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## **WTO Constraints on U.S. and EU Domestic Support in Agriculture: The October 2005 Proposals<sup>\*</sup>**

Lars Brink

*Agriculture and Agri-Food Canada, Ottawa, Ontario*

The USA, the EU and the G-20 submitted proposals on domestic support in the WTO agriculture negotiations in October 2005. This research projects future support, allowances and constraints for the USA and the EU under these proposals. Accounting properly for the *de minimis* rules generates a “maximum usable components” constraint, which, even when added to the cap on blue, can be more constraining than the new overall commitment. The overall commitment under the U.S. proposal constrains neither the USA nor the EU in the future. However, the Overall commitment under the EU and G-20 proposals constrains both the USA and the EU to provide less future Overall Support than the sum of the cap on blue and maximum usable components. In general the three proposals are weak in constraining future distorting support in the USA and the EU.

Keywords: agriculture, AMS, *de minimis*, domestic support, overall reduction, WTO

## Introduction

The 2004 Framework Agreement on Agriculture that emerged from the Doha Round of WTO trade negotiations articulated many elements that together form the basis for the negotiations of modalities (WTO, 2004).<sup>1</sup> Members have since submitted proposals referring to the 2004 Framework. In particular, the USA, the EU and the G-20 submitted domestic support proposals in October 2005.<sup>2</sup>

This article reviews the major elements of the three proposals, examines key issues in assessing how they would constrain future distorting support, and introduces projections of future U.S. and EU support to estimate the severity of any constraints the proposals would impose on projected future U.S. and EU support. The term “AMS” (Aggregate Measurement of Support) is used here as defined in the Agreement on Agriculture (WTO, 1995), contrary to its use in many popular writings. Since the Agreement on Agriculture does not define “amber” support, and a variety of meanings are ascribed to the term in other writings, it is not used here. However, while the agreement does not define “green” or “blue” support, popular writings are quite uniform in what these terms mean: support that is exempt from Current Total AMS on grounds of meeting the criteria and conditions of Annex 2 and Art. 6.5, respectively. For an introduction to the categories of domestic support under the Agreement on Agriculture and to the constraints applying under that agreement and introduced in the 2004 Framework Agreement on Agriculture, the interested reader is referred to, for example, Blandford (2005) and Brink (2005).

## The October 2005 Domestic Support Proposals

The elements of the proposals from the USA, the EU and the G-20 are outlined in table 1. These proposals are partly couched in conditional terms relating to progress in the negotiations outside the domestic support pillar.

### *Total AMS*

The USA proposes harmonizing Total AMS reduction commitments at 83 percent, 60 percent and 37 percent, depending on the size of the base (final bound Total AMS in Members’ schedules). This is called an 83/60/37 scenario. The EU proposes a 70/60/50 scenario for reduction of Total AMS, and the G-20 proposes 80/70/60. The placement in tiers is the same for the three proposals, except that the EU places Japan either in the top tier, where the USA and G-20 proposals place Japan, or in the second tier but with a larger cut than that for other countries in that tier (Japan’s final bound Total AMS commitment ranks between those of the EU and the USA).

### *Overall Reduction*

The Overall reduction refers to reducing “all trade-distorting domestic support”, or “Overall support” for brevity. Overall support encompasses all non-green support, i.e., all blue and AMS support (including *de minimis* AMSs). For the Overall reduction the three proposals also indicate identical placements in tiers, except that the EU proposal is not explicit about the placement of Japan. The Overall reduction scenarios proposed by the USA, the EU and the G-20 are, respectively, 75/53/31, 70/60/50 and 80/75/70. These reduction proposals lead to several observations. The EU proposal would apply the same reduction scenarios for Total AMS and Overall support, although the 2004 Framework does not require this. In fact, because of how the base for the Overall reduction is calculated, relatively more slack will be built into the base for Overall reduction than will be built into the base for Total AMS reduction. This suggests that the percentage reduction in Overall support needs to be larger than the reduction in Total AMS. The G-20 proposal goes some way towards reducing Overall support by relatively more than Total AMS (80/75/70 vs. 80/70/60), but the difference between the scenarios is small. The U.S. proposal makes the Overall reductions (75/53/31) even smaller than the Total AMS reductions (83/60/37). This is contrary to the *a priori* expectation that Overall reductions, because of the larger built-in slack, would need to be relatively larger than Total AMS reductions.

