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## ARTICLE

# NATURE CONSERVATION AND TRADE DISTORTION: GREEN BOX AND BLUE BOX FARMING SUBSIDIES IN EUROPE\*

BY JIM DIXON\*\*

### I. THE CHANGING EUROPEAN AGRICULTURAL SECTOR

Agriculture policy has a particularly important role in European politics. European Union (EU) agriculture policy has been considered one of the successes of post war European development with technological progress, farm structural adjustment and increasing yields and production its practical manifestations. Across much of Europe, EU agriculture policy is held up as one of the enduring successes of European integration, economic liberalisation across European nation states, and state support for farming. Europe has undoubtedly made considerable strides since many millions of people starved for want of bread in the post war 1940s. However, this has been at a cost to the environment, agrarian society, tax-payers, consumers, the food industry, farmers and the EU's reputation as a globally efficient trader.<sup>1</sup> In the 1980s and 1990s the EU has

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\* This article was developed as a discussion paper. Anyone interested in more information should contact the author.

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1. See, e.g., D. Baldock, *Agriculture and Habitat Loss Under the CAP (1990)* (WWF CAP Discussion Paper 1, WWF, Brussels); J.B. Dixon, *European Agriculture: Threats and Opportunities*, in *FARMING AND BIRDS IN EUROPE: THE COMMON AGRICULTURAL POLICY AND ITS IMPLICATIONS FOR BIRD CONSERVATION* (D.J. Pain & M.W.

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been forced to re-examine its agriculture policy, addressing its high cost, perceived inefficiencies and distortions to markets.<sup>2</sup>

The EU is now part way through a reform to its agricultural policies—Agenda 2000<sup>3</sup>—brought on by several factors. This is neither the first nor will it be the last reform that will be necessary to address a number of concurrent factors forcing the pace of reform.<sup>4</sup>

Firstly, there is a rural crisis, resulting from reduced farm profitability, declining effectiveness of policy instruments to address falling incomes, reduced consumer and public confidence in conventional farming technologies and systems and conflicts between agriculture and other rural policies. Short term crises in farming, brought on by the collapse in beef prices following alarm over Bovine Spongiform Encephalitis (BSE) in cattle, or by short term price falls, are merely manifestations of longer term trends. Secondly, international trade imperatives are broadly based on trade liberalisation, reducing both protectionist instruments (such as levies and border controls) and farm subsidies. These impact EU policy by challenging traditional EU protectionist policies, such as high levels of border protection, and production subsidies, and favouring direct social, and environmental income aids. Mounting competitive pressures both within and outside the EU are increased with freer trade forcing the adoption of new technologies, such as pesticides and genetically-modified crops. Thirdly, there is a conflict between the high cost, agricultural production-orientated EU agriculture policy and objectives of enlarging the EU, allowing for the accession of former communist countries to the EU.<sup>5</sup>

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Pienkowski eds., 1997); MAFF, EUROPEAN AGRICULTURE: THE CASE FOR REFORM (1999); J. OCKENDEN & M. FRANKLIN, EUROPEAN AGRICULTURAL POLICIES (1994).

2. See, e.g., M. TRACY, FOOD AND AGRICULTURE POLICY IN A MARKET ECONOMY: AN INTRODUCTION TO THEORY, PRACTICE AND POLICY (Agricultural Policy Studies (APS) 1993); MAFF, *supra* note 1.

3. Agenda 2000: For a Stronger and Wider Union, 1997 O.J. (C 388, 22.12) 17 [hereinafter Agenda 2000].

4. See Dixon, *supra* note 1.

5. See EUROPEAN COMMUNITIES COMM., THE IMPLICATIONS FOR AGRICULTURE OF THE EUROPE AGREEMENTS, TENTH REPORT (1994).

Agriculture is a politically complex policy area within the EU, combining as it does arcane rule-making for a single market in agricultural markets with the social objectives of retaining rural communities, cultural landscapes and national agricultural systems. The “European model” of agriculture—a concept much favoured by EU farming organisations<sup>6</sup> and the EU institutions<sup>7</sup>—has been proposed to describe this multi-functional policy. EU agriculture can be characterised as polarised between, on the one hand, cultural landscapes where farming is extensive in its use of land and artificial inputs and production is often on a sub-optimal scales and undertaken on “family” farms. The small-scale nature of production, ancient patterns of settlement and distinctive and specific origins of production (typified by the *Appellation contrôlée* system of describing French wine production) contribute to the concept of the European model. Conversely, on the other hand, EU farming in places has adopted modern technologies, increased efficiency in production and is often globally-efficient or ambitious to meet global market demands. EU pig and poultry production, cereal growing, and the horticultural industries operate on a large scale, working increasingly close to consumer demands, and they adopt an aggressive approach to global competitiveness.

Many rural communities are distinctively dependent on farming. Also, the very close association between Europe’s environmental assets—soil, water, forests, biodiversity—and farming make a strong case for integrating environmental objectives in farm policy.<sup>8</sup> However, the European model too often assumes that Europe’s farming is static and that market protection (in the form of export subsidies, tariffs and subsidies) will automatically deliver the additional functions of the European model. This article will seek to critique this assump-

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6. See COMITÉ DES ORGANISATIONS PROFESSIONELLES AGRICOLES DE L’UE, *THE EUROPEAN MODEL OF AGRICULTURE: THE WAY AHEAD* (1998).

7. See *Agenda 2000*, *supra* note 3.

8. See *FARMING AND BIRDS IN EUROPE: THE COMMON AGRICULTURAL POLICY AND ITS IMPLICATIONS FOR BIRD CONSERVATION* (D.J. Pain & M.W. Pienkowski eds., 1997) [hereinafter *FARMING AND BIRDS*]; G. BEAUFOY ET AL., *JOINT NATURE CONSERVATION COMMITTEE/WWF/INSTITUTE FOR EUROPEAN ENVIRONMENTAL POLICY, THE NATURE OF FARMING* (1994).

