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CURRENT WTO NEGOTIATIONS ON DOMESTIC SUBSIDIES IN AGRICULTURE: IMPLICATIONS FOR INDIA

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Foreword

In the Doha Development Round of trade talks, agriculture has emerged as one of the most important issues for negotiations. Developing countries are particularly concerned about the widespread use of domestic farm subsidies by developed countries. Estimates suggest that domestic farm support in developed countries amounts to about 300 billion US dollars. Such huge subsidies not only create distortion in the domestic markets of these countries, they also distort trade by artificially influencing commodity prices.

One of the priorities of the current round of WTO negotiations is to bring substantial reduction in trade distorting domestic support. This paper analyses the present state of play of WTO negotiations and evaluates how effective the current WTO provisions will be to reduce domestic subsidies in developed countries. The findings of the paper suggests that the broad framework of subsidy reduction, as outlined in the July package, can be considered as a step towards the right direction but it does not guarantee significant reduction in subsidies.

A simulation using the subsidy reduction formulas mentioned in the draft ministerial text for the Hong Kong meet also indicates that due to the existence of significant overhang between actual and committed levels of subsidies in developed countries, the effective rate of reduction of subsidies will be much less than it appears at the first glance. It follows that unless deep reduction commitments are imposed on developed countries, it will not lead to a substantial cut in their trade distorting domestic supports. This study suggests that the negotiators should calibrate the subsidy reduction formulas so that the post-cut level of trade distorting support for developed countries should not exceed 5 percent of their total value of agricultural production.

This study emphasizes that as a part of the G20 initiative India should take a firm stand on this issue and ensure that an appropriate formula with high reduction coefficients is adopted in this round. Secondly, they must draw lesson from the implementation experience of the Uruguay Round Agreement on Agriculture and take measures to prevent 'box shifting' of subsidies as far as possible. It will also be important to impose strong and legally tight definitions of Green box subsidies to ensure that subsidies within these boxes are not production or trade distorting.

It is hoped that the Working Paper would be helpful to the policy-makers, the stake holders and other interested persons to take a view on this important issue.

We are very grateful to the Sir Ratan Tata Trust for funding our research on WTO issues.

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Section.1. Introduction

The Ministerial Declaration launching the Uruguay Round observed that there was an "urgent need to bring more discipline and predictability to world agricultural trade by correcting and preventing restrictions and distortions including those related to structural surpluses so as to reduce the uncertainty, imbalance and instability in world agricultural markets"[1].

This concern was not misplaced as, prior to WTO, agriculture was among the most distorted sectors in international trade. The principal source of these distortions (which were in addition to those resulting from international market concentration) was the co-existence of very high level of domestic and export subsidies and almost impenetrable import barriers for temperate zone agricultural goods in developed countries.

Farm subsidies distort the production structure of a country by raising crop prices in a country's internal market. Higher prices induce over-production of the subsidized crop. Most agricultural goods are price and income inelastic in nature and therefore, high income countries tend to have a stagnant demand for such commodities. Over-production and stagnant demand for agricultural goods lead to 'structural surpluses' in these countries. This surplus not only squeezes out imports in the already restricted domestic markets, it is also dumped in the international market at a cheaper rate. This leads to price suppression of that commodity in the international market. Export subsidies are used to cover the price difference between high domestic prices and lower international prices.

Domestic support in developed countries led to low international commodity prices which have forced many developing countries out of farm trade. Though many of the developing countries are low cost producers of agricultural goods, they have not been able to compete with artificially cheap exports from developed countries. The Uruguay Round Agreement on Agriculture (AoA) tried to discipline the farming sector by putting restrictions and imposing reduction commitments on domestic and export subsidies. It was expected that the integration of agriculture in the multilateral system would reduce distortions in international agricultural trade and would bring benefits for developing countries.

[1] WTO/GATT Ministerial Declaration on the Uruguay Round (Declaration of 20 September 1986).

It has been more than ten years since the Uruguay Round (UR) AoA was implemented. The implementation experience shows that domestic subsidy reduction commitments turned out to be the least binding of all WTO commitments. Farm support given by OECD countries still amounts to more than US$300 billion a year, which is about half the total value of international trade in agricultural goods, which in 2003 was around US$ 674 billion[2] (also see Box 1.1).

Box 1.1. To put the extent of farm support in perspective, Ann Krueger has some interesting observations:

"I'd like to start by sharing with you one of my favorite—and most telling—illustrations of the folly of agricultural support. Somebody has taken the trouble to do some calculations putting the cost of farm support in the OECD countries into context. It turns out that those countries spend enough to send every one of the 56 million cows in the OECD's dairy herd on a first class round the world ticket—complete with $1450 spending money—every year." -

Anne O. Krueger, Moving on from Cancun: Agricultural Trade and the Poor, First Deputy Managing Director, IMF, Agricultural Trade Policy Workshop, November 3, 2003, Washington D.C.

Given this backdrop, it is expected that the current round of WTO negotiations on agriculture is going to have an emphasis on more effective reduction of domestic farm subsidies. Not surprisingly, the Doha Ministerial Declaration, launching the Doha Development Round calls for "substantial reductions in trade-distorting domestic support"[3]. However, the progress of the Doha Round of negotiations has not been smooth. The failure of the Cancun Ministerial Meet and lack of convergence among Members on key issues have slowed down the progress of negotiations on agriculture in World Trade Organization. As a result, farm talks are lagging much behind the timetable published by WTO during the Doha Ministerial Meet. According to this timetable, a consensus on the modalities of agricultural negotiations was supposed to be met by March 31st 2003. It was also decided that, based on the 'modalities', WTO members would produce their offers or 'comprehensive draft commitments' by the Cancun Ministerial. As things stand now, Members have not yet managed a consensus

[2] Source: International Trade Statistics 2004, WTO, internet address: http://www.wto.org/english/res_e/statis_e/its2004_e/section4_e/iv03.xls (visited 15th July 2005)

[3] Paragraph 13, Doha Ministerial Declaration, WTO document number WT/MIN(01)/DEC/1, 20th November 2001.

on an official ‘modalities text' on agriculture. There were deadlocks in other areas of negotiations as well and almost all the deadlines set by the Doha Development Agenda (DDA) have been missed.

Members managed some sort of a breakthrough in July 2004 when they reached an agreement on a set of broad guidelines for the current round of negotiations. The text of this agreement is known as the ‘July Package’ or the ‘July Framework’[4]. The most important achievement of the July Framework was that an agreement was reached on elimination of export subsidies in agriculture. It also provided guidelines for reductions of domestic support in agriculture.

The Annex A of the July package contains some of the major elements of a still elusive ‘modalities text’ for the current round of negotiations on agriculture. In WTO negotiations, ‘modalities text’ attempts to set terms of reference and broad targets (including numerical targets) for achieving the objectives set out for the negotiations. The July Framework tried to pave the way for a formal modalities text. It only provided broad guidelines and left many finer details to be decided through the subsequent negotiation process. It also showed the areas where consensus had already been reached.

In the context of the current round of negotiations on agriculture, the importance of the July framework is paramount because of two reasons. The failure at the Cancun Ministerial virtually stalled the progress of negotiations on agriculture in WTO. The July package ended the stalemate and brought the current negotiations back on track. Secondly, since the July Package there has not been an updated framework text on agricultural negotiations from WTO. There was supposed to be an updated text during July 2005 and it was tentatively named the ‘July Approximation’. However, due to key differences among Members, the ‘July Approximation’ could not be achieved. Consequently, the July Framework still forms the basis of negotiations on agriculture and negotiations on agriculture are being conducted within the parameters set by it.

In general, the July Package has been received well by WTO Members. On the surface the July Package does look like a step in the right direction as it promises substantial reduction in domestic subsidies in developed countries. However, a closer scrutiny of

[4] The July Framework is officially called ‘Doha Work Programme: Decision Adopted by the General Council on 1 August 2004’.

the July Framework reveals the existence of some glaring loopholes, which can potentially lead to much lower level of subsidy reduction in developed countries. This paper looks closely at the domestic subsidy reduction provisions of the July Framework and analyses these issues, particularly from India's point of view.

This paper also reviews the post-July framework negotiations on agriculture and analyses the draft Honk Kong Ministerial text. Most importantly, the Hong Kong ministerial draft presents a set of working hypothesis on domestic subsidy reduction. This study analyses these provisions to find out how effective they will be in reducing domestic support in developed countries. Based on these findings, this study suggests a few negotiating options for India.

This paper is organized in five sections. Section 1 is the introduction. Section 2 briefly reviews the status of domestic farm subsidies in developed countries since the implementation of the UR AoA. Section 3 discusses the provisions of the July Framework regarding domestic subsidies in the light of the experience of the implementation of AoA. It also looks at the developments of agricultural negotiations since the July Package was announced. A simulation exercise is also carried out in this section to find out how the subsidy reduction formulas spelt out in the draft Honk Kong ministerial text translate into effective reduction. Section 4 analyses how the provisions of the July Package and the subsequent negotiations on domestic farm subsidies are likely to affect India. Section 5 concludes the study and suggests some negotiating options for India.

Section 2. Domestic Subsidies in Developed Countries: A Status Check

The Uruguay Round negotiations explicitly recognized the extreme trade distorting impact of domestic support and the necessity to impose restrictions on it. As mentioned before, domestic support encourages overproduction, which in turn increases supplies in world markets (by reducing import demand or increasing export supply) and depresses world prices.

The Uruguay Round AoA distinguishes between support programmes that directly stimulate production and trade, and those that are considered to have no direct effect. AoA does not impose restrictions on the latter category. Support measures that are exempt from reduction commitments are categorized as 'Blue Box' and 'Green Box' subsidies. Production and trade-distorting subsidies are classified as 'Amber Box' subsidies, and they are subject to reduction commitments. Amber Box subsidies are measured by Aggregate Measure of Support or AMS.

It must be mentioned here that the Blue Box subsidies do have production and trade distorting impact. However, it is generally believed that these subsidies are less distorting than the Amber Box subsidies. The Blue Box subsidies were initially introduced in the Uruguay Round as a transitional mechanism to encourage countries to move towards a less trade distorting regime. It was a result of the Blair House Accord[5] between the developed countries. However, according to this arrangement, Blue Box subsidies were slated to be phased out after the implementation of the Uruguay Round agreement[6].

AoA allows developed countries to have Amber Box subsidies up to 5 per cent of the value of agricultural production (VOP). This is called the *'de minimis'* level. The 5 percent *'de minimis'* exemption is available separately for product specific support and non-product specific support[7]. Amber Box subsidies above the *'de minimis'* level come under reduction commitments. It was stipulated that developed countries should reduce their Amber Box subsidies from the base period level (1986-88) over a period of five years (1999-2000) by 20 per cent.

Empirical evidence shows that although most WTO Member countries have fulfilled their AoA commitments and have reduced their AMS, total support given to agriculture in developed countries has not declined. Organisation for Economic Co-operation and Development (OECD) statistics report different farm support estimates for its member countries. Among them, Producer Support Estimate (PSE) and Total Support Estimates (TSE) provide a good idea about farm support levels in these

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[5] The Blair House Accord was an in-house deal struck at an informal meeting between the developed countries during the Uruguay Round negotiations on agriculture. The accord resulted in the creation of the Blue Box subsidies. A set of support measures that were officially defined as trade-distorting was incorporated in the Blue Box and were exempted from reduction commitments. This allowed some developed countries, especially the EU, to provide substantial protection for their farming community. Moreover, it was agreed at Blair House that the AoA would incorporate a 'Peace Clause' that prevented countries from challenging those support measures during the implementation period.

[6] See WTO Document Number AIE/10 dated 31 October 1997 of WTO AIE Process of Analysis and Information Exchange. This is an informal submission by US on Article 6.5. This document strongly argues in favour of phasing out of Blue Box subsidies by saying that Article 6.5 direct payments are essentially distortionary in nature but were introduced in the UR as a transitionary mechanism to encourage countries to move towards a less trade distorting regime. As the Blue Box measures have served this purpose and they should be phased out in the current round.

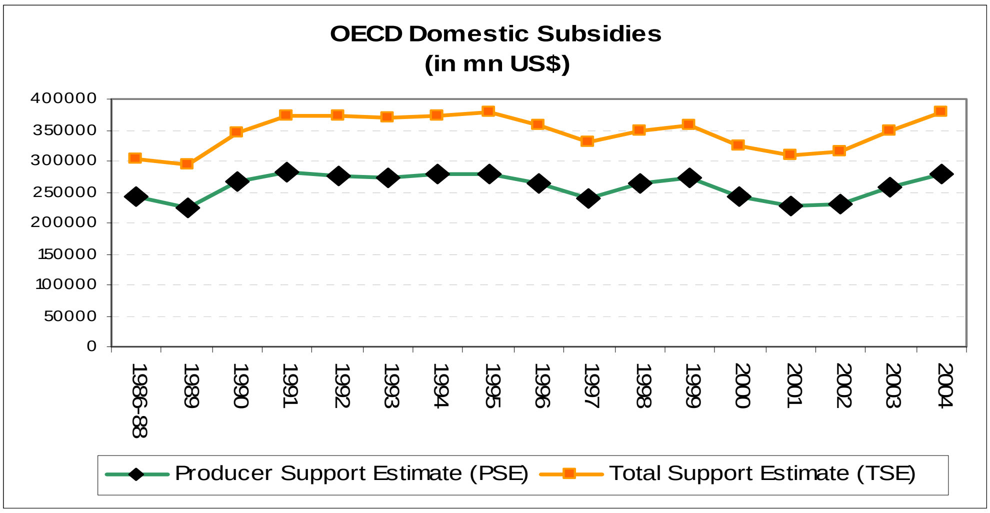
[7] For developing countries, the 'de minimis' ceiling is 10 percent of VOP.

countries. PSE is defined as “the annual monetary value of gross transfers from consumers and taxpayers to agricultural producers, measured at the farm-gate level, arising from policy measures that support agriculture, regardless of their nature, objectives or impacts on farm production or income”[8].

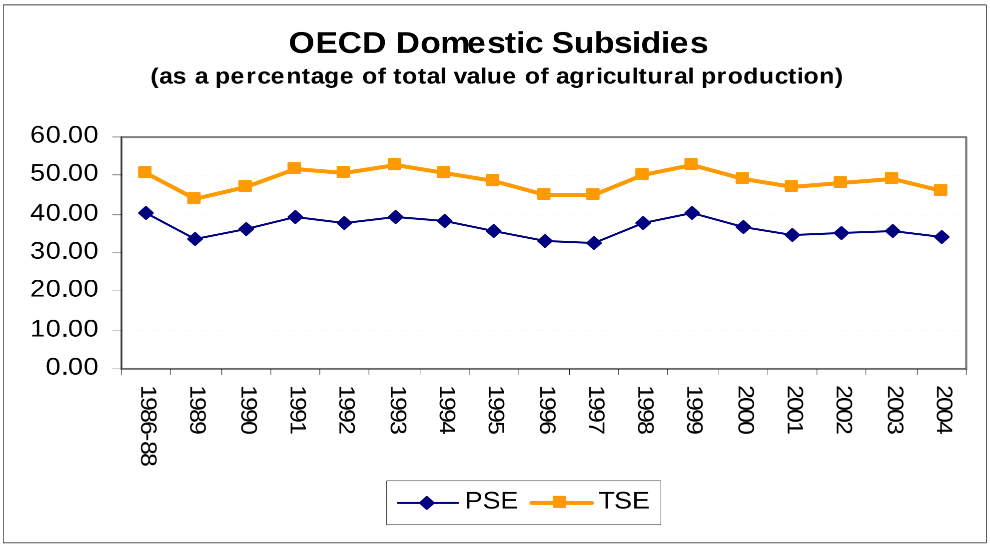
Another measure which provides a wider definition of farm subsidies is the Total Support Estimate or the TSE. According to OECD (2004), TSE is an ‘indicator of the annual monetary value of all gross transfers from taxpayers and consumers arising from policy measures that support agriculture, net of the associated budgetary receipts, regardless of their objectives and impacts on farm production and income, or consumption of farm products’. TSE can be considered as an indicator of the total amount of support given to the farm sector in the OECD countries.

