Decoupling and the Green Box: 
International Dimensions of the Reinstrumentation of Agricultural Support

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Abstract

Agricultural support systems in OECD countries have experienced an important change in the last 15 years, in part as a result of the Uruguay Round Agreement on Agriculture (URAA) and expectations about the likely disciplines in a Doha Round Agreement. Overall support has fallen in OECD countries in relative though not in absolute amounts, and there has been a shift away from more trade-distorting forms of support to less distorting ones. This shift has been encouraged by the creation of a Green Box in the domestic support pillar in the URAA to shelter minimally- or non-trade-distorting support payments.

Supporters of the Green Box point out that it allows governments to pursue domestic farm policy objectives in ways which are compatible with WTO rules. However, developing countries and some NGOs have argued that the reinstrumentation of agricultural support policies and the growth in Green Box payments is merely evidence of ‘box-shifting’. They question whether individual Green Box measures are sufficiently decoupled to warrant exemption from disciplines, and argue that the sheer size of Green Box support means that it has a trade-distorting effect. Other countries have proposed some relaxation in the criteria in order to better accommodate the non-trade concerns of some WTO members.

In the August 2004 Framework Agreement it was agreed to review and clarify Green Box criteria with a view to ensuring that Green Box measures have no, or at most minimal, trade-distorting effects or effects on production. However, the Agriculture Committee Chairman’s report to the Hong Kong WTO Ministerial Conference in December 2005 admitted that the review and clarification commitment had not resulted in any discernible convergence on operational outcomes. This paper reviews the background to this discussion and examines possible strategies for Green Box reform. It supports tightening the rules on a number of individual Green Box measures, but argues against attempting to negotiate an overall ceiling on the total amount of Green Box support.

Keywords: Green Box, decoupling, WTO negotiations, agricultural trade

JEL: F13, F53, Q17
I. Introduction

Agricultural support systems in OECD countries have experienced an important change in the last 15 years, in part as a result of the Uruguay Round Agreement on Agriculture (URAA) and expectations about the likely disciplines in a Doha Round Agreement. Overall support has fallen in OECD countries in relative though not in absolute amounts, and there has been a shift away from more trade-distorting forms of support to less distorting ones. Total support to the OECD agricultural sector (Total Support Estimate, TSE) amounted to $378 billion in 2004, accounting for 1.2 per cent of Gross Domestic Product (GDP), compared with a nominal $306 billion or 2.3 per cent of GDP in 1986–88. Support to OECD agricultural producers accounted for 30 per cent of total farm receipts (percentage Producer Support Estimate, PSE) in 2004, compared with 37 per cent in 1986–88. There has been a greater change in the composition of support, with a noticeable shift away from transfers paid by consumers (market price support, MPS) to budgetary payments, and also between the different types of budget payments provided to producers. The share of MPS and output payments taken together decreased from 83% of overall OECD support to producers in 1986-88 to 65% in 2002-04. This is important because the smaller the share of output-linked support measures, the greater the extent to which world markets influence domestic production decisions (OECD, 2006).

This shift has been encouraged by the creation of a Green Box in the domestic support pillar in the URAA to shelter minimally- or non-trade-distorting support payments. Provided such payments meet conditions set out in Annex 2 to the Agreement, they are exempt from reduction commitments under the URAA, although they are open to challenge under the normal rules of the WTO Agreement on Subsidies and Countervailing Measures following the expiration of the Peace Clause.

Supporters of the Green Box point out that it allows governments to pursue domestic farm policy objectives in ways which are compatible with WTO rules (European Communities, 2001). However, developing countries, some NGOs and some farm groups have argued that the reinstrumentation of agricultural support policies and the growth in Green Box payments is merely evidence of ‘box-shifting’ (G20, 2005; Joint NGO, 2005; Grey, Clark, Shih and Associates, Limited, 2006). They question whether individual Green Box measures are sufficiently decoupled to warrant exemption from disciplines, and argue that the sheer size of Green Box support means that it has a trade-distorting effect. From the critics’ point of view, “It is the same money going to the same place – it just has a different name” (Joint NGO, 2005).

Much of the debate surrounding the Green Box concerns the minimal production impact requirement and its relationship with decoupling. There are two separate issues (Blandford, 2001). The first is whether individual Green Box measures are indeed truly decoupled. If payments are made whose primary aim or effect is to increase producer incomes, will such payments indeed have a minimal impact on production? Second, is it right to require that all Green Box measures should be decoupled? If payments are made to producers in order to achieve other aims, such as environmental objectives, is it logical to require these to have a minimal impact on production? Even if it is conceded that market-correcting measures with a positive production impact should be eligible for the Green Box, can the Green Box criteria distinguish between measures that actually address market failures from policies that appear to be merely labelled “green” and used as a means of disguised protection?
The purpose of this paper is to examine the current status of Green Box payments and to survey the various proposals for reform in the Doha Round negotiations. We focus on three major criticisms.

First, there are those for whom the criteria for exempt payments in the Green Box are not restrictive enough. Many Green Box measures are classified in the OECD PSE calculations as based on yields, the use of particular factors of production or numbers of livestock, suggesting potentially significant production effects. These countries want Green Box payments capped overall, specific types of programmes limited, or some income support programmes removed from the Green Box (WTO, 2004a; G20, 2005).

Second, there are those countries which argue that the Green Box requirement that policies be no more than minimally trade–distorting prevents them from meeting what they feel are legitimate domestic objectives. Countries which put a lot of emphasis on the multifunctional outputs of agriculture are found in this group. They want to re-examine the fundamental requirement that these subsidies should be non- or minimally-trade-distorting. Their key argument is that maintaining the output of these multifunctional benefits requires agricultural production and that the basic philosophy of the Green Box does not recognise this.

Third, developing countries argue that the Green Box reflects more the requirements and policy objectives of the developed countries, and takes little recognition of the problems typical of developing countries in promoting their agriculture. “Developing counties may not necessarily be able to cover their programs under such provisions” (G20, 2005). In the URAA, special provisions were added to the Green Box which only developing countries were entitled to use, but developing countries argue that the scope of these provisions should be expanded.

In the August 2004 Framework Agreement it was agreed to review and clarify Green Box criteria with a view to ensuring that Green Box measures have no, or at most minimal, trade-distorting effects or effects on production. The Framework Agreement emphasised that “Such a review and clarification will need to ensure that the basic concepts, principles and effectiveness of the Green Box remain and take due account of non-trade concerns” (WTO, 2004b). The Hong Kong Ministerial Conference agreed “inter alia, to ensure that programmes of developing country Members that cause not more than minimal trade-distortion are effectively covered” (WTO, 2005). However, the Agriculture Committee Chairman’s report to that Conference admitted that the review and clarification commitment had not resulted in any discernible convergence on operational outcomes (WTO, 2005). In this paper, we review some of the major issues at stake.

