(Draft - Comments Welcome)

Towards a More Equitable Regime of Domestic Agricultural Support

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1. Background

After the conclusion of the Uruguay Round (UR) of negotiations, member countries believed that by adopting disciplines on domestic support they have achieved a great deal. This is because of the fact that the primary focus of the disciplines of the erstwhile General Agreement on Tariffs and Trade (GATT) before this round was largely on trade measures.[2] Through the disciplines on domestic support in agriculture, member countries attempted to rein in the unbridled growth of support that flows to the agricultural sector. Because the support which is generally granted through a number of policy instruments such as support prices, input subsidies, monopoly procurement operations and restrictions on imports and exports to control domestic prices and costs seriously distorts production. These distortions influence resource allocation and affect more efficient producers of agricultural commodities from exploiting their true potential in agricultural production and exports.

As these policy instruments affect incentives, which the farmers receive in terms of prices, one of the basic requirements of the disciplines on domestic support was to calculate the amount of support provided to the agricultural sector. In the Agreement on Agriculture (AOA), the impact of domestic support policies is captured through a measure known as the Aggregate Measure of Support (AMS), which essentially measures the direct impact of intervention policies on the agricultural sector.[3]

The concept measures the impact of policy instruments by comparing prices, which the farmers get under the environment created by domestic policies and the prices, which the farmers would have received in the absence of such policies. In a net importing country, it is

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[2] The only exception was Article XVI of GATT 1994 on Subsidies, where domestic policies had an impact of trade.

[3] The economy-wide macro and trade policies, which affect exchange rate and domestic prices in the non-agricultural sector *vis a vis* their free trade prices also have an impact on the relative prices of agricultural and non-agricultural products. The impact of such economy-wide policies is referred to as the indirect impact on the agricultural sector. Krueger, Schiff and Valdes (1988), in their study, which covered 18 countries of the world, have developed a framework to capture both direct and indirect impact that various policies have on the agricultural sector.

the import parity price (*cif* price), which is the relevant reference price and in a net exporting country the appropriate price is the export parity price (*fob* price). Such a comparison between the domestic prices and the border prices reveals the amount of implicit support that the agricultural sector gets if the domestic price is higher than the border price or the amount of implicit tax, which is being imposed on the sector if the domestic price is lower than the border price.

The provisions of the agreement classify such support as non-exempted and subject the same to reduction commitments barring a few exceptions, which are discussed in the paper. And, the support, which is provided to the agricultural sector through publicly funded programmes, which do not involve transfers from the consumers and does not provide price support to the producers, is termed as exempted support and is not subject to reduction commitments. This is the broad framework within which the domestic support has been treated under the AOA. In the WTO terminology, these support systems are identified by "boxes" which are given the colours of traffic lights - green (permitted), amber (slow down, which means to be reduced).

As per the agreement, the level of non-exempt support, thus worked out has to be reduced if it exceeds the *de minimis* level of 10 per cent of the value of agricultural output in the case of a developing country (5 per cent in the case of a developed country). The level of support, which exceeds the *de minimis* limit, has to be reduced by 13.3 per cent over a period of 10 years in the case of a developing country and 20 per cent in case of a developed country over a period of 5 years. What it implies is that support above 10 per cent of the value of agricultural output does not qualify for exemption during the implementation period. Only the least developed countries have been exempted from the domestic support reduction commitments under the agreement.

2. Components of Domestic Support

As mentioned above, the domestic support has two components – non-exempt domestic support, which is to be reduced exempt support, which is permitted. Each of these two components is discussed below.

2.1 Non-exempt Domestic Support Measures

2.1.1 The Aggregate Measure of Support (Annex 4)

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The AMS has been defined as the sum of the annual value of aggregate product-specific support plus the non-product specific support and equivalent measure of support. Thus AMS has three components – product specific support, non-product specific support and equivalent measure of support for those products for which product specific support cannot be calculated.

(a) Product Specific Support (PSS)

Product specific support is the level of support provided to each basic product such as rice, wheat, cotton and so on that they obtain through (a) market price support; (b) non-exempt direct payments, and (c) other subsidies not exempted from reduction commitments. The market price support refers to the support, which is provided through minimum support prices to various agricultural products. This is calculated as the gap between a fixed external reference price[4] and applied administered price which is the domestic support price times the quantity eligible to receive the applied administered price. Any associated fees/levies that are paid by the farmers on a particular product are deducted from the market price support. The reference price is based on the years 1986-87 to 1988-89. The external reference price is adjusted for quality differences as necessary in order to make it comparable with the domestically produced product.