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tion. It is argued that the European Model is justifiable as a descriptor of part of the EU countryside but that existing policy instruments are mis-matched to delivering these objectives. Instead, subsidies are used to ensure EU farmers have a place in global food markets. These neither work in the interests of ensuring the continuation of the European model, nor are they sustainable within international trade discussions.

The context of this discussion will be past and future trade negotiations and the extent to which forms of agricultural protectionism—or conversely the process of liberalising trade—can secure the so-called European model of agriculture. It will be argued that substantial reform of EU agriculture is necessary for many objectives and that one route chosen for this reform can also address trade policy objectives, namely shifting agricultural support towards more direct support for the other products of rural areas that policies have so far failed to reward. To what extent will this be acceptable to trading partners? To what extent will a model of policy adopted by the EU be legal in the World Trade Organization (WTO)? What are the hidden dangers of using agriculture subsidies to achieve social and environmental objectives? Can international trade legislation provide guidance or rules for doing this that are globally appropriate? These are the policy and legal questions this article will address

## II. AGRICULTURE AND ENVIRONMENT POLICY IN THE EUROPEAN UNION

### A. THE LEGAL BASIS OF EU AGRICULTURE AND ENVIRONMENTAL POLICY

The framework for inter-governmental decision making in the European Union is based on a hierarchy of legislation consisting of Treaties (which are the legal foundation of all EU activity), Regulations, Directives and Decisions. The basic

aims of the Common Agricultural Policy (CAP) are set out in the 1958 Treaty of Rome<sup>9</sup> (the founding Treaty) Article 39 as:

- to increase agricultural productivity through the rational development of agriculture towards the optimum utilisation of the factors of production;
- to ensure a fair standard of living for agricultural producers;
- to stabilise agricultural markets;
- to guarantee regular supplies of food to consumers;
- to ensure reasonable prices of food to consumers.<sup>10</sup>

Article 40<sup>11</sup> sets out the powers of setting up common organisation of markets and Article 43<sup>12</sup> provides the basis of decision-making. Subsequent inter-governmental conferences have concluded with amendments to basic EU treaties. The Single European Act<sup>13</sup> created a single market in agricultural products, inputs etc. and brought some harmonisation to environment, health and consumer legislation. Article 130(R)(2) required that the environment be integrated into all other policies.<sup>14</sup> The Maastricht Treaty<sup>15</sup> only marginally affected agriculture, but established the legal basis behind the revised Structural and Cohesion funds for economic development. The Amsterdam Treaty<sup>16</sup> further strengthened the legal basis for integration of environmental objectives into economic sectors.

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9. The Treaty Establishing the European Community, March 25, 1957, 298 U.N.T.S. 11.

10. *Id.* at 30, art. 39.

11. *Id.* at 31, art. 40.

12. *Id.* at 32, art. 43.

13. The Single European Act, June 29, 1987, 1987 O.J. (L 169/1) reprinted in 25 I.L.M. 503.

14. *Id.*

15. The Maastricht Treaty, February 7, 1992, 1992 O.J. (C 224/1) reprinted in 31 I.L.M. 247.

16. The Amsterdam Treaty, October 12, 1997, 33 I.L.M. 56.

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European environmental policy is not strictly based in the EU treaties but is, instead, developed within a series of Environment Action Programmes, of which the fifth is the current programme and which is discussed below.<sup>17</sup>

The three types of EU legislation are Regulations, Directives and Decisions prepared, approved and implemented by the three principal EU institutions: the Commission; Council of Ministers; and European Parliament. Regulations are binding on all citizens and override national legislation. They are approved by the Council of Ministers on a recommendation of the Commission after an opinion is passed by the European Parliament. For most EU legislation, the EU Parliament must assent to legislation before the Council can approve the legislation, however this does not generally apply to most measures funded under the CAP. Most CAP legislation is in the form of Regulations. Directives are a framework within which Member States are required to amend or introduce national legislation so as to implement the objectives of the Directive. Directives are also approved by the Council of Ministers on a recommendation of the Commission after an opinion is passed by the European Parliament. Decisions by the Council or Commission are specific to individuals or bodies. The European Court of Justice (ECJ) exercises judicial scrutiny over the whole EU and ensures legislation is applied fairly.

The most important specific pieces of legislation and programmes derived from the Treaties will be discussed below.

### B. OVERVIEW OF THE COMMON AGRICULTURAL POLICY

The CAP consists of several mechanisms, principal amongst these are the Common Market Organisations (CMOs).<sup>18</sup> Other important mechanisms are “green money” (environmental incentives paid to farmers) and structural measures.

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17. See *Towards Sustainability: The Fifth Action Programme on the Environment*, 1994 O.J. (C 138, 7.2) 13 [hereinafter *Towards Sustainability*].

18. See N. Robson, *Evolution of the Common Agricultural Policy*, in *FARMING AND BIRDS*, *supra* note 8.

### 1. *Common Market Organisations*

CMOs exist for cereals, oilseeds, olive oil, sugar, wine, fruit and vegetables, tobacco, cotton, dairy, beef and veal, sheepmeat, poultry and eggs, and pigmeat. The basic model is one in which the real world market price for products is enhanced within the EU to a target price through the implementation of levies on imports, subsidies on exports, supply controls on production and direct payments to EU producers. The 1992 CAP reform shifted the emphasis towards supply controls (e.g. set aside for cereals) and direct payments and away from higher market prices. Proposals to extend these reforms are discussed below as part of the Agenda 2000 measures. Until the introduction of the single currency, the euro, on January 1st 1999, the EU member states operated separate currencies in each member state. Indeed, only 11 of the 15 member states have aligned their currencies and four countries are yet to join the single currency. To ensure that the Single Market in agricultural products operates effectively, the EU operates a complex set of compensatory payments and exchange rates, known as the agri-monetary system.

