of illicit narcotic crops. At one level this is easily accomplished by reducing tariffs on a specific list of products to be agreed. To be of maximum value, developed countries would also have to agree not to nominate such products as "Sensitive".

Erosion of Preferential Access

The erosion of preferences is a natural and generally desirable consequence of trade liberalization, at all levels: multilateral, regional and bilateral. For a variety of current and historical reasons, preferences grant developing countries special (often duty-free) access to developed country markets, relative to other suppliers. If the MFN tariff is reduced (but not to zero) then the preference still exists. There is increasing evidence that preferences have not helped developing countries as much as is sometimes assumed or averred. Preferences have locked countries into certain commodities for which they might not have a comparative advantage. Preferences have also shielded producers from competition and many are now so high-cost and inefficient that they cannot compete on world markets. Importers, not farmers, often capture the economic rents from preferences. Finally, preferences are very inefficient ways to transfer incomes to farmers in developing countries. Thus, it behooves most developing countries to begin to transition away from trade dependent on preferences and toward more sustainable and competitive sectors.

However, as has become clear in the recent expiration of the Multi-fiber Agreement, large and competitive exporters can overwhelm smaller producers who have not or cannot make adjustments that would otherwise make them more competitive or allow them to shift to other endeavors. Moreover, reducing preferences in a way that causes direct harm (even if only short-term) to specific developing countries would be politically difficult in the Doha Development Round. Given the very real political and economic ramifications, it is important that the Doha Round recognize that the erosion of preference can have important consequences for some countries and for some politically powerful sectors. To compensate for the negative impacts of preference erosion on uncompetitive sectors, preference-granting countries could offset the declining value of those preferences either through financial transfers or additional market access for all products from the current preferred exporters.

Market Access and Least Developed Countries

LDCs will not be required to undertake any reduction commitments (as agreed in the Framework). It was agreed that developed countries and those developing countries that were in a position to do so, should provide duty and quota-free access to LDCs. Such concessions to LDCs reflect a widespread view that they are in no position to contribute by opening up markets to imports. In fact, they may well have much to gain by opening their markets. So it is necessary to provide the possibility that LDCs be allowed the same benefits from bargaining tariff reductions that other countries enjoy. This may have to be on a case-by-case basis, as not all LDCs will be in the same position.

There are other ways of encouraging market access for products from LDCs. Countries with TRQs in products of export interest to LDC, for instance, could provide duty-free access up to the quota and reimburse tariff revenues on imports when the above-quota tariff is in operation.

Though the cotton issue involves more than just LDCs and more than market access, the Framework Agreement ties the cotton question into the treatment of LDCs. To that effect, the recommendations of the Cotton sub-committee will need to be considered as a part of the obligation to improve market conditions for LDCs.

Market Access and Recently Acceded Members

Recently acceded Members have argued that they should be able to take any increased market access above that which would have normally been expected to have resulted from previous tariff cuts in Rounds into account in their tariff reduction schedules prior to their accession. However, the provision that significant market access improvements should result from the Agreement will apply to these countries as well as to other Members. As a result, it is probably best to avoid any blanket formula for these countries but deal with this in the process of scrutinizing the draft schedules. One possibility would be to provide these countries with some form of credit for concessions made in their accession agreements toward any new WTO commitments stemming from the Doha Round.

Other Market Access-Related Issues

Two other issues with implications for market access are mentioned in the Framework: sectoral initiatives and Geographical Indications (GIs).

Sectoral initiatives are possible within the Framework, and could still be suggested by one or more members at any time. A sectoral initiative might take the form of a more-than-average tariff cut (perhaps to zero) coupled with an agreement to end export subsidies (ahead of the timetable suggested above) and trade-distorting domestic support (over and above the schedules suggested above). Such a sectoral agreement does not help to reduce tariff disparity, but the example of open trading in particular sectors could eventually be encouraging for those sectors not ready for such action.

The EU originally raised the issue of GIs as one element of market access. Failure to protect European GIs was considered to limit the access for European exports in foreign markets. The United States and the European Union, in a recent dispute on these issues both claimed victory: the United States because the European Union was found not to be enforcing GIs on imported and domestic products equally, and the European Union because the WTO's Dispute Settlement Panel upheld the existence of GIs. The establishment of a multilateral register for wines and spirits is still under negotiation under the TRIPS Council. The results of those negotiations will be considered as integral parts of the "agricultural package," but will not subject to modification by the Agricultural Committee. A similar discussion might be launched under the auspices of the TRIPS Council regarding whether and how such a system might be extended to GIs for food products.