Non-exempt direct support payments are two types – payments that are dependent on a price gap and payments that are based on factors other than price. Payments that are dependent on a price gap are computed either by using the gap between the fixed reference price and the administered price multiplied by the quantity eligible to receive the administered price or by using budgetary outlays.[5] Payments that are based on factors other than price are worked out by using budgetary outlays.

Other non-exempt support measures, including subsidies and other measures such as marketing cost reduction are calculated by using budgetary outlays. However, if budgetary outlays do not reflect the full extent of subsidy, the support is worked out by using the gap between the subsidised price of input or service in question and a representative market price multiplied by the quantity used of that input or service.

(b) Non-product Specific Support (NPS)

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[4] FOB unit value in a net exporting country and cif unit value in a net importing country.

[5] The fixed reference price should be based on the years 1986-87 to 1988-89 and should generally be the actual price used for determining payment rates.

Non-product specific support is the support given by the government to the agricultural sector in general but is not specific to products. Thus, support that falls under the purview of non-product specific component includes subsidies on various inputs such as fertilisers, irrigation, electricity, credit, seeds, insecticides and so on. For inputs such as seeds, fertilisers and insecticides, which are tradable, support is calculated on the basis of external reference price and the domestic price times the quantity used of that particular input. For other inputs, which are non-tradable, budgetary outlays are used to measure the subsidies. All these subsidies are added together into one non-product specific AMS expressed in monetary terms.

© *Equivalent Measurement of Support (EMS)*

Equivalent measure of support is worked out for those products for which the calculation of the market price support component of the AMS is not practicable. For these products equivalent measure of support is worked out by using the applied administered price and the quantity of production eligible to receive the administered price. Where this is not possible budgetary outlays used to maintain producer prices are used for measuring the support.

2.2 Support Exempted from Reduction Commitments

There are four categories of support measures that are not subject to reductions under the AOA. These are mainly government services and direct payments of one kind or the other. There is no limit on support under these three categories however any new or modified exempt measures have to be notified to the Committee on Agriculture. These are:

(a) *Green Box Measures (Annex 2 of the AOA)*

These are those measures that are considered to have no or at most minimal production and trade distorting effects. These measures include general services such as publicly funded government programmes on research both general and product-specific, pest and disease control (general as well as product- specific), training services, extension and advisory services, inspection services, marketing and promotion services excluding expenditure on purposes that could be used by sellers to reduce their selling price or confer direct economic benefit to buyers, infrastructure services (expenditure directed to the provision or construction of capital works only).

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These measures also include government expenses on public stockholding for food security purposes including government aid to private storage of products as a part of such programme, domestic food aid to sections of population in need.

And, direct payments to producers, decoupled income support; income insurance and safety net programmes, payments for relief from natural disasters and structural adjustment assistance provided through - (i) producer retirement programmes, (ii) resource retirement programmes, (iii) investment aids, (iv) environmental programmes and (v) regional assistance programmes.

(b) *Special and Differential Box Measures (Article 6.2)*

These are developing country measures, which are otherwise subject to reduction commitments. Included in these are rural development programmes, investment subsidies generally available to agriculture, input subsidies to low income or resource poor producers in developing countries. In addition to these, domestic support, which is provided to the producers to encourage diversification from growing illicit narcotic crops, is also incorporated.

(c) *Blue Box Measures* (Article 6.5)

These are direct payments under production limiting programmes. These shall not be subject to reduction commitments if such payments are based on fixed area or yield (in the case of livestock made on a fixed number of head), payments made on 85 per cent or less of the base level production.

(d) *Product and Non-product Specific Support* (*de minimis* clause under Article 6.4)

The product and non-product specific support each of which amounts to less than 5 per cent of the value of agricultural output in the case of a developed country and 10 per cent of the value of agricultural output in the case of a developing country, respectively is also exempt from reduction commitments.

3. The Use of Domestic Support during the Implementation Period

Of the current 144 Members, 34 have, in Section I of Part IV of their Schedules, Total AMS reduction commitments.[6] As in the case of export subsidies, the usage of domestic

[6] Counting the EC and its member States and Switzerland-Liechtenstein, respectively, as one. In addition, Latvia has, during a transition period, which expires on 1 January 2003, a Total AMS commitment of SDR 24 million for each implementation year.

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support at the aggregate level has been low when compared with the levels of commitments that the member countries have made in their submissions to the WTO. For the period under consideration, Table 1 provides data on the use of Total AMS commitments by a member as a percentage of the relevant Total AMS commitment level. In the first year of the implementation period, the level of usage ranged from 0 per cent in the case of Costa Rica and New Zealand to 144 per cent for Argentina. The original values of the domestic support commitments submitted by Argentina were revised and adjusted for excessive inflation, which explains the excessively high level of usage in the first year and lower levels of usage thereafter. For the year 2000, the corresponding figures are 0 (New Zealand) and 90 per cent (Norway).