### 2. *Structural measures*

These were initially introduced to accompany the CAP CMOs and have been designed to achieve structural change in agriculture to facilitate economic objectives and, more latterly, social and environmental objectives. Measures have included regional development measures (now incorporated in the EU Structural and Cohesion Funds), support to young farmers and for the re-parcelling of land, capital and development aids, support to afforestation and payment to reward environmental services by farmers. The latest EU proposed regulation, the proposed Rural Development Regulation,<sup>19</sup> incorporates structural measures in one over-arching regulation. This is discussed below.

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19. Rural Development Regulation, 1998 O.J. (C 150) 14.



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C. OVERVIEW OF ENVIRONMENTAL POLICY IN THE EU  
AGRICULTURE SECTOR

The direct taxpayer cost of the CAP to Europe's taxpayers is euro 40,000m.<sup>20</sup> With the effects of higher food prices the average cost to Europe's citizens is 277 euros per year, a figure which makes the public increasingly question what it receives in return. Fewer, larger farms produce most of EU food production, 25% accounting for 75% domestic production.<sup>21</sup> In the UK fewer than 9, 000 growers account for 60% of cereals and 10,000 dairy farmers account for 60% production and yet the UK has nearly 200,000 registered farmers.<sup>22</sup> Yields have rocketed since the 1940s and the EU Commission predicted in 1996 that cereal and dairy yields will increase by 20% before 2005.<sup>23</sup> Markets and technology demand higher specifications, higher yields and the CAP fuels this process.

The public are right to show growing alarm at an industry changing at a pace which is difficult to grasp. Consumers demand fresh, unpolluted and healthy food and they want food produced in ways which minimise environmental harm, where farming acts to build a more coherent rural society and where animals are treated well

Data and trends in relation to biodiversity, particularly birds, in Europe are well known. Drawing on two major publications supported by or published by BirdLife International over the last 5 years, namely *Birds in Europe*<sup>24</sup> and *Farming and Birds in Europe*<sup>25</sup> it is possible to describe a continent-wide picture of habitat loss, species decline and persecution. The decline of farmland birds is one of many adverse environmental effects resulting from intensification of food production under the CAP. It reflects a decline in biodiversity in general, which has been accompanied by other adverse impacts including pol-

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20. From 1st January 1999 1 euro = c. 1 US Dollar = c. £0.7

21. See MAFF, AGRICULTURE IN THE UK 1996 (MAFF, 1996).

22. *Id.*

23. See COMMISSION OF THE EUROPEAN UNION, STATE OF MARKETS REPORT (1998).

24. See G.M. TUCKER & M.F. HEATH, BIRDS IN EUROPE: THEIR CONSERVATION STATUS (BirdLife International, 1994).

25. See FARMING AND BIRDS, *supra* note 8.

lution, landscape changes and increased use of non-renewable resources.<sup>26</sup> The current BSE crisis provides further evidence of the unsustainable nature of some of the agricultural practices that have developed under the CAP.

Some steps have already been taken to “green” the CAP and introduce environmental policies, although such policies are frequently under-funded and poorly administered.<sup>27</sup> They are too often “bolted-on” to the existing CAP. It has frequently been argued that a major step forward in reform of the CAP would be revision of its original objectives to include the environment, but little progress has been made to date on this issue. The objectives of the CAP are therefore still those as set out at Article 39 in the original Treaty of Rome signed in 1957.<sup>28</sup>

A number of Directives have also been agreed which have environmental objectives and set timetables for their achievement. These Directives include legislation to protect species and habitats, protect groundwaters, control over use of pesticides, and provide for environmental impact assessments. These are summarised in Box 1.

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26. See D. BALDOCK ET AL., GROWING GREENER: SUSTAINABLE AGRICULTURE IN THE UK (1996).

27. See BIRDLIFE INTERNATIONAL, NATURE CONSERVATION BENEFITS OF PLANS UNDER THE AGRI-ENVIRONMENT REGULATION (EEC 2078/92) (1996) (available through RSPB) [hereinafter BIRDLIFE INTERNATIONAL I].

28. Treaty Establishing the European Community, *supra* note 9, at 30, art. 39 (and accompanying text).

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*Box 1: European Union Environmental Legislation Which Impacts on Agriculture*

91/676/EEC concerning the protection of waters against pollution caused by nitrates from agricultural sources (Nitrates Directive). This includes regulations on how to handle manure and fertilisers in zones which are vulnerable to leaching of nitrate,<sup>29</sup>

91/414/EEC concerning the placing of plant protection products on the market. This plays a major role in the authorisation of plant protection products and use in the Community,<sup>30</sup>

92/43/EEC on the conservation of natural habitats and of wild flora and fauna (Habitats Directive). This contributes '*towards ensuring biodiversity through the conservation of natural habitats and of wild flora and fauna of Community interest*';<sup>31</sup>

79/409/EEC on the Conservation of Wild Birds. The Directive requires Member States to take appropriate special protection measures to maintain populations of all species of wild birds that occur naturally within their territories, including establishment of Special Protection Areas (SPAs);<sup>32</sup>

85/337/EEC requiring environmental impact assessments of certain public and private projects. The annexe to the Directive lists the projects for which an impact assessment is compulsory;<sup>33</sup>

Community guidelines on state aid for environmental protection (EEC 94/C72/03). Guidelines for state aid for environmental protection are provided on investment aid, horizontal support measures and operating aid. In the agricultural sector, the guidelines do not apply to the field covered by Council Regulation 2078/92 concerning the agri-environment measures.<sup>34</sup>

Objectives for agri-environment policy include promoting systems such as organic (sometimes known as biological or bio-dynamic) farming, low input (sometimes known as precision or integrated) farming, traditional low intensity pastoral farming systems and programmes for integrating conservation objectives alongside "conventional" farming. Attempts have been

29. Council Directive 91/676, 1991 O.J. (L 375, 31.12).

30. Council Directive 91/414, 1991 O.J. (L 230, 19.8).

31. Council Directive 92/43, 1992 O.J. (L 206, 22.7) 77.

32. Council Directive 79/409, 1979 O.J. (L 103, 25.4).

33. Council Directive 85/337, 1985 O.J. (L 175, 5.7).

34. Council Regulation 2078/92, 1992 O.J. (L 215, 30.7) 85.

made to use national and EU policy to support these objectives. These have included general or specific environmental policy through legislation applicable to all farmers, landowners and (in the case of EU wide legislation) member states, such as relating to pollution or protection of wildlife. This regulatory approach has often been backed up with advisory, training and other "extension" services which have often been provided by the state free to farmers. Since the mid 1980s, a growing element in policy has been the development of incentive schemes which provide cash payments in return for specific works done or constraints on farming activities. In 1992, a number of programmes were combined in the EU "Agri-environment" Regulation (EEC 2078/92)<sup>35</sup> and other means of achieving environmental objectives such as environmental conditions, eco-taxes, support to rural development, etc.