II. What does the Green Box cover?

II.1 Outcome of the Uruguay round

In the URAA, government support was classified into three categories or “boxes”. The Amber Box consists of policies judged to have the most distorting effect on trade. Each country with such policies in place during the base period 1986-88 was required to limit its use of such payments to the amount used in the base period, called its Total Aggregate Measure of Support (AMS), and to reduce this ceiling on the allowable amount of payments during the implementation period of the URAA (1995–2000). In calculating a country’s current AMS, trade-distorting payments below a minimum threshold (de minimis), as well as direct payments made under production-limiting programmes (Blue Box) could be excluded from the calculation. Developing countries, in addition, could exclude a further set of specific measures included as
part of special and differential treatment (SDT Box). The Green Box consists of minimally trade distorting measures which were also exempted from reductions. These box categories are not actually mentioned in the AoA, but it has been customary to use them as shorthand labels in discussions on types of domestic support. Under the due restraint provision (Peace Clause) which operated until the end of the implementation period, Green Box supports were identified as non-actionable subsidies. This meant that countries could not impose countervailing duties to offset the imputed effects of such subsidies on the price of imports.

Annex 2 of the URAA sets out the terms on which certain domestic support measures can be exempt from reduction commitments. Paragraph 1 of this Annex sets out the basic structure of the disciplines on Green Box payments (italics added):

“1. Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:

(a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,

(b) the support in question shall not have the effect of providing price support to producers;

plus policy-specific criteria and conditions as set out below.”

In general, the policy-specific criteria require that payments be transparent, targeted to specific objectives, and where possible not linked directly to production decisions (Blandford, 2001). However, the drafters recognised that by their very nature some of the allowable payments are likely to influence production and consequently trade. Some measures will reduce production, as in the case of producer or resource retirement aid. Others will increase production, as in the case of investment aids to correct structural problems. In some cases, for example environmental payments, production could be increased or decreased depending on the conditions attached to the payment. The criteria for allowable domestic support are intended to ensure that any support provided to producers should have a minimal (positive) impact on production.

The disciplines are a mixture of ex ante (the basic and policy-specific criteria) and ex post criteria (the fundamental requirement). What remains unresolved is the relationship between them. The difficulty with the ex post criterion is that the minimal level of trade distortion is not defined and, given the uncertainty of empirical estimates of actual policies, may not be judicable in practice. The panel on upland cotton considered, but did not resolve, the relationship between these requirements and, in particular, whether the fundamental requirement is a freestanding obligation or not (WTO, 2004c). Brazil argued that measures that do not comply with that fundamental requirement cannot be deemed Green Box irrespective whether they comply with the basic or policy-specific criteria in Annex 2. On the other hand, the EU submitted that the first sentence of paragraph 1 of Annex 2 does not set out an independent obligation but simply signals the objective of Annex 2.1 The US agreed that compliance with the fundamental requirement will be demonstrated by conforming to the basic and policy-specific criteria in Annex 2. Much would

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1 The European Communities is the signatory to the WTO Agreement but for convenience we refer to it as the EU throughout this paper.
depend on the legal interpretation given to the word “accordingly” which links the two sets of criteria. There is no disagreement that a domestic support measure that does not comply with one of the basic or policy-specific criteria in Annex 2 is presumed to violate the fundamental requirement. Because the panel had already ruled that the measures did not satisfy a criterion in paragraph 6, it did not deem it necessary to resolve the status of the fundamental requirement (op.cit., para. 7.412). Previously, however, in discussing paragraph 6(b), it had apparently accepted that the fundamental requirement should be taken into account in interpreting this criterion (op.cit., para. 7.371), implicitly suggesting that it would have given it independent weight if it had been necessary in order to reach a determination. It would be very desirable to resolve this basic tension in the definition of a Green Box measure.

Table 1. Green Box measures outlined in Annex 2

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Source: Uruguay Round Agreement on Agriculture

Table 1 describes the measures identified in Annex 2 as potentially exempt from trade disciplines if they meet the eligibility criteria. For the purposes of discussion, they are grouped into four categories:

- Indirect payments through the provision of government or publicly-funded services. These payments are not made to farmers directly, but they can positively influence farm incomes and the volume of production through enhancing the productivity and competitiveness of the agricultural sector as a whole.
- Programmes which expand food consumption. These payments are primarily intended to benefit food consumers, but they can have an indirect positive impact on farm incomes and production capacity in agriculture through strengthening market prices.
- Direct payments to support farm incomes. These are the most controversial individual elements of the Green Box. The key requirement is that these payments are decoupled from production. Although still accounting for a relatively small proportion of total Green Box support, they could grow very rapidly in view of announced policy changes.

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2 This categorisation is not found in the AOA Annex 2 itself.
• Direct payments for structural assistance. These payments are also made to individual farmers, but it is characteristic for the criteria associated with these payments that they attempt to limit any positive impact effect on farm income and production by requiring the removal of resources from production, by limiting payments to the costs incurred, or in other ways.

In the remainder of this section, the policy-specific conditions attached to these various categories of payments are described in more detail.

**General Government Service Programmes** in Paragraph 2 include but are not restricted to the following: (a) research, including general research and studies in connection with environmental programs and specific products; (b) pest and disease control measures, including general and product-specific pest and disease controls; (c) training services to farmers, extension and advisory services, general inspection services, and the inspection of particular products for health, safety, grading or standardization purposes; (d) marketing and promotion services, including market information, consultation and promotion relating to particular products, but excluding expenditure for unspecified purposes that could be used by sellers to reduce their selling prices or vouchsafe a direct economic benefit to purchasers; and (e) infrastructure services including electricity supply, roads and other means of transport, market and port facilities, water supply facilities, dams and drainage schemes, and infrastructural works associated with environmental programmes. The expenditure must be directed to the provision or construction of capital works only and must exclude the subsidised provision of on-farm facilities other than for the supply of generally available public utilities. Also excluded are subsidies to inputs or operating costs, or preferential user chargers.

**Food programmes:** Paragraphs 3 and 4 cover public stockholding for food security purposes, and expenditures for the provision of domestic food aid to sections of the population in need. The conditions applied to public stockholding programmes are that the volume and accumulation of such stocks shall correspond to predetermined targets related solely to food security; the process of stock accumulation and disposal shall be financially transparent; and food purchases by the government shall be made at current market prices and sales from food security stocks shall be made at no less than the current domestic market price for the product and quality in question.

Paragraph 5 governing **Direct Payments to Producers** introduces the remaining measures which have the common characteristic that payments are made directly to producers. The remaining list in paragraphs 6 through 13 is not intended to be exclusive, and Paragraph 5 sets out that any new measures or measures not covered must meet the specific criteria set out in Paragraph 6 pertaining to **Decoupled Payments** which are intended to ensure that such payments must have no bearing on production decisions. Where a farmer receives a government subsidy, this support must not be related to, or based on, the type or yields of production undertaken, or prices, or the factors of production employed by the farmer in any given year after the base period. On the other hand, no production will be required in order to receive such payments.

Paragraphs 7 and 8 cover government participation in **Income Insurance and Income Safety-Net Programmes and Disaster Relief**. Income insurance payments must relate solely to the income of a producer and cannot be influenced by the type of nature of production, prices or factors of production. An overall cap on the amount of income aid is also established. In the case of disaster relief payment, the income aid should not exceed the compensation required to cover losses.