For the entire period for which the data are available the rates of utilisation on an average have been high in the case of Argentina (109 per cent), Iceland (101 per cent), Korea (89 per cent) and Norway (83 per cent). But, in other countries the rates of utilisation of the domestic support are quite low and some of the members such as New Zealand did not even make use of domestic subsidies.

There are several reasons for the low level of usage of domestic support in these countries that have reduction commitments.

Firstly, the base period, which was chosen to calculate domestic support was the period when the levels of domestic support were historically at very high levels since world market prices were low during that period.

Secondly, the reduction commitments for domestic support are not product specific. The commitments require countries to carry out reductions at the level of aggregate support that is provided to the entire agricultural sector as a whole. Such an approach to reduce domestic support grants countries the freedom to shift support among various products, that is support on some of the less sensitive commodities can be brought down while on others can be raised without violating the agreement.

Thirdly, there are two key weaknesses in the very definition of the trade distorting support, which is the basis for reductions in domestic support. The first weakness relates to the exclusion of trade distorting production-linked payments in some of the developed countries of the world, which are included in the blue box. The omission of such support lowered the level of domestic support, which was taken as the reference level for meeting the reduction commitments. There are only six members that have reported the use of blue box payments. The USA has emptied the blue box and de-coupled the support system.

Table 1: Country-wise use of Domestic Support since the beginning of the Implementation Period (as a percentage of total value of the committed level)							
Country/Group	1995	1996	1997	1998	1999	2000	Average
Argentina	144	100	100	99	100		109
Australia	27	26	25	23	13		23
Brazil	28	35	30	8			25
Bulgaria	n.r.	n.r.	1	3	2		2
Canada	15	12	11	17			14
Chinese Taipei	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	
Colombia	15	1	4	3	2		5
Costa Rica	0	0	0	0	9		2
Croatia	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	
Cyprus	63	63	45	39	53	43	51
Czech Republic	7	11	7	7	31	35	16
EC	64	67	68	65			66
Hungary	51						51
Iceland	79	71	74	178			101
Israel	71	79	83	66	42		68
Japan	73	72	71	18	18		50
Jordan	n.r.	n.r.	n.r.	n.r.	n.r.		
Korea	95	93	95	80	83		89
Lithuania	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	
Mexico	5	3	11	14			8
Moldova	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	
Morocco	12	33	12	17	24		20
New Zealand	0	0	0	0	0	0	0
Norway	71	79	82	88	90	90	83
Papua New Guinea	n.r.						
Poland	6	6	8	8	7		7
Slovak Republic	58	59	73	70	66	78	67
Slovenia	93	91	87	97	85	25	80
South Africa	67	82	97	38	38		64
Switzerland-Liecht.	83	74	72	71			75
Thailand	72	60	79	79			73
Tunisia	87	77	81	94	46		77
United States	27	26	29	50			33
Venezuela	42	26	36	17			30

Source: WTO "Domestic Support" Background paper by the Secretariate.

Notes:

1. NR means not reported
2. Simple average use of commitment levels across all relevant product groups in per cent (excluding zero-use notifications)

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The amounts of payments in the Norway and the EU are particularly high and are of the magnitude of about 71 per cent and 42 per cent of the product specific support, respectively (averages for the period from 1995 to 2000) (Table 2).

The second shortcoming of the definition is the freedom with which countries have been allowed to shift support that falls under the amber and blue boxes to the green box under some heads simply because it is considered to be less production and trade distorting. But it is very difficult to argue that direct payments not linked to production do not distort production. Clearly, even if these payments are de-coupled, they do tend to lower the cost of production and do not in any way discourage farmers from producing an inefficient crop, which he is currently growing. This is simply because such payments could cover quite a substantial part of his cost of production.

Table 2: Expenditure on Blue Box measures in selected countries (US $ million).

Country	Box	1995	1996	1997	1998	1999	2000
EU	Blue	26850	25848	23040	22418		
Iceland	Blue	23	0	0	0		
Japan	Blue	0	0	0	392	831	
Norway	Blue	1124	1124	1043	1044	984	871
Slovak Republic	Blue	1	1	1	0	0	2
Slovenia		0	0	0	0	0	23
USA	Blue	7030	0	0	0		

Source: WTO (2002).