Towards Sustainability, the EU's Fifth Environmental Programme (March 1992) also provided "a framework for a new approach to the environment and to economic and social activity."<sup>36</sup> This was closely followed by the United Nations Conference on Environment and Development (UNCED) in Rio de Janeiro in June 1992, where the EU signed the Biodiversity Convention.<sup>37</sup> This forms the basis of the EU Biodiversity Strategy, and agrees to "integrate the conservation and sustainable use of biodiversity into relevant sectoral and cross sectoral plans, programmes and policies." However, the implementation of the Fifth Environmental Action Programme has been widely criticised, and many sectoral policies (including agriculture) are still far from achieving the objectives set in the Action Plan. Furthermore, the directives listed above have often been inadequately implemented by Member States. Therefore, although the introduction of these environmental policies is progress in the right direction, analysis suggests that many sectoral policies of the CAP still have little regard to the envi-

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35. *Id.*

36. Towards Sustainability, *supra* note 17.

37. Biodiversity Convention, *opened for signature* June 5, 1992, U.N. Doc. UNEP/Bio. Civ./Conf/L2 (1992) *reprinted in* 30 I.L.M. 818.

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ronment and fail to incorporate even the most basic requirements of environmental protection.<sup>38</sup>

Further reforms are urgently needed to integrate environmental objectives into all agricultural policies. This is required under Article 3d of the Treaty of Amsterdam, which states that environmental protection must be integrated into the definition and implementation of all EU policy areas, including agriculture, in order to promote sustainable development.<sup>39</sup> At the Vienna Council in December 1998, Heads of Government stated clearly that the practical manifestation of the integration principal meant specific commitments within agricultural (and structural) policies:

The European Council reaffirms its commitment made in Luxembourg and Cardiff to integrate environment and sustainable development into all Community policies in view of the Amsterdam Treaty.... The European Council recognises that it will be important to ensure that environmental integration is adequately treated in the decisions to be made on agricultural and structural policies within the context of Agenda 2000.<sup>40</sup>

This section will conclude by explaining the likely trajectory of agri-environment policy in future, considering to what extent these policies will impose extra burdens, costs or advantages on EU farmers trading in international markets. Strict environmental policies can disadvantage producers, but also secure markets.

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38. See F.M. BROUWER & S. VAN BERKUM, CAP AND ENVIRONMENT IN THE EUROPEAN UNION: ANALYSIS OF THE EFFECTS OF CAP ON THE ENVIRONMENT AND AN ASSESSMENT OF EXISTING ENVIRONMENTAL CONDITIONS IN POLICY (1996).

39. The Amsterdam Treaty, *supra* note 16.

40. COUNCIL OF THE EUROPEAN UNION, CONCLUSIONS OF THE VIENNA COUNCIL (1998).

### III. SUBSIDIES AND INTERNATIONAL TRADE: GATT, AGENDA 2000 AND BLAIR HOUSE

#### A. AGRICULTURE IN TRADE POLICY

Although largely absent from global trade discussions until recently, trade in agriculture products has been one of the more controversial issues during the most recent Uruguay Round GATT (General Agreement on Tarriffs and Trade) discussions and is likely to prove an issue in the forthcoming WTO led discussions. Agriculture was excluded from early trade negotiations because the main trading economies, Japan, Europe and the US, required special treatment for agriculture. This stemmed in each case from recent experience of serious food shortages (in post-war Europe and Japan) and instability and social vulnerability in the farm sector. It was argued that farming needed "special treatment" and demands of rural life and food security meant that farming should not be subject to free trade. This was challenged in the 1980s, particularly as the farm sector had largely recovered in the developed economies, indeed to the point that there were serious conflicts between trading countries in some sectors (especially oilseeds and grains). Agriculture was thus included in the Uruguay Round of the GATT for the first time, eventually leading to a hard-fought Agreement on Agriculture. This is discussed in detail below.

Payment of subsidies for production and export by governments in order to promote production and to protect farmers from instability of markets has been a widespread policy, especially in the developed OECD (Organization for Economic and Development) countries.<sup>41</sup> However, this has been increasingly challenged by a free trade ethic widespread in major developed governments, inter-governmental agreements and multinational businesses, and supported by some political and producer interests. Trade distortions in agriculture, as a direct effect of subsidies, have proven to be highly detrimental for the environment and so environmentalists have supported the

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41. See TRACY, *supra* note 2.

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challenge to protectionist policies.<sup>42</sup> In Europe, the CAP has been widely criticised for stimulating surplus production and rewarding intensive agriculture at the expense of extensive or sustainable agriculture.

Production subsidies relating to the quantity of agricultural output (product specific) and tax allowances for fertilisers and pesticides or grants for irrigation or drainage (non-product specific), have been justified by the need for food self-sufficiency and protecting the farm sector. In protecting their markets and subsidising export of surpluses and imposing levies on imports, developed countries have created unfair competition. There is now an increased recognition that subsidies for production (so-called “amber” box subsidies<sup>43</sup>) should be reduced and be replaced by policies supporting environmentally friendly farming and development of the economy in rural areas wider than agriculture (so-called “green-box” subsidies). This should result in a direct benefit to consumers as prices will be lower all across the world.