A series of structural adjustment assistance programs including **Producer Retirement Programs, Resource Retirement Programs and Investment Aids** are covered in Paragraphs 9 through 11.
Payments under producer retirement programmes can facilitate either retirement or movement to non-agricultural occupations, but must be conditional on the permanent and total exit of recipients from marketable agricultural production. Resource retirement payments should also be conditional on the retirement of land from marketable agricultural production for at least three years or the slaughter of livestock. They should not be related to the type or quantity of production or to prices for products produced using the remaining resources, and should not dictate the alternative uses for retired land. Investment aids should be designed to assist the physical and financial restructuring of a producer’s operations in response to objectively demonstrated structural disadvantages, and should be limited to the amount required to compensate for the structural disadvantage. No production conditions can be attached to investment aid. Generalised investment aid schemes open to all producers or to producers of specific products would appear not to be eligible under these conditions.

Paragraph 12 covers *Environmental payments*. The requirements for such payments are that they are determined as part of a clearly-defined government environmental or conservation programme and are dependent on the fulfilment of specific conditions under the government programme, including conditions related to production methods or inputs; and that the amount of payment shall be limited to the extra costs or loss of income involved in complying with the government programme.

In the case of *Regional Assistance payments* under Paragraph 13, eligibility for such payments is limited to producers in disadvantaged regions, and the amount of such payments must not be related to, or based on, the type or volume of production or prices undertaken by the producer in any given year after the base period. Where payments are linked to a production factor, some element of degressivity above a certain threshold is required. Payments of this nature are generally available to all producers within such regions, and must be limited to the extra costs or loss of income involved in undertaking agricultural production in the prescribed areas.

### III. Use of the Green Box

Information on the total expenditure on Green Box measures and the types of measures covered is gathered from the notifications made by WTO Members. Each WTO member country is expected to routinely submit reports (called notifications) on the implementation of its domestic support commitments for monitoring and review by the WTO Committee on Agriculture. Although the URAA has no firm deadlines for notifications, the Committee on Agriculture has adopted explicit notification requirements and formats that member countries are expected to follow. Members with base and annual domestic support commitments should submit notifications on domestic support implementation no later than 120 days following the end of the marketing year. Although all WTO members agreed to abide by their commitments and to provide notifications of their implementation status, the WTO has no formal method for enforcing such promises. As a result, there are long delays in submitting notifications and a substantial number of notifications has fallen overdue (Schnepf, 2005).

The WTO Committee on Agriculture releases occasional reports detailing the status of members’ implementation of policy commitments (of which the most recent is WTO, TN/AG/S/10, dated November 8, 2004). This has been updated by the Congressional Research Service of the US Library of Congress through June 1, 2005 (Schnepf, 2005) based on subsequent notifications.

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For countries which had domestic support commitments, 1995 was the sole year for which all such members had submitted a notification. For 2000, out of 30 countries with commitments, 25 (or 83%) had notified. For 2003, of the 35 countries with commitments, 8 (or 23%) had notified and 27 were overdue (Schepf, 2005). In view of the lack of notifications after 2001 (and, in particular, the last notifications by the US and the EU relate to the 2001 marketing year), the analysis in this section is based on statistics up to and including 2001.

Countries notify their domestic support expenditures in national currencies. For purposes of comparison across countries, these data are converted into the common currency of US dollars. The WTO has made available for each country an appropriate exchange rate based on International Monetary Fund data but adjusted to take into account the start of the marketing year on which the notifications are based. The data in a common currency are influenced by exchange rate fluctuations; for example, it is possible for a country’s domestic support expenditure to rise in US dollar terms even when it is falling in local currency terms. This exchange rate effect should be borne in mind in interpreting the Figures which follow.

III.1 Importance of Green Box expenditures

Figure 1 shows the value of domestic support expenditures as reported to the WTO according to their box classification. Amber Box payments include both market price support as well as trade-distorting direct payments. Exempted payments are those covered by de minimis, the Blue Box and the SDT Box reserved for use by developing countries.

In 1995, Green Box payments accounted for 44% of total domestic support; this had increased to 52% by 2001. The share of Amber Box support fell quite sharply over the 1995-2001 period, from 41% to 31%. This should not be surprising, as only Amber Box expenditure was disciplined under the URAA and faced a reduction requirement. Exempt payments fluctuated around 16% throughout the period. These percentages give some support to the oft-expressed view that countries substituted from trade-distorting to minimally-distorting support mechanisms over the Uruguay Round implementation period. Note, however, that Amber Box figures are subject to some sleight-of-hand. Market price support in the Amber Box is calculated on the basis of the difference between administered prices and fixed world reference prices. A country can remove a substantial tranche of notified support by simply eliminating administered prices, even though high tariffs mean that there is no reduction in the actual level of support to those farmers.

Figure 1 shows a clear downward trend in the total volume of support notified since the start of the implementation of the URAA. This contrasts with the trend shown by the OECD PSE and TSE figures quoted in the introduction to the paper. Not only total support, but also notified Green Box expenditure fell. In 1995, Green Box expenditure was $129 billion; by 2001 this had fallen steadily to $98 billion. Amber Box support fell from $120 billion to $58 billion over the period. At least some of this reduction reflects the elimination of administered prices during this period.

In view of the tardiness of notifications, some of this downward trend also reflects the declining number of reporters in later years. The data includes the three main domestic support providers, the EU, US and Japan. Figure 2 illustrates the dominance of the ‘big’ three providers of domestic support in total notified support. Between them, the EU, US and Japan accounted for 84% of total support.

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4 Green Box measures can also be identified using the OECD PSE database, but the purpose and definitions of the two sets of indicators are different, see Diakosavvas, 2002 for a discussion). It is useful to bear in mind the distinction between support provided and support notified in interpreting the figures in this section.
domestic support notified to the WTO in 1995; this proportion increased to 92% in 2001. This upward trend in the share of the ‘big three’ is partly due to the absence of later notifications from some major developing countries, such as China and India.

However, the downward trend in total notified support is also evident for the ‘big three’ alone (Figure 2). During this period, the EU’s share remained roughly constant at around 40%. There was a sharp fall in Japan’s share from 24% in 1995 to 14% in 2001. An important contributor to this was the elimination of administered prices for rice support, and the consequent reduction in its rice AMS to zero (even though its huge rice tariffs remained in place). The US share increased steadily over the period, from 21% of the total in 1995 to 38% of the total in 2001. This reflected, in particular, the large increase in emergency aid payments in the latter years of the 1990s. Meanwhile, the contribution by Rest of the World countries fell from 16% to 8% over the period.

Figure 3 shows that Green Box expenditures vary considerably across countries. Among the ‘big three’, Japan has the greatest reliance on Green Box measures in its total notified support, while the EU has the smallest. Indeed, in 2001 nearly half (47%) of total notified EU support consisted of Amber Box measures, almost entirely market price support. The EU was also the biggest user of exempt measures in 2001 (largely Blue Box area payments and headage premia), while the US was also a significant user of exempted support (large de minimis payments in its case). The Rest of the World region is a mixed bag. It contains some of the smaller European countries and Korea which are heavy users of market price support in the AMS, but also developing countries who are heavily reliant on the Green Box.