The flexibility and the two exemptions make it easier for countries which subsidise their agriculture to maintain high levels of support and puts those countries at a disadvantage, which do not have resources to pay farmers directly. Precisely, because of these reasons, AMS reduction commitments have not proved to be a binding constraint for a majority of countries, which maintain high levels of support for the agricultural sector. And, the evidence clearly suggests that despite agreed reductions the actual level of support as measured by the Producer Support Equivalents (PSE)[7], which includes all forms of production distorting support has in

[7] This measure of support estimates the value of transfers from government policies to producers of a given commodity.

PSE = [Qd (Pd - Pb) + D + I] / (Qd*Pd + D)

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fact exhibited an increase. This is particularly true for the major countries that subsidise their agriculture heavily – the EU, Japan, USA, Korea and Mexico (Table 3).

Table 3: Domestic Support as defined under the AOA and the Actual Level of Support						
Country	Base period AMS	Final Year AMS	Base Year PSE	Current PSE (1999-2001)	Base year PSE/Base year AMS	Final year PSE/Base year AMS
	Value (US $ billion)	Value (US $ billion)	Value (US $ billion)	Value (US $ billion)		
Australia	0.4	0.3	1.3	1.0	3.00	2.76
Canada	3.8	3.0	5.7	3.9	1.49	1.29
EU	86.7	72.0	93.7	99.3	1.08	1.38
Japan	49.8	39.8	49.5	52.0	0.99	1.31
Korea	2.8	2.3	12.1	18.2	4.28	8.03
Mexico	9.5	7.6	-0.3	5.7	-0.03	0.75
Norway	2.2	1.7	2.6	2.3	1.21	1.30
Switzerland	4.4	3.5	5.1	4.5	1.16	1.29
USA	23.1	18.5	41.8	51.3	1.81	2.78
Source: Developed from WTO (2002) and OECD (2002).						

The actual levels of market distorting support for the major commodities produced in the OECD countries continue to remain excessive and there are hardly any signs of their significant reduction. In fact, for some of the products the levels of actual support have gone up significantly (Table 4).

Table 4: Producers Subsidy Equivalents (PSE's) for Selected Commodities in the OECD countries (Per cent)		
Product	Producers Subsidy Equivalents	
	1986-88	1999-2001
Wheat	48	41
Maize	40	33
Other grains	51	44
Rice	81	81
Oilseeds	26	28
Sugar	54	52
Milk	59	48
Beef and Veal	33	35
Sheep meat	55	47
Wool	7	6
Pig meat	14	21
Poultry	16	16
Eggs	16	10
Other commodities	32	25
Source: OECD (2002)		

Where, D and I are the direct payments and the indirect transfers through input subsidies, marketing

From the above it is clear that the levels of support continue to remain very high despite agreed reductions, because there are clear inconsistencies in the agreement.

There are several points that emerge from the above analysis. The AMS is not a very correct indicator of market distorting support. The exempt character of domestic support provided through both blue as well as some components of the green box measures grants unlimited freedom to some countries, which can afford these costly measures.

As a result, the disciplines of the agreement on domestic support give a lot of space for the developed countries to continue with a system of market distorting support. For example, the reductions in the support prices in the EU have been accompanied by a significant increase in the direct payments, which were used to compensate the producers for the price cuts. Similarly, the replacement of deficiency payments in the USA with production flexibility contract payments and market loss assistance payments has provided their farmers more or less stable prices.

While these payments fulfil the conditions for exemptions under the green box as these are not linked to prices or production are de-coupled, but their oblique linkage to either reductions in the AMS or the movements in the international prices, clearly weakens the disciplines that have been put in place to reduce the support that distorts production.

The de-coupled support has a minimal production distorting effect if producers receive world market prices for their produce, cover all agricultural activities and such payments cover only a small proportion of the marginal cost of production.

In the current agreement there is no mention of any objective criteria, which could set a ceiling on such payments. Further, even if one argues that this flexibility was granted as a transitional mechanism, yet there is no mention of any time frame within which these would be disciplined or dismantled.

Proposals for Further Reforms in Domestic Support Measures

Proposals for further reforms in domestic support are quite diverse and reflect the views of the various countries and their country groupings. For example, the EU says it is ready to negotiate additional reductions in amber box support so long as the concepts of the blue and green boxes are maintained. The Cairns Groups says that a formula approach should be used to deliver major reductions in trade and production distorting domestic support,

assistance, research, infrastructure support and other income support programmes etc.

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including AMS and blue box, leading to the elimination of such support and thus the removal of disparities in the levels of this support provided by countries. Similarly, the proposal put forward by the USA suggests a formula-based approach that will result in levels of support that are more proportionate among WTO members at the end of implementation than they are now.