The issues of subsidies is one of the most complex issues in international trade. Several questions arise from subsidies, such as whether an absence of (or failure to enforce) environmental rules constitutes an “unfair” subsidy.<sup>44</sup> This can be complex to consider where different environmental situations or public concerns require different environmental policies. Also, if subsidies are paid for environmental clean-up or investment, could this be unfair or could a consequent levy on imports from that country (a countervailing measure) be acceptable? In order to consider the specific case of agriculture, this article goes on to consider in detail the Uruguay Agreement on Agriculture.

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42. See Baldock, *supra* note 1; J.P. TAYLOR & J.B. DIXON, AGRICULTURE AND THE ENVIRONMENT: TOWARDS INTEGRATION (RSPB 1990); BIRDLIFE INTERNATIONAL, A FUTURE FOR RURAL EUROPE: REFORM OF THE COMMON AGRICULTURAL POLICY (1997) (available through RSPB) [hereinafter BIRDLIFE INTERNATIONAL II].

43. In concluding the Uruguay Round, agricultural subsidies were divided into “amber” and trade distorting and subject to reductions under the Agreement on Agriculture (AoA); “green” and non-trade-distorting, and so not subject to reductions; and “blue” which were trade-distorting but exempted from reductions under the agreement.

44. *Id.*

## B. AGRICULTURAL SUBSIDIES IN THE GATT URUGUAY ROUND

The GATT Uruguay Round Agreement on Agriculture was essentially an agreement between the EU and the US, despite its formal inclusion in the final Marrakesh agreement of 118 countries.<sup>45</sup> Issues covered in the agreement were improved market access by controls on levies, tariffs and conversion of “non-tariff” barriers into quantitative tariffs. Agreements were also reached on support measures (especially subsidies) and the rules for future negotiations (essentially a “peace clause” with a requirement to begin a renegotiation in 1999). The requirement to re-negotiate also imposes a duty on parties to include an examination of “non-trade” issues such as the environment and food security. The WTO established a new Committee on Agriculture and has recently begun an analysis and information exchange process to determine the approach to future agreements. The Uruguay Round Agreement on Agriculture (AoA) incorporated agricultural trade in a multilateral framework for the first time. The main parts of the agreement are discussed here.

Central to the AoA is increased preferential access for imports and reduction in import tariffs: the agreement requires conversion of non-tariff barriers to trade (such as import bans and voluntary restraint) into tariffs. These, and all existing tariffs, are then subject to a 36% reduction from 1986-88 base year over 6 years subject to basic reduction per commodity of 15%. The EU agreed to 20% as a minimum. In parallel, direct subsidies were to be reduced by 20% of the “Aggregate Measure of Support,” an index combining a wide range of subsidy types, from 1986-88 levels over 6 years. This category includes all production subsidies (amber box) but excludes direct payments to farmers (compensation or Arable Area Aids) which are linked to limits to production (blue box) and non-trade-distorting LFA and environmental payments (green box). The blue box - agreed under the Blair House Agreement by the EU

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45. Agreement on Agriculture, Marrakesh Agreement Establishing the World Trade Organization, April 15, 1994, Annex 1A, available in LEXIS, Int'l Law Library, GATT File.



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and US - in effect excludes some 16,000m ECU or 40% of the EU Common Agricultural Policy spending from UR reductions because, in the case of cereal payments, they are linked to set aside. The third element of the agreement relates to reductions in the volume of subsidised exports by 21% and value of export subsidies by 36% between 1993 and 1999.

The AoA was a key factor driving the MacSharry EU CAP reforms of 1992, discussed below.<sup>46</sup> By cutting price support, increasing direct payments and introducing arable set-aside, the reforms introduced the mechanisms to equip the EU to meet its GATT commitments. To allow the EU to meet future world trade commitments, the reformed CAP of 1992 cut support prices further to bring them equal or close to world market prices in order to allow exports to take place without subsidy. Furthermore, in the future, the EU will face pressure from its trading partners to reform existing direct subsidies, such as arable area payments and headage livestock payments, which are at present not de-coupled from production.

### C. REFORM OF THE CAP

The last reform of the CAP, introduced in 1992, by then Agriculture Commissioner Ray MacSharry,<sup>47</sup> was a step in the right direction and went some way towards addressing the problems of subsidies in agriculture.<sup>48</sup> For example it introduced cuts in support prices and introduction of livestock quotas and arable set-aside which helped to reduce surplus production and meet GATT commitments. Livestock quotas imposed a limit on the environmental damage and budgetary costs caused by increases in livestock numbers. In arable, cuts in prices were compensated for by direct arable area aids, a necessary, but expensive way of winning agriculture Ministers and farmers over to price cuts. However, arable aids are now a

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46. See, Robson, *supra* note 18.

47. The Development and Future of the Common Agricultural Policy, COM(91)100; Proposals Based on the Development and Future of the Common Agricultural Policy, COM(91)258.

48. See M.D. RAYMENT, A REVIEW OF THE 1992 CAP REFORMS (RSPB 1995); Agenda 2000, *supra* note 3.

significant element of CAP spending and farm incomes, so their future will be a large part of future trade negotiations.

The EU also introduced a number of “accompanying” measures for forestry, early retirement of farmers and protection of the environment, especially with a regulation by which the CAP’s environmental problems could be addressed and less intensive farming systems sustained and reintroduced. This is discussed in more detail below. At the same time, the Structural Funds have addressed some of the problems faced by Europe’s rural economies. The 1992 Structural Fund Regulations provided for a new six year programme to last between 1994 and 1999, accounting for one third of the EU budget. The Regulations amended the list of areas eligible for funding under Objective 1 (less developed regions) and Objective 5b (rural areas). Objective 5b areas now cover 8.2% of the EU’s population and 26.6% of its territory.<sup>49</sup>

However, a number of serious problems remained. The EU Commission and Council initially hailed the 1992 reforms as a success, but in the last 4 years it has become increasingly evident that prices for most commodities are still held above world levels and are likely to be unacceptable in future trade talks. As a consequence of shifting from a policy where both the taxpayer and consumer pay to one where the taxpayer shouldered more of the burden, the reforms increased the budget of the CAP (by 40% between 1990 and 1996). Extending the new “high-cost” CAP to the countries queuing up to join the EU (such as Hungary and Poland) would be prohibitively expensive. Moreover, the effectiveness of the “accompanying” environmental and rural development policies (especially the agri-environment regulation) has been limited by competition from high levels of existing subsidies.<sup>50</sup> In short, the reforms did little to reverse the environmental damage caused by intensive arable and livestock farming, with environmental measures dealt with through bolt on measures rather than as an integral

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49. See EUROPEAN COMM., THE AGRICULTURAL SITUATION IN THE COMMUNITY (1994).