Jales (2006) provides a comprehensive analysis of developing countries’ expenditure on domestic support. Based on the last year for which a notification is available for a sample of 50 countries, Green Box support accounted for 67% of the total support notified by the average developing country. For comparison, the share of Green Box support for the period 1995-2001 was 58% for Japan, 75% in the US and 23% in the EU. In absolute terms, China is by far the developing country that provides the most Green Box support. Its notified amount in 1998 was $20.4 billion, compared to $18.5 billion in the EU and $50.7 billion in the US in 2001. Korea, India, Cuba and Thailand are the only other developing countries that have provided more than $1 billion in Green Box in the last year for which a domestic support notification is available. These five countries together account for close to 90% of all Green Box support notified by the 50 countries (Jales, 2006).

### III.2 Composition of Green Box expenditures

Country shares in Green Box expenditures are not the same as for total domestic support. The US is the largest user in absolute terms, and has accounted for a steady 50% of the total in most years. Much of this is accounted for by large expenditures on domestic food aid, although the conversion to decoupled Production Flexibility Contract payments in the 1996 FAIR Act and subsequent Direct Payments in the 2002 Farm Act also accounts for its heavy use. Japan is the next largest user, where most payments take the form of general government services, and particularly infrastructure payments. The sharp fall in the proportion of the Rest of the World in total Green Box payments may reflect the lack of notifications in later years from some important Green Box users.

A breakdown of the relative importance of different Green Box measures is shown in Figure 5 for the ‘big three’ users, based on total expenditure on each measure over the period 1995-2001.5

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5 Recall that the ‘big three’ accounted for around 85% or more of total Green Box expenditure over the period.
Domestic Food Aid is the most frequently-used category, accounting for 36.9% of the $670 billion of gross expenditures on Green Box measures during those years, but overwhelmingly used by the US. It was closely followed by General Services, at 35.5%, where a very high proportion is contributed by Infrastructure Services expenditure by Japan. Investment Aids and Environmental Payments are the next most important measures, each contributing about 6.5% of total Green Box payments over the period, and in each case the EU is the biggest user. Decoupled payments only accounted for 5.1% of total Green Box payments, with the US the dominant user during the period. Resource retirement payments (dominated by the US Conservation Reserve Programme during the period) and Regional Assistance (dominated by the EU’s payments to farmers in less favoured areas) account for 2% and 3% of total Green Box expenditure, respectively. None of the ‘big three’ used income insurance schemes although natural disaster payments accounted for about 2% of total payments. Very small amounts were spent on producer retirement and public stockholding programmes in the three countries.

Announced policy changes, particularly for the EU, will alter these percentages in future. Taking into account the sugar reform, the use of partial recoupling, and the provisions on modulation, and speculating that the EU will modify the measurement of its beef AMS, Butault and Bureau (2006) estimate that decoupled payments eligible for the Green Box (provided that their classification is not challenged by other WTO members) would amount to €28.6 billion, i.e., 39% of notified domestic support. Other green box expenditures would represent 20% of total support. That is, total Green Box expenditures could amount to roughly 60% of EU15 domestic support. Amber Box expenditures would represent 25% and Blue Box expenditures 6% of EU15 support.

The pattern of Green Box expenditures in developing countries is somewhat different, according to Jales (2006). General government services are the most important category – sanitary defence alone accounts for between 40-60% in important meat exporters such as Argentina, Paraguay and Uruguay. In other developing countries (e.g., China, Chile, Colombia), infrastructural expenditures are the most important component in this category. Other important measures include public stockholding for food security purposes (30% share in China and 70% share in India), domestic food aid, payments for relief from natural disasters, and structural adjustment assistance provided through investment aids.

From the perspective of the potential trade-distorting effect of Green Box support, these absolute numbers should be normalised with respect to the value of agricultural production in each country. This is done for the four biggest users in Figure 6. Japan is the clear outlier, with Green Box expenditure equivalent to 29% of the value of its agricultural output in 2001. As noted, the great bulk of this is classified as “Infrastructural services for agricultural sector and rural area: construction of irrigation/drainage facilities and rural roads, land consolidation”. Although the US share also appears high, at 26%, the largest share of this is domestic food aid. If this item is ignored, the US figure falls to 8%, in line with the EU and China.

IV. Decoupled income support

The purpose of WTO disciplines is not to restrict the policy preferences of members, but rather to ensure that these do not have adverse trade consequences for other countries. The support of farm incomes has been the underlying justification for farm policies in developed countries, and may well become more important in middle-income developing countries as economic growth continues. The WTO, as an international trade organisation, does not say to member countries that the support of farm incomes is wrong or an illegitimate policy measure; what it does say is that such support measures should not undermine the farm incomes of other members. Decoupled income supports paid directly to farmers are the suggested means to square this circle.
It is generally accepted that, in order to avoid creating production incentives, direct payments should either be fixed, or if variable, should not be related to prices but should be related to a production parameter which is outside the farmer's control. This means that payments should not be determined by current prices, by current or future levels of production or by levels of input use. The logic behind these conditions is that as long as a subsidy does not affect marginal cost or marginal benefit conditions, it will have a neutral impact on production (Rude, 2000). However, more sophisticated models which take account of liquidity, wealth, risk and expectations suggest some production effects (OECD, 2001; OECD, 2005). The magnitude of these effects will depend on the conditions attached to the payment and on producer behaviour.

The existing restrictions on decoupled income payments are as follows (Paragraph 6 of Annex 2):

(a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.

(b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.

(c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.

(d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.

(e) No production shall be required in order to receive such payments.

The question is whether these policy-specific criteria are sufficient to ensure that decoupled income supports meet the fundamental requirement of no more than minimal trade-distorting effects and, if not, what modifications should be made to this paragraph. Gaining agreement is made more difficult by the absence of any consensus on whether decoupled income supports have more than a minimal production impact or not (see, for example, the contrary conclusions reached in Westcott and Young, 2004 and Grey, Clark, Shih and Associates, Limited, 2006).

The most contentious proposal for change is to add an additional sub-paragraph (f) to paragraph 6 to reflect that direct payments under paragraph 6 should not be made along with Amber Box or Blue Box support if the total value of support exceeds a certain percentage of the annual value of production of a given product (G20, 2005). It is helpful to get a sense of the likely magnitude of this problem. In 2001, EU15 Green Box direct payments amounted to around $13 billion, or around 6% of the value of production. However, with the conversion of the majority of Blue Box payments to Green following the introduction of the SFP in 2005, as well as the transfer of some Amber Box support to Green arising from the reform of particular commodity market regimes (dairy, sugar,), EU15 Green Box direct payments could rise to around $35 billion by the end of the decade, or around 15% of the value of production. US direct payments in the Green Box in 2001 amounted to around 9% of the value of production, while the figure in Japan was 4%.

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6 The figures for direct payments in this paragraph are those confined to farmers and included in paragraphs 5 through 13 of Annex 2.
Tighter constraints on the Amber and Blue Boxes could lead to increases in these percentages over time. Payments of this size at least in principle have the potential to create distortions in world markets.