### *De Minimis*

On *de minimis* the proposals are, like the 2004 Framework, relatively vague on what it is that will be reduced (such as “*de minimis* cut by 50%” [U.S. proposal]) and “*de minimis* support should be reduced ... by 80% ...” [EU proposal]). This is assumed to mean that the *de minimis* percentage of 5 percent, from Art. 6.4 of the Agreement on Agriculture, is to be reduced by 50 and 80 percent, respectively. Cutting 5 percent by 50 and by 80 percent leaves 2.5 and 1 percent, respectively, under the U.S. and EU proposals (these percentages are applied to value of production to establish the *de minimis* allowances). The G-20 proposes that the reductions in *de minimis* “will be such to adjust to the rate of cut for the overall trade-distorting support [*sic*].” This is interpreted to mean that *de minimis* AMS support will be allowed only to the extent it can be accommodated, along with Current Total AMS and blue-box payments, within the overall commitment. The percentage cut can therefore not be determined in advance and will depend upon how much distorting support the country provides and in which form.

**Table 1** Comparing the U.S., EU and G-20 October 2005 Proposals

	Proposal by USA 10 October		Proposal by EU 28 October		Proposal by G-20 12 October and earlier elements	
<b>Cut TAMS (percent)</b>	EU Japan USA Canada	83 83 60 37	EU Japan USA Canada	70 60+ 60 50	EU Japan USA Canada	80 80 70 60
<b>Cut Overall (percent)</b>	EU Japan USA Canada	75 53 53 31	EU Japan USA Canada	70 ? 60 50	EU Japan USA Canada	80 75 75 70
<b>Cut <i>de minimis</i> % (percent)</b>	50		80		Adjust to Overall Reduction	
<b>Cap on Blue (percent)</b>	2.5		5		5	
<b>Rules for Blue</b>	?		Limit ability to offset price drops; no PS caps		Limit ability to offset price drops; PS caps; non-accumulation; no production increase	
<b>Basis for Caps on PS AMs</b>	1999-2001		1995-2000		1995-2000; discipline on disguising PS support as NPS	
<b>Green Box</b>	"No material changes"; no caps		"Review and clarify"		Identifies specific issues for "review and clarification"	
<b>Other</b>	Peace clause; interlude and elimination				Monitoring and surveillance; cotton	

Notes: Captures major changes from, or further specification of, elements of the 2004 Framework.

Placement in tiers for harmonizing reductions of Total AMS and overall is based on data in World Trade Organization, Committee on Agriculture, Special Session, "Total Aggregate Measurement of Support" (TN/AG/S/13/Add.1; 28 February 2005), and "Total Value of Agricultural Production" (TN/AG/S/21; 4 July 2005). G-20 refers to a group of 21 developing country Members of the WTO. For source references of the proposals, see Brink (2005).

### *Cap on Blue*

Both the EU and the G-20 proposals keep the cap on blue payments at 5 percent of some historical value of production, as per the 2004 Framework. The USA would, however, reduce the percentage to 2.5 percent. The USA does not mention how it would pursue the additional criteria to be negotiated under the framework, while the EU and the G-20 propose limits on the ability of blue payments to offset price drops.

The G-20 also proposes product-specific caps on blue, while the EU rejects them. The G-20 proposal rules out the provision of blue payments for a product that receives more than *de minimis* AMS support and also rules out the classification of payments as blue if the production volume has increased.

The following section examines key issues in assessing the constraints that would apply to distorting domestic support under the 2004 Framework and the proposals of the USA, the EU and the G-20.

## **Consideration of the *de Minimis* Rules**

### ***De Minimis Rules***

The effect of new domestic support constraints on countries' ability to provide AMS support in the future is often discussed without considering how the *de minimis* rules work. The *de minimis* provisions of the Agreement on Agriculture are laid out in Art. 6.4 (WTO, 1995). Art. 6.4(a) reads as follows:

A Member shall not be required to include in the calculation of its Current Total AMS and shall not be required to reduce:

- (i) product-specific domestic support which would otherwise be required to be included in a Member's calculation of its Current AMS where such support does not exceed 5 per cent of that Member's total value of production of a basic agricultural product during the relevant year; and
- (ii) non-product-specific domestic support which would otherwise be required to be included in a Member's calculation of its Current AMS where such support does not exceed 5 per cent of the value of that Member's total agricultural production.