Aggregate data for OECD countries show that both PSE and TSE were actually higher in 2003 as compared to the corresponding figures in 1986-88 (Fig 2.1). The figure further shows that in the last few years there has been an increase in the amount of farm support provided to the OECD countries. However, when one looks at the PSE and TSE figures as a percentage of total value of agricultural production, they show that there has been a slight decline in the levels of support. Between 1986-88 and 2003, TSE as a percentage of total value of agricultural production has declined from about 51 percent to about 49 percent. Over the same period, PSE as a percentage of total value of agricultural production has declined from 40.4 percent to 36 percent.

Figure 2.1. OECD Domestic Subsidies



[8] See OECD (2004): ‘Agricultural Support: How is it Measured and What does it Mean? OECD Policy Brief, July 2004, http://www.oecd.org/dataoecd/63/8/32035391.pdf,



Source: Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005, http://www.oecd.org/dataoecd/56/33/35009952.xls (last visited 20th July 2005)

These data show that in spite of the disciplines introduced in the UR AoA, the total amount of support extended to the farm sector in developed countries has not shown any significant decline. This large scale subsidization of the agricultural sector in developed countries has continued to have a considerable impact on agricultural market.

It is notable here that in two recent dispute settlement cases WTO has found that subsidies in developed countries are directly responsible for price suppression in the international market. In a dispute between Australia and European Communities regarding export subsidies on sugar (WTO Dispute DS265), the WTO dispute settlement panel has ruled that EC export subsidies have allowed EC to export sugar below its cost of production. Similarly, in another dispute (WTO Dispute DS267), Brazil alleged that US domestic subsidies to its US producers, users and exporters of upland cotton is leading to price suppression in the international market. The WTO Panel Report and the Appellate Body Report have ruled that US domestic subsidies are indeed leading to oversupply of cotton in the international market which is leading to price decline of cotton in the international market (see Annex 1 for a more detailed discussion on this dispute).

To put the extent of US cotton subsidies into perspective, a study by Oxfam highlights: “America’s cotton farmers receive:

- more in subsidies than the entire GDP of Burkina Faso – a country in which more than two million people depend on cotton production. Over half of these farmers live below the poverty line. Poverty levels among recipients of cotton subsidies in the US are zero.
- three times more in subsidies than the entire USAID budget for Africa's 500 million people."[9]

To justify such high levels of subsidies, it is sometimes argued that agricultural support in developed countries protect the interests of vulnerable communities and serve the objective of rural development in those countries. However, there is little evidence to support this justification. WTO Annual Report of 2003 shows that contrary to popular belief, subsidies in most developed countries are not targeted towards the poor farmers. In fact, in most OECD countries, a very high proportion of subsidies go to the top 25 percent of farmers. Quoting an OECD study, the WTO annual report highlights that in EU, USA, Canada and Japan top 25 percent of farmers receive 70 percent, 89 percent, 75 percent and 68 percent of total agricultural subsidies respectively[10]. These findings are not surprising because farm subsidies in US and EC are linked to output and size of land holding. As a consequence, bigger farmers garner more subsidies. As large agribusiness firms control a very high percentage of agricultural trade in developed countries (see Box 2.1), a significant part of the farm subsidies is appropriated by these firms.

The Human Development Report (HDR) 2005 also finds that the farm subsidy system in developed countries is extremely inequitable. According to the figures quoted in the HDR2005, more than three quarters of CAP (Common Agricultural Policy) support goes to top 10 percent of subsidy recipients. The distribution is also skewed in USA where the top 5 percent get over half the total subsidies[11]. The inequitable nature of farm subsidies becomes more evident if one constructs a Gini coefficient for farm subsidies in US and EU. Quoting Samman (2005), the report shows that the subsidy Gini coefficients for US and EU (66 and 77 respectively) are much higher than the income Gini coefficient (60) for Brazil, one of the most unequal countries in the world.

[9] Oxfam (2002): 'Cultivating Poverty: The Impact of US Cotton Subsidies in Africa', Oxfam briefing paper 30, available at: http://www.oxfam.org.uk/what_we_do/issues/trade/bp30_cotton.htm

[10] WTO Annual Report 2003, Page 21

[11] See Box 4.5, Page 130, Human Development Report 2005, UNDP

These figures corroborate the conclusion of the HDR that the annual multi billion dollar farm subsidies are a regressive form of financial transfer where the real gainers in subsidies are not poor farmers but large-scale farmers, corporate agribusiness interests and landowners[12].

Box 2.1. Concentration of Agribusiness Firms in US Agriculture

- Four companies (Cargill, Cenex Harvest States, Archer Daniels Midland, or ADM, and General Mills) own 60% of terminal grain handling facilities.
- Three companies (Cargill, ADM, and Zen Noh) carry out 82% of corn exporting.
- Four companies (Tyson, ConAgra, Cargill, and Farmland Nation) concentrate 81% of the beef-packing industry.
- Four companies (ADM, ConAgra, Cargill, and General Mills) own 61% of flour milling capacity.

Source: 'Agricultural Restructuring and Concentration in the United States: Who wins, who loses?' by Sanaz Memarsadeghi and Raj Patel, August 2003, available at: http://www.foodfirst.org/node/270/print

OECD data[13] also highlight that these countries still provide high levels market distorting subsidies like Market Price Support (MPS). OECD statistics show that for the year 2004, MPS accounted for about 60 percent of total PSE[14]. The high level of MPS is directly reflected in the producer Nominal Protection Coefficient (NPC)[15] of OECD countries. The NPC shows that the prices received by the OECD farmers were 31-33 percent higher than international prices during 2002-04. On this, the WTO Annual Report 2003 comments: "… the continued dominance of the most distortive forms of support means that farmers in many OECD countries remain largely insulated from world market signals. They also constrain agricultural growth and development opportunities in non-OECD countries"[16].

Recent domestic policies undertaken in most OECD countries suggest that the high subsidization of agriculture is going to continue. The proposed reform of Common

[12] HDR2005 says: "It would be hard to design a more regressive-or less efficient-system of financial transfer than currently provided through agricultural subsidies." Chapter 4, Page 130, HDR2005

[13] Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005,

http://www.oecd.org/dataoecd/56/33/35009952.xls (last visited 20th July 2005)

[14] It must be mentioned here that the MPS is calculated differently for Amber Box and PSE subsidy calculations. The MPS component of AMS is calculated with fixed external reference price (base period 1986-88), whereas for PSE the price gap is updated and calculated on yearly average prices.

[15] For a commodity, Nominal Protection Coefficient (NPC) is defined as the ratio of domestic prices and international prices. An NPC of 1.3 indicates that domestic price is 30 percent higher than international prices.

[16] WTO Annual Report 2003, Page 22

Agricultural Policy (CAP) of EU will only restructure, not reduce the subsidy regime. An OECD study projects that under the new CAP the PSE will still amount to about one-third of the value of agricultural production in EC (resulting in about 1 percentage point decline from the present regime)[17]. There are also strong indications that CAP payments is set to increase over the next decade. It is also notable here that CAP reforms have also run into problems in countries like France and it is not yet certain whether and when the CAP reforms will be eventually implemented.

Secondly, USA, through its Farm Bill 2002 (Farm Security and Rural Investment Act of 2002), has proposed to increase its agricultural subsidies significantly. Under this law, federal spending on US agriculture is slated to increase by US$ 82.6 billion over the next ten years. This will be in addition to US$ 100 billion which the US Government was already set to give farmers (TSE). This increase in US farm subsidies is reflected in the increased PSE for the 2004. OECD statistics show that between 2003 and 2004, PSE of USA has increased from US$ 35618 million to US$ 46504 million, a jump of about 30 percent. The WTO Annual Report 2003 indicated that this huge increase in subsidies primarily would be in production enhancing subsidies. It says: “several of the subsidies contained in the bill would provide incentives to boost production. This is particularly true of "counter-cyclical payments", under which growers of wheat, corn, rice, soyabeans, and cotton will be guaranteed a certain price irrespective of market conditions, thereby distorting both production and trade; in the event that prices fall further, such subsidies will rise accordingly, although a "circuit breaker" built into the legislation is designed to keep spending within the WTO ceiling”[18].

This large increase in production enhancing subsidies in the US is likely to exacerbate the distortions present in global agricultural trade.

Section 2.1. AoA Implementation and Box Shifting: Are Blue and Green Boxes really Non-trade Distorting?

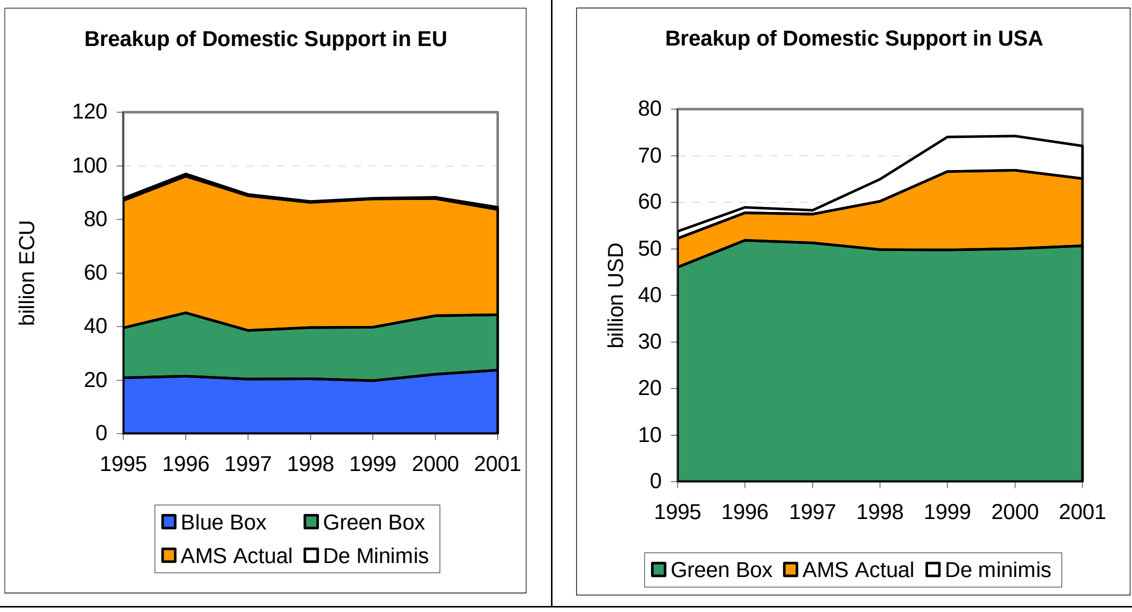
It was mentioned above that many WTO Member countries, particularly the developed countries have increased their domestic subsidies, while they have had fulfilled their WTO subsidy reduction commitments. This apparently puzzling situation can be

[17] OECD (2004): ‘Analysis of the 2003 CAP Reform.’ Working Party on Agricultural Policies and Markets, Directorate for Food, Agriculture, and Fisheries, Paris

[18] WTO Annual Report 2003, Page 22

explained by the fact that after the Uruguay Round, most developed countries have shifted a significant part of the prohibited subsidies (the Amber Box subsidies) to the permissible Blue and Green Box subsidies, which are supposedly less trade distorting. Currently, Blue and Green Box subsidies account for a significant share of domestic subsidies in many WTO Member countries (Fig 2.2).

Figure 2.2. Breakup of Domestic Subsidies in EU and USA



Source: Country Submissions to WTO

However, there is a growing consensus among economists that all Blue Box measures and some of the Green Box measures indeed have trade distorting effects and by providing exemptions to these types of subsidies the agreement has allowed the distortion in agricultural trade to continue.

India, in its proposal to WTO[19], has categorically pointed out that all Blue and Green Box subsidies are not as minimally trade distorting as is made out on account of the following reasons:

‘(i) The ability of the farmers to take risk as well as to make farm investments substantially increases if support in the form of assured payments including de-coupled income support is provided, since such payments entail insurance and wealth effects.

[19] WTO Document number G/AG/NG/W/102, Proposals by India in the areas of: (i) Food Security, (ii) Market Access, (iii) Domestic Support, and (iv) Export Competition; date 15/01/2001. Also see OECD (2001): ‘Decoupling: A Conceptual Overview’ and World Bank (2003): ‘Trade Note: Domestic Support for Agriculture: Agricultural Policy Reform and Developing Countries’, September 2003.

(ii) These direct payments encourage greater use of farm inputs and enhance access to technology leading to over-production, which in turn distorts agricultural markets.

(iii) De-coupled or direct payments can be a powerful incentive to maintain or increase current production in the expectation of receiving higher levels of future support.

(iv) De-coupled or direct payments have been found to increase land values resulting in maintenance of land in farming rather than putting it to some other economically better use.

(v) De-coupled or direct payments heavily subsidise the cost of production, which enables the receivers of such support to capture a substantial share in the export markets at the cost of more efficient producers.'

Box shifting allowed developed countries to maintain and in some cases increase trade and production distorting supports to their farm sector and yet remain WTO consistent. In fact, data presented in the next section will show that EU and USA have managed to bring down their actual levels of AMS much below their committed levels. If one juxtaposes this finding with the increased PSE and TSE in these countries, the failure of the AoA to reduce domestic farm subsidies becomes even more stark. Given the continuation of very high levels of domestic subsidies in developed countries, it is not surprising that some of the chronic problems of international agricultural trade like secular decline in commodity prices and high volatility of commodity prices continue unabated even after the Uruguay Round.

High subsidies in developed countries are hurting the developing countries. Recent estimates by International Food Policy Research Institute (IFPRI) reveal that protectionism and subsidies in industrialized countries cost developing countries about US$24 billion in agricultural and agro-industrial income. If all dynamic and spill-over effects are taken into account, the gains will be much higher. Simulations suggest that real cost for developing countries of farm subsidies in developed countries can be as high as $72 billion a year[20]. The HDR2005 squarely blames the present subsidy regime

[20] See Diao, Xinshen, Eugenio Diaz-Bonilla, and Sherman Robinson (2003): "How Much Does It Hurt: The Impact of Agricultural Trade Policies on Developing Countries." International Food Policy Research Institute, Washington, DC.

for helping very few but depriving a large section of the poor population across the world from reaching a number of UN Millennium Development Goals (MDGs) including poverty reduction (see Box 2.2).

Box 2.2. The HDR 2005 has some strong words against the prevalent farm subsidy system in developed countries. It says:

"The financial commitment to a small group of largely high-income beneficiaries in developing countries puts the financing requirements for the MDGs in perspective. Rich countries spend just over $1 billion a year on aid to developing country agriculture and just under $1 billion a day supporting their own agricultural systems. For a fraction of what rich countries spend subsidizing the overproduction of crops like rice and sugar, it would be possible to meet the financing requirements for achieving the MDGs in areas such as education, health and water. Adding insult to injury, the subsidies in rich countries not only divert resources but also reinforce poverty in poor countries. Industrial countries are locked into a system that wastes money at home and destroys livelihoods abroad. When it comes to world agricultural trade, market success is determined not by comparative advantage, but by comparative access to subsidies-an area in which producers in poor countries are unable to compete."

