

# **Constraining U.S. and EU Domestic Support in Agriculture: The October 2005 WTO Proposals**

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## **Constraining U.S. and EU Domestic Support in Agriculture:**

### **The October 2005 WTO Proposals**

#### **The October 2005 Domestic Support Proposals**

The 2004 Framework on agriculture in the Doha Round of WTO trade negotiations underpins the negotiations of modalities on domestic support (WTO). In October 2005 the USA, the EU and the G-20 group of developing countries submitted domestic support proposals. We examine how to assess the proposals, project future U.S. and EU support, and estimate the severity of any constraints the proposals would impose on projected future U.S. and EU support.

The following distills the three proposals in terms of TAMS (Total Aggregate Measurement of Support), Overall reduction, de minimis (DM), and blue for the EU and the USA. The U.S. proposal would cut the TAMS commitments by 83 and 60 percent, respectively, for the EU and the USA. The EU proposal would make 70 and 60 percent cuts and the G-20 proposes 80 and 70 percent cuts. The Overall reduction refers to reducing all trade-distorting domestic support, or Overall support for brevity. Overall support comprises all non-green support, i.e., all blue and AMS support, including DM AMSs. The Overall reductions in the U.S. proposal, the EU proposal and the G-20 proposal are, respectively, 75 percent for the EU and 53 percent for the USA, 70 and 60, and 80 and 75. On de minimis the proposals are vague on what is to be reduced, so it is assumed that the DM percentage of 5 percent, from Art. 6.4 of the Agreement on Agriculture, is to be reduced. Cutting 5 percent by 50 and by 80 percent leaves 2.5 and 1 percent, respectively, under the U.S. and EU proposals. The G-20 seems to propose that DM AMS support will be allowed only to the extent it can be accommodated, along with Current TAMS and blue payments, within the Overall commitment. The percentage cut can therefore not be

determined in advance. Both the EU and the G-20 proposals keep the cap on blue payments at 5 percent of a historical value of production, while the U.S. proposal reduces it to 2.5 percent.

### ***De minimis* Rules and the Value of Production: Historical, Current or Future**

Analyses of countries' future ability to provide AMS support often ignore how the DM rules work. Art 6.4 of the Agreement on Agriculture defines the DM rules: "(a) A Member shall not be required to include in the calculation of its Current Total AMS and shall not be required to reduce: (i) product-specific domestic support which would otherwise be required to be included in a Member's calculation of its Current AMS where such support does not exceed 5 per cent of that Member's total value of production of a basic agricultural product during the relevant year, and (ii) non-product-specific domestic support which would otherwise be required to be included in a Member's calculation of its Current AMS where such support does not exceed 5 per cent of the value of that Member's total agricultural production."

Neglecting these rules gives estimates that deviate from the AMS support that will in fact be allowed. Our analysis accounts for the DM rules and examines the three AMS components of distorting domestic support: Current TAMS, DM non-product-specific AMS, and the sum of DM product-specific AMSs. We distinguish between allowed support within the constraints (commitments or allowances) and current support that counts towards the constraints.

The AMS support that can be exempted from future Current TAMS on DM grounds is often estimated by applying a DM percentage to a historical value of production, such as 2004. This deviates from the DM rules, which refer to the "the relevant year", i.e., the notified year and not a historical year. Estimating future DM allowances thus requires estimating the value of production for a future year, such as 2014, the year the Doha Round commitments are assumed

to be fully implemented. The USDA (2005b) projects a 2014 value of production in agriculture of more than \$260 billion, i.e., 30 percent larger than the \$200 billion or so of recent years. The 2014 DM exemptions would thus increase by 30 percent for a given DM percentage.

### **Maximum Usable Components**

The allowed future AMS support is sometimes estimated as the sum of the TAMS commitment, the DM allowances for product-specific AMSs for all products, and the DM allowance for non-product-specific AMS. If the future TAMS commitment is \$7.6 billion, and 2.5 percent of the future value of production in agriculture is \$6.5 billion, the future sum of allowed AMS components is  $\$7.6 + \$6.5 + \$6.5 = \$20.6$  billion. The \$6.5 billion is counted once for the sum of product-specific DM allowances and once for the non-product-specific DM allowance. However, given the DM rules, this overestimates what can be provided in the form of AMS support, whether DM or not.