Art. 6.4 uses terms such as "AMS" and "Current Total AMS", which are defined in Art.1 of the agreement. There have been no suggestions that these articles would be changed, other than the percentage "5". Observing the practices Members use to notify domestic support to the WTO Committee on Agriculture also informs the understanding of the *de minimis* rules. Enhanced monitoring and surveillance are foreseen in the 2004 Framework (para. 48), and no one has suggested any weakening of the present practices of claiming *de minimis* exemptions.

Assessing how the proposals would constrain future AMS support without considering the *de minimis* rules gives estimates that deviate from the AMS support that will in fact be allowed. The present examination of two such deviations looks at the three AMS components of distorting domestic support: Current Total AMS, *de minimis* non-product-specific AMS, and the sum of *de minimis* product-specific

AMSs. It distinguishes between allowed support within the constraints (commitments or allowances) and current support that counts towards the constraints.

### **Values of Production: Historical or Current**

The amount of AMS support that can be exempted from future values of Current Total AMS on *de minimis* grounds (*de minimis* allowance) is often estimated by applying a *de minimis* percentage to historical values of production, such as for the year 2001 or the year 2004. This deviates, however, from Art. 6.4 of the Agreement on Agriculture, which refers, at least in the case of product-specific *de minimis* AMSs, to the value of production “during the relevant year”. Moreover, the usual practice in notifying domestic support is to base *de minimis* claims on the value of production of the notified year, not a historical year. Estimating future *de minimis* allowances thus requires first estimating the value of production for a future year, such as 2014 (For the purposes of this research, the implementation of the Doha Round reductions is assumed to be complete in 2014).

For countries with a rapidly growing value of production in agriculture, such as Brazil, the future amounts that may be exempted as *de minimis* AMS will be significantly larger than the corresponding amounts in 2001 or 2004. The value of production in U.S. agriculture may also grow considerably by 2014 (see the technical annex). The U.S. Department of Agriculture’s 2014 projections indicate a value of production of around \$260 billion, which is 30 percent larger than the approximately \$200 billion usually assumed for recent years. The 2014 *de minimis* exemptions for the USA are thus likely to be 30 percent larger than in recent years, for any given *de minimis* percentage.

### **Maximum Usable Components**

The allowed future amount of AMS support (support that is neither green nor blue) is sometimes estimated as the sum of the Total AMS commitment, the *de minimis* allowances for product-specific AMSs for all products, and the *de minimis* allowance for non-product-specific AMS. For example, assume that the future Total AMS commitment is \$7.6 billion, and 2.5 percent of future value of production in the agriculture sector as a whole is \$6.5 billion. The future sum of allowed AMS components would then be  $\$7.6 + \$6.5 + \$6.5 = \$20.6$  billion (table 2 and figure 1). The \$6.5 billion is counted once for the sum of all product-specific *de minimis* allowances and once for the non-product-specific *de minimis* allowance.

However, because of how the *de minimis* rules work, the \$20.6 billion in this example is an overestimate of what can actually be provided in the form of AMS

support, whether *de minimis* or not. The following consideration of three extreme cases illustrates the root of the overestimation. The three extreme cases sum different combinations of the Total AMS commitment, *de minimis* allowances for product-specific AMSs, and the *de minimis* allowance for non-product-specific AMS (see table 2 and figure 1).

