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Progress of WTO Negotiations and their Potential Impacts on U.S. Agricultural Policy

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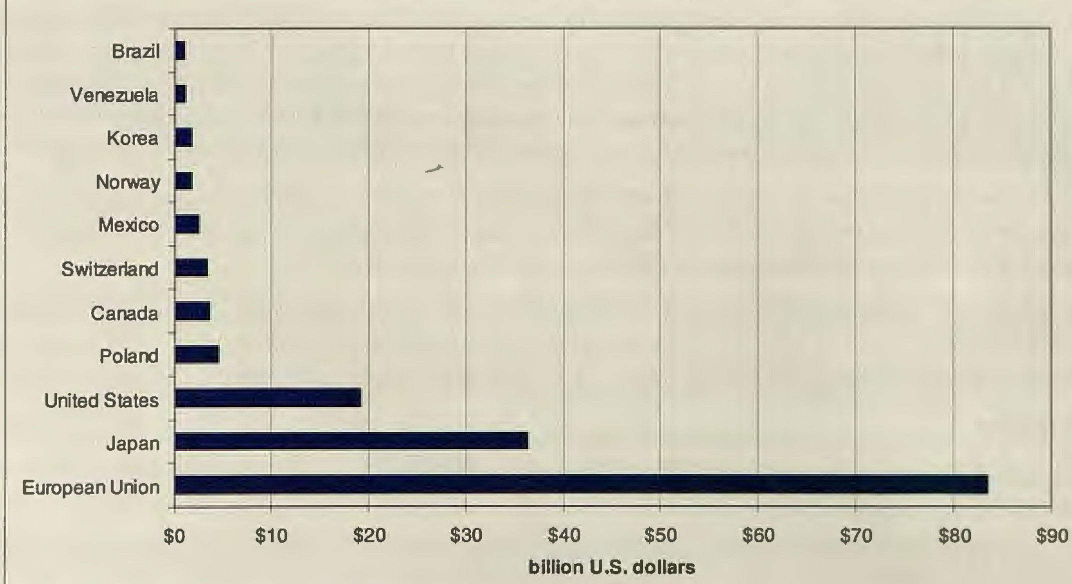
Future U.S. agricultural policy could be influenced significantly by the World Trade Organization (WTO). The current round of WTO negotiations call for cuts in permitted levels of domestic subsidies, export subsidies, and tariffs. While there was little progress at the Hong Kong ministerial meeting in December 2005, WTO members have committed themselves to finishing negotiations by the end of 2006. The Hong Kong talks grew out of an agreement the members reached on July 31, 2004, on the framework for the final phase of the Doha Development Agenda of global trade talks. The 2004 agreement provided a number of objectives and a framework for the final agreement, but much was left to be negotiated. Some additional progress was made at Hong Kong, but many details are still to be negotiated in 2006. The following is a summary of the agreements already made, the current status of negotiations, and the potential impact of an agreement on U.S. agricultural policy.

Domestic Support

Trade-distorting domestic support, which is calculated as a country's aggregate measure of support (AMS), is categorized into the amber box under WTO rules. Amber box support was capped under the Uruguay Round. Figure 1 shows the AMS ceilings for the United States, the EU, Japan, and a few other countries. The U.S. limit for amber box support is currently \$19.1 billion. In previous years, the United States has spent about \$14-\$17 billion in amber box support (Table 1). The most recent data for amber box spending are from 2001, but estimates indicate that spending totaled about \$14 billion in 2005.

A certain level of trade-distorting support, called the de minimis, is currently exempt from being included in the amber box and the AMS calculations. The de minimis rule states that product-specific trade-distorting support is not included in the amber box if it totals less than 5 percent of the total value of production for that product, and non-product-specific support is not included if it totals less than 5 percent of the total value of agricultural production. The United States has spent about \$7 billion annually in trade-distorting support which is exempt from the amber box under the de minimis rule. Another exception is the blue box. Any support that would normally be in the amber box is placed in the blue box if it also requires farmers to limit production. There is currently no spending limit on blue box subsidies. There is also no limit on green box

Figure 1. Current AMS Ceilings



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subsidies, which are those that do not distort trade or are, at most, minimally trade-distorting. Green box support includes spending for a number of programs including decoupled income support, disaster relief, conservation, agricultural research, and domestic food aid. The Food Stamp Program, which cost about $30 billion in 2005, accounts for the largest share of the U.S. green box subsidies.

The July 2004 framework agreement states that each member's total trade-distorting support - including amber box, blue box, and de minimis - must be cut by 20 percent from currently allowed levels in the first year of implementation, with additional reductions planned for subsequent years according to a yet-to-be-determined tiered formula. Under the tiered formula, countries having higher levels of trade-distorting support will make greater overall reductions in order to achieve a harmonized result. There was no agreement at the Hong Kong meeting on the overall reduction. It has been agreed that there will be three bands for reductions in Final Bound Total AMS (amber box support) and in the overall cut in trade-distorting domestic support, with higher linear cuts in higher bands.