Assume that a country seeks to provide as much AMS support as is theoretically possible. There are three extreme cases, summing different combinations of the TAMS commitment (assume \$7.6 billion), DM allowances for product-specific AMSs (assume \$6.5 billion) and the DM allowance for non-product-specific AMS (assume \$6.5 billion). See Table 1 and Figure 1.

1. Give a non-product-specific AMS just up to the DM threshold (\$6.5 billion), and give a product-specific AMS for each and every product just up to the product's DM threshold (these AMSs sum to \$6.5 billion). A total of \$13 billion of AMS support is given. The Current TAMS has to be zero, since all AMSs are exempted as DM. The TAMS commitment is unused.
2. Give a non-product-specific AMS just up to the DM threshold (\$6.5 billion) and product-specific AMSs on all products in amounts that are larger than each product's DM allowance and

that sum to the TAMS commitment (\$7.6 billion). The Current TAMS is equal to the TAMS commitment. Both the TAMS commitment and the non-product-specific DM allowance are used to the hilt, totalling  $\$6.5 + \$7.6 = \$14.1$  billion. The sum of the product-specific DM allowances is unused.

3. Give a non-product-specific AMS just up to the DM threshold (\$6.5 billion), and give product-specific AMSs for some individual products that are larger than their DM allowances and that sum to the TAMS commitment. The question is what to assume about the share of the sector on which the larger-than-DM product-specific AMSs are concentrated. The USA has notified larger-than-DM product-specific AMSs on products accounting for between 12 and 40 percent of the sector's value of production and the EU for about 60 percent. The future caps on product-specific AMSs may make it impossible to distribute the whole TAMS commitment as larger-than-DM product-specific AMSs for only a few products. Moreover, in 2003 the EU reduced policy prices so that only DM AMSs or zero are reported for some products and the USA may contemplate similar changes for dairy and sugar. The past distribution of product-specific AMSs is thus irrelevant for the future. Assume therefore that governments will seek to make Current TAMS equal to the TAMS commitment by giving larger-than-DM AMSs to products that account for half of the sector's value of production. This allows the product-specific DM allowances for the products making up the other half of the sector's value of production to be fully "used". In this illustration the usable components sum to \$17.4 billion.

At least one of the three AMS components is, either in full or in part, never usable. The usable sum of the AMS components is always less than the full sum of the three AMS components (intuitively this is explained as "an AMS can not at the same time be DM and part of Current TAMS"). Call this usable sum "Maximum Usable Components" (MUC).

### **Estimating 2014 Distorting Support**

The support and value of production (VOP) in 2014 for the USA are based on prices and payments in the USDA Baseline projections (USDA 2005a, 2005b). Price gaps for market price support assume unchanging policy prices from 2004, and are multiplied by 2014 production. AMS payments in 2014 are assumed to comprise mainly loan deficiency payments and marketing loan gains. It is assumed that Direct Payments and Counter-Cyclical Payments (CCP) in 2014 will not be part of Current TAMS (claimed as green, blue or DM AMS). Market prices for crops are projected to increase by 2014, so the AMS payments are nil or very low. The 2014 Current TAMS is therefore as low as \$6.5 billion, most of which is market price support for dairy (\$5.2 billion) and sugar (\$1.2 billion). The Baseline does not account for market prices possibly falling below the projections, which would trigger payments (Westhoff et al. (2005) analyze such situations). Values of production would also be different, giving different DM allowances.

The EU-15 support projections assume that the 1999, 2003 and 2004 CAP reforms remain in place (sugar policy as in the June 2005 proposal), enabling the EU to calculate a much smaller Current TAMS in 2014 than notified in recent years. The 2014 blue payment is assumed to be €3.7 billion, based on indications that 10 percent of all EU-15 payments in 2014 are blue and that green payments sum to €33.2 billion. Reducing or eliminating policy prices reduces the 2014 price gaps. Eliminating the sugar intervention price may allow the EU to notify no market price support for sugar, thus reducing Current TAMS by a further €2 billion. If the EU replaces market price support for fruit, vegetables and wine with payments, the 2014 Current TAMS may

be much less than the €20 billion used here. The 2000-02 average VOP is raised by 10 percent for assumed nominal growth between 2000-02 and 2014.

The major projected 2014 AMS components for the USA and the EU-15 are shown in Table 2. Based on past and projected values of production and projected support, we derive the constraints under the three proposals and see to what extent they would actually constrain 2014 support. The results are shown for the USA in Figure 2 and the EU in Figure 3. Since the G-20 DM allowance cannot be determined independently of the Overall commitment, we initially assume it to be no larger than the present 5 percent applied to value of production in 2000-02.