1. Provide a non-product-specific AMS just up to the *de minimis* threshold (\$6.5 billion), and provide a product-specific AMS for each and every product in the agriculture sector just up to the product's *de minimis* threshold (these AMSs thus sum to \$6.5 billion). A total of \$13 billion of AMS support is provided. The Current Total AMS has to be zero, since all AMSs are exempted as *de minimis*. The Total AMS commitment is unused (\$7.6 billion).
2. Provide a non-product-specific AMS just up to the *de minimis* threshold (\$6.5 billion), provide product-specific AMSs for each and every product in the agriculture sector in amounts that are larger than each product's *de minimis* allowance and which sum to the Total AMS commitment. The Current Total AMS is equal to the Total AMS commitment, i.e., both the Total AMS commitment and the non-product-specific *de minimis* allowance are used to the hilt. A total of  $\$6.5 + \$7.6 = \$14.1$  billion is provided. The sum of the product-specific *de minimis* allowances is unused (\$6.5 billion).
3. Provide a non-product-specific AMS just up to the *de minimis* threshold (\$6.5 billion), and provide product-specific AMSs for *some* products in amounts that are larger than their *de minimis* allowances and which add up to the Total AMS commitment. At the limit, one product-specific AMS would be concentrated on only one product with an infinitesimally small value of production. That product-specific AMS would be as large as the Total AMS commitment. This would allow product-specific AMSs to be provided for all the other products in the sector in amounts just up to their respective *de minimis* allowances. In practice, of course, product-specific AMSs larger than the *de minimis* allowances will be provided to real products with each product accounting for a significant share of the sector's value of production. Assume for the purpose of this analysis that product-specific AMSs larger than each product's *de minimis* allowance are provided to products accounting for one-half of the sector's value of production. Current Total AMS is then  $\$6.5 + \$7.6 + \$3.3$  billion, which equals \$17.4 billion.

The example is illustrated in table 2 and figure 1. The full sum of the components is \$20.6 billion. In case 1 the Total AMS commitment is not used at all, but all *de minimis* allowances, whether product-specific or non-product-specific, are fully used

and sum to \$13 billion. In case 2 the fully used Total AMS commitment is larger than the (unused) sum of product-specific *de minimis* allowances, and support adds to \$14.1 billion. Finally, in case 3 the usable components sum to \$17.4 billion.

The point of this discussion is to demonstrate that at least one of the three AMS components is, either in full or in part, never usable. The *usable* sum of the AMS components is always less than the full sum of the three AMS components. Intuitively this is explained as “an AMS cannot at the same time be *de minimis* and part of Current Total AMS.” Call this usable sum “maximum usable components” (MUC).

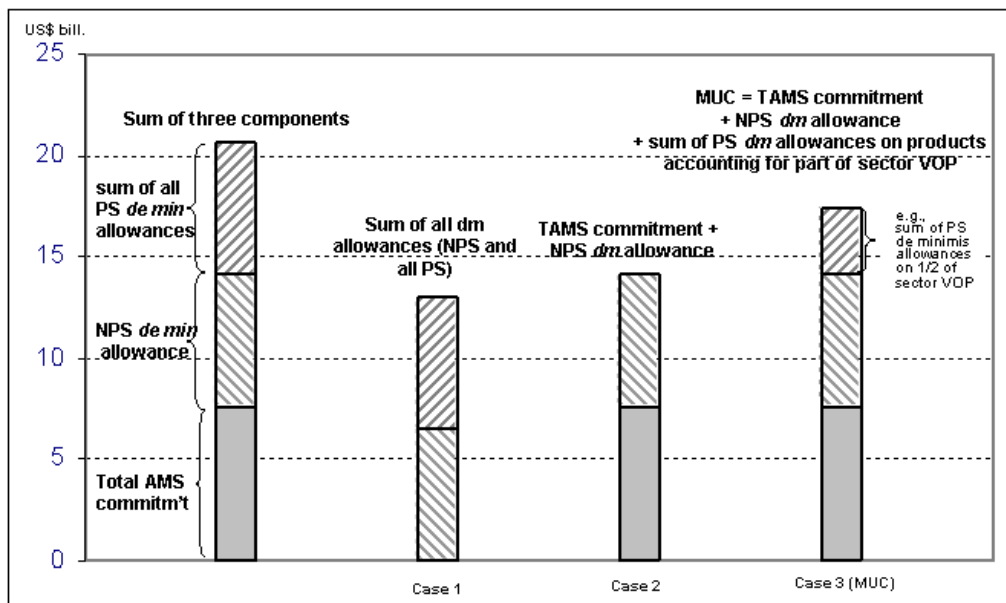


Figure 1 Calculating Maximum Usable Components (MUC)