50. See BIRDLIFE INTERNATIONAL I, *supra* note 27.

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part of agricultural policy.<sup>51</sup> There is an overall problem of a lack of integration between agricultural, environmental, forestry, water management and rural development policies which represents a constraint to meeting rural policy objectives.

No real effort was made in the 1992 reforms to make the CMOs for cereals, livestock, dairy or other crops, more environmentally-friendly. The root of the CAP problem was not addressed, nor was the wider rural perspective properly considered. This was recognised by the new Commissioner for Agriculture and Rural Development, Franz Fischler, when he took up office in January 1995 and his attempts to address these fall within the overall EU budget proposals for the EU for 2000-2006, known as Agenda 2000.<sup>52</sup>

D. AGENDA 2000

The Commission estimates that even before enlargement of the EU and under current Uruguay Round world trade agreements, the steady growth of yields and output and limited growth of consumption of EU agriculture will require reforms additional to the 1992 reforms.<sup>53</sup> Further reforms will be necessary if the forthcoming enlargement and WTO negotiations require so. Final regulations were agreed by the EU Commission on March 18, 1998 and published for discussion shortly afterwards.<sup>54</sup> Agreement is expected in February 1999.

The proposals reduce price support for cereals towards world market prices, increase and simplify arable area payments, and (effectively) abolish set-aside except on a voluntary basis. As with cereals, beef prices are to be cut towards world market levels. Direct payments are increased to fully compensate farmers for this price cut. Member states will have some

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51. See RAYMENT, *supra* note 48.

52. See Agenda 2000, *supra* note 3.

53. See *id.*

54. See, e.g., Proposal for a Council Regulation on Support for Rural Development from the European Agriculture and Guarantee Fund, 1998 O.J. (C 170) 67; Proposal for a Council Regulation Laying Down General Provisions on the Structural Funds, 1998 O.J. (C 179) 1; Proposal for a Council Regulation Establishing a Support System for Producers of Certain Arable Crops, 1998 O.J. (C 170) 4.

flexibility in how they allocate some of these extra compensation payments. The dairy proposals aim to cut dairy prices and introduce a new headage compensation payment for dairy cows. As with beef, Member States will have some flexibility in allocating compensation payments.

As an attempt to integrate environmental and social considerations into the direct payments, which will be extended, Member States are required to “take the environmental measures they consider to be appropriate in view of the specific situation of the agricultural land used and the production concerned. Measures may include support in return for agri-environment undertakings, general mandatory environmental requirements and specific environmental requirements.” Member States are allowed to define the sanctions for non-compliance, which may include reduction or withdrawal of support. Subsidies can also be paid in ways that favour smaller farmers and support rural employment.

The Commission also proposes a single Regulation on Community Support for Rural Development to replace the existing regulations covering the CAP elements of the Structural Funds, Objective 5a, the three accompanying measures regulations (including the agri-environment Regulation 2078) and the regulation on structural forestry support. This proposed regulation will provide support for investment in farm holdings, young farmers, training, early retirement, LFAs, agri-environment schemes, processing/marketing activities, forestry and “promoting the adaptation and development of rural areas.” The latter includes a range of measures including land improvement, development and renovation of buildings, diversification, water resource management, rural infrastructure, tourism, crafts, environmental protection, etc.—and will be available to wider rural communities as well as farmers. LFA support will gradually be transformed into an instrument to maintain and promote low input farming systems. LFA payments will be made on an area rather than a headage basis and may be subject to environmental conditions.

The Agenda 2000 reforms would help address many problems within the CAP and could potentially improve the com-

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patibility between EU policy and the demands of trading partners. However, the EU will have difficulties balancing demands for further reductions in direct and indirect subsidies (including price supports, direct payments, supply controls, subsidised exports and import controls) with demands from farmers and some Ministers of Agriculture to retain the status quo. A more complete shift away from production supports to "green box" supports, favouring the development of agri-environment and rural development schemes in place of production subsidies, would be popular with environment, rural development and consumer groups and is supported by the UK and Swedish Governments. However, most farmers and countries such as Germany and Austria favour retaining price support and attaching environment and rural development policies to these separately. The Commission is caught in the middle, trying to defend its existing policy mechanisms against a critical public and trading partners.

Critics say that partially de-coupled direct area-based subsidies to arable farmers (who receive 40% of the CAP budgets in direct payments) and livestock producers (especially in LFAs) directly support and stimulate production.<sup>55</sup> This will dominate future discussions in WTO negotiations on agriculture.

Payments to farmers for provision of environmental services offer the advantage that they are less trade distorting and more de-coupled from production than production-related subsidies. Providing that it can be demonstrated that they are designed with genuine environmental objectives in mind, environmental payments are more likely to be acceptable in trade liberalisation negotiations than most existing subsidies.<sup>56</sup> In the longer term, it is likely that sustainable development issues will increase in prominence in trade discussions.

Thus, one of the most complex areas for the future is the extent to which existing classification of subsidies will be legiti-

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55. See BIRDLIFE INTERNATIONAL II, *supra* note 42.