Clearly, there are differences in the proposals on the disciplines that need to be framed for carrying out further reductions in domestic support, but the majority view is clearly in favour of a substantial reduction of all forms of market distorting support. An analysis of the proposals that have been submitted during the first two rounds of negotiations shows that there are mainly three types of suggestions on the future reforms in this area of the agreement.

(a) The market distorting support provided by a few selected member countries should be reduced substantially and brought down to the *de minimis* levels by the end of the next implementation period.

(b) The provisions of the agreement on domestic support related to the special and differential treatment (Article 6.4), which grant freedom to the developing and the least developing countries should be further strengthened.

(c) Reforms must be initiated to develop disciplines governing the use of both coupled as well as de-coupled support.

The Doha Declaration also endorses these opinions, but the language on domestic support is rather weak, particularly when viewed against the language, which has been used for further reductions in export subsidies. This is clearly evident from the following paragraph:

"Building on the work carried out to date and without prejudging the outcome of the negotiations we commit ourselves to comprehensive negotiations aimed at: substantial improvements in market access; **reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support.**"

Proposals

Keeping in view the overall objective of the agreement, which is to remove distortions in the world trade for agricultural commodities and formulate rules of international trade so that the trade is fair and transparent, the aim of the new provisions on domestic support

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should be to discipline the use of all forms of market distorting support. The existing agreement does bind countries to support their agriculture in accordance with certain defined rules, but it does very little in terms of the actual reduction of support that distorts both production and trade. The current provisions of the agreement have not succeeded in meeting the objective of the agreement because of the serious drawbacks in the provisions of the agreement.

The evidences shown also prove beyond doubt that the provisions of the current agreement on domestic support are very weak and will not be able to discipline the usage of support, which clearly distorts production and hurts efficient producers. Therefore, if the new provisions do not discipline all production distorting support then in the end there may not any significant reduction in domestic subsidies, which will surely undermine the long-term objective of the agreement and the system will not be equitable.

To make the system more equitable, the flexibility granted under the S&D treatment of the AOA for the developing countries in the field domestic support should be continued and strengthened. In the current provisions the domestic support, which has been granted exemption from reduction commitments for the developing countries includes support for investment subsidies usually available to agriculture and input subsidies provided to low-income resource poor farmers. Further strengthening should be in the form of greater flexibility on domestic support measures to be able to address the concerns of the rural population in this sector for the sustenance of their livelihood and employment.[8]

Based on the analysis carried out in the earlier sections of the paper modalities for further reforms in the area of domestic support should ensure the following.

Further Changes

As was evidence shows that the level of domestic support during the base period was very high, which has allowed countries to maintain high levels of domestic support. In the next implementation period, if the final committed levels are to be taken as a reference point for further reductions, the changes in domestic support will not be significant.

[8] A concern that is often voiced against granting more freedom to developing countries to support their agriculture the way they want is that these countries will misuse the provisions to support or protect their agriculture. But the experience during the implementation period does not bear testimony to this fact. The lack of resources in these countries will in any case prevent most of these countries from misusing these provisions to subsidise or protect their agriculture.

Therefore, a lower starting base should be taken as the reference point for carrying out future reductions in export subsidies. There could be three new bases:

(i) 50 per cent of the final agreed limits, which has been proposed by a majority of member countries.

(ii) 87 per cent of the final committed levels assuming that if the developed countries were to carry out further cuts, the new level would be 13 per cent lower by the end of 2004.

(iii) The actual levels of domestic support provided in 2000 in the case of developed countries and 2004 in the case of developing countries.

The remaining balance should be reduced in equal instalments over the remaining years so that by the end of the implementation period (assuming 2010 (developed) and 2014 (developing)) the domestic support should be brought down to the de minimis level.

Further reductions in domestic support should be made commodity specific. Such a framework will bring the current system of shifting support from one product to another to an end.

Ambiguities in various components of the Aggregate Measure of Support (AMS), accounting for inflation and variations in exchange rates should be removed by evolving a system of reporting AMS in Special Drawing Rights equivalents of some stable currency.

The payments under the blue box (Article 6.5) and green box (de-coupled support - paragraphs 5, 6 and 7)), should be clubbed with the amber box and subject to the same disciplines as the amber box measures.

The exemptions granted for the developed countries under the peach clause, which give "legal rights" to those which subsidise without any countervailing actions should not be extended after the expiry of the peace clause (Article 13 of AOA).

As a special and differential measure, the provisions of Article 6.2 should be extended to product specific domestic support. And, these should be exempt from countervailing duties and actions based on Article XVI of GATT 1994 and the agreement on Subsidies and Countervailing Measures (SCM) till the time these countries graduate and their per capita income levels have risen above US$ 1000.