3. CONCLUSION

The market access pillar is by far the most complicated and politically sensitive. Even in the Framework Agreement, political sensitivities have created a number of exceptions and exemptions in the form of Special and Sensitive Products, as well as Special Safeguards and Special Safeguard Measures. While some flexibility will be necessary to convince governments to move forward with ambitious market access reforms, there is a real risk that the accumulation of these flexibilities could jeopardize meaningful results in the most critical pillar of the negotiations.

4. REFERENCES

For complete list of references, see the commissioned paper on the IATRC website, www.iatrcweb.org

Appendix: The July Framework Agreement

Annex A: Framework for Establishing Modalities in Agriculture

1. The starting point for the current phase of the agriculture negotiations has been the mandate set out in Paragraph 13 of the Doha Ministerial Declaration. This in turn built on the long-term objective of the Agreement on Agriculture to establish a fair and market-oriented trading system through a programme of fundamental reform. The elements below offer the additional precision required at this stage of the negotiations and thus the basis for the negotiations of full modalities in the next phase. The level of ambition set by the Doha mandate will continue to be the basis for the negotiations on agriculture.

2. The final balance will be found only at the conclusion of these subsequent negotiations and within the Single Undertaking. To achieve this balance, the modalities to be developed will need to incorporate operationally effective and meaningful provisions for special and differential treatment for developing country Members. Agriculture is of critical importance to the economic development of developing country Members and they must be able to pursue agricultural policies that are supportive of their development goals, poverty reduction strategies, food security and livelihood concerns. Non-trade concerns, as referred to in Paragraph 13 of the Doha Declaration, will be taken into account.

3. The reforms in all three pillars form an interconnected whole and must be approached in a balanced and equitable manner.

4. The General Council recognizes the importance of cotton for a certain number of countries and its vital importance for developing countries, especially LDCs. It will be addressed ambitiously, expeditiously, and specifically, within the agriculture negotiations. The provisions of this framework provide a basis for this approach, as does the sectoral initiative on cotton. The Special Session of the Committee on Agriculture shall ensure appropriate prioritization of the cotton issue independently from other sectoral initiatives. A subcommittee on cotton will meet periodically and report to the Special Session of the Committee on Agriculture to review progress. Work shall encompass all trade-distorting policies affecting the sector in all three pillars of market access, domestic support, and export competition, as specified in the Doha text and this Framework text.

5. Coherence between trade and development aspects of the cotton issue will be pursued as set out in paragraph 1.b of the text to which this Framework is annexed.

DOMESTIC SUPPORT

6. The Doha Ministerial Declaration calls for “substantial reductions in trade-distorting domestic support”. With a view to achieving these substantial reductions, the negotiations in this pillar will ensure the following:

- Special and differential treatment remains an integral component of domestic support. Modalities to be developed will include longer implementation periods and lower reduction coefficients for all types of trade-distorting domestic support and continued access to the provisions under Article 6.2.
- There will be a strong element of harmonisation in the reductions made by developed Members. Specifically, higher levels of permitted trade-distorting domestic support will be subject to deeper cuts.
- Each such Member will make a substantial reduction in the overall level of its trade-distorting support from bound levels.
- As well as this overall commitment, Final Bound Total AMS and permitted *de minimis* levels will be subject to substantial reductions and, in the case of the Blue Box, will be capped as specified in paragraph 15 in order to ensure results that are coherent with the long-term reform objective. Any clarification or development of rules and conditions to govern trade distorting support will take this into account.

Overall Reduction: A Tiered Formula

7. The overall base level of all trade-distorting domestic support, as measured by the Final Bound Total AMS plus permitted *de minimis* level and the level agreed in paragraph 8 below for Blue Box payments, will be reduced according to a tiered formula. Under this formula, Members having higher levels of trade-distorting domestic support will make greater overall reductions in order to achieve a harmonizing result. As the first instalment of the overall cut, in the first year and throughout the implementation period, the sum of all trade-distorting support will not

exceed 80 per cent of the sum of Final Bound Total AMS plus permitted *de minimis* plus the Blue Box at the level determined in paragraph 15.

8. The following parameters will guide the further negotiation of this tiered formula:

This commitment will apply as a minimum overall commitment. It will not be applied as a ceiling on reductions of overall trade-distorting domestic support, should the separate and complementary formulae to be developed for Total AMS, *de minimis* and Blue Box payments imply, when taken together, a deeper cut in overall trade-distorting domestic support for an individual Member.

The base for measuring the Blue Box component will be the higher of existing Blue Box payments during a recent representative period to be agreed and the cap established in paragraph 15 below.

Final Bound Total AMS: A Tiered Formula

9. To achieve reductions with a harmonizing effect:

- Final Bound Total AMS will be reduced substantially, using a tiered approach.
- Members having higher Total AMS will make greater reductions.
- To prevent circumvention of the objective of the Agreement through transfers of unchanged domestic support between different support categories, product-specific AMSs will be capped at their respective average levels according to a methodology to be agreed.
- Substantial reductions in Final Bound Total AMS will result in reductions of some product-specific support.