### **Findings: Maximum Usable Components (MUC) vs. sum of allowed AMS components**

For the USA, the reduced Total AMS commitment by itself under either the U.S. or the EU proposal will not constrain projected 2014 Current TAMS, whereas this commitment under the G-20 proposal will be a constraint. For the EU, the reduced TAMS commitment under both the U.S. proposal and the G-20 proposal will constrain projected 2014 Current TAMS. The EU proposal would not make the EU 2014 TAMS commitment constrain Current TAMS.

The Overall commitment of the U.S. proposal will not constrain the sum of blue and AMS support for either the USA or the EU. Instead the (smaller) sum of the blue cap and MUC will be binding. If future values of production are lower than projected, the DM allowances will also be smaller, making the sum of the blue cap and MUC even smaller and reinforcing the role of this constraint. Under the EU and the G-20 proposals the Overall commitment would constrain the sum of blue and AMS support for both the USA and the EU. If the future value of production is significantly smaller than projected, the sum of the blue cap and MUC would be the binding constraint on the sum of blue and AMS support.

While the G-20 proposal does not specify a particular reduction of the DM percentage, the cut in the Overall commitment is so large that it eliminates DM allowances for both the USA and the EU, i.e., the DM percentage goes from 5 percent to zero. The Overall commitment for the USA and the EU is smaller than even the sum of just the blue cap and the TAMS commitment. The G-20 proposal will thus prevent the USA and the EU from fully using either blue payments up to the blue cap or AMS support up to the TAMS commitment, or both.

## **Conclusions**

Estimating the effectiveness of future constraints in constraining future support requires adherence to the DM rules of the Agreement on Agriculture and requires estimates of future values of production, especially if these future values differ significantly from historical values. The DM rules also require us to go beyond calculating simply the full sum of the allowed components of AMS support (TAMS commitment, non-product-specific DM AMS allowance, and the sum of all product-specific DM AMS allowances). Since an AMS cannot at the same time be DM and part of Current TAMS, it is necessary to calculate the smaller allowed sum of AMS components. Call this sum “Maximum Usable Components” (MUC). The future difference between the full sum of components of AMS support and the MUC may amount to one or a few billion dollars or euros for the USA and the EU. Although not large, compared to the support provided in recent years, the difference can be significant in evaluating the future constraints.

The Overall commitment under the U.S. proposal is so large that it will not constrain projected 2014 applied support: the sum of MUC and blue is the binding constraint on Overall support for both the USA and the EU. The Overall commitment under both the EU and G-20 proposals is smaller, so it will constrain the sum of MUC and blue, rendering parts of these



components unusable for the USA and the EU. Compared to projected 2014 applied support, the U.S. proposal will constrain only the Current Total AMS for only the EU and no other indicator for either the USA or the EU. The EU proposal constrains no applied indicator for either the USA or the EU. The G-20 proposal constrains all indicators for the EU but only the Current Total AMS for the USA. In spite of the three October 2005 proposals exhibiting seemingly large percentage reductions, any of the three proposals would thus impose only very modest, if any, constraints on projected 2014 applied trade-distorting domestic support of the USA and the EU.

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Table 1. Illustration of the three components of AMS support

AMS components (maximum)	Sum of three components	AMS components (used)	Case 1	Case 2	Case 3 (MUC)
Total AMS commitment	7.6	Current Total AMS	0	7.6	7.6
NPS AMS DM allowance	6.5	Used NPS DM AMS	6.5	6.5	6.5
Sum of PS AMS DM allowances	6.5	Used PS DM AMSs	6.5	0	3.3
Sum of above components of AMS support	20.6	Sum of above current components of AMS support	13.0	14.1	17.4

Case 1: NPS DM allowance + sum of PS AMS DM allowances on all products in sector VOP.

Case 2: Total AMS commitment + NPS DM allowance.