Page 130, Human Development Report 2005, UNDP

Given the serious implications of the present subsidy regime, it is of great importance to have a more effective subsidy reduction mechanism in this round of negotiations. The loopholes in the UR AoA have allowed developed countries to continue with high subsidization of their farm sector by allowing Box shifting of subsidies[21]. Any meaningful subsidy reduction strategy for the next round of negotiations should keep the implementation experience of the UR AoA in mind and develop a tighter legal clause to restrain domestic subsidies. In this light, it is important to probe the July Framework and the subsequent negotiations to evaluate how effective they will be in reducing subsidies.

Section 3. WTO Negotiations on Domestic Subsidies in the Doha development Round

Section 3.1. The July Framework and Domestic Subsidies: A Critical Look

As mentioned before, the 'July Framework' was considered as a major breakthrough in the current round of negotiations. After the framework was signed, most developing country representatives gave an impression that the July Framework was a "victory" and it would help protect the interests of the developing countries by eliminating

[21] For a more detailed exposition of the problems with Uruguay Round Agreement on Agriculture see Pal, Parthapratim (2002): 'Implementation Issues in Agreement on Agriculture and its Implications for Developing Countries', available at:

http://www.networkideas.org/themes/agriculture/sep2002/ag09_AOA.htm billions of dollars in farm subsidies. It is undoubtedly true that the July Package is an improvement over the 'Derbez text'[22] and it proposed a number of new measures to substantially reduce domestic subsidies in developed countries. Among the salient points of the July framework are the following proposals:

1. Reduction of AMS commitments by a tiered formula; with higher AMS levels to be reduced by proportionately higher amount-thereby leading to near harmonization. The appropriate formula has not been spelt out and left to be decided through negotiations.

2. Reduction of *'de minimis'* subsidies by a certain percentage. The extent of reduction is to be negotiated.

3. Capping of Blue Box subsidies. The July framework suggested Blue Box subsidies should not exceed 5 percent of total value of agricultural production during a 'historical period' which is to be decided.

4. An overall reduction in Trade Distorting Subsidies (TDS) which includes disciplining Amber Box, *'de minimis'* and Blue Box subsidies. This is discussed below in more detail.

5. An explicit recognition that Special and Differential (S&D) Treatment for developing countries is an integral component of domestic support.

At first glance, these measures look impressive and it appeared that the July Package was pointing towards a high level of ambition. However, closer scrutiny of the July framework reveals that its level of ambition might be more modest as the existence of a few escape clauses would lead to a much lower level of subsidy reduction than what appears possible from the first glance.

This section will carefully look at the July Framework text on domestic subsidies to analyze and probe what it actually means for developing countries. More importantly, it will look for caveats and escape clauses in the text which might allow countries to get away with little or no subsidy reduction. To facilitate the discussion, this section will quote the relevant paragraph of Annex A (Framework for Establishing Modalities

[22] This is the Draft Cancún Ministerial text which was eventually rejected. The Derbez text was almost a total endorsement of the US-EU view on agriculture.

in Agriculture) of the July Framework and discuss its implications. Paragraph 6 to 16 of the ‘Annex A’ are devoted to domestic subsidies.

Paragraph 6

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

- Special and differential treatment remains an integral component of domestic support. Modalities to be developed will include longer implementation periods and lower reduction coefficients for all types of trade-distorting domestic support and continued access to the provisions under Article 6.2.

- There will be a strong element of harmonisation in the reductions made by developed Members. Specifically, higher levels of permitted trade-distorting domestic support will be subject to deeper cuts.

- **Each such Member will make a substantial reduction in the overall level of its trade-distorting support from bound levels.**

- As well as this overall commitment, Final Bound Total AMS and permitted de minimis levels will be subject to substantial reductions and, in the case of the Blue Box, will be capped as specified in paragraph 15 in order to ensure results that are coherent with the long-term reform objective. Any clarification or development of rules and conditions to govern trade distorting support will take this into account.”

Implications

This paragraph spells out some broad guidelines about farm subsidy reduction. It reiterates the goal of DDA about substantial reduction in domestic subsidies and also categorically mentions that special and differential treatment is going to be an integral component of new subsidy reduction schemes.

However, the rider of this paragraph is in the third bullet point. This provision mentions that reductions are to be made not from the actual levels of AMS but from the bound levels of AMS committed during the AoA negotiations. This provision looks quite innocuous, but its implications become clearer if one looks at the difference between the Annual Bound Commitment Level of some developed countries and their current total AMS levels. Table 3.1 shows the total and bound level of AMS for EU. The table shows that the current of AMS in these countries are already about 40 percent lower than their bound or committed levels of AMS. This gap (‘overhang’ or ‘water content’ in WTO jargon) implies that EU countries will not have to undertake any reduction in their current level of AMS even if 40 percent reduction from the bound level of AMS is called for. If the actual reduction requirement is less than 40 percent, EU will have some headroom for, in fact, increasing their current level of AMS. However, it must be mentioned here that in WTO, reductions are always undertaken from bound rates. But it is still important to highlight this point because unless deep reduction commitments are imposed on the bound rates, it will not lead to an effective reduction of domestic support in developed countries.

Table 3.1. Current and Bound Commitment Levels of AMS for EU (mn Euros)

Year	Annual Bound Commitment	Current Total AMS	Gap	Gap in Percentage
I	Ii	Iii	iv (ii-iii)	V
1995	78672	50026	28646	36.41
1996	76369	51009	25360	33.21
1997	74067	50194	23873	32.23
1998	71765	46683	25082	34.95
1999	69463	47886	21577	31.06
2000	67159	43654	23505	35.00
2001	67159	39281	27878	41.51

Source: EU Notifications to WTO, G/AG/N/EEC/47, 29 July 2003 G/AG/N/EEC/49, 1 April 2004G/AG/N/EEC/51, 4 November 2004

Similarly, US data show that its current level of AMS for the year 2001 is about 24.5 percent lower than its committed level[23].

Therefore, for the biggest subsidizers of agriculture, the requirement of AMS reduction from the bound level allows them significant latitude in reduction of their TDS.

In defence of EU and USA it can be argued that if a country has undertaken more subsidy reduction than the UR AoA called for, then the country should not be penalised by asking it to schedule its reduction commitments from the current level of AMS. However, as it has been discussed in the previous sections, it must be kept in mind that OECD countries, including the EU and the USA have not made any meaningful reduction in farm subsidies during the last ten years. They took advantage of the loopholes present in the UR AoA to re-schedule their subsidies. The provision in the July framework to allow AMS reduction from the bound level looks like another of those escape clauses which will allow developed countries to maintain their trade distorting supports with some cosmetic changes.

[23] Source: WTO Document No. G/AG/N/USA/51 dated 17 March 2004

Paragraph 7&8
"7. Overall Reduction: A Tiered Formula

The overall base level of all trade-distorting domestic support, as measured by the Final Bound Total AMS plus permitted de minimis level and the level agreed in paragraph 8 below for Blue Box payments, will be reduced according to a tiered formula. Under this formula, Members having higher levels of trade-distorting domestic support will make greater overall reductions in order to achieve a harmonizing result. As the first instalment of the overall cut, in the first year and throughout the implementation period, the sum of all trade-distorting support will not exceed 80 per cent of the sum of Final Bound Total AMS plus permitted de minimis plus the Blue Box at the level determined in paragraph 15.

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

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

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

Implications

The Paragraphs 7 and 8 spell out some modalities of reduction of domestic subsidies. The language used in the paragraph 7 is somewhat complicated. There have been a few interpretations of this language but the general consensus is that it implies that at least 20 percent initial reduction in the first year of the implementation period of:

Total Bound AMS + Permitted De Minimis + Blue Box at level determined by Paragraph 15 … (1)

Before proceeding, it is important to analyse the Paragraph 15 of July Framework. It says:

"Blue Box support will not exceed 5% of a Member's average total value of agricultural production during an historical period. The historical period will be established in the negotiations. This ceiling will apply to any actual or potential Blue Box user from the beginning of the implementation period. In cases where a Member has placed an exceptionally large percentage of its trade-distorting support in the Blue Box, some flexibility will be provided on a basis to be agreed to ensure that such a Member is not called upon to make a wholly disproportionate cut."

This paragraph is important because of a few interesting caveats. This paragraph implies that Blue Box subsidies are to be capped at 5 percent of total value of production during an "historical period". The experience with UR AoA has shown that the choice of a base period has a significant bearing on the actual levels of commitment. In the July framework, countries have been given the choice of selecting an appropriate base period for calculation of the cap on Blue Box subsidies. It is obvious that if a 'historical period' is chosen in which the total value of agricultural production was very high, then it will also inflate the ceiling imposed on the Blue Box subsidies. For example, if one looks at the value of agricultural production of EU, choosing 1995 as the base period (value of agricultural production 268 billion USD), the Blue Box entitlement will be 13.4 billion USD. But if 2000 is chosen as the base period (value of agricultural production 216 billion USD), the Blue Box entitlement will be 10.8 billion USD[24].

Secondly, the sentence 'This ceiling will apply to any actual or potential Blue Box user from the beginning of the implementation period' implies that countries who were not existing users of Blue Box subsidies will be allowed to introduce this form of subsidy. Here it is notable that during the UR AoA, Blue Box was thought of as a transitory subsidy measure, which should be phased out by the end of the implementation period of the Uruguay Round. However, this has not happened and the July Framework actually legitimises the Blue Box measure and facilitates its introduction in countries like the USA, which previously have not used this form of subsidy.

Thirdly and most importantly, the final sentence of the paragraph 15 can be seen as a big let off for EU. EU is the biggest user of Blue Box subsidies and in 2000-01 these subsidies accounted for about 10 percent of its total value of agricultural production[25]. Capping the Blue Box at 5 percent of total value of agricultural production (even with the 'historical period' caveat) would have required EU to cut down on its Blue Box

[24] Source of the data on Value of Agricultural production is WTO Document Number TN/AG/S/21 dated 4 July 2005, titled 'Total Value of Agricultural Production: Note by the Secretariat'.

[25] According to figures published in the WTO Document 'Blue Box Support: Note by the Secretariat' (WTO Document No. TN/AG/S/14, dated 28 January 2005) Blue Box support as a percentage of the value of total agricultural production is highest for EU.

subsidies. However, the last sentence of Paragraph 15 can provide an escape route to EU.

So, if one reads Paragraph 7, 8 and 15 together, an interesting scenario emerges. Table 3.2 shows data on subsidies and agricultural production in EU and USA.

Table 3.2 Domestic Support: Actual and Entitlement in EU (in billion Euros) and USA (in billion USD) in 2001

Categories	EU (in billion Euros)	USA (in billion USD)
Bound AMS (AMS Commitment)	67.16	19.1
Product specific *'de minimis'* entitlement (@ 5% of VOP)	12.3	9.9
Non-product specific *'de minimis'* Entitlement (@5% VOP)	12.3	9.9
Actual 'de minimis support' (product specific and non-product specific)	0.86	7.04
Proposed Blue Box Entitlement (@ 5 % of VOP)	12.3	9.9
Existing Blue Box	23.7	0
Actual AMS	39.3	14.4
Memo Item		
Value of Agricultural Production (VOP)	246	198.5

Source: Notification of European Communities on Domestic Support, WTO Document Number G/AG/N/EEC/51, dated 04/11/2004, Notification of USA on Domestic Support, WTO Document Number G/AG/N/USA/51 dated 17 March 2004

Assuming that the current value of agricultural production is used for calculation of Blue Box cap and assuming that 5 percent cap on Blue Box is imposed on EU, the base level of TDS (i.e. equation 1) will be:

AMS Commitment + 5% of VOP (product specific de minimis entitlement) + 5% of VOP (non-product specific de minimis entitlement) + 5 % of VOP (Blue Box entitlement)

Adding these up shows that the base level of Overall Trade distorting Support (OTDS) will be 104.06 billion Euros. However, in 2001, actual AMS of EU was 39.3 billion euros, actual Blue Box was 23.7 billion euros and EU has used only 0.86 billion Euros as *'de minimis'* support[26]. Therefore, if one sums up the existing support, it comes to around 63.87 billion euros. Therefore unless the OTDS is cut by 38.6 percent or more, the EU will not have to undergo any reduction in its OTDS. Therefore, the 20 percent downpayment proposed in the July Framework will not be binding for EU. Here it

[26] Data on *'de minimis'* of EU are taken from WTO Document titled "De Minimis Support: Note by the Secretariat" WTO Document Number TN/AG/S/16, dated 1 February 2005, the same data are available in the EU submission to WTO on Domestic Support in WTO Document number G/AG/N/EEC/51 dated 4 November 2004.

must be remembered that this calculation has been done under the assumption of 5 percent cap on Blue Box. As discussed before, because of the leeway given in Paragraph 15, EU may get a higher level of cap on its Blue Box payments.

This requirement of 20 percent down-payment in the first year will not be binding for the US also. This is because currently USA does not use Blue Box subsidies. The provisions of July framework will allow USA to add 5 percent of their value of total agricultural subsidies as Blue Box subsidies.

Calculations based on 2001 data of USA and the reduction commitments specified under the July framework shows that USA can subsidise up to 48.88 billion US$ in trade distorting subsidies. It is notable that in 2001, AMS and *'de minimis'* support of USA add up only to US$ 21.4 billion[27]. Therefore, provision of 20 percent downpayment will not affect USA either.

In fact, there have been allegations that the paragraph 13 on the 'Framework for Establishing Modalities in Agriculture' actually proposes to alter the Article 6.5 of the UR AoA to facilitate countercyclical payments introduced in the latest US Farm Bill to be categorized as Blue Box support. A study by International Centre for Trade and Sustainable Development[28] has pointed out that paragraph 13.2 of the July Framework has made provisions for the creation of a new category of Blue Box measure called 'direct payments that do not require production'. According to the study, this provision allows counter-cyclical payments under the US Farm Bill to be categorized as Blue Box subsidies. As counter-cyclical payments are not decoupled from prices, these cannot be put under the Green Box and without this new provision, these payments would have been included under the Amber Box and thus would have been subject to substantial reduction commitments.

Thus, as far as USA is concerned, the July Framework actually allows inclusion of some of its trade distorting counter-cyclical payments in the proposed new Blue Box[29].

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[27] In 2001, ''*de minimis*'' support of USA was 3.5 percent of value of total agricultural production. USA currently does not use Blue Box subsidies.

[28] "Agriculture Negotiations at the WTO: The July Package and Beyond"- Quarterly Intelligence Report No. 12, ICTSD, Geneva, Switzerland.

[29] It should be reiterated here that during the Uruguay Round the Blue Box measures were introduced as a transitory measure with a commitment to phase them out by the end of the implementation period of the Uruguay Round.

Paragraph 9

"Final Bound Total AMS: A Tiered Formula

To achieve reductions with a harmonizing effect:

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

Implications

The introduction of a tiered formula allows better harmonization of AMS levels. However, the effectiveness of a tiered formula will only be clear when the structure of the formula and the accompanying reduction rates are announced. As the reduction of AMS will be from the bound levels, there will be significant 'water content' in it and only a deep cut in AMS will lead to an effective reduction in subsidies.

Capping of product specific support seems to be a welcome move. This is likely to prevent developed countries from putting a very high percentage of their domestic support into a small group of commodities. This provision is likely to be helpful for some commodities like cotton and sugar which attract very large subsidies in developed countries.