56. This was the topic of a seminar hosted by the Organisation for Economic Co-operation and Development, in Helsinki, November 1996.

mate. Can we continue to divide agriculture subsidies into amber box (deemed “trade-distorting” and subject to reductions under the Uruguay Round Agreement on Agriculture), green box (deemed not trade-distorting and therefore not subject to reductions) and blue box (trade-distorting but deemed acceptable under the Blair House agreement)? Central to this debate will be the extent to which EU environmental subsidies will be compatible with further liberalisation. To what extent are these subsidies formally linked to legitimate national environmental legislation and objectives, and will the “exceptions” to illegal trade restrictions listed in article XX of the GATT allow them to survive if they are? This is particularly difficult, because the subsidies usually relate to the nature of production systems as much as to the products traded, a traditionally difficult area in trade policy.

#### IV. REFORMING THE CAP: AMBER, BLUE AND GREEN BOX SUBSIDIES

##### A. OVERVIEW OF CAP REFORMS

The next round of world trade talks, due to begin in 1999/2000, will bring further pressure for trade liberalisation and require further reductions in export subsidies and import levies. The US has prepared itself for these negotiations through its 1996 Federal Agricultural Improvement and Reform Act (FAIR),<sup>57</sup> which fully de-couples agricultural support from production and abolishes supply controls. The EU is likely to come under increasing pressure to do the same, and there is a strong need to work on proposals for CAP reform now, to avoid a position in which the EU is ill-prepared and exposed when negotiations begin. Furthermore, liberalisation of agricultural trade presents farmers with the opportunity to benefit from rising world food demand by exporting to international markets, freed from the restrictions of supply controls.

In the EU, there is much confusion about the objectives of support to farmers. Broadly, 66% of the current CAP budget of

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57. 7 U.S.C. § 7236 (1996).

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40,000m ECU is paid to cereal growers, 30% to livestock farmers and less than 3% under specific agri-environment measures.<sup>58</sup> Under the proposed Rural Development Regulation (RDR)<sup>59</sup> (which incorporates support to LFAs, young farmers, environmental management and rural development), 14% of the CAP will be spent on these elements.<sup>60</sup> However, it is clear that overall the policy instruments of the CAP vary from highly coupled to production to highly de-coupled to production in a spectrum of instruments. For example, the RDR generally incorporates more de-coupled payments than the CMOs, but there are highly production-linked payments in the RDR (e.g. LFA livestock subsidies). Support for extensive, low input farming and sustainable farming practices (e.g. organic) need to be exempted from reductions and genuinely environmental subsidies must be protected.

The Blair House agreement, struck between the U.S. and EU in 1992 in order that the Uruguay Round could be completed, essentially identified the two sorts of payments, categorising each element of EU and U.S. subsidies into amber (subject to reductions) and green (exempt from reductions). The most difficult element for the EU was to defend its now substantial area-based compensations for price cuts. The EU argued that these were both de-coupled from production and that they were linked to supply controls because producers were required in return to set aside a proportion of their cultivated land. In the eventual agreement a special category, blue box, was established whereby the U.S. recognised that whilst these were trade-distorting, the EU had indeed made considerable efforts to de-couple them. Demanding a further reduction in the immediate future would be politically risky for the EU. These subsidies were, effectively, put to one side, but on the clear understanding that they would be subject to negotiation in future trade talks and so were neither amber nor green box.

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58. UK CAP Alliance, THE CAP FACT PACK (1998).

59. Rural Development Regulation, 1998 O.J. (C 150) 14.

60. See Agenda 2000, *supra* note 3.

**B. DISTINGUISHING AMBER BOX, GREEN BOX AND BLUE BOX SUBSIDIES**

Broadly, there is a spectrum of payment types that vary from highly de-coupled to production (coupled to other objectives) through to closely coupled to production. It is assumed that the more coupled to production a subsidy is the more trade distorting it is. However, as will be shown, this is not always the case and a clear framework is needed to legitimise trade-distorting but environmentally-important subsidies. From most coupled to least coupled, payments can be characterised as:

- production-related, permanent, targeted to products actively involved in trade (e.g. export subsidies, yield-related payments, market support);
- production-related payments that are temporary, degressive so that they decline over time or that fall within ceilings of internationally agreed ceilings for domestic support;
- production-related payments linked to production controls (such as set aside for cereal or stocking limits for livestock);
- area-based payments not related to current, or preferably, historical yield;
- area-based payments related to social need (i.e. paid only to certain categories of needy farmers), structural adjustment or for specific environmental objectives;
- personal or family-based income aid;
- support to rural businesses not related to farm production (e.g. for agri-tourism); or
- general economic support to rural areas for economic development outside of the farm sector.



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Clearly, some of the more de-coupled payments will lead to benefits to farm businesses conferring competitive advantage, but the further these payments are from production-linked payments the less likely this will be to distort trade, and the more likely that other legitimate social and environmental objectives will be met. Within the context of future trade negotiations, it may be possible to score payment schemes for their degree of de-coupling, and, indeed, possibly exclude certain highly de-coupled payments from debate on agriculture altogether. However, for some social and especially environmental objectives, it is envisaged that the EU will make substantial transfers to farmers and so a clear framework is necessary to ensure that only legitimate payments are made. Conceptually, we should consider these payments for environmental services that use farming methods, rather than, as currently, compensation to farmers for environmental constraints.

In a review of EU agri-environment measures, BirdLife International has identified criteria for assessing the effectiveness of agri-environment programmes based on questions that should be asked of payment programmes.<sup>61</sup> These criteria, suitably adapted, could be used as a framework for distinguishing between amber and green box subsidies.

1. Are the payments part of a clearly-defined environment programme within an overall rural policy?
2. Are the objectives of the programme clearly stated and do these clearly link to national and international environmental strategies (such as Biodiversity strategies)?
3. Has an evaluation been done to examine whether more efficient policy instruments (advice, regulation, taxation) could be applied to the environmental objective?

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61. See BIRDLIFE INTERNATIONAL I, *supra* note 26. This project was partly funded by the European Commission (DGXI).