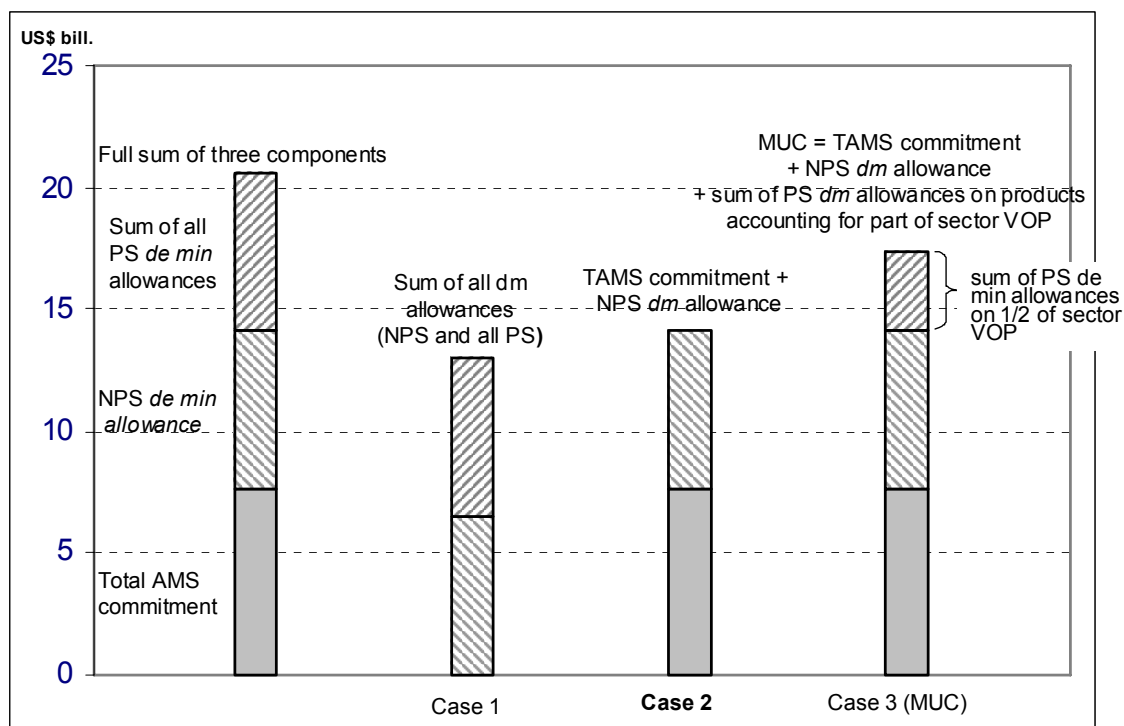
Case 3: Total AMS commitment + NPS DM allowance + sum of PS AMS DM allowances on products accounting for 1/2 \* (sector VOP).

Table 2. Key 2014 projections

		USA (\$ bill.)	EU-15 (€ bill.)
	Value of production	260.3	269.3
	Sum of product-specific DM AMSs	0.0	0.2
	Non-product-specific DM AMS	3.0	0.6
	Current Total AMS	6.5	19.4
	Blue payments	0.5	3.7
	Current Overall support (sum of above four components)	10.0	23.9
MUC (Maximum Usable Components)	U.S. proposal	17.4	21.5
	EU proposal	11.5	24.2
	G-20 proposal	20.1	31.8
TAMS commitment	U.S. proposal	7.6	11.4
	EU proposal	7.6	20.1
	G-20 proposal	5.7	13.4
Overall commitment	U.S. proposal	22.5	28.7
	EU proposal	19.2	34.4
	G-20 proposal	12.0	23.0