Paragraph 11. De Minimis

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

Implications

The reduction of *'de minimis'* is likely to become a contentious issue in the present round of negotiations. Particularly, developing countries have already expressed their reservations about any possible reduction of the *'de minimis'* support. It is notable that the July Framework exempt developing countries from reduction in '*de minimis*' level of subsidies if a high percentage of such subsidies are given to 'subsistence and resource-poor' farmers. However, the term 'subsistence or resource poor farmers' has not been defined in the July Framework. It is notable here that the Uruguay Round AoA also contained a clause which provides exemption of input subsidies to 'low-income or resource poor farmers' for developing countries. However, the term 'low income or resource poor farmers' is not defined in the agreement. In a notification submitted to WTO by India[30] it is claimed that farmers holding less than 10 hectares of land are considered to be resource poor or low income. In India, operational land holdings of 10 hectares or less accounted for 80 percent of agricultural land. So if above definition of resource poor farmer is accepted, India stands a good chance of getting a significant exemption in reduction of *'de minimis'* subsidies.

Green Box

The paragraph 16 of the July Framework has discussed the Green Box subsidies. The crux of the discussion is about tightening of the Green Box so that only minimal trade and production distorting subsidies are included in it. The modalities of tightening the Green Box have been left for negotiation.

It is important to note here that developed countries are big users of Green Box subsidies. For example, data for the period 1995-98 show that USA, EU and Japan accounted for about 80 percent of total Green Box subsidies given by all WTO Member countries (Table 3.3). Also many of the present Green Box measures do seem to have some production distorting effect. For example, 'Investment aids' accounts for about 26 per cent of all Green Box measures given by EU during 1995-2001. Hoda and Gulati (forthcoming) suggest that investment subsidies have the potential to cause considerable economic distortions by reducing the fixed cost of farm operations and artificially increasing the profitability of such operations. Therefore there is an urgent need to tighten the definition of the Green Box to stop its misuse.

[30] India's Notifications to WTO on Domestic subsidies, WTO Document number G/AG/N/IND/1 dated 17 June 1998 and WTO Document number G/AG/N/IND/2 dated 11 June 2002. G/AG/N/IND/1 says: "In India, operational land holdings of 10 hectares or less accounted for 79.5 per cent of agricultural land. If farmers holding less than 10 hectares of land are considered to be resource poor or low income, almost 80 per cent of the input subsidies will qualify for exemption from inclusion in non-product-specific AMS." Page 1.

Table 3.3. Green Box Subsidies given by USA, EU and Japan as a percentage of total Green Box support given by all WTO Members

	1995	1996	1997	1998	average 1995-98
United States	35.36	40.28	43.66	43.78	40.77
Japan	25.23	20.67	18.41	20.60	21.23
EC	18.57	19.44	17.44	18.42	18.47
Total	**79.16**	**80.39**	**79.52**	**82.79**	**80.47**

Source: Calculated from Members' Usage of Domestic Support Categories, Export Subsidies And Export Credits, Background Paper by the Secretariat, WTO document Number TN/AG/S/1 dated 5 March 2002

In the current round of negotiations, developing countries have expressed the opinion that the provisions of the Green Box measures reflect the nature of the support programmes administered by developed countries. Agricultural sector in developing countries often have different requirements and may require different set of agricultural support instruments. Developing countries are of the opinion that the Green Box provision should be modified to suit the requirements and needs of developing countries also. Therefore, many developing countries are insisting on a re-structuring of the Green Box subsidy to suit the legitimate concerns of these countries. However, there is also a view that the Article 6.2 of Agreement on Agriculture provides adequate policy instruments for developing countries and the Green Box Subsidies only need a tighter definition to ensure that it is not being misused by developed countries.

Section. 3.2. Post July Framework Negotiations on Domestic Subsidies

The discussion shows that the July Framework allows enough room to allow developed countries get away with much less than 'substantial reductions in trade-distorting domestic support'. This brings back the memories of Uruguay Round AoA where the domestic subsidy reduction commitments turned out to be least binding of all WTO commitments. However, the negotiation is still on and there are many important details of subsidy reduction which will be decided through the negotiation.

Developments following the announcement of the July package show that countries are now trying to device a specific tiered formula for AMS reduction. A few approaches have been suggested by negotiating countries and country-groups, however the discussion is still on the structure of the tiers. Actual reduction formula (including numerical values) will be negotiated once the structure of the tiers is finalized.

Till date different structures of the tiered formula have been suggested by Member countries. For example, according to the approach suggested by the G-20 country group, there would be four bands, with the first band comprising countries with support of less than $2 billion; the second band comprising countries with $2-12 billion support; the third band comprising countries with $12-25 billion support; and the fourth band comprising countries with above $25 billion support. The rate of reduction would be higher for countries with higher level of support. Other countries like USA and Australia have also proposed different variants of this tiered formula. These are shown in Table 3.4. EU, on the other hand, has proposed a three-tier formula that has EU in the highest bracket with US and Japan falling into the second category.

Table. 3.4. AMS Reduction Tiers Suggested in the WTO Negotiations

US: 4 bands		G-20: 4 bands		Australia: 4 bands	
$10 billion or less.	all other countries	$2 billion or less	Most developing, few developed countries	$1 billion or less	Most developing countries, Australia, New Zealand
Between $10-$20 billion	US	Between $2-$12 billion	Mexico, other developed countries	Between $1-$10 billion	Thailand, other developed countries
Between $20-$40 billion	Japan	Between $12-$25 billion	US	Between $10-$25 billion	Mexico, US
More than 40 billion	EU	More than $25 billion	EU, Japan	More than $25 billion	EU, Japan

Source: Aggarwal (2005)

Regarding the reduction formula for the overall Trade Distorting Support (TDS), the negotiations are also stuck at the stage of structuring the tiers. In this case also there are also a few approaches suggested by negotiating groups (Table 3.5). It is notable that G20 has suggested a three-stage structure for developed countries whereas for developing countries they have suggested a separate category. G20 has suggested that reduction commitments for developing countries to be 2/3rd of the reduction commitment for the developed countries which are in the lowest bracket. It is notable here that the tiered formulas for both AMS and TDS reduction will be based on absolute, not relative, levels of subsidies.

Recent reports indicate that there is some convergence among the Members that there would be three bands, with EU in the top band and Japan and USA in the middle band. However, there are unresolved issues regarding the treatment of developing countries within this structure[31].

[31] ‘Agriculture Negotiations - Status Report, Key Issues to be Addressed by 31 July 2005’, WTO Document Number JOB(05)/126, dated 27th June 2005

Table.3.5. TDS Reduction Tiers Suggested in the WTO Negotiations

US: 4 bands		G-20: 3 bands for developed countries		Australia: 5 bands	
		No cuts for developing countries with no AMS			Developing countries with no AMS
Less than $20 billion	Other countries	**Separate band for developing countries (2/3 cut of lowest band of developed countries)**		**Less than $5 billion**	Switzerland, Norway, South Africa, Tunisia, etc.
Between $20-40 billion	US, Japan, Canada	**Less than $10 billion**	Other developed countries	**Between $5-$30 billion**	Canada, Mexico, Korea, Brazil, etc
Between $40-60 billion		**Between $10-45 billion**	US, Japan	**Between $30-$90 billion**	US, Japan
More than 60 billion	EU	**More than $45 billion**	EU	**More than $90 billion**	EU

Source: Aggarwal (2005)

On the reduction of *'de minimis'* support by developed countries, G20 has proposed that reductions shall be made to both product specific and non-product specific *'de minimis'* support. Developing countries with no AMS entitlements shall be exempt from reductions. India has a strong position regarding this and thinks that the de-minimis support by developing countries should not be subject to any reduction commitments.

Though some progress have been made in the area of structuring the tiers for AMS and TDS reductions, significant differences exist regarding the treatment of Blue and Green Box subsidies. There has hardly been any convergence on the issue of tightening the Blue Box payments to ensure that these payments are least trade distorting. Developing countries are particularly concerned about the provisions (under the paragraph 13.2 of the Annex A of the July Framework) to incorporate counter-cyclical payments under the Blue Box category. However, there are indications that an additional restriction on the use of the Blue Box subsidies (along with the 5% cap suggested in the July framework) is under consideration.

Regarding the Green box subsidies, developing countries are approaching the issue from two different angles. On one hand they want Green Box subsidies to be tightened to ensure that they are non-trade distorting while on the other hand these countries want a review of the provisions under this box to include the support programmes suited to the requirements of developing country agriculture provided these support programmes are minimally trade-distorting.

Overall, it can be said that after the breakthrough achieved in the July Framework, the negotiation has not progressed very well. There is hardly any chance that a full 'modalities text' on agriculture will be achieved before the Hong Kong Ministerial. However, the negotiation will soon be entering a crucial stage where details regarding the actual agriculture modalities such as percentages for tariff and subsidy cuts, reduction formulae, criteria for domestic support, deadlines and transition periods will have to be decided. The negotiators from developing countries should try to identify the loop holes present in the July Framework and bargain hard to plug those using appropriate measures. In the UR AoA, the existence of the loopholes made the domestic support commitments least binding for developed countries and it helped perpetuate the distortions in agriculture. This time negotiators should make sure that it does not happen again.

Section 3.3. The Draft Text of Hong Kong Ministerial Meet on Domestic Support in Agriculture

The present Director General of WTO has recently produced a Draft Ministerial Text for the Hong Kong conference which sums of the consultative process during the run up to the Hong Kong Ministerial. The Paragraph 3.5 of the text mentions:

"On domestic support, we note in particular that there is a working hypothesis of three bands for developed countries for reductions in Final Bound Total AMS and in the overall cut in trade-distorting domestic support with higher linear cuts in higher bands. In addition, developed countries in the lower bands with high relative levels of Final Bound Total AMS will make an additional effort in AMS reduction. We also note that there has been some convergence concerning the reductions in Final Bound Total AMS, the overall cut in trade-distorting domestic support and in both product-specific and non product-specific de minimis limits"[32].

The ministerial draft provides a matrix on the range of cuts which has been suggested by the Members. The reduction schedule given in the ministerial text reproduced below (Table 3.6). According to this table, the EU would be placed in the top band (where 70 to 80 percent reduction in OTDS is required) with USA and Japan in the middle-tier.

Table. 3.6. Range of Cuts of OTDS as indicated in the Draft Ministerial Text

Bands	Thresholds (US$ billion)	Cuts
1	0-10	31%-70%
2	10-60	53%-75%
3	> 60	70%-80%

[32] Doha Work Programme, Preparations for the Sixth Session of the Ministerial Conference, Draft Ministerial Text, WTO Document Number JOB(05)/298/Rev.1, dated 1st December 2005.

However, these numbers should be interpreted with caution as they may translate into much lower level of effective reduction in subsidies. This happens because the way the OTDS is defined in the July Package, in most developed countries, there is a considerable overhang between the base level OTDS and the actual OTDS. As the stipulated cuts are from the base level, the effective reduction will be much less when it is calculated from the actual level. A simulation exercise is carried out to analyze the extent of effective subsidy reductions that major developed countries will need to undertake if the numbers given in Table 3.6 are used. The simulation is carried for USA and EU, the two largest users of domestic supports in the agriculture sector.

Methodology:

As mentioned before, the base OTDS is defined as the sum of AMS (commitment), Blue Box subsidy entitlement and de minimis subsidy entitlement for the base period.

Actual OTDS for a certain year can be defined as the sum of actual AMS, Blue Box and de minimis support given by a country in that year.

AMS: Data on AMS commitment and actual AMS are available from country submissions to WTO.

Blue Box Subsidies: The July framework and the draft ministerial text propose to impose a ceiling of 5 percent of the value of agricultural production on Blue Box subsidies. The ministerial draft text also mentions a proposal by USA to shrink the Blue Box to 2.5 percent of the value of agricultural production. However, the US proposal is also contingent upon a few additional conditions like a more flexible Blue Box and the reintroduction of the peace clause. Views expressed by developing countries in the current round of negotiations suggest that most of these countries will be totally against these conditions. Therefore, there is not a very high chance that the US proposal of 2.5 percent cap of Blue Box subsidies (along with the additional conditions of flexible Blue box and reintroduction of peace clause) will be accepted. Moreover, it is not likely that EU will be ready to accept a 2.5 percent cap on the Blue Box. Given these reasons, to calculate base OTDS, this study will assume 5 percent of VOP as a measure of Blue Box subsidy entitlement. For calculating actual OTDS, the amount of domestic support notified by the country under the Blue Box scheme (notified under the head ‘Direct Payments under Production-Limiting Programmes’) will be used.

De Minimis Subsidies: For developed countries, the maximum allowed de minimis support is 5 percent of the VOP. However, the 5 percent ceiling is separately applicable for product specific support and non-product specific support. So, the total allowed de minimis comes to 10 percent of the value of production for developed countries. For calculating the base level of OTDS, therefore, it seems logical to take 10 percent of VOP as de minimis support. However, this method of calculation induces an upward bias in the calculation of OTDS. This happens because the way de minimis and AMS are defined in AoA, if a country manages to use up the entire 5 percent entitlement for product specific de minimis, then by definition, it cannot have any product specific AMS. So, for a country with positive product specific AMS, taking the product specific de minimis entitlement as 5 percent of VOP, inflates the base OTDS. In spite of this inaccuracy, for the sake of simplicity, this study assumes that the total de minimis entitlement for calculating base level of OTDS is 10 percent of VOP. For calculating actual OTDS, this study uses the value of 'de minimis' support (sum of product and non-product specific 'de minimis') notified by the country in its notifications to WTO.

For both USA and EU, data for the year 2001 are taken for calculating the base OTDS.

Based on Table 3.6 and the using the methodology mentioned above, projected OTDS levels are calculated taking into account the range of cuts proposed in the draft HK ministerial text.

Results

Figures 3.1 and 3.2 show the findings. For USA, it is interesting to note that for OTDS cuts up to 56 percent of the base period, USA will not be required to make any reductions from its actual OTDS. In fact, 53 percent cut from its base OTDS level will imply that USA can actually increase their trade distorting subsidies by more than 1.5 billion USD. Table 3.7 and Table 3.8 show effective reduction rates for EU and USA respectively for the entire range of cut proposed in the draft ministerial text. It can be seen from the table that for EU, the stipulated 70 to 80 percent cut from the base level will only translate to an effective rate of reduction of only around 51 to 67 percent. Table 3.7 and 3.8 also show that even with cuts of around 60 percent for USA and 76 percent for EU, these countries will be able to maintain domestic support amounting to about 10 percent of the vale of production of their domestic agriculture.