**Table 2** Illustrating the Calculation of Maximum Usable Components (MUC)

<b>AMS components (maximum)</b>	<b>Sum of three comps</b>	<b>Case 1 NPS <i>dm</i> allowance + sum of PS AMS <i>dm</i> allowances on products accounting for the whole sector VOP</b>	<b>Case 2 Total AMS commitment + NPS <i>dm</i> allowance</b>	<b>Case 3 (MUC) Total AMS commitment + NPS <i>dm</i> allowance + sum of PS AMS <i>dm</i> allowances on products accounting for one-half of sector VOP</b>
	<i>\$ Billions</i>	<i>\$ Billions</i>	<i>\$ Billions</i>	<i>\$ Billions</i>
<b>Sum of PS AMS <i>dm</i> allowances</b>	6.5	6.5	0	3.3
<b>NPS AMS <i>dm</i> allowance</b>	6.5	6.5	6.5	6.5
<b>Total AMS commitment</b>	7.6	0	7.6	7.6
<b>Sum of above components of AMS support</b>	20.6	13.0	14.1	17.4

The choice of one-half as the parameter in the calculation of MUC is of course arbitrary. The USA has notified larger-than-*de minimis* product-specific AMSs on products accounting for between 12 percent (in 1995) and 40 percent (in 1999) of the agriculture sector's value of production. The EU reports corresponding percentages of 61 percent in 2000 and 60 percent in 2001. However, the distribution of product-specific AMSs in the past is not necessarily a guide for the future. For example, the 2004 Framework requires caps on product-specific AMSs. If the caps are low enough, it will not be possible to distribute the whole Total AMS commitment as larger-than-*de minimis* product-specific AMSs for only a few products. Political considerations may also make it difficult to do so.

Moreover, policy changes may reduce or eliminate the amounts reported as product-specific AMSs for some products. The EU 2003 CAP decision, for example, reduced the "applied administered price" such that only *de minimis* AMSs or zero are reported for some products. Japan's price policy changes reduce the reported product-

specific AMSs for rice and milk. Similar changes are possible for the products for which the USA reports significant product-specific AMSs (dairy and sugar). Such decisions would make the past distribution of product-specific AMSs largely irrelevant for estimating the future distribution.

If a split of one-third and two-thirds were assumed instead of the one-half and one-half, Current Total AMS would consist of product-specific AMSs for products that account for one-third of the sector's value of production, and the product-specific *de minimis* allowances for products accounting for the other two-thirds of the sector would be fully "used". This would generate \$18.4 billion as the sum of usable components. It is also possible to devise differently structured examples, where a Member's Total AMS commitment is much smaller than the sum of the product-specific *de minimis* allowances, contrary to the \$7.6 vs. \$6.5 billion of this example. Argentina is an example of such a situation.

### **Assessing the Constraints on Future Support**

The constraints on future support are determined not only by the fixed ceilings resulting from ceiling commitments on Total AMS, Overall Support and blue support; in addition, the *de minimis* allowances are important in constraining the future AMS support. The future *de minimis* allowances are calculated from fixed percentages of future values of production. Assessing the constraints imposed under the proposals of the USA, the EU and the G-20 thus requires projecting not only future amounts of support in the different categories subject to constraint but also projecting the future values of production. The projections of support and values of production for the USA and the EU in 2014 are shown in the technical annex to this article. The annex also presents the calculation of the 2014 constraints, including the MUC. Comparing the projected support against the constraints leads to conclusions about the effectiveness of the three proposals in constraining future distorting U.S. and EU support.

For the USA, the reduced Total AMS commitment by itself under either the U.S. or the EU proposal will not be low enough to constrain projected 2014 Current Total AMS, whereas the Total AMS commitment under the G-20 proposal is low enough to be a constraint. For the EU, the reduced Total AMS commitment under both the U.S. proposal and the G-20 proposal will be low enough to constrain projected 2014 Current Total AMS. The EU proposal would not reduce the EU 2014 Total AMS commitment enough to constrain Current Total AMS.<sup>3</sup>

The overall commitment of the U.S. proposal will not be a binding constraint on the sum of blue and AMS support for either the USA or the EU (under the baseline

projections for prices and quantities that underlie this analysis). Instead the (smaller) sum of the blue cap and MUC will be binding. If future values of production were lower than projected, the future *de minimis* allowances would also be smaller, making the sum of the blue cap and MUC even smaller and reinforcing the role of this constraint. Under the EU and the G-20 proposals the overall commitment would be the binding constraint on the sum of blue and AMS support for both the USA and the EU. If the future value of production were significantly smaller than projected, the sum of the blue cap and MUC would be the binding constraint on the sum of blue and AMS support.