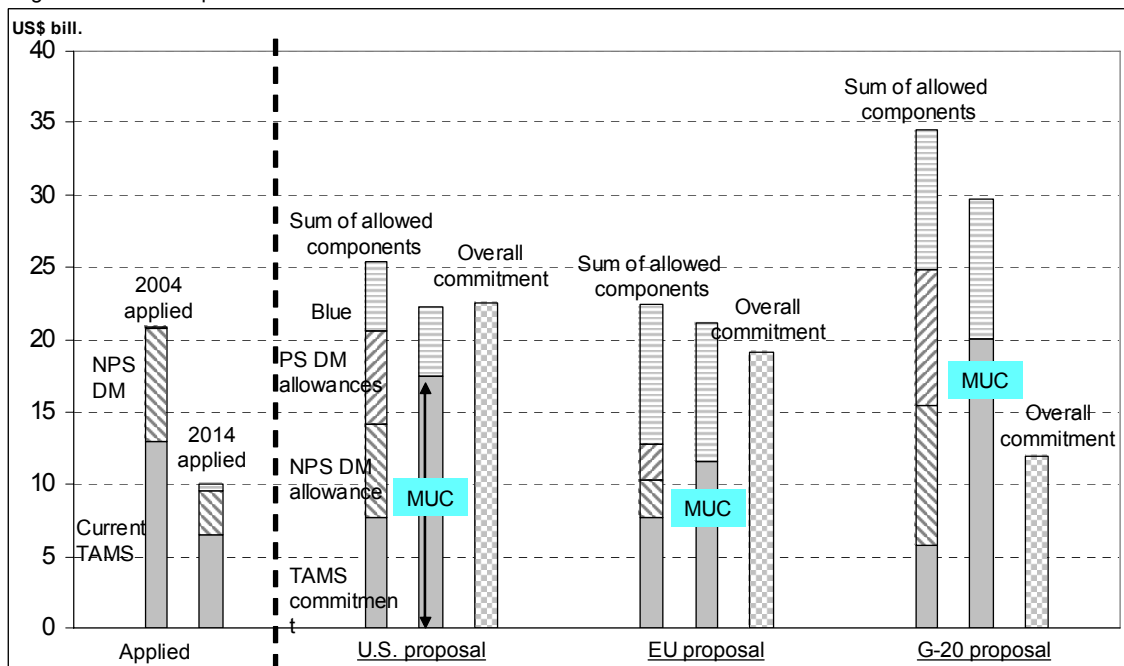
Source: See text (2000-02 components of Overall base underlying 2014 MUC and Overall commitment are from notifications and national data).

Figure 1. Calculating Maximum Usable Components (MUC)



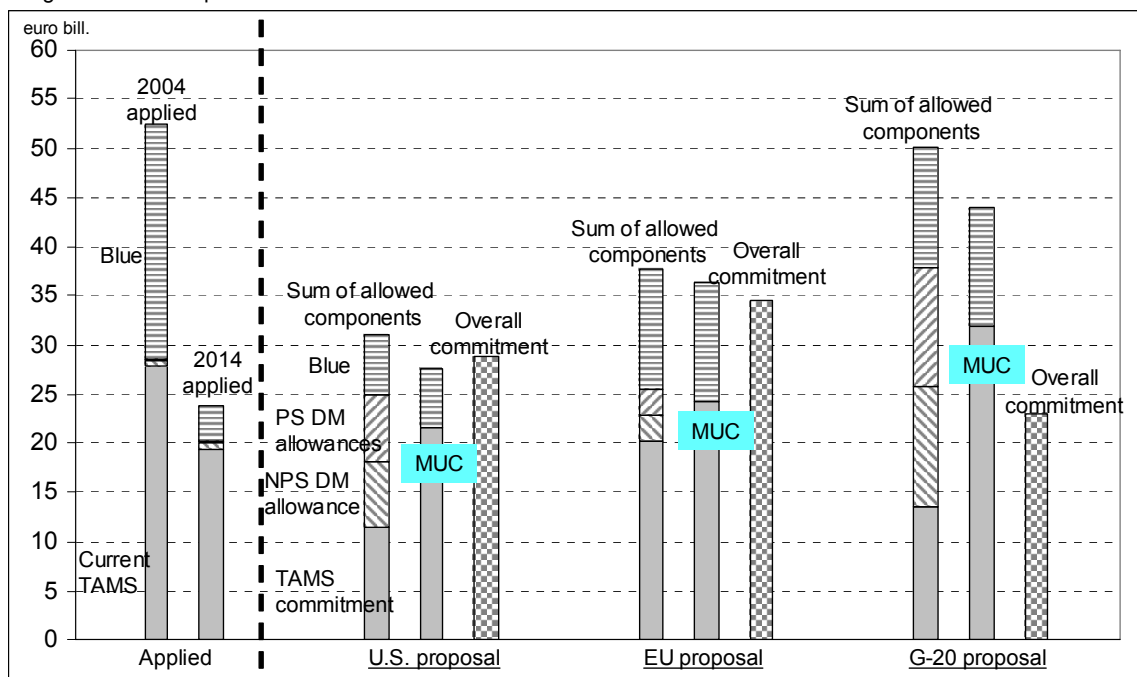
Source: Table 1

Figure 2: USA: Components and constraints



Source: Table 2 (2004 estimated from 2001 notifications and national data)

Figure 3. EU: Components and constraints



Source: Table 2 (2004 estimated from 2001 notifications and national data)