Figure 3.1. USA: Projected OTDS levels after Implementing the cuts proposed in the Hong Kong Draft Ministerial Text

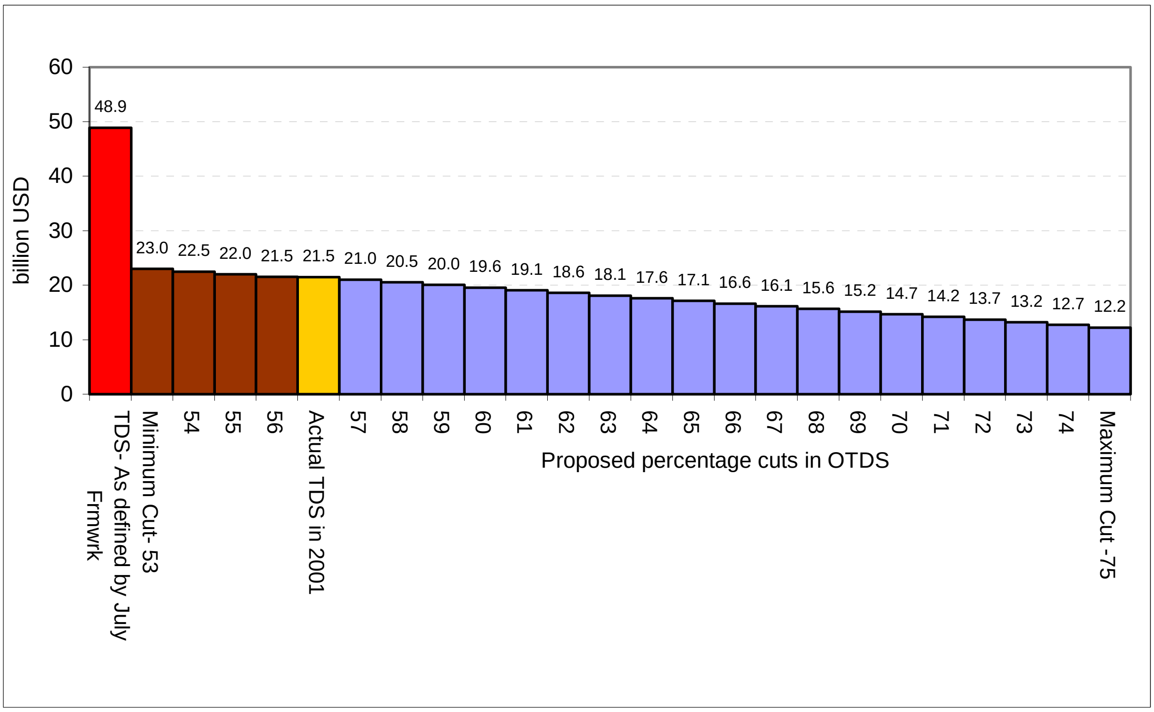
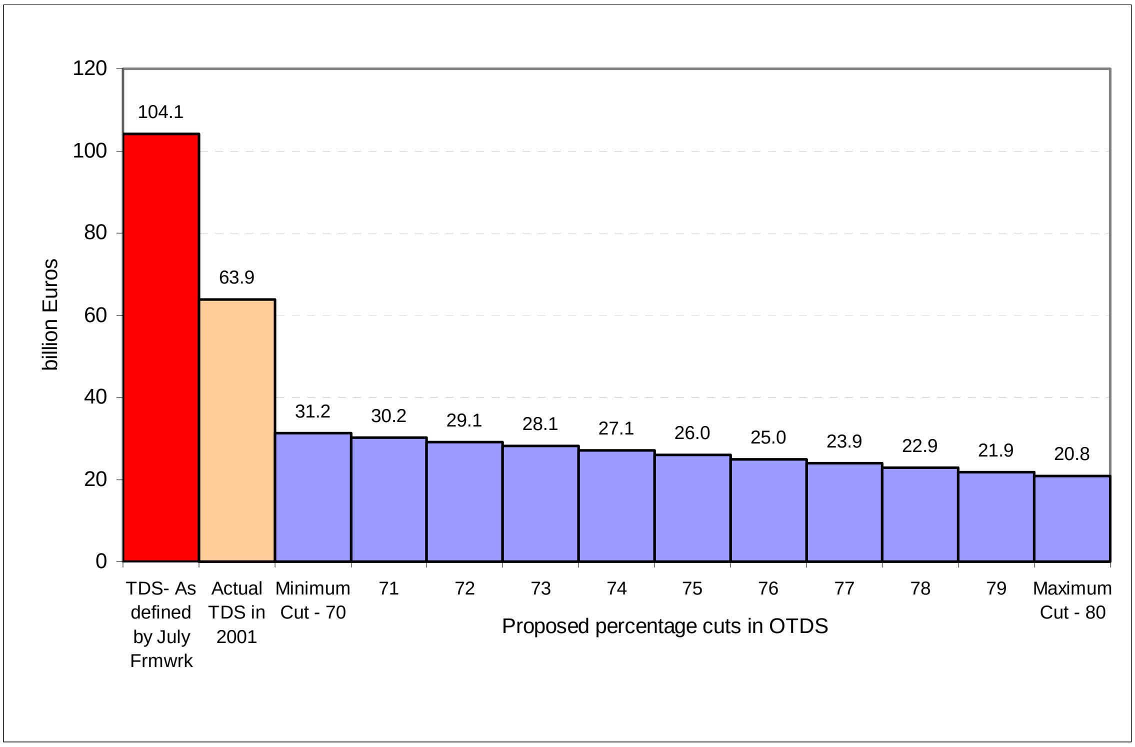


Figure 3.2. EU: Projected OTDS levels after Implementing the cuts proposed in the Hong Kong Draft Ministerial Text



Notes: for European Union, data are taken from EU's submission to WTO on Domestic Support for the Marketing Year 2001-02, WTO Document number G/AG/N/EEC/51 dated 4 November 2004

For USA, data are taken from USAs submission to WTO on Domestic Support for the Marketing Years 2000 and 01. Data for the marketing year 2001 are used for the calculation. Data are from WTO Document number G/AG/N/USA/51 dated 17 March 2004

Table 3.7. USA: Proposed OTDS Rate Cuts and Effective Reduction Based on 2001 Figures

Proposed Cuts from Base OTDS (in percentage)	Post Cut OTDS level (in billion USD)	Effective Rate of Reduction based on Actual OTDS on 2001 (in percentage)	Post Cut OTDS as a % of VOP
53	22.97	-7.06	11.57
54	22.48	-4.79	11.33
55	22.00	-2.51	11.08
56	21.51	-0.23	10.83
57	21.02	2.05	10.59
58	20.53	4.33	10.34
59	20.04	6.60	10.10
60	19.55	8.88	9.85
61	19.06	11.16	9.60
62	18.57	13.44	9.36
63	18.08	15.72	9.11
64	17.60	17.99	8.86
65	17.11	20.27	8.62
66	16.62	22.55	8.37
67	16.13	24.83	8.13
68	15.64	27.11	7.88
69	15.15	29.38	7.63
70	14.66	31.66	7.39
71	14.17	33.94	7.14
72	13.69	36.22	6.89
73	13.20	38.50	6.65
74	12.71	40.77	6.40
75	12.22	43.05	6.16

Table 3.8. EU: Proposed OTDS Rate Cuts and Effective Reduction Based on 2001 Figures

Proposed Cuts from base OTDS (in percentage)	Post Cut OTDS level (in billion Euros)	Effective Rate of Reduction based on actual OTDS on 2001 (in percentage)	Post Cut OTDS as a % of VOP
70	31.22	51.12	12.69
71	30.18	52.75	12.27
72	29.14	54.38	11.84
73	28.10	56.01	11.42
74	27.06	57.64	11.00
75	26.01	59.27	10.58
76	24.97	60.90	10.15
77	23.93	62.53	9.73
78	22.89	64.16	9.31
79	21.85	65.79	8.88
80	20.81	67.42	8.46

Notes: for European Union, data are taken from EU's submission to WTO on Domestic Support for the Marketing Year 2001-02, WTO Document number G/AG/N/EEC/51 dated 4 November 2004. For USA, data are taken from USA's submission to WTO on Domestic Support for the Marketing Years 2000 and 01. Data for the marketing year 2001 are used for the calculation. Data are from WTO Document number G/AG/N/USA/51 dated 17 March 2004

Aggregate Measure of Support (AMS)

Unlike OTDS, for AMS reduction there is close (but not full) convergence on the thresholds for the bands. There is almost a consensus that the top tier should be US$25 billion and above. But there is some remaining divergence over the ceiling for the bottom band, whether it should be up to US$12 billion or 15 billion. These thresholds indicate that EU should be in the top tier (and undertake AMS cuts within the range 70 to 83 percent). USA, which had AMS commitment of around 19 billion USD in 2001, is to be placed in the middle tier.

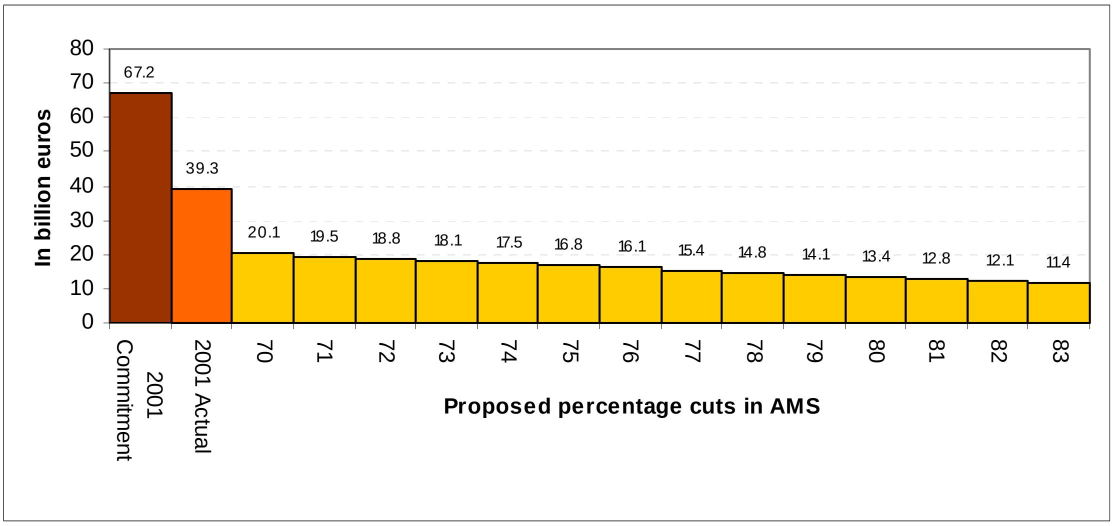
Table 3.9 gives the thresholds and the range of AMS cuts suggested under each band.

Table. 3.9. Range of Cuts of AMS as indicated in the Draft Ministerial Text

Bands	Thresholds (US$ billion)	Cuts
1	0-12/15	37-60%
2	12/15-25	60-70%
3	>25	70-83%

To estimate the extent of actual reduction these formulas will lead to, a simulation is done here. The results are shown in Figures 3.3and 3.4 and in Tables 3.10 and 3.11. The results show that due the presence of significant gap between the committed and actual AMS, the effective reduction of AMS will be much less for US and EU. For example, a 60 percent reduction of AMS for USA will translate into only about 47 percent effective reduction in the actual AMS levels of 2001. Similarly for EU, a 70 percent AMS cut will mean only 48.7 percent effective reduction from the actual AMS levels of 2001.

Figure 3.3. EU: Projected AMS levels after implementing the cuts proposed in the HK Draft Ministerial Text



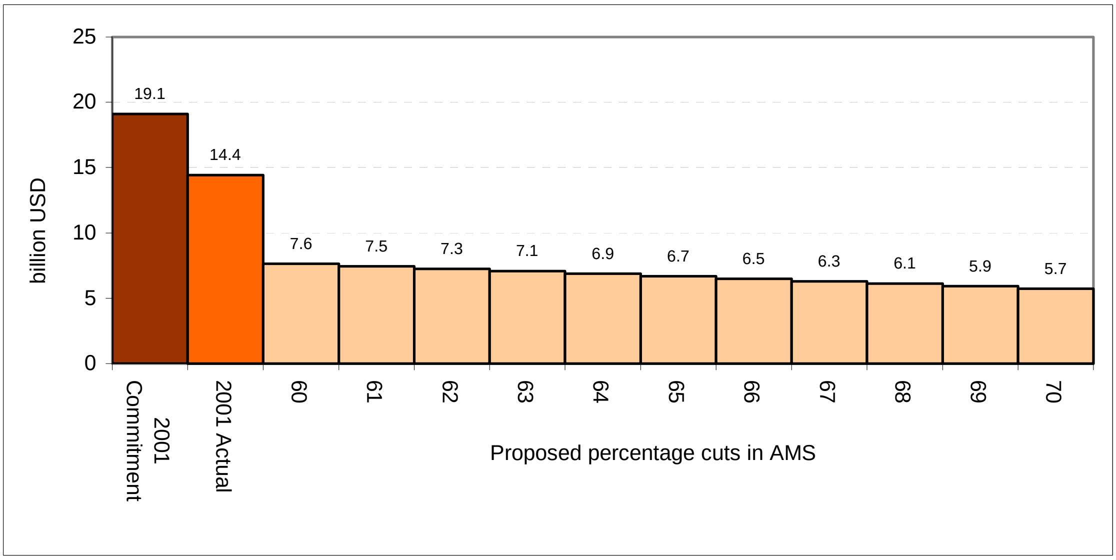


Table 3.10. USA: Proposed AMS Rate Cuts and Effective Reduction Based on 2001 Figures

Proposed Cuts (in percentage)	Post Cut AMS level (in billion USD)	Effective Reduction based on Actual AMS of 2001 (in percentage)	Post Cut AMS as a % of VOP
60	7.64	46.98	3.85
61	7.45	48.31	3.75
62	7.26	49.63	3.66
63	7.07	50.96	3.56
64	6.88	52.28	3.46
65	6.69	53.61	3.37
66	6.50	54.94	3.27
67	6.30	56.26	3.18
68	6.11	57.59	3.08
69	5.92	58.91	2.98
70	5.73	60.24	2.89

Table 3.11. EU: Proposed AMS Rate Cuts and Effective Reduction Based on 2001 Figures

Proposed Cuts	Post Cut AMS level (in billion Euros)	Effective Reduction based on Actual AMS of 2001 (in percentage)	Post cut AMS as a % of VOP
70	20.15	48.71	8.19
71	19.48	50.42	7.92
72	18.80	52.13	7.64
73	18.13	53.84	7.37
74	17.46	55.55	7.10
75	16.79	57.26	6.83
76	16.12	58.97	6.55
77	15.45	60.68	6.28
78	14.77	62.39	6.01
79	14.10	64.10	5.73
80	13.43	65.81	5.46
81	12.76	67.52	5.19
82	12.09	69.23	4.91
83	11.42	70.93	4.64

Notes: for European Union, data are taken from EU's submission to WTO on Domestic Support for the Marketing Year 2001-02, WTO Document number G/AG/N/EEC/51 dated 4 November 2004. For USA, data are taken from USA's submission to WTO on Domestic Support for the Marketing Years 2000 and 01. Data for the marketing year 2001 are used for the calculation. Data are from WTO Document number G/AG/N/USA/51 dated 17 March 2004

Overall, it can be seen that due to considerable overhang between actual and committed levels of subsidies, the effective reduction in subsidies will be much less than what it looks at the first glance. In fact, the above analysis shows that for certain reduction rates, USA will be able to increase its actual OTDS from its 2001 level. To avoid this kind of scenario, Members must ensure that reduction rates on OTDS are deep enough to translate into substantial effective reduction in trade distorting subsidies. In fact, there is a view that it will be much more important to focus more on achieving deeper cuts on OTDS than to spend too much negotiating effort on disciplining the individual components of OTDS. According to this view, if substantial reduction commitments are imposed on OTDS then it will automatically compress the AMS, Blue Box and the de minimis support.

As a benchmark for effective reduction of OTDS, it can be suggested that the negotiators should target that post-cut level of OTDS for developed countries should not exceed 5 percent of their total value of agricultural production (VOP). This will warrant even deeper cuts than suggested in the Honk Kong ministerial draft. The simulation exercise done in this section shows that even with 75 and 80 percent cut on base OTDS for USA and EU respectively, total trade distorting support levels in these countries exceed the 5 percent of VOP benchmark by a fair margin (Table 3.7 and 3.8).