4. Does the programme have clear performance targets that relate to the clearly stated objectives of the programme and are these translated into measurable objectives?
5. Are objectives monitored and the programmes evaluated? Are the results published?
6. Do programme staff have sufficient expertise? Are they recruited, trained and supported to ensure they have ecological expertise?
7. Is it clear to the participants of the schemes that the objectives relate primarily to environmental goals and that farm income, employment and socio-economic objectives are secondary?
8. Are environmental authorities, NGOs and experts involved in establishing programme objectives, targets and priorities and also in scheme review and evaluation?
9. Are the programmes subject to parliamentary and other public interest and efficiency reviews?
10. Is there local community input into programme design and management ensuring full public interest participation?<sup>62</sup>

The EU has embarked on one type of regulation which could be a model for future support to rural areas, the agri-environment regulation.

#### C. THE EU AGRI-ENVIRONMENT REGULATION: AN OPTION CONSISTENT WITH WTO

The agri-environment regulation 2078/92 provided member states with a substantial new opportunity to introduce schemes that benefit farmland wildlife and the environment. This has

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62. *See id.*

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resulted in the implementation of a wide variety of schemes across Europe, covering a range of different farmed habitats. This variation has reflected the freedom given to Member States (through the subsidiarity principle) to determine conservation priorities and to develop agri-environment programmes accordingly.

BirdLife International has recently completed a review of the impact of the regulation on nature conservation in Europe.<sup>63</sup> This project defined priority bird species and their associated agricultural habitats across the EU and analysed the extent to which agri-environment schemes aid the conservation of these species and habitats. In many countries, it is simply too early to determine whether schemes have yet had a positive impact on the environment, although there are sufficient problems in the design and implementation of schemes to suggest that the environmental potential of this regulation is not being maximised. This is not helped by the fact that few countries have introduced rigorous monitoring programmes, or adequate baseline surveys of important species and habitats.

The report makes a series of recommendations about how the design and implementation of agri-environment schemes can be improved in order to enhance their benefits to nature conservation.<sup>64</sup> It places particular emphasis on the role the European Commission (DGXI) must take in being constructively critical of national programmes and giving guidance, based on its experience across Europe, to individual countries. It also calls for a comprehensive review of the regulation coordinated by the Commission and bringing together a wide range of experts and organisations to contribute to the process.

A further significant area of concern is the extent to which agri-environment schemes are forced to compete with other agricultural and rural policies, limiting their effectiveness. For example, many schemes pay farmers to reduce stocking rates in order to limit overgrazing, competing directly with headage

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63. *See id.*

64. *See id.*

livestock subsidies. This means that budgets are used up in trying to undo the damage caused by other subsidies, so that the funds available for positive environmental enhancement work are limited. In many parts of the EU, agri-environment schemes compete with forestry and rural development policies that promote alternative land uses. For example, in Spain and Portugal afforestation payments administered through regulation 2080 are significantly higher than 2078 payments while substantial amounts of funding are available for irrigation schemes. A more coherent and integrated framework is needed in which agri-environment schemes work with, rather than against, other policies in order to provide conservation benefits in the European countryside.

It is apparent that agri-environment schemes not only benefit the environment, but also can have income and employment benefits. By supporting land management in marginal areas they can play an important role in sustaining rural communities. Agri-environment schemes often support traditional, labour intensive land management practices and fund conservation work in managing hedgerows, farm woodlands and other habitats, which can have rural employment benefits. The Commission now plans to incorporate the Agri-environment Regulation into a new, larger and more comprehensive “flanking” policy to the CAP market mechanisms. This follows a long history of agricultural structures regulations within the CAP.<sup>65</sup>

It is the practical outcome of the remains of the “new CAP” that the Commission has been pursuing for some time as central to Agenda 2000.<sup>66</sup> It consolidates existing CAP Accompanying Measures and Structural Funds Rural Development support into one overall “rural development” regulation which will require Member States to submit an overall Rural Development Plan to the Commission, so allowing flexibility and, theoretically, integration.

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65. See Robson, *supra* note 22.

66. See Agenda 2000, *supra* note 3.

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Its strength is, on paper, the integrated approach to each of the countryside sectors and the high prominence given to the environment, but its weakness lies in the continued imbalance between funding for this and the remainder of the CAP. The Regulation also relies very heavily on a model of rural areas where farmers are the central economic activity rather extending to the wider rural economy and other landowners, managers and rural communities. The Regulation is based on the strong assumption that intensifying agriculture is necessary. It covers a wide range of agriculture and rural policy issues and will work in association with the provisions of the future Objective 1 and 2 Structural Funds programmes. It will also provide important support to areas that in the future are not designated 1 or 2 (commonly known as the new Objective zero).

#### V. CONCLUSIONS

Agriculture is a dominant force for change in the European environment. It both dominates the real landscape and also rural policy. In the very populated and historically settled landscapes of Europe, a complex range of farming systems are necessary to protect the social, cultural and environmental heritage of rural Europe. This has been characterised as part of the "European Model" of farming, alongside the more progressive and technological and market-driven production agriculture. In both elements of the European model, sustainability is increasingly required as a benchmark of the success of agriculture. Policies must reflect this and the European Union is now itself recognising the need to go further in policy reform to achieve this. New forms of payments to farmers are required, identifying environmental assets and sustainable practices and paying farmers for these. To date, progress has been limited, partly because of inherent difficulties in developing these policies and partly because of resistance from farmers and others who prefer to stay with the status quo.

The next round of WTO talks begins this year and already countries such as Norway and Switzerland are arguing for support to multi-functional agriculture. The EU is arguing for this in a more muted way. Other parties to the WTO, such as

the developing countries, the food exporting “Cairns Group” and the US, are more sceptical. It is necessary, therefore, for the WTO to accept the principles and develop clear criteria for judging programmes of support to “multifunctional” agriculture. The EU should be judged as partially serious in its attempts to develop legitimate multifunctional programmes, particularly with its experience of agri-environment programmes, and its proposed reforms of rural development programmes. However, its adherence to production-linked area-based “compensations” should be examined with much caution. The EU would be well advised to reconsider its reliance on the “blue box” if it is not to be caught out in the WTO talks with an unacceptably trade-distorting, production-linked policy.