While the G-20 proposal does not specify a particular reduction of the *de minimis* percentage, the depth of cut in the overall commitment is large enough to imply the elimination of *de minimis* allowances for both the USA and the EU, i.e., reducing the *de minimis* percentage from 5 percent to zero. Even with this elimination of the *de minimis* allowances under the G-20 proposal, the sum of the blue cap and the Total AMS commitment is larger than the overall commitment for the USA and the EU. This means that the G-20 proposal will prevent the USA and the EU from fully using either blue payments up to the blue cap or AMS support up to the Total AMS commitment, or both.

## Conclusions

The proposals submitted in October 2005 by the USA, the EU and the G-20 differ significantly in key features that would determine future constraints on distorting domestic support, such as the reduction percentages for Total AMS and Overall Support, the reductions of *de minimis* percentages, and the size of the cap on blue. Estimating the effectiveness of the future constraints in constraining future support, while taking account of the *de minimis* rules of the Agreement on Agriculture, requires projections of future values of production. This is important if the future values of production are expected to differ significantly from historical values, which may be the case for the USA and the EU.

The *de minimis* rules also require going beyond calculating simply the full sum of the allowed components of AMS support (Total AMS commitment, non-product-specific *de minimis* AMS allowance, and the sum of product-specific *de minimis* AMS allowances). The analysis needs to consider the sum of allowed AMS components, accounting for the fact that an AMS cannot at the same time be *de minimis* and be part of Current Total AMS. This sum is called maximum usable components (MUC). The future difference between the full sum of components of AMS support and the MUC

may amount to one or a few billion dollars or euros for the USA and the EU, which can be significant in evaluating the future constraints.

The overall commitment resulting from the U.S. proposal is so large that it is not a binding constraint on either the USA or the EU. The MUC is smaller and is therefore the effective constraint on Overall Support. However, both the EU proposal and especially the G-20 proposal constrain Overall Support to be smaller than MUC for both the USA and the EU.

The EU proposal does not constrain any of the measurements of applied 2014 support, in either the USA or the EU (Current Total AMS, current Overall Support, sum of applied AMSs and blue support). The U.S. proposal is almost as ineffective in constraining 2014 applied support, but it does constrain EU 2014 Current Total AMS. The G-20 proposal is somewhat more effective – it constrains all three measurements of 2014 EU support, yet only the 2014 Current Total AMS for the USA. Altogether the three October 2005 proposals show seemingly large percentage reductions in the constraints applying to future distorting domestic support, but the effectiveness of these constraints is found to be weak.

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## Endnotes

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- \* Any policy views, whether explicitly stated, inferred or interpreted from the contents of this paper, should not be represented as reflecting the views of Agriculture and Agri-Food Canada.
- 1. In the WTO Agreement on Agriculture, which resulted from the Uruguay Round of negotiations, Members agreed that negotiations would be initiated to continue the reform process. In November 2001 Members launched a new, broadly based round of multilateral trade negotiations known as the Doha Development Agenda. It incorporated the agriculture negotiations, which had been launched in 2000. Following a conference in 2003, where Members were unable to reach agreement on key issues, Members intensified their efforts. They achieved an important milestone in July 2004, when they reached agreement on a framework for the agriculture negotiations. It proposed concepts and approaches to guide negotiators in working toward a package of modalities (i.e., detailed rules and formulas for taking commitments) in the three main areas of the negotiations, namely export competition, market access and domestic support.
- 2. In October 2005 the G-20 group appears to have comprised the following 21 developing country Members of the WTO: Argentina, Bolivia, Brazil, Chile, China, Cuba, Egypt, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, the Philippines, South Africa, Tanzania, Thailand, Uruguay, Venezuela and Zimbabwe.
- 3. While this analysis addresses future constraints, it should be noted that the future Total AMS commitments of both the USA and the EU under all three proposals are smaller than the respective estimated Current Total AMS in 2004 (the estimates of 2004 Current Total AMS shown in Figures 2 and 3 are based on data in Brink (2005)). If the proposed future Total AMS commitments had been in place in 2004, both the USA and the EU would have been constrained from providing as much Total AMS support as they provided in 2004.

The technical annex to this paper, pages 110-115, is available as a separate document.

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