Moreover, one should also keep in mind that the Green Box support is yet uncapped. Some countries may take advantage of this to shift some of their subsidies in the Green Box category. As it has been mentioned in this study, some of the Green Box subsidies indeed have production and trade distorting impact. As the Hong Kong Ministerial text gives no firm indication how the Green Box rules are going to be tightened, one must remain open to the possibility that to avoid actual reduction in their domestic support, developed countries may try the trick of 'box shifting' between OTDS and Green Box subsidies. Therefore, deep cuts in OTDS must also be accompanied by a tighter definition of Green Box subsidies to ensure that production or trade distorting subsidies cannot be given under the guise of Green Box support.

Section 4. Current Negotiations on Domestic Subsidies: Implications for India

Any multilateral rule regarding domestic farm subsidies can have an impact on India through two different routes. The most obvious and direct impact will be on the way the government provides subsidies to its farm sector. A less direct but equally important impact of the rule will be via the trade route. As it has been mentioned before, domestic subsidies in other countries can influence supply and prices of commodities in the international market. In an open trade regime, these effects get directly transmitted to the local economy. This section will analyze how the changes introduced in the July Framework can affect India through these two routes. The possible impact of the July Framework will be discussed under the light of India's domestic subsidy related commitments under the UR AoA.

4.1. Current WTO Negotiations and Domestic Farm Subsidy in India

India had no specific total AMS reduction commitments in its schedule. India's notifications submitted to WTO show that India's product specific support is negative and its non-product specific support is well below the *'de minimis'* level. India's product specific support is negative because India's Market Support Prices (MSP) for most commodities was below the external reference price (ERP)[33] for the concerned

[33] The average international price of a commodity for the period 1986-88 is taken as the External Reference Price for calculating product specific support for that commodity. To be more specific, Market price support for a product = (administered price at the farm gate - fixed external reference price) x eligible production… Where fixed external reference price = c.i.f. unit value for 1986-88 and eligible production = quantity of production receiving the administered price.

periods. And India does not provide any product-specific support other than market price support.

From India's first submission to WTO about domestic subsidies (document number G/AG/N/IND1 dated 17 June 1998), it can be seen that in 1995-96, India had market price support programmes for 22 products. Among these 22, 19 were reported in the document. Among the products reported in the document, only sugar cane had a support price higher than the external reference price. For all the other products, the MSPs were lower than the corresponding ERPs and hence India's total product specific support was negative.

India's second and latest submission to WTO[34] about domestic subsidies, however, reports lesser number of commodities under the MSP scheme. The commodities reported in these tables are rice, wheat and coarse cereals (bajra, jowar, maize and barley). The supporting table produced in G/AG/N/IND2 show that all these products had lower MSPs than ERPs for both the marketing years. As a consequence, India's total product specific supports were negative for both the years.

India's non product specific support shows some interesting changes over the years. For the marketing year 1995-96, India's non-product specific subsidies were in fertilizer subsidy, credit subsidy, subsidy on electricity, irrigation subsidy and subsidy on average supply of seeds. These subsidies amounted to about US$ 5,722 million, which was about 7.52 per cent of the corresponding total value of Indian agricultural production. This was below the *'de minimis'* level of 10 percent allowed for developing countries. Subsidies given under Special and Differential provisions (Article 6.2 of AoA) amounted to only US$ 254.3 million.

However, for the marketing years 1996-97 and 1997-98, there were some noticeable changes in the way India categorized its non-product specific subsidies and subsidies given under the S&D provisions in AoA. Using the S&D provisions of

[34] WTO document number G/AG/N/IND2 dated 11 June 2002, this document notified India's domestic subsidies for marketing years 1996-97 and 1997-98. This is the latest publicly available document on India's domestic subsidy notification to WTO (site accessed 24th July 2005).

Article 6.2[35] of AoA, India put a significant share of its non-product specific subsidies under the heads 'investment subsidies generally available to agriculture' and 'agricultural input subsidies to low income or resource poor producers'. The way this classification changed India's non-product specific support can be understood from Table 4.1

Table 4.1. India's Non Product Specific Support and Support under the S&D Provision

	S&D	Non Product Specific Support	total value of agricultural production	S&D	Non Product Specific Support
	In million US$			As a percentage of total value of agricultural production	
1995-96	254.31	5772.062	76736	0.33	7.52
1996-97	4855.09	930.34	85280	5.69	1.09
1997-98	5171.8	1003.48	84972	6.09	1.18

Source: Calculated from G/AG/N/IND1 (for 1995-96) and G/AG/N/IND2 (for 1996-97 and 1997-98)
Note: For developing countries, 'de minimis' level is 10 percent of the value of agricultural production

It is notable from the table that once a large percentage of India's non-product specific support has been shifted under the S&D category, India's notified non-product specific subsidy becomes rather insignificant[36].

India does not have any Blue Box payments but India has notified Green Box subsidies. Green Box subsidies were around US$ 2,502 million in 1996-97 and US$ 2,873 million in 1997-98. Among the Green Box subsidies a very high percentage (68 percent in 1996-97 and 70 percent in 1997-98) of subsidies went into public stockholding for food security purposes.

This discussion shows that India does not have any AMS or Blue Box support. India's current domestic subsidy levels are well below the permissible *'de minimis'* category

[35] Article 6.2 of Uruguay Round Agreement on Agriculture says:

'In accordance with the Mid-Term Review Agreement that government measures of assistance, whether direct or indirect, to encourage agricultural and rural development are an integral part of the development programmes of developing countries, investment subsidies which are generally available to agriculture in developing country Members and agricultural input subsidies generally available to low-income or resource-poor producers in developing country Members shall be exempt from domestic support reduction commitments that would otherwise be applicable to such measures, as shall domestic support to producers in developing country Members to encourage diversification from growing illicit narcotic crops. Domestic support meeting the criteria of this paragraph shall not be required to be included in a Member's calculation of its Current Total AMS.'

[36] As mentioned in Section 3, India assumes that farmers with less than 10 hectares of land can be called resource-poor and as four-fifth of landing holdings in India are in lands less than 10 hectares in size, India shifted 80 percent of its non-product specific support under the S&D provision.

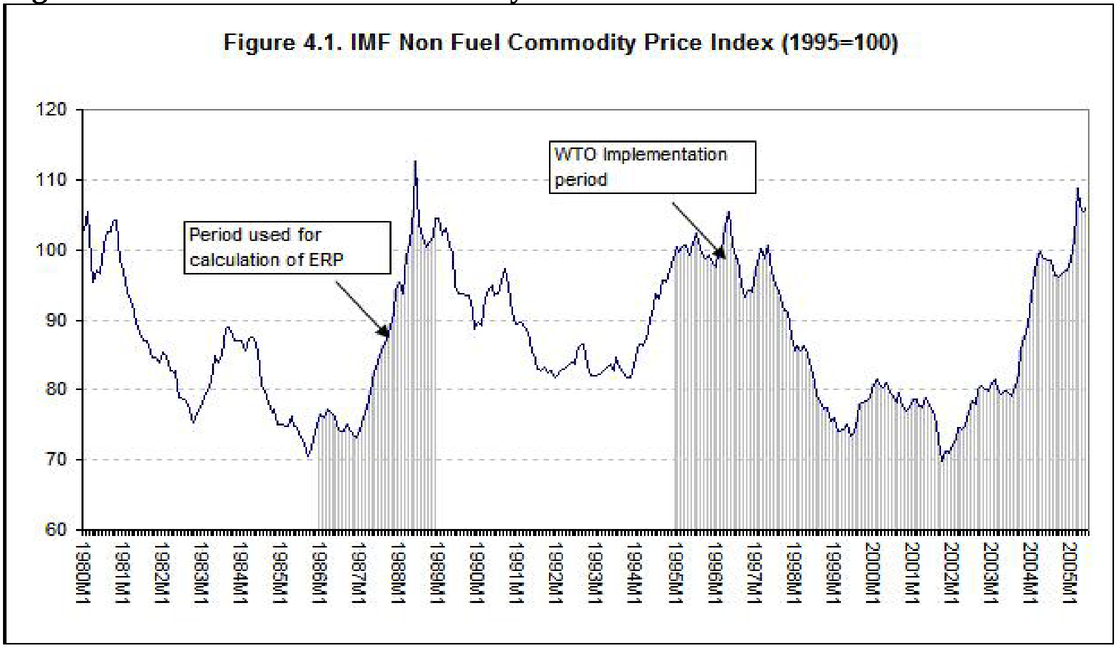
both in product specific subsidies and non-product specific subsidies. To reiterate, for product specific subsidies, India's support level were negative for all the years reported by India and non-product specific subsidies for India was only about 1.2 percent of the total value of agricultural production in the latest year reported by India. Therefore, the subsidy reduction formula suggested in the July Framework is unlikely to cause any problems for India. Subsidization of agriculture in India will be constrained more by fiscal compulsions rather than any incipient WTO rules[37].

However, as a small note of caution, it can be pointed out that the base year for calculation of ERP in the UR AoA was 1986-88. During this period, commodity prices were at a high level. However, after 1996-97, there was a decline in commodity prices till about early 2002. As Figure 4.1 shows, commodity prices were at a very low level during the period 1996-2002. If in the current round of negotiations, there is a change in the base period and if the new base period happens to coincide with one of the low commodity-price years, then India's product specific subsidy may turn positive[38]. This can happen because the Minimum Support Prices given by the Government of India have steadily increased over the years whereas the international commodity prices have gone through a steep decline. In fact, for a few commodities in certain years, India's MSP were higher than international prices. But to be realistic, the base change, even if it happens, is unlikely to coincide with a low price period as it will harm the bigger subsidizers of agriculture much more than it will do to India.

[37] It must be mentioned here that though the pressure to reduce non-product specific subsidies (like water and power subsidies) and Green Box subsidies (public investment in agriculture) does not come from WTO, but it comes more from fiscal constraints faced by the Government. Due to fiscal compulsions the Government is forced to cut down on some farm subsidies even when they are WTO compatible.

[38] However, in the current round of negotiations there have been no proposals to change the base period.

Figure 4.1. IMF Non-Fuel Commodity Price Index



Source: IMF Primary Commodity Prices, (http://www.imf.org/external/np/res/commod/index.asp)
Note: M1 stands for Month 1, i.e. January, last visited 15th July 2005

4.2. Current WTO Negotiations on Domestic Subsidies and Its Impact on India through Trade

During the Uruguay Round, initial projections suggested that the reform measures initiated by the AoA would open up new opportunities for developing countries. Early analysis of the likely effect of the AoA on world markets predicted that reduction in domestic support and export subsidies in the developed countries would lead to a deepening of world trade in agriculture, a spatial redistribution of agricultural production, an increase in the share of developing countries in global agricultural exports and more transparency in agricultural trade.

A recent WTO Secretariat paper[39] has analyzed agricultural trade performance by developing countries for the period 1990-2003. This paper shows that share of developing countries in world agricultural exports have increased only marginally over the period 1995-2003 (Table 4.2). Table 4.2 shows that between 1995 and 2003, developing countries have only managed to increase their share in global agricultural trade by 2 percentage points. A closer look at the regional trade patterns shows that

[39] 'Agricultural Trade Performance By Developing Countries 1990-2003, Note by the Secretariat' WTO document number TN/AG/S/19 dated 26 April 2005.

'Developing Asia'[40] has not gained any market share during this period and its market share has stagnated at around 16.5 percent for the entire period. The table also shows that the 2 percent gain in market share experienced by developing countries happened mostly because of good export performance of countries from Latin America and the Caribbean (mainly due to good export performance of Brazil, Argentina and Mexico).

Table 4.2. Share of Developing Countries in World Agricultural Exports by Region, 1990-2003(Percentage)

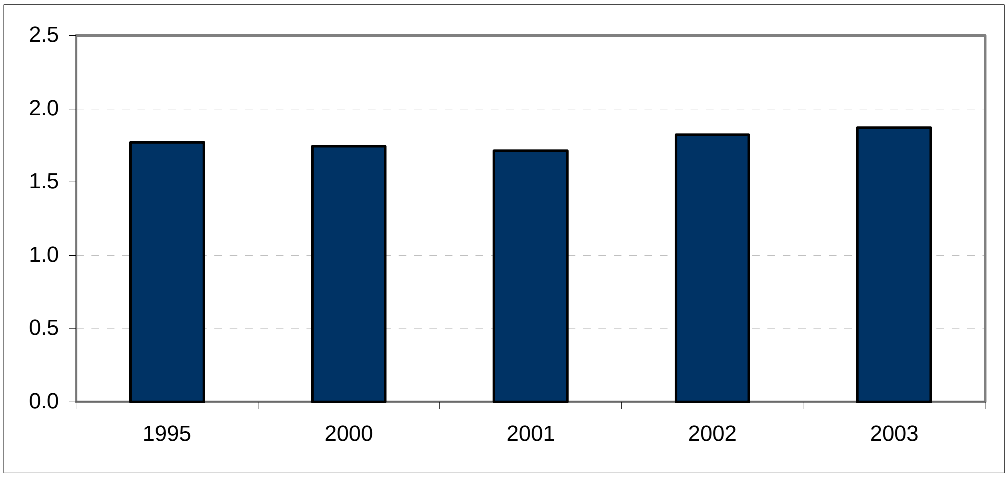
	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003
All Developing Countries	39	39½	39½	40	41½	42	40	40	41	41½
of which:										
Africa	6	5½	5½	5	5½	5½	4½	4½	5	5
Developing Asia	15	16½	16	15½	16	16½	16	15½	16½	16½
Latin America and the Caribbean	16	15½	16	17½	18	17½	17	17½	17½	17½
Middle East	2	2	2	2	2	2½	2½	2½	2½	2½

Note: The shares are expressed as a percentage of world agricultural exports, excluding intra-EC trade.
Source: WTO Secretariat.
Source: TN/AG/S/19

Calculations based on the data provided in the WTO document (TN/AG/S/19) shows that India's share in world agricultural exports has increased marginally from 1.77 percent in 1995 to 1.87 percent in 2003 (Fig 4.2). In fact the graph shows that for the UR AoA implementation period (1995- 2001), India's share in total agricultural exports was on a decline. Table 4.3 also shows that even in nominal terms (current US Dollars), India registered a decline in agricultural exports over the period 1995 to 2001. India's farm exports have marginally recovered in the last two years reported in the WTO study.

[40] Developing Asia include countries like China, Malaysia, Thailand, India, Indonesia, Singapore, Republic of Korea, Philippines, Pakistan, Chinese Taipei, Hong Kong, China and Macao, China.

Figure 4.2. India's Share in Global Agricultural Exports, (in percentage)



Source: Calculated from data provided in TN/AG/S/19

Table 4.3. Agricultural Exports of Twelve Developing Asian Countries, 1990-2003

	Value of Agricultural Exports					Share in Total Agricultural Exports		
	1995	**2000**	**2001**	**2002**	**2003**	**1995**	**2000**	**2003**
	Million USD (values in current US dollars)					**Percentage**		
China	11,483	11,951	11,950	13,514	15,974	3.81	4.11	4.52
Malaysia	6,907	5,461	5,319	7,211	8,995	2.29	1.88	2.54
Thailand	6,864	6,094	6,487	6,751	8,043	2.27	2.10	2.28
India	**5,345**	**5,072**	**5,089**	**5,612**	**6,616**	**1.77**	**1.75**	**1.87**
Indonesia	3,700	4,239	3,761	5,347	5,667	1.23	1.46	1.60
Singapore	4,371	2,849	2,597	2,740	2,608	1.45	0.98	0.74
Republic of Korea	1,669	1,596	1,673	1,706	1,935	0.55	0.55	0.55
Philippines	1,875	1,529	1,531	1,510	1,867	0.62	0.53	0.53
Pakistan	1,122	1,088	1,040	1,083	1,217	0.37	0.37	0.34
Chinese Taipei	2,927	1,019	939	939	976	0.97	0.35	0.28
Hong Kong, China	669	351	323	345	362	0.22	0.12	0.10
Macao, China	78	36	36	49	55	0.03	0.01	0.02
Total of above	**47,010**	**41,285**	**40,745**	**46,807**	**54,315**	15.58	14.21	15.37
Total Developing Asia	**49,783**	**46,499**	**45,985**	**50,735**	**58,322**	16.5	16	16.5

Source: Calculated from data provided in TN/AG/S/19
Note: Revised values for Hong Kong, China exclude re-exports, Zero indicates a value less than half of one per cent.