Table 1. Total Domestic Support for the United States, European Union, and Japan, 1995-2001 (US$ million)

		Amber box (AMS)	*de minimis*	Blue box	Green box	Total
United States						
	1995	6,214	1,483	7,030	46,041	60,769
	1996	5,898	1,155	0	51,825	58,877
	1997	6,238	804	0	51,252	58,294
	1998	10,392	4,762	0	49,820	64,974
	1999	16,862	7,435	0	49,749	74,046
	2000	16,803	7,341	0	50,057	74,200
	2001	14,413	7,054	0	50,672	72,139
European Union						
	1995	66,524	804	27,720	24,972	120,020
	1996	64,815	637	27,345	28,120	120,917
	1997	55,896	370	22,765	20,230	99,261
	1998	52,394	142	23,012	21,513	97,060
	1999	49,933	57	20,638	20,783	91,411
	2000	39,758	678	20,239	19,895	80,570
Japan						
	1995	36,767	0	0	33,219	69,986
	1996	29,765	333	0	25,192	55,291
	1997	25,851	294	0	21,616	47,762
	1998	5,911	582	387	23,150	30,030
	1999	6,689	292	829	24,022	31,832
	2000	6,461	0	845	23,367	30,673

Source: Economic Research Service calculations from WTO domestic support notifications.

Amber box: The United States has proposed that members with a current AMS ceiling over $25 billion would be required to cut permitted amber box spending by 83%; those with a current limit of $12-$25 billion would cut permitted amber box spending by 60%; and a 37% cut would be required for those with a current limit under $12 billion. Under this proposal, most countries would fall into the bottom band, the EU would fall into the top band, and the United States would be in the middle band. Most proposals agree that the EU should be in the top tier and the United States in the second tier. If the U.S. proposal was adopted, the U.S. amber box spending limit would drop from $19.1 billion to $7.6 billion. This would require a significant cut in current programs. Other proposals call for a greater level of cuts for the second tier. Most proposals call for range of cuts of 70-83% for the top tier, 60-70% for the second tier, and 37-60% for the bottom tier.

Blue box: A cap on blue box spending was agreed to in the July 2004 framework agreement. This cap was set at 5% of a country's average total value of agricultural production during a historical period. The United States has since proposed that the cap be set at 2.5%. A 2.5% cap would limit U.S. blue box spending to about $5 billion. The United States has not used the blue box, but counter-cyclical payments could possibly be classified under this category. U.S. counter cyclical spending has been less than $5 billion in recent years, but could be higher than $5 billion if prices decreased.

De minimis: Reducing the de minimis support was also agreed to in the July 2004 framework, but there has not been an agreement yet on the level of reduction. The United States proposed reducing de minimis 50% (from 5% of the value of production to 2.5%), while others have proposed reducing it by as much as 80%.

Overall cut: Under the U.S. proposal, total permitted trade-distorting support would be cut by 53% for the United States and Japan, 75% for the EU, and 31% for all other countries. Others propose cuts as high as 75% for the United States. The range of cuts proposed are 70-80% for the top band, 53-75% for the middle band, and 31-70% for the bottom band.

Export Competition

Export subsidies: All forms of export subsidies will be eliminated by the end of 2013, as agreed to at the Hong Kong ministerial meeting.

Export credits: The July 2004 framework agreement calls for the elimination of export credits, export credit guarantees, and insurance programs with repayment periods beyond 180 days. There has also been negotiation on export credits and programs of 180 days or less. In Hong Kong, it was agreed that such programs should be self-financing, reflecting market consistency, and that the period should be of a sufficiently short duration so as not to effectively circumvent real commercially-oriented discipline.

Exporting state-trading enterprises (STEs): The WTO members agreed to eliminate trade-distorting practices with respect to exporting STEs in the July 2004 framework. These include export subsidies provided to or by them, government financing, and the underwriting of losses. The United States has argued for the elimination of monopoly export rights, termination of special financial privileges, and greater transparency. At the Hong Kong meeting, it was agreed that as a means of ensuring that the trade-distorting practices of STEs are eliminated, disciplines relating to exporting STEs will extend to the future use of monopoly powers so that such powers cannot be exercised in any way that would circumvent the direct disciplines on STEs on export subsidies, government financing, and the underwriting of losses.

Food aid: There is agreement that the WTO should not stand in the way of genuine food aid, but that there should be an elimination of commercial displacement. To this end, there will be disciplines on in-kind food aid, monetization, and re-exports to close any loop-hole for continuing export subsidization. The United States has argued that there should be broad discretion for donors to meet needs in emergency situations and low-income countries, and tighter disciplines to deal with other situations, but no requirement for "cash-only."