However, the G20 proposal does not refer to all direct payments but only decoupled income supports under paragraph 6. The figures in the previous paragraph also include disaster relief, investment aids, agri-environment payments, resource retirement payments and regional assistance. Decoupled income supports alone would be less significant in relation to the value of production, although potentially still important particularly in the EU. Another objection to the G20 proposal is that it requires the assignment of decoupled income support to individual products, when a condition of these payments is that they cannot be assigned to specific products and indeed may not require production of any kind. An overall ceiling relative to the total value of agricultural production would be more feasible, although still faces the logical inconsistency that payments can be made on fallow land. The fear is that these programmes could explode in size, but they may be self-limiting for political economy reasons. Unlike market price support, they must be financed by budget transfers, and must therefore compete with other government expenditure priorities. Tightening Green Box criteria could also have the paradoxical effect of making countries more reluctant to agree to disciplines on explicitly trade-distorting policies in the Amber and Blue Boxes. For these reasons, a general ceiling on Green Box expenditures or a specific ceiling on decoupled income supports does not appear to be desirable, provided that the policy-specific criteria are sufficiently tightened to minimise their likely trade-distorting effect.

One important change would be to control the expectations effect of decoupled payments by eliminating the possibility of base updating. The G20 have proposed to define the meaning of a “defined and fixed base period” to eliminate the possibility of updating these periods. Opponents of a change argue that there is a need to provide flexibility for the evolution of farm programmes and for practical adjustments, so some creative drafting may be needed to ensure that the overall intention is met. The G20 also proposes to add to 6(e) a provision that “Land, labour, or any other factor of production shall not be required to be in ‘agricultural use’ and no production shall be required in order to receive such payments”. While apparently aimed at the EU’s condition for receiving the Single Farm Payment, the latter requires that land be maintained in “good agricultural and environmental condition” which is not the same concept (see further discussion in Section IX).

V. Income and crop insurance

Rude (2000) discusses the justification for government financial participation in income insurance and safety net programmes. Their rationale originates in a market failure which results in the lack of contingency markets allowing the producer to deal with production and price risk. Risk sharing in all industries faces the challenge of dealing with moral hazard (where the provision of insurance, for example, encourages the insuree to adopt more risky behaviour) and adverse selection (where, for example, low risk producers do not find it worthwhile to purchase insurance which is priced to cater for the average or high risk producer). Although these problems are encountered in all insurance markets, specific features of agricultural production combine to further hamper the growth of private insurance markets. Price risks, either across crops or across seasons, are not independently distributed. Yield risks brought about by weather vagaries or pest infestations may affect large numbers of producers at the same time. For these reasons, private insurance premiums would usually be prohibitively expensive and private insurance markets fail to develop. The government may step in to create this market by

\[\text{\footnotesize The G20 also propose making similar changes in other paragraphs in Annex 2, notably paragraphs 11 and 13.}\]
subsidising premiums. If this encourages farmers to take bigger risks (for example, by bringing more marginal land into production), then additional production will be encouraged. The empirical literature surveyed by Rude (2000) is agnostic on this point, noting that there may be circumstances where risk insurance could decrease input use and therefore production. A further incentive may be provided in stabilisation schemes where, frequently, safety nets only cut the trough of the cycle but not the peaks, thus raising average income and inducing additional production.

The policy-specific rules set out in paragraph 7 of Annex 2 recognise that this type of support is potentially distorting and place strict limits on the amount of support which can be provided.

(a) Eligibility for such payments shall be determined by an income loss, taking into account only income derived from agriculture, which exceeds 30 per cent of average gross income or the equivalent in net income terms (excluding any payments from the same or similar schemes) in the preceding three-year period or a three-year average based on the preceding five-year period, excluding the highest and the lowest entry. Any producer meeting this condition shall be eligible to receive the payments.

(b) The amount of such payments shall compensate for less than 70 per cent of the producer's income loss in the year the producer becomes eligible to receive this assistance.

(c) The amount of any such payments shall relate solely to income; it shall not relate to the type or volume of production (including livestock units) undertaken by the producer; or to the prices, domestic or international, applying to such production; or to the factors of production employed.

(d) Where a producer receives in the same year payments under this paragraph and under paragraph 8 (relief from natural disasters), the total of such payments shall be less than 100 per cent of the producer's total loss.

No specific proposals have been made to change these criteria, although Rude (2000) suggests that crop insurance is not specifically covered except in the context of payments for relief of natural disasters in paragraph 8. One proposal to add a new subparagraph to paragraph 7 to permit full compensation for destruction of crops or animals to control or prevent the spread of pests or diseases has been made in the current negotiations. Such a measure would have the predicted effect of encouraging greater production of such crops or animals than would be the case if producers had to bear these losses, but as the producer has no way of influencing the size of the payment it would appear to meet the policy-specific criteria for direct payments.

VI. Payments for environmental protection and multifunctionality

Agri-environment payments make up a small but growing share of total Green Box expenditures. For the ‘big three’, agri-environment payments grew from $4.7 billion to $6.6 billion between 1995 and 2001, and their share of total Green Box payments increased from 4.5% to 7.4% over the same period. The justification for these payments lies in the fact that agriculture may be a source of public goods or positive externalities—joint products that are consumable but not priced in the market. In either case, it can be argued that some means needs to be found to reward producers in order to ensure a sufficient supply of the desired goods. In such cases, the payment of a subsidy to producers requires that production be affected to some degree. If the supply of the
public good depends on there being agricultural production, then the payment of a subsidy must be linked to farming activity in some way. Moreover, like other direct payments, agri-environmental payments can indirectly influence production and trade through wealth, liquidity, or income risk effects.

The argument that the provision of these public goods and externalities requires generalised support for agricultural production has been widely debated (OECD, 2000; OECD, 2003). However, if there is some legitimacy in this argument, the principle of only permitting government payments that have a minimal impact on production in the Green Box becomes questionable. The issue is not whether the support payment increases output, but whether the output-increasing policy is actually distorting. If levels of production, consumption, and trade are determined without taking into account unpriced but valuable outputs, then markets are already distorted (Blandford, 2001; Runge, 2003). The payment of the subsidy is justified by the need to correct the existing distortion. OECD (2000) calls this type of measure trade-correcting rather than trade-distorting.

The actual trade impact of an agri-environment measure will depend on two factors. The first is the way in which property rights in the environment are distributed in a particular country, which in turn determines the incidence of applying the polluter-pays principle. Suppose that farmers are asked to reduce nitrogen inputs below the existing good agricultural practice standard in order to help improve water quality. If farmers are paid to undertake this reduction (as is allowed under the EU agri-environment measure), the production and trade impacts are very different compared to a policy in which the government simply raised the good practice standard.

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<tr>
<td></td>
<td>US$ million</td>
<td>Share (%)</td>
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<tr>
<td>Input use</td>
<td>1172</td>
<td>27</td>
<td>174</td>
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<tr>
<td>Input constraint</td>
<td>2707</td>
<td>62</td>
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<td>89</td>
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<td>General services</td>
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<td>2</td>
<td>186</td>
</tr>
<tr>
<td>Total</td>
<td>4357</td>
<td>100</td>
<td>6835</td>
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Source: Diakosavvas, 2002

Second, the trade impact will depend on the nature of the agri-environment measure. Land retirement programmes remove land from production and have a negative impact on agricultural output. On the other hand, support for organic farming will lead to an increase in the production of organic food products. In general, the production and trade impacts will depend on the extent to which agricultural and environmental output are joint products. If there is only a weak link between agricultural output and the level of environmental improvement sought then the trade effect will be smaller than otherwise would be the case. Diakosavvas (2002) notes that most environmental programmes in the Green Box are linked to area planted, livestock numbers, or input use in the OECD PSE classification, but his table, reproduced here as Table 2, suggests that the dominant type - more than 60% - of agri-environment measures require input constraints. Despite this characterisation, his empirical work using both meta-production function and gravity model approaches finds support for a positive impact of agri-environment expenditure on production. To repeat, however, the finding of a positive impact on production is not evidence of a distorting effect on trade if the environmental measures are indeed trade-correcting.
Whatever the merit of these arguments in the abstract, the fear of exporters is that the public good justification is simply a cover for the true objective of policy which is to provide income support to producers. The crucial issue, therefore, is defining whether a measure constitutes environmental protection or trade protection. This requires some mechanism to trade off harmful trade effects against beneficial environmental effects. The way this is done in the URAA is through the two policy-specific criteria for agri-environment payments set out in paragraph 12 of Annex 2. The phrases underlined are those where potential ambiguities exist.