From time-series data it is notable that between 1995-96 and 2003-04, India's agricultural trade surplus has shown a decline (Table 4.4). This again highlights the fact that like most other developing countries, the anticipated gains from the AoA have mostly eluded India. The Table also shows that India's agriculture trade virtually stagnated for most part of the post WTO period; only to recover marginally in the past two years (Table 4.4). Continued distortion of the global agricultural trade market is said to be one main reason behind this poor performance of India in the agriculture trade front. Box 4.1 highlights The Economist's view about how farm support is hurting the agricultural exporters from developing countries like India.

Table 4.4: India's agriculture trade before and after WTO, million $.

Year	Import	Export	Trade surplus
1990-91	672	3352	2680
1991-92	604	3203	2599
1992-93	938	2950	2012
1993-94	742	4013	3271
1994-95	1891	4211	2320
1995-96	1761	6098	4337
1996-97	1863	6806	4943
1997-98	2364	6685	4321
1998-99	3462	6064	2602
1999-2000	3708	5842	2134
2000-01	2646	6273	3627
2001-02	3408	6234	2826
2002-03	3542	7161	3619
2003-04	4765	8029	3264

Source: Chand (2005)

Box 4.1 highlights that domestic support in developed countries not only insulates the markets of developed countries and threatens the domestic markets of developing countries with artificially cheap exports. Moreover, domestic supports in developed countries also negatively affect market access of developing countries in the third country markets by distorting the prices in those markets. Therefore, it is imperative that this round of negotiations try to correct the prevailing problems of global agricultural trade by ensuring more effective reduction of subsidies.

Box 4.1. How Subsidies in Developed Countries Hurt Developing Countries

'But agricultural policies in rich countries still distort markets at home and abroad. Worse, they hurt the poor. Price-support mechanisms make domestic consumers pay more for their food, hitting low-income families the hardest. And for farmers in poor countries, OECD agricultural policies are disastrous. If those farmers aren't being kept out of export markets by quotas or tariffs, they are being undercut in domestic markets by heavily subsidised produce from the developed world. While some have argued that rich-world subsidies are a net boon to poor countries because they provide cheap food to the masses, in those countries the poorest are often rural farmers, whose lives would be improved by higher prices for their products'.

Farm Support's Deep Roots, The Economist, June 22nd 2005.
(http://www.economist.com/agenda/displayStory.cfm?story_id=4100673)

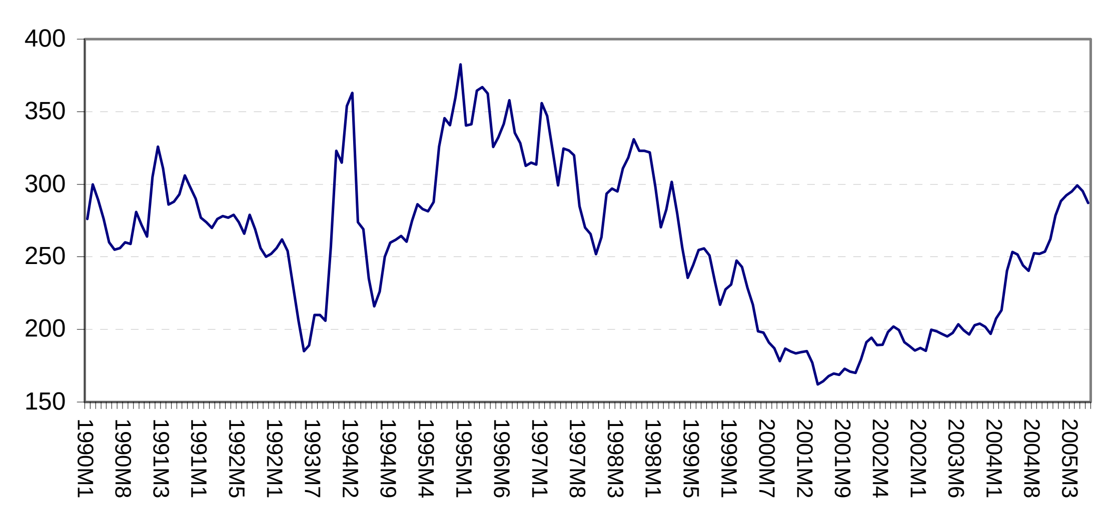
Subsidies in developed countries have affected the trading pattern of a number of Indian agricultural products. The example of rice can be pertinent here. During the early 1990s, India removed restrictions on rice exports. Following the removal of export restrictions, India emerged as a major rice exporting country. However, just after the Asian crisis, international price of rice started declining (fig 4.3). Low demand from some big importers of rice from Asia and Latin America was one of the reasons behind this decline. On the supply side, India and China's entry as an exporter in the international rice market and domestic policies undertaken by developed countries increased the supply-demand gap. This decline in international prices of rice was accentuated by heavy subsidization of rice farmers in USA.

Hoda and Gulati (forthcoming)[41] show that during the period when international rice price was declining, a massive dose of counter-cyclical subsidies were provided to the US rice farmers (fig 4.4). As a result, US rice producers were insulated from the price shock and they managed to maintain their high trading volumes. As USA is a major rice exporting country, this resulted in oversupply of rice in the international market and exacerbated the decline in international rice prices. The sharp drop in rice prices negatively affected all other rice exporting countries. During this period, domestic prices of most efficient rice producers like Thailand, Vietnam and India were above the international price of rice. India's exports of rice started declining from 1998 and it picked up again in 2000 when India started subsidizing freight and marketing costs for rice exporters. This managed to counter, to some extent, the negative effect created by international demand-supply imbalances and high subsidies in USA.

India had to change its tariff structure to counter this fall in international commodity prices. Till 1999, India had zero duty on some foodgrains including rice. However, the steady decline in international prices and the threat of an import surge led India to renegotiate tariff bindings on some products including rice. The tariff renegotiation also became important because at that time it was also realized that the quantitative restrictions India was having on the pretext of Balance of Payment (BoP) problems would no longer be allowed. India undertook tariff renegotiations under the Article XXVIII of GATT and as a result of it, in 1999-2000, bound tariffs on various rice types were raised from 0 to 70-80 percent.

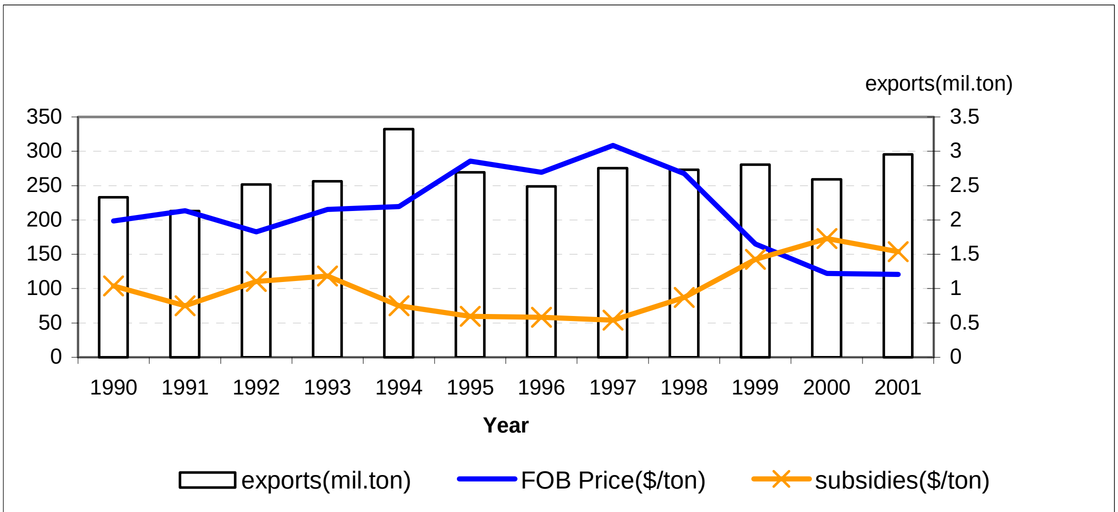
[41] Hoda, Anwarul and Gulati Ashok (forthcoming): *WTO, Agricultural Negotiations, and Developing Countries: Lessons from the Indian Experience,* Indian Council for Research on International Economic Relations, New Delhi.

Fig 4.3. International Price of Rice (Rice, 5 percent broken milled white rice, Thailand nominal price quote, US$ per metric tonne)



Source: International Monetary Fund (see notes for figure 4.1)

Fig. 4.4. USA: Domestic Support, F.O.B. Price, and Exports of Rice



Source: Hoda and Gulati (forthcoming)

Instability of international prices has negatively affected export performance of a few crops in which India is internationally competitive. NPC based analysis carried out Hoda and Gulati highlights that India has demonstrated competitiveness in three temperate zone crops- rice, wheat and cotton. However, exports of these crops have been sporadic because of low international prices faced by these commodities since the mid 1990s. These authors also point out that India can emerge as a competitive supplier of sugar and dairy products if international market distortions caused by the policies of support and protection pursued by some of the developed countries can be eliminated.

There is a possibility that as a result of the sustained decline in commodity prices, producers of some agricultural crops in India may become uncompetitive even at the domestic level. After the abolition of quantitative restrictions (QRs), the only instrument of protection available to the domestic governments is the tariff rate. Though India's tariff rates (applied and bound) are quite high by international standards, if the price decline continues unabated, then it is possible that the tariff adjusted prices of some of the agricultural goods can make the local production uncompetitive even at the domestic level.

It can be argued that in a free trade regime, producers of uncompetitive commodities should shift to the commodities where the country is internationally competitive. Under the current set of circumstances, this basically suggests that farmers of this country should diversify towards the cultivation of cash crops. However, this argument does not take into account the fact that for small and medium farmers of poor developing countries, it is not easy to shift from one crop to another. Low capital, inadequate rural credit which results from increased withdrawal of state and lack of information about the international commodity market conditions make it difficult for the farmers to make this transition. Also it is important to recognize that diversification is crucially dependent on food security. Unless a basic cushion of food security is assured, it will be extremely risky for small and medium farmers to diversify into non-foodgrain crops.

Box 4.2. Cash Crops, Price Volatility and Food Security Problem in India

Higher returns from some export oriented cash crops like tobacco and sunflower have lured even smaller farms to undertake cash crop cultivation at the expense of traditional crops including foodgrains. This is a risky move because these farmers are now totally dependent upon the revenue form the cash crops even for their domestic consumption. International prices for cash crops are volatile and they fluctuate wildly from year to year. Every now and then, low prices of these commodities lead to heavy losses for farmers. The farmers who do not maintain a cushion of self-produced foodgrains to support them, such losses can create huge food security problems. In southern part of India, there have been numerous cases of farmer suicides because of this reason.

Opening up of the agriculture sector has also introduced a new element of risk in the system. International commodity prices are highly volatile in nature. A study by Pal (2004)[42] shows that for a large number of commodities, price volatility has actually

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[42] Pal, Parthapratim, 'The WTO Agreement on Agriculture and Its Impact on Employment and Gender in India', Paper Prepared for the Conference on Gender and Macroeconomics, University of Utah, June 2004

increased in the post UR period. In a tariff only regime, the instability of international commodity prices is likely to be transmitted directly to the domestic market. High volatility of agricultural commodities alters the risk perception of farmers and introduces a speculative element in agricultural prices. This is likely to have serious implications for farmers in India[43]. In fact, a committee looking at the issue of suicide by farmers in Andhra Pradesh have found that the volatility of crop prices has

been a major source of income instability and distress for farmers (see Box 4.2)[44].

To a large extent the decline and volatility of international commodity prices can be attributable to the subsidy regime in developed countries[45]. Findings of the WTO Dispute Settlement Board (DSB) on sugar and cotton subsidies have clearly established the causal relationship between farm subsidies, over production of subsidized products and the consequent decline in international commodity prices. This brings the issue of interaction between domestic subsidies and market access into the picture. If international commodity prices can be artificially manoeuvred by developed countries using their domestic subsidies, then there is a case for non-subsidizing countries to protect their domestic markets from unfair competition through some form of market access barriers. In AoA, almost all forms of explicit Non-Tariff Barriers (NTBs) are prohibited. Variable levies (i.e. tariffs that are imposed as an inverse function of international prices) are also not allowed under the AoA agreement. The Special Safeguard (SSG) mechanism (which allows countries to impose higher duties if there is an import surge) is only available to countries which went for the tariffication-Tariff-Rate Quota (TRQ) route in UR. As India took the ceiling binding approach (or the Bound Tariff route) in AoA, SSG mechanisms are not available to India. In the absence of SSG mechanisms, countries like India derive their flexibility in application of tariffs from the differences between bound and applied tariff rates. There have been suggestions that India's bound tariff rates are inordinately high and they should be brought down to more reasonable levels. While it is indeed true that 300 percent tariff

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[43] See Nayyar, Deepak and Sen, Abhijit (1994) 'International Trade and the Agricultural Sector in India' in Economic Liberalization and Indian Agriculture. In G. S. Bhalla. ed. *Economic Liberalisation and Indian Agriculture, New Delhi: Institute for Studies in Industrial Development*

[44] See 'Report of the Commission on Farmers' Welfare', Government of Andhra Pradesh, dated April 7th 2005, available at: http://www.macroscan.net/pol/apr05/pol070405Andhra_Pradesh.htm

[45] The basic argument is that continued subsidization of agriculture and the dominance of a few developed countries in world agricultural trade have not allowed other countries to join the international farm trade. As a result, the depth of international agriculture trade market has not increased. Therefore, prices of agricultural goods remain as volatile as before.

rate is unlikely to be required for the protection of any commodity, to counter the threat of subsidies and artificially low international commodity prices it is important to allow for some headroom (in the form of difference between bound and applied tariff rates) and flexibility in tariff application. Therefore, India should be careful about its market access strategy. In this context, in the current round of negotiations, developing countries should link the issue of tariff reduction with the level of subsidization in developed countries.

However, it must be mentioned here that in the current round of negotiations, there are indications that a SSG type instrument will also be made available to developing countries. Moreover, there are talks about providing additional protection to some agricultural commodities in the form 'Special Products' and 'Sensitive Products'[46]. If these new instruments are made available, then the need for the additional headroom in the application of tariff rates may be less.

Section 5. Conclusions and Negotiating Options for India

The discussion in this paper once again highlights the fact that the UR disciplines to reduce domestic farm subsidy have been largely unsuccessful in bringing down trade and production distorting domestic subsidies in developed countries. Given the call for substantial reduction of trade distorting subsides in the Doha Ministerial Declaration, a lot of hope is placed on the current round of negotiations to achieve a more meaningful reduction in these subsidies.