Market Access

Tariff reductions will be made through a tiered formula that takes into account different tariff structures. Deeper cuts will be made for higher tariffs, which should lead to greater harmonization in tariff levels across countries. Flexibilities will remain, however, for sensitive products. WTO members adopted four bands for structuring tariff cuts at the Hong Kong meeting, but negotiations remain for the relevant thresholds. There is agreement that developing countries will be required to make lesser cuts, but there is no decision about how much less.

There is still a significant divergence on proposals for tariff cuts. For developed countries, the United States has proposed cuts of 85-90% for tariffs over 60%, 75-85% cuts for tariffs of 40-60%, 65-75% cuts for tariffs of 20-40%, and 55-65% cuts for tariffs below 20%. There would also be a tariff cap of 75%. Developing countries would be required to make lesser cuts. A certain number of goods can be classified by each country as sensitive products that would be subject to lesser tariff cuts. The United States has proposed that just 1% of products should be allowed to be classified as sensitive, but the EU proposed 8%, and other members proposed as much as 15% of products. There is agreement that developing countries should be allowed more sensitive products, but there is no agreement on how many more, and there is also no agreement on how exactly the sensitive products should be treated.

Cotton

An agreement specific to cotton was made at the Hong Kong meeting. All forms of export subsidies for cotton will be eliminated by developed countries in 2006. Developed countries will give duty- and quota-free access for cotton exports from least-developed countries immediately upon implementation. It was also agreed that trade-distorting domestic subsidies for cotton production should be reduced more ambitiously than under whatever general formula is agreed upon by the members, and that it should be implemented over a shorter period of time.

Potential Impacts on 2007 Farm Bill

The Hong Kong ministerial meeting for the WTO negotiations did not reach any agreements on domestic support, export competition, and market access. However, the proposals by the United States, the EU, and other members strongly suggest a steep cut in domestic subsidies and the elimination of export subsidies. For example, the WTO limit for U.S. amber box payments is $19.1 billion, and U.S. amber box spending has been about $14-17 billion. However, these payments would be reduced to less than $8 billion under the U.S. proposal, and would be reduced even more under other members' proposals. The United States and other members have also proposed to reduce the cap on blue box and de minimis payments. If the U.S. proposal or a similar proposal is adopted, the 2007 farm bill would be significantly different from the 2002 farm bill. Amber box payments, including marketing loan deficiency payments, would have to be cut dramatically. Loan deficiency payments and counter-cyclical payments under the current farm bill reduce uncertainty and increase farm income, but these programs would be less effective under the WTO proposals. Counter-cyclical payments may be allowed in the blue box, but the proposed cap on blue box support would limit the effectiveness of these payments.

Maintaining the current farm program structure would require significant reductions in loan rates, target prices, and milk and sugar price support levels. Alternatively, more comprehensive reform could be enacted, which could include a shift in payments to non-trade-distorting green box subsidies. One alternative is to introduce a revenue insurance program which will reduce uncertainty in farm income stemming from variations in both yields and market prices. The revenue insurance program could be classified as green box and it may be more efficient in minimizing uncertainty in price and yield than the current counter-cyclical and marketing loan programs, but it does not necessarily increase farm income to

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a desirable level. An increase in direct payments, which are classified as blue or green box, coupled with the revenue insurance program, may provide additional income to farmers and reduce uncertainty.

Another important component of the new farm bill could be the development of a bio-energy program. Ethanol can be produced from both corn and cellulosic biomass produced in marginal land, including CRP land. Currently, the United States produces approximately 4 billion gallons of ethanol from 1.6 billion bushels of corn and 75 million gallons of biodiesel from about 55 million bushels of soybeans. The 2005 energy bill requires combined ethanol and biodiesel consumption to total 7.5 billion gallons by 2012, but a much more aggressive policy could be pursued. This policy could include the production of cellulosic ethanol from CRP land. There is 39 million acres of CRP land in the United States, including 3 million acres in North Dakota. If we assume half of this land could be used for ethanol production, over 40 million tons of biomass could be produced per year which would yield about 3.7 billion gallons of ethanol, nearly doubling the current level of ethanol production. Additionally, increased ethanol production could also come from the use of other sources of plant matter on non-CRP land such as switchgrass, wheat straw, or corn stover, and from increased use of corn.

The final approval of a WTO agreement in the near future is not a certainty. Much still remains to be negotiated. However, there is significant desire among negotiators to reach an agreement by the end of 2006. WTO members resolved to establish modalities no later than April 30, 2006, and to submit comprehensive draft Schedules based on these modalities no later than July 31, 2006. If adopted, an agreement would certainly impact U.S. farm policy. A shift in farm payments from the amber box to the blue and green boxes could provide a similar level of support as the current farm program, while being WTO compliant. However, another factor that will influence the 2007 farm bill discussions is the large federal deficit. The necessary increase in blue and green box subsidies may be difficult to obtain due to budget constraints.

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