(a) Eligibility for such payments shall be determined as part of a clearly-defined government environmental or conservation programme and be dependent on the fulfilment of specific conditions under the government programme, including conditions related to production methods or inputs.

(b) The amount of payment shall be limited to the extra costs or loss of income involved in complying with the government programme.

Paragraph 12(a) requires that the programme be clearly defined, but what this means in practice is not so clearly defined. Following the suggestions of Diakosavvas (2002), notifying countries might be asked to provide concrete evidence that the alleged environmental problem is an issue of genuine concern. The programme should have quantifiable objectives, and notifying countries should demonstrate that they have in place the ability to monitor and evaluate programmes against these objectives.

Paragraph 12(b) requires that the payment amount should be limited to the extra costs or loss of income involved in compliance. Three issues are raised in the implementation of programmes in interpreting this requirement, namely, deadweight, the use of standardised payments, and incentives. Deadweight effects occur when only minor or no adjustments in farm management are necessary to fulfill the specific conditions set down in the government programme. In such cases, any income payment is pure rent. It might be possible to argue that producers have the option in future to change their behaviour, but as Wiggerthale (2004) remarks: “How far the panel will recognise the threatening [sic] reduction of positive environmental impacts can not be predicted”.

The use of standardised payments is one of the contributors to deadweight. Its impact can be reduced through the use of regionalised payments, and possibly eliminated through offering agri-environmental contracts on a competitive basis, though very likely at the cost of higher transactions costs for the state. Diakosavvas (2002) notes that limiting compensation payments to compliance costs or income losses, literally, would mean that only mandatory agri-environmental programmes could be in the Green Box. If a programme, for example to maintain low-intensity farming in disadvantaged areas, were indeed voluntary while the financial payment to farmers was equal or below their compliance costs, no farmer would enrol in the programme. The EU has removed the explicit reference to incentive payments in its earlier agri-environment regulation but now speaks of payments covering, where necessary, [farmers’] transaction costs, which would have the same effect.

Paragraph 12(a) refers to programmes requiring the fulfilment of specific conditions. Again, the ambiguity arises because there could be a variety of policy conditions which would meet the environmental objective, each with very different impacts on trade. Blandford (2001) gives the example of Swiss support for its dairy industry because the grazing of dairy cattle on Alpine pastures protects Alpine flora and fauna. But does the current intensity of dairy production need
to be maintained? Why should dairy production be subsidised, if the same ecological benefits could be realised by allowing farmers to switch to extensive beef production or by encouraging them to stock the hillsides with wild deer? In general GATT jurisprudence, a number of tests can be applied in which the benefits to the environment are weighed against its harm to trade. These include the tests of necessity, proportionality, and whether or not the measure is a disguised restriction on trade (Runge, 2003; see also Runge 1999). Whether the application of the fundamental requirement in Paragraph 1 would allow a panel to apply these tests to a challenged agri-environment measure is not clear, because this requirement does not mandate the least trade-distorting measure for the purpose at hand, but only that the measure does not have more than minimal trade-distorting effects.

Finally, paragraph 12(a) also requires that payments should be determined as part of an environmental or conservation programme, but the meaning of the term “environmental” is not defined in the URRAA (Wiggerthale, 2004). The GATT has tended to define the environment as referring to the natural environment whereas some countries would like to extend this to the human environment as well. For example, an environmental payment that helps prevent soil erosion by retiring fragile land from production might be seen as “environmental”, whereas payments which aim at preserving the amenity value of a “traditional” agricultural landscape might be more contentious.

Payments for any multifunctional benefit of agriculture, if considered legitimate, face the same issues as agri-environment payments. Although the 2004 Framework Agreement recognises that Green Box criteria should be reviewed and clarified, taking into account non-trade concerns, the main demandeurs in this area have not put forward any specific proposals. A number of strategies would appear possible. Consider payments intended for the protection of landscape values. One strategy would seek to affirm that the concept of an environmental programme in paragraph 12 encompasses socially-constructed natural environments as well as the physical environment itself. To meet the eligibility conditions, payments to producers could not exceed the cost of maintaining those desirable landscape features and, depending on how one interprets the relationship between the various criteria in Paragraph 1, should not be more than minimally trade-distorting. Indeed, it might be possible to argue that such measures are trade-correcting rather than trade-distorting and thus are not in breach of the fundamental requirement in Paragraph 1 in any event. A second alternative would be to introduce a new direct payments programme under paragraph 5, but this would have to meet the much stricter criterion of paragraph 6(e) that no production can be required to receive such payments. Perhaps the most satisfactory solution would be to define the programme as a non-agricultural programme in the first instance. To return to the example of protecting Alpine flora and fauna, the authorities could define a programme in which payments are made to keep land open (for example, as protection against avalanches) and with a defined amount of biodiversity. Whether dairy farming was the cheapest way of achieving these public goods would then be left to the individual recipients to decide. If the public goods could only be jointly produced with agricultural commodities, it would not be a matter for the URRAA as it does not concern an agricultural payment. However, as no specific negotiating proposals have been put on the table to deal with multifunctionality concerns, it is hard to know what specific changes in Annex 2 criteria would be sought by its proponents.

One tentative proposal under the heading of non-trade concerns has been made by the EU which argues that the imposition of higher welfare standards for farm animals could impose additional

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8 Vatn (2002) raises the general objection to targeted programmes of this nature that they may have high transactions costs and that requiring agricultural production may be the lowest-cost solution when all costs, including transactions costs, are taken into account.
costs on its producers and put them at a competitive disadvantage (European Communities, 2000). “It may therefore be necessary to consider whether it would be legitimate to provide for some sort of compensation to contribute to the additional costs where it can be clearly shown that these additional costs stem directly from the higher standards in question. For any such compensation to be acceptable, it would have to have no or at most minimal effects on trade and production.” In the light of the previous discussion, it might be possible to compensate producers for the costs of adopting higher animal welfare standards, if animal welfare were viewed as a legitimate ‘environmental’ objective.

VII. Making the Green Box more development friendly

The objective of demands to broaden the Green Box for development concerns is that developing countries should not be prevented by URAA rules from pursuing policy interventions designed to encourage agricultural growth. The G20 proposes to review Green Box criteria to ensure that programmes of developing countries that cause not more than minimal trade distortion are effectively covered. In evaluating proposals to revise the criteria, existing provisions for special and differential treatment (SDT) for developing countries need to be borne in mind.