10. Members may make greater than formula reductions in order to achieve the required level of cut in overall trade-distorting domestic support.

De Minimis

11. Reductions in *de minimis* will be negotiated taking into account the principle of special and differential treatment. Developing countries that allocate almost all *de minimis* support for subsistence and resource-poor farmers will be exempt.

12. Members may make greater than formula reductions in order to achieve the required level of cut in overall trade-distorting domestic support.

Blue Box

13. Members recognize the role of the Blue Box in promoting agricultural reforms. In this light, Article 6.5 will be reviewed so that Members may have recourse to the following measures:

- Direct payments under production-limiting programmes if:
  - such payments are based on fixed and unchanging areas and yields; or
  - such payments are made on 85% or less of a fixed and unchanging base level of production; or
  - livestock payments are made on a fixed and unchanging number of head.

Or

- Direct payments that do not require production if:
  - such payments are based on fixed and unchanging bases and yields; or
  - livestock payments made on a fixed and unchanging number of head; and
  - such payments are made on 85% or less of a fixed and unchanging base level of production.

14. The above criteria, along with additional criteria will be negotiated. Any such criteria will ensure that Blue Box payments are less trade-distorting than AMS measures, it being understood that:

- Any new criteria would need to take account of the balance of WTO rights and obligations.
- Any new criteria to be agreed will not have the perverse effect of undoing ongoing reforms.

15. Blue Box support will not exceed 5% of a Member's average total value of agricultural production during an historical period. The historical period will be established in the negotiations. This ceiling will apply to any actual or potential Blue Box user from the beginning of the implementation period. In cases where a Member has placed an

exceptionally large percentage of its trade-distorting support in the Blue Box, some flexibility will be provided on a basis to be agreed to ensure that such a Member is not called upon to make a wholly disproportionate cut.

Green Box

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

EXPORT COMPETITION

17. The Doha Ministerial Declaration calls for "reduction of, with a view to phasing out, all forms of export subsidies". As an outcome of the negotiations, Members agree to establish detailed modalities ensuring the parallel elimination of all forms of export subsidies and disciplines on all export measures with equivalent effect by a credible end date.

End Point

18. The following will be eliminated by the end date to be agreed:

Export subsidies as scheduled.

- Export credits, export credit guarantees or insurance programmes with repayment periods beyond 180 days.
- Terms and conditions relating to export credits, export credit guarantees or insurance programmes with repayment periods of 180 days and below which are not in accordance with disciplines to be agreed. These disciplines will cover, *inter alia*, payment of interest, minimum interest rates, minimum premium requirements, and other elements which can constitute subsidies or otherwise distort trade.
- Trade distorting practices with respect to exporting STEs including eliminating export subsidies provided to or by them, government financing, and the underwriting of losses. The issue of the future use of monopoly powers will be subject to further negotiation.
- Provision of food aid that is not in conformity with operationally effective disciplines to be agreed. The objective of such disciplines will be to prevent commercial displacement. The role of international organizations as regards the provision of food aid by Members, including related humanitarian and developmental issues, will be addressed in the negotiations. The question of providing food aid exclusively in fully grant form will also be addressed in the negotiations.

19. Effective transparency provisions for paragraph 18 will be established. Such provisions, in accordance with standard WTO practice, will be consistent with commercial confidentiality considerations.

Implementation

20. Commitments and disciplines in paragraph 18 will be implemented according to a schedule and modalities to be agreed. Commitments will be implemented by annual instalments. Their phasing will take into account the need for some coherence with internal reform steps of Members.

21. The negotiation of the elements in paragraph 18 and their implementation will ensure equivalent and parallel commitments by Members.

Special and Differential Treatment

22. Developing country Members will benefit from longer implementation periods for the phasing out of all forms of export subsidies.

23. Developing countries will continue to benefit from special and differential treatment under the provisions of Article 9.4 of the Agreement on Agriculture for a reasonable period, to be negotiated, after the phasing out of all forms of export subsidies and implementation of all disciplines identified above are completed.

24. Members will ensure that the disciplines on export credits, export credit guarantees or insurance programs to be agreed will make appropriate provision for differential treatment in favour of least-developed and net food-importing developing countries as provided for in paragraph 4 of the Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries.

Improved obligations for monitoring and surveillance of all new disciplines as foreshadowed in paragraph 48 will be critically important in this regard. Provisions to be agreed in this respect must not undermine the commitments undertaken by Members under the obligations in paragraph 18 above.

25. STEs in developing country Members which enjoy special privileges to preserve domestic consumer price stability and to ensure food security will receive special consideration for maintaining monopoly status.