The July Framework has been seen by many developing countries as a breakthrough that would eliminate billions of dollars in farm subsidies. According to Celso Amorim, Foreign Minister of Brazil, *"Obviously, developing nations did not get everything they asked for in Geneva. But the overall direction is clear: This is the beginning of the end to export subsidies; the stage is set for a substantial reduction in all types of trade-distorting domestic support; market access negotiations will open up new opportunities for trade, without prejudice to the needs of developing countries*."[47]

However, a closer scrutiny of the July Framework reveals that there are some waivers built into the framework which may allow developed countries to maintain and, in some cases, increase domestic farm support and still remain WTO consistent.

[46] For a detailed discussion on these issues see 'Special Products: Options for Negotiating Modalities' by Anwarul Hoda, ICTSD, 2005. Available at http://www.ictsd.org/dlogue/2005-06-16/Hoda.pdf

[47] Financial Times, 4th August 2004.

Negotiators from developing countries should remain cautious about these possibilities and should try to plug these legal loopholes. Otherwise, the current round of farm trade talks on disciplining domestic subsidies may end up being as ineffective as the Uruguay Round disciplines.

An analysis of the draft ministerial text for the Hong Kong meet also indicates that unless deep reduction commitments are imposed on developed countries, it will not lead to a substantial cut in actual trade distorting domestic subsidies in these countries. Otherwise, the existence of significant overhang between actual and committed levels of subsidies will allow developed countries get away with minimal effective reduction in their domestic support. To avoid this kind of scenario, Members must ensure that reduction rates on OTDS are deep enough to translate into substantial effective reduction in trade distorting subsidies. As a numerical benchmark, it can be suggested here that the negotiators should calibrate the subsidy reduction formulas so that the post-cut level of OTDS for developed countries should not exceed 5 percent of their total value of agricultural production. It will also be extremely important to introduce strict disciplines on Green Box subsidies so that the scope of shifting some of the subsidies from OTDS category to Green Box does not exist.

As far as India is concerned, it appears that the subsidy disciplines introduced in the July Framework are not going to have a constraining impact on the domestic subsidies given to the farm sector in this country. India's farm subsidy levels are well below the *'de minimis'* level prescribed by the AoA and it is unlikely that India will be hitting the *'de minimis'* level either in the product specific or non product specific subsidies in anytime soon. However, the current round of negotiations and its subsidy reduction provisions will be extremely important for India in the trade front. The poor performance of India's agricultural trade in the post WTO period can be largely attributed to the distortions of the international agricultural trade market. In the current round of trade talks, India must negotiate hard to effectively and significantly reduce the production and trade distorting subsidies in developed countries.

Section 5.1 India's Negotiating Strategies and Options in the Current Round of Negotiations

India has followed a two pronged approach towards domestic subsidies in the current of negotiations. On one hand, India wants substantial reduction in domestic subsidies in developed countries. On the other hand, it proposes that there should be sufficient flexibility in the rules to allow developing countries pursue support measures towards non-trade concerns like poverty alleviation, rural development, rural employment and diversification of agriculture[48].

As a part of the G20 initiative, India is now pursuing a similar set of objectives. To achieve these goals, the G20 group has adopted the following strategies:

1. It has been recognized by the G20 that under the framework suggested by the July package, effective reduction in trade distorting domestic support is not going to be achieved unless significant reduction commitments are undertaken by the developed countries. Therefore, the G20 group has proposed appropriately structured 'tiered subsidy reduction formula' with high reduction coefficients for countries with high level of TDS. If effectively calibrated, such a formula can lead to a near harmonization of subsidy levels and can also take care of some of the shortcomings of the July framework which this paper has highlighted. The G20 should try to fine tune the subsidy reduction formula in a way which will allow them to plug the loopholes present in the framework agreement. The G20 should take a firm stand on this issue and ensure that an appropriate formula with high reduction coefficients is adopted in this round. G20 may suggest a formula which will bring down the existing level of OTDS in developed countries to around 5 percent of their value of agricultural production.

2. G20 feels that the present definition of Blue Box subsidies does not ensure that subsidies categorized under this box are 'minimal or least trade distorting'. According to G20, any change in the Blue Box subsidy system 'should be contingent upon agreement on additional criteria in order to make it substantially less trade-distorting than it is now'[49]. G20 is particularly concerned about the possibility of re-classification of US counter-cyclical payments as Blue Box subsidies. It has been historically seen that counter-cyclical payments insulate farmers from price fluctuations and lead to overproduction and price suppression in the international market. Therefore, these payments are neither 'production limiting' nor do they justify the requirement 'minimally trade distorting'. G20 should resist any attempts to classify these subsidies as 'Blue Box' subsidies.

[48] WTO Document number G/AG/NG/W/102, Proposals by India in the areas of: (i) Food Security, (ii) Market Access, (iii) Domestic Support, and (iv) Export Competition; date 15/01/2001.

[49] Paragraph 12, G-20 Delhi Declaration, dated 18th and 19th March 2005

3. G20 is also proposing to tighten the Green Box subsidies for developed countries. However, they also feel that the provisions categorized as Green Box subsidies do not adequately cover the subsidy measures specifically required to cater to the needs of developing countries (like poverty alleviation and rural development). Therefore, a restructuring of the Green Box subsidies has been proposed to ensure that it will not only be non-trade distorting but it will also take into account the legitimate concerns of developing countries. G20 also suggested putting in place a monitoring mechanism to ensure that Member countries are not misusing the provisions of the Green Box. These are valid concerns because during the UR implementation period, there were evidences that countries like USA were providing huge supports by 'dressing up all support measures in Green'[50]. G20 should take utmost care to ensure that the possibility of such 'box shifting' in minimal in this round of negotiations.

4. Regarding *'de minimis'* level of subsidies, G-20 is of the opinion that the *'de minimis'* ceiling should not be reduced for developing countries as for many of these countries, this is the only form of support available to most farmers. The Indian position suggests that India wants the *'de minimis'* ceiling for developed countries to be reduced by 1 percent (to 4 percent of the value of agricultural GDP) but does not want any reduction in the *'de minimis'* level for developing countries. India's position is not unjustified because in developing countries, a very large number of people are dependent on agriculture for their livelihood and food security. Putting a tighter lid on governments of developing countries from supporting these people will not be fair. Secondly, the amount of subsidies given to the farmers in developing countries under the *'de minimis'* clause is virtually insignificant when it is compared to the subsidy levels of the developed countries.

Strategies followed by the G20 group suggest that they are moving in the right direction. They must ensure that the current round of negotiations leads to substantial and effective reduction in domestic farm subsidy levels in developed countries. However, it must be kept in mind that farm subsidy is a politically sensitive issue in many developed countries and these countries will be playing all their cards to avoid any substantial cuts in their subsidy levels. One possible way of pressurizing developed

[50] See 'The Green Barrier to Free Trade' by C.P. Chandrasekhar, Jayati Ghosh and Parthapratim Pal, available at: http://www.networkideas.org/focus/feb2003/fo03_Free_Trade.htm

countries will be to link market access in developing countries to the levels of domestic subsidies in developed countries. Inter-sectoral bargaining can also be used to force significant reduction in subsidies in this sector.

Secondly, any pressure to re-introduce the ‘Due Restraint’ clause or the Peace Clause should be resisted. It is noteworthy that a ‘Due Restraint Clause’ or ‘Peace Clause’ was incorporated in the AoA which provided significant immunity to the subsidizers of agricultural products from countervailing duties. The Peace Clause has expired in 2004 and now WTO Member countries have the option to use Anti Dumping (AD) and Countervailing duties (CVD) against subsidized agricultural exports. The expiry of the Peace Clause has made many commodity-specific EC and US agricultural subsidies vulnerable to legal challenges (see Steinberg and Josling[51]).

And most importantly, the G20 initiative should be strengthened. Brazil, China, India and other members of the G20 groups have emerged as a counter weight to the traditional big players in WTO. The ‘Blair House’ kind of a deal will be difficult to impose in the current context[52]. However, there will be pressures from different groups to break the G20 alliance. It must be remembered that G20 is still a fragile alliance and there were some signs of mistrust among members when Brazil and India joined the Five Interested Parties (FIPs) group during the signing of the July Package.

Recent reports coming out of Geneva indicate that high level bi-lateral talks on agriculture between EU and USA has taken place in Paris during September 2005. Along with these two countries, these talks also involved Brazil and India (called the ‘new QUAD’) and a few other countries (dubbed FIPS+)[53]. Though, apparently the Paris meet did not yield much results, India’s participation in these meets may again raise some uneasy questions within the G20 group. While joining these select groups of powerful WTO Member countries must be giving India greater leverage and voice in the negotiations, India must remain very careful that it carries the concerns of other G20 members and does not become soft towards the countries which are responsible for the current distortions in the international agricultural trade.

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[51] Steinberg, Richard H. and Timothy ~~E. Josling, ‘When~~ the Peace Ends: The Vulnerability of EC and US: Agricultural Subsidies to WTO Legal Challenge’, November 2003, http://www.ictsd.org/issarea/atsd/products/docs/Steinberg_Josling.pdf (last visited July 15th, 2005)

[52] For example, in Cancun, developing countries managed to fend off the so called ‘Derbez Text’ which was based closely on a joint EU-US proposal on agriculture circulated a few days before the Cancun Ministerial.

[53] Bridges Weekly, 21st September 2005 and 28th September 2005, http://www.ictsd.org/weekly/

Annex 1. WTO Ruling against US Cotton Subsidies

Domestic subsidies given to farmers in the US and its impact on other cotton exporting countries have become an issue of serious discontent among WTO Members. According to estimates, USA's 20,000 cotton farmers will be given subsidies in the tune of around $4.7 billion in 2005, which is an amount equivalent to the market value of the crop[54]. In October 2002, the Government of Brazil disputed the legal status of US cotton subsidies under WTO and requested consultations with the Government of the United States about prohibited and actionable subsidies provided to producers, users and exporters of upland cotton in USA. In its submission to WTO[55], Brazil argued that at the core of this case are $12.9 billion of US subsidies for upland cotton for the years 1999-2002. According to Brazil, these subsidies increase and maintain the production of high-cost US upland cotton, increase US cotton exports, suppress US, world and Brazilian prices and lead to the United States having a more than equitable share of world export trade. Brazil has also established that the US subsidies between 1999 and 2002 caused significant price suppression of cotton in the international market. Brazil alleged that these US subsidies are inconsistent with various provisions of the Agreement on Agriculture (AoA), the Agreement on Subsidies and Countervailing Measures (SCM) and the GATT.

The submission of Brazil also highlighted some interesting facts. It showed that in spite of steady decline of prices of cotton over the last few years, US planted acreage of cotton has increased. The paper argued that without the US subsidies, many US upland cotton producers would have to switch to crops providing a higher market return or take marginal land out of production. Estimates published in the submission show that without subsidies, US acreage and production of cotton would fall considerably. In addition to falling US production, the removal of US subsidies would also result in significant reductions in US exports contributing to increased world prices. Calculations show that for the period 1999-2002, in absence of subsidies, US exports of cotton would fall from the annual actual average exports of 8.62 million bales by 41.2 per cent to 5.07 million bales. This reduction of 3.55 million bales represents 13.4 per cent of the total average world export market between 1999 and 2002. The paper argues that given the relatively inelastic demand for upland cotton, the 13.4 per cent decrease in the supply of cotton to the world export market would have led to an increase of cotton prices in the international market[56].

Price distortions caused by US subsidies have a direct impact on other cotton exporting countries. The worst sufferers are some countries from West Africa, which are heavily dependent upon cotton for their export earnings. In Benin, Burkina Faso, Mali, and Chad cotton production accounts for five to ten per cent of gross domestic product (GDP). Cotton also plays a central role in their trade balance, accounting for close to thirty per cent of total export revenue, and more than 60 per cent of

[54] Human Development Report 2005, Page 131

[55] 'United States - Subsidies on Upland Cotton - Request for Consultations by Brazil', WTO Document Number G/AG/GEN/54, dated 03/10/2002

[56] Submissions regarding this dispute settlement case are available here http://www.wto.org/english/tratop_e/dispu_e/cases_e/

agricultural exports revenue[57]. It is notable here that cotton exports are of marginal relevance for the United States. Estimates by IMF show that when world cotton prices fell to a 50-year low in 2001, losses attributable to US subsidies were estimated at 1 percent to 3 percent of GDP for countries such as Burkina Faso and Mali in West Africa[58].

A Panel was established on 18 March 2003 to consider claims by Brazil regarding various support measures given by USA to its cotton sector that allegedly constituted actionable subsidies. The WTO Panel Report[59] ruled in favour of Brazil saying that some of the subsidies given by US result in serious prejudice to Brazil's interests in the form of price suppression in the world market. The Panel report also found that there a causal link exists between US price-contingent subsidies and the significant price suppression in the international cotton market. The Panel Report has give four reasons for this. They are:

1. The United States exerts a substantial proportionate influence in the world upland cotton market.

2. The Panel Report found that the US price-contingent subsidies are directly linked to world prices for upland cotton, thereby insulating United States producers from low prices.

3. The Panel found that there is a coincidence of suppressed world market prices and the price-contingent United States subsidies.

4. The Panel found credible evidence on the divergence between United States producers' total costs of production and revenue from sales of upland cotton. This finding supported the claim by Brazil that United States upland cotton producers would not have been economically capable of remaining in the production of upland cotton had it not been for the United States subsidies at issue and that the effect of the subsidies was to allow United States producers to sell upland cotton at a price lower than would otherwise have been necessary to cover their total costs[60].

On 18 October 2004, the United States notified the DSB of its intention to appeal against some of the conclusions reached by the Panel. The USA appealed to the WTO Dispute Settlement Body and in its submission to the WTO[61] sought a "review by the Appellate Body of the Panel's legal conclusion that certain U.S. decoupled income support measures - that is, production flexibility contract payments under the Federal

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[57] WTO document number TN/AG/SCC/GEN/2, dated 22 April 2005

[58] International Monetary Fund (2005): 'Burkina Faso: Second and Third Reviews under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Requests for Waiver of Nonobservance of Performance Criteria and Extension of Commitment Period.' IMF Country Report 05/95. Washington, DC. http://www.imf.org/external/pubs/ft/scr/2005/cr0595.pdf]. May 2005

[59] United States – Subsidies on Upland Cotton Report of the Panel WTO document number WT/DS267/R, dated 8 September 2004

[60] WT/DS267/R, para. 7.1351

[61] 'United States - Subsidies on Upland Cotton - Notification of an Appeal by the United States under Paragraph 4 of Article 16 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU")', WTO Document Number WT/DS267/17, dated 20 October 2004

Agricultural Improvement and Reform Act of 1996 ("1996 Act"), direct payments under the Farm Security and Rural Investment Act of 2002 ("2002 Act"), and "the legislative and regulatory provisions which establish and maintain the [direct payments] programme" - are not exempt from actions under Article 13(a) of the Agreement on Agriculture."

The Appellate body ruled mostly in favour of Brazil and upheld all the major conclusions of the earlier Panel Report. Taken together, the recommendations and conclusions of the AB and the Panel Report can have far reaching implications for future trade disputes. Apart from giving a much tighter interpretation of permissible agricultural subsidies (blue and green box subsidies), it appears that a long standing question whether agricultural subsidies should be dealt with under the SCM agreement has also been resolved. The Panel report has made it clear that the SCM is applicable to agricultural products and the obligations under the SCM run parallel to the AoA provisions. This is an important verdict as the expiry of the Peace Clause will allow many countries to initiate countervailing measures against subsidized agricultural exports. It is also worth highlighting here that this ruling is the first ever to target domestic agricultural subsidies in the WTO.

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