As noted in Section 3, Green Box measures account for 67% of the total support notified by developing countries. Very few developing countries have Amber Box commitments greater than zero, but all developing countries are entitled to provide product-specific trade-distorting support up to 10% of the value of production and a further non-product-specific trade-distorting support up to 10% of the value of production. In the Hong Kong Ministerial Declaration, WTO member countries agreed that developing countries with no AMS commitments will be exempt from reductions in _de minimis_ and the overall cut in trade-distorting domestic support. This provision exempts 94 of the 111 WTO developing country members from undertaking reduction commitments in _de minimis_ and overall trade-distorting support, including large developing countries such as China, India, Indonesia and Pakistan (Jales, 2006). This provision can potentially shelter a large volume of agriculture-related expenditure in developing countries; the constraint is much more likely to be the ability of these countries to finance such expenditure. In fact, relatively few countries notified such support – only 16 out of 50 countries analysed by Jales (2006) utilised this provision. Overall, _de minimis_ accounted for 10% of total support provided by these developing countries, with China, Brazil, India and Korea being the big users. In all four countries, non-product-specific support accounted for over 80% of total _de minimis_ support.

A further AMS exemption is provided by the SDT treatment for developing countries in Article 6.2 of the URAA. 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 are exempt from domestic support reduction commitments that would otherwise be applicable to such measures, as is domestic support to producers in developing country Members to encourage diversification from growing illicit narcotic crops. Domestic support meeting these criteria is not required to be included in a Member’s calculation of its Current Total AMS. Jales (2006) reports that these measures accounted for 16% of the total support notified by developing countries. India is the largest user, notifying support under this provision of $5.2 billion in 1997, with all other countries using Article 6.2 measures accounting for a further $1.1 billion. Input subsidies are the dominant form of support, followed by investment subsidies generally available to agriculture.

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9 For China, the corresponding percentages are 8.5% under the terms of its WTO accession agreement.
Developing countries thus have considerable flexibility under existing rules to ensure that they can pursue policies to promote agricultural and rural development. To the extent that they have scope to classify domestic support expenditures under de minimis or Article 6.2 provisions, there is less necessity to extend the scope of Green Box measures. If measures are likely to have an impact on production, but are nonetheless important to help developing countries to achieve food security or rural development objectives, expanding the scope of Article 6.2 measures is the more appropriate route. For example, some developing countries have proposed an exemption from spending limits for crops that meet food security criteria. A proposal from some Like-Minded Group members submitted in November 2002 (JOB(02)/174) suggested that if production of a crop is below the FAO determined world average for national production and if exports of that crop are less than 3.25 per cent of world trade in that crop for five years or more consecutively, then spending on that crop should be exempt from the calculations for reduction. This proposal also suggests excluding expenditures on transportation of staple foods to food deficit areas within the country from spending disciplines.

Chairman Falconer’s Green Box reference papers acknowledged that participants are open to specification of programmes that would cover the special needs of developing country Members, provided that such programmes would not cause more than minimal trade distortion (WTO, 2006a and b). A specific proposal from the G20 under the general services heading in paragraph 2 of Annex 2 is to add a sub-paragraph (h) with a view to covering settlement, land reform and any programme related to food and livelihood security and rural development in developing country Members. In his view, there is already effectively consensus on agrarian, land and institutional reform, including related services which would include at least such matters as settlement programmes, issuance of property titles, employment assurance, nutritional security, poverty alleviation, soil conservation and resource management, and drought management and flood control. The remaining areas of divergence relate to whether there is a case for a still broader concept of any programme related to food and livelihood security, and rural development and infrastructure provision. Given that much of the latter is already covered by paragraph 2(g), and provided that any draft text on the former is not too open-ended, Falconer’s view was that it should be feasible to bridge these differences.

With respect to public stockholding for food security purposes, a footnote to paragraph 3 gives extra flexibility to developing countries to include such expenditure in the Green Box even where stocks are acquired and released at administered prices (as opposed to the general requirement that transactions should take place at market prices), provided that the difference between the acquisition price and the external reference price is accounted for in the AMS. A further footnote to paragraph 4 mandates that the provision of foodstuffs at subsidized prices with the objective of meeting the food requirements of urban and rural poor at reasonable prices shall be considered to be in conformity with the provisions of the domestic food aid paragraph. There is a technical issue that the footnote to paragraph 3 appears to mandate that the expenditure concerned be included in the AMS calculation, even if this expenditure would otherwise fall under the de minimis provision. The Chair has suggested that an unambiguous clarification that support expenditure incurred in stockholding (and in providing domestic food aid?) could be freely accommodated within the full 10 per cent de minimis allowance may be sufficient to meet these concerns.

VIII. EU farm policy and the Green Box

The EU has embarked on a particular strategy of CAP reform, as set out in the Luxembourg Agenda and followed through in the subsequent reform proposals for other commodities such as cotton, tobacco, olive oil, wine and fruits and vegetables. There are two main elements to this
reform strategy: to shift income support from the farm to the farmer by converting area and premium payments into a decoupled Single Farm Payment; and to shift payments from Pillar 1 (market price and income support) to Pillar 2 (rural development). The EU’s presumption in both cases is that these measures would be sheltered by the Green Box. Bearing in mind the mandate laid down by the Council of Agricultural Ministers for the agricultural negotiations that a Doha Round agreement should not lead to further CAP reform beyond that already contemplated, it is clearly in the EU’s interests to ensure that this reform strategy is not going to be challenged under existing or revised WTO rules.

Swinbank and Tranter (2005) have raised a number of questions about the compatibility of the SFP with the Green Box. Under paragraph 6(a), eligibility must be based on clearly defined criteria in a fixed base period. As SFP entitlements can be transferred by sale, inheritance etc., this could be problematic. But they point that the scheme could then be notified under paragraph 5 which omits this requirement.

They see criterion 6(b), that a payment should be unrelated to the type or volume of production, as more problematic in the light of the panel finding in the WTO upland cotton case (WTO, 2004). In this case, Brazil argued that the US regulations behind Production Flexibility Contract (PFC) payments and subsequent Direct Payments (DP) which reduced or even eliminated all payments under those programmes if certain types of production (fruits, vegetables, wild rice) are produced on the base acreage had the effect of funnelling production on base acreage to particular types of crops. The US responded that the payments were Green Box because they did not mandate certain types of production in order to be eligible, that restricting production was not the same as mandating production and that Brazil’s reasoning meant that payments which mandated no production (e.g. setaside) would also not be decoupled. The panel accepted that in general (their italics) the amount of PFC and DP payments is not related to the amount of production undertaken by producers, but it did agree that because of the planting flexibility limitations the amount of payments in any year were linked to some extent to what a farmer decided to produce and thus that they could not be considered decoupled payments within the definition of Annex 2.