Special Circumstances

26. In exceptional circumstances, which cannot be adequately covered by food aid, commercial export credits or preferential international financing facilities, ad hoc temporary financing arrangements relating to exports to developing countries may be agreed by Members. Such agreements must not have the effect of undermining commitments undertaken by Members in paragraph 18 above, and will be based on criteria and consultation procedures to be established.

MARKET ACCESS

27. The Doha Ministerial Declaration calls for "substantial improvements in market access". Members also agreed that special and differential treatment for developing Members would be an integral part of all elements in the negotiations.

The Single Approach: a Tiered Formula

28. To ensure that a single approach for developed and developing country Members meets all the objectives of the Doha mandate, tariff reductions will be made through a tiered formula that takes into account their different tariff structures.

29. To ensure that such a formula will lead to substantial trade expansion, the following principles will guide its further negotiation:

- Tariff reductions will be made from bound rates. Substantial overall tariff reductions will be achieved as a final result from negotiations.
- Each Member (other than LDCs) will make a contribution. Operationally effective special and differential provisions for developing country Members will be an integral part of all elements.
- Progressivity in tariff reductions will be achieved through deeper cuts in higher tariffs with flexibilities for sensitive products. Substantial improvements in market access will be achieved for all products.

30. The number of bands, the thresholds for defining the bands and the type of tariff reduction in each band remain under negotiation. The role of a tariff cap in a tiered formula with distinct treatment for sensitive products will be further evaluated.

Sensitive Products

Selection

31. Without undermining the overall objective of the tiered approach, Members may designate an appropriate number, to be negotiated, of tariff lines to be treated as sensitive, taking account of existing commitments for these products.

Treatment

32. The principle of 'substantial improvement' will apply to each product.

33. 'Substantial improvement' will be achieved through combinations of tariff quota commitments and tariff reductions applying to each product. However, balance in this negotiation will be found only if the final negotiated result also reflects the sensitivity of the product concerned.

34. Some MFN-based tariff quota expansion will be required for all such products. A base for such an expansion will be established, taking account of coherent and equitable criteria to be developed in the negotiations. In order not to undermine the objective of the tiered approach, for all such products, MFN based tariff quota expansion will be provided under specific rules to be negotiated taking into account deviations from the tariff formula.

Other Elements

35. Other elements that will give the flexibility required to reach a final balanced result include reduction or elimination of in-quota tariff rates, and operationally effective improvements in tariff quota administration for existing

tariff quotas so as to enable Members, and particularly developing country Members, to fully benefit from the market access opportunities under tariff rate quotas.

36. Tariff escalation will be addressed through a formula to be agreed.

37. The issue of tariff simplification remains under negotiation.

38. The question of the special agricultural safeguard (SSG) remains under negotiation.

Special and differential treatment

39. Having regard to their rural development, food security and/or livelihood security needs, special and differential treatment for developing countries will be an integral part of all elements of the negotiation, including the tariff reduction formula, the number and treatment of sensitive products, expansion of tariff rate quotas, and implementation period.

40. Proportionality will be achieved by requiring lesser tariff reduction commitments or tariff quota expansion commitments from developing country Members.

41. Developing country Members will have the flexibility to designate an appropriate number of products as Special Products, based on criteria of food security, livelihood security and rural development needs. These products will be eligible for more flexible treatment. The criteria and treatment of these products will be further specified during the negotiation phase and will recognize the fundamental importance of Special Products to developing countries.

42. A Special Safeguard Mechanism (SSM) will be established for use by developing country Members.

43. Full implementation of the long-standing commitment to achieve the fullest liberalisation of trade in tropical agricultural products and for products of particular importance to the diversification of production from the growing of illicit narcotic crops is overdue and will be addressed effectively in the market access negotiations.

44. The importance of long-standing preferences is fully recognised. The issue of preference erosion will be addressed. For the further consideration in this regard, paragraph 16 and other relevant provisions of TN/AG/W/1/Rev.1 will be used as a reference.

LEAST- DEVELOPED COUNTRIES

45. Least-Developed Countries, which will have full access to all special and differential treatment provisions above, are not required to undertake reduction commitments. Developed Members, and developing country Members in a position to do so, should provide duty-free and quota-free market access for products originating from least-developed countries.

46. Work on cotton under all the pillars will reflect the vital importance of this sector to certain LDC Members and we will work to achieve ambitious results expeditiously.

RECENTLY ACCEDED MEMBERS

47. The particular concerns of recently acceded Members will be effectively addressed through specific flexibility provisions.

MONITORING AND SURVEILLANCE

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

OTHER ISSUES

49. Issues of interest but not agreed: sectoral initiatives, differential export taxes, GIs.

50. Disciplines on export prohibitions and restrictions in Article 12.1 of the Agreement on Agriculture will be strengthened.

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