As in the US, in the EU land growing fruits and vegetables including table potatoes is not eligible for the SFP. Member States must also ensure that land which was under permanent pasture at the date provided for the area aid applications for 2003 is maintained under permanent pasture, although there is scope for a limited derogation from this provision in duly justified circumstances (EU Council Regulation No 1782/2003). The EU in its third party submission to the panel argued that the limitations were justified because they were designed to avoid unfair competition. The Panel expressly asked the US to comment on this argument, but the US failed to do so. Therefore the Panel concluded that there was no evidence before it that the rationale for the payment limitations was to avoid unfair competition. It was careful, however, to insert a further sentence that “This does not imply any view as to whether such evidence is relevant to the interpretation of paragraph 6(b)”. Thus it may still be open to the EU, if challenged on this, to try to defend its classification of the single farm payment as Green Box on this basis. Presumably, if this defence failed, the EU could bring the SFP into compliance by allowing fruit and vegetable production on SFP land.

Swinbank and Tranter suggest that criterion 6(d) that “the amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period” may be the most difficult to satisfy. The insistence that SFP payments are tied to land that is maintained in good agricultural and environmental condition weakens the EU’s case that it is a Green Box payment, as an SFP payment in any year depends on the amount of land ‘farmed’ that year.
The EU has two defences. One is that no production is required on this land and thus that there is no requirement to ‘farm’ the land to justify eligibility for the SFP. The Joint NGO briefing paper (2005) makes the point that, even if producing nothing, farmers are required to keep the land open and prevent both erosion and coverage by trees and shrubs. Given that meeting this requirement in the absence of production would incur a cost, it could be more remunerative to a farmer to produce, even at a small loss, provided that the loss is smaller than the costs of keeping fallow land in good condition. Would this be deemed by a panel to be sufficient to ‘funnel’ resources into agricultural production even in the absence of an explicit requirement? A second defence is that tying the payment to land is necessary to ensure cross-compliance, and thus that the measure could be justified as an environmental measure. This argument is used for public consumption in the EU to justify the payment of decoupled payments to farmers. However, agri-environment programmes have their own specific set of criteria to be eligible for Green Box status. The standards that have to be met for SFP payments are all existing statutory standards, so farmers, provided they are not breaking the law, comply with these standards without having to change any of their existing practices. Thus the payments would not appear to meet the basic criteria for agri-environment payments set out in paragraph 12. How a panel would decide on these arguments cannot be determined in advance.

There is also the question how partially coupled payments are treated. Also, EU Member States have the option to retain some of the old arable aid and headage payments. We might expect the EU to declare the coupled element as blue box and the decoupled payment as green box. Swinbank and Tranter raise the question whether this system of dual payments would mean that the decoupled SFP payment would be subordinated to the crop-specific payment. To claim the SFP, the farmer has to show that the land is being maintained in good agricultural and environmental condition, which requirement is met by the arable crop. Does that make the SFP dependent on the planting of the arable crop? More generally, whether the coexistence of coupled and decoupled programmes means that the decoupled payment also contributes to the incentives to overproduce is contentious. The Joint NGO briefing paper (2005) points out that cereal farmers who stop production, or shift to livestock production, receive only 75% of their previous payments, and have to cover the costs of keeping the land in good condition. However, this does not seem to add any additional production requirement to the SFP that is not implicit in its general conditions. It is possible that the continued coupling of the remaining 25% of the payment would be sufficient to retain resources in their existing use – this is an empirical question – but again, this does not invalidate the distinction between the two types of payments.

With respect to its rural development measures, the EU may also face instances of non-compliance. For example, investment assistance under paragraph 11 should be limited to structurally disadvantaged farms and only the amount necessary to remedy that disadvantage should be given, according to clear and transparent criteria. But the EU regulation defining the criteria for investment assistance makes no mention of disadvantage. The only conditions attached to Article 26 of the new EU Rural Development Regulation 1698/2005 which specifies that support shall be granted for investments are that they should (a) improve the overall performance of the agricultural holding, and (b) respect the Community standards applicable to the investment concerned.

In other areas, the new Regulation brings EU practice into line with Annex 2 policy criteria. Article 37 on less favoured area scheme payments specifies that payments should be degressive above a certain threshold. Article 39 on agri-environment payments removes the reference in earlier legislation that payments can include an incentive element for farm income and now simply state that the payments shall cover additional costs and income foregone resulting from
the commitment made, including transaction cost. We noted already that there could be a potential question mark over payments for landscape conservation and rural environments for amenity purposes if environmental protection is interpreted narrowly to solely include the natural environment (Wiggerthale, 2004).

New payments to assist farmers to meet standards imposed by Community legislation, to encourage participation of farmers in food quality schemes and to compensate farmers who meet higher animal welfare standards were also introduced in this Regulation. Because these standards may impose new obligations on farmers, the EU proposes to provide support to help cover partly the additional costs or income foregone arising from these obligations. To help farmers meet higher standards, the support shall be granted as a flat-rate, temporary and degressive aid on an annual basis, for a maximum duration of five years from the date the standard becomes mandatory in accordance with Community legislation. Support is limited to the additional costs and income foregone resulting from the commitment made, including any transaction cost. The Regulation also introduces a new animal welfare payment to farmers who make on a voluntary basis animal welfare commitments which go beyond the relevant mandatory standards. Payments are made annually to cover additional costs and income foregone resulting from the commitment made, including transaction cost.

Whether these payments are decoupled in the sense of paragraph 5 in Annex 2 depends on the interpretation of paragraph 6(e), that no production shall be required to receive these payments. Although the payments are not related to the volume of production, they assume that commercial agricultural production is taking place on the holding, even if this may not be formally “required” by the terms of the Regulation. Arguably, in these cases, production is anyway taking place, albeit at lower standards. The EU policy is to encourage farmers to raise their standards, and to compensate them for the costs of so doing. Assuming that a panel would agree that the measures met the policy-specific conditions in paragraph 5, because they are limited to the additional costs incurred, they should be neutral with respect to production and trade and thus also meet the general criteria for Green Box payments.

IX. Conclusions

The proposal to review and clarify Green Box criteria to ensure that Green Box payments have no or at most minimal trade-distorting impacts is largely being pushed by developing countries in the Doha Round negotiations, although some developed countries have also sought changes with a view to accommodating particular non-trade concerns. There are two principal questions to be asked of the current eligibility criteria for Green Box measures.

(a) For those payments whose primary aim or effect is to increase producer incomes, are the criteria sufficient to ensure that such payments are indeed decoupled and have a minimal impact on production?

(b) For payments designed to correct for market failures or ensure the provision of public goods, are the criteria sufficiently flexible to accommodate genuinely market-correcting policies and sufficiently discriminating to ensure that these policies do not become a disguised restriction on trade?

We have seen that the overall volume of Green Box expenditures can be significant in relation to the value of agricultural production. EU Green Box direct payments could rise to around $35 billion by the end of the decade, or around 15% of the value of production. US direct payments in the Green Box in 2001 amounted to around 9% of the value of production, while the figure in Japan was 4%. Green Box expenditures could rise further with tighter constraints on the Amber
and Blue Boxes. Payments of this size at least in principle have the potential to create distortions in world markets. For this reason, some countries have proposed an overall ceiling on Green Box expenditures, while the G20 has proposed a ceiling on the decoupled income supports as potentially the most trade-distorting of Green Box measures.

An important question is how significant are the distortions caused by Green Box policies in practice? The theoretical literature has identified a series of mechanisms which link direct payments to increased production. Unfortunately, there is as yet no consensus in the empirical literature on the magnitude of these effects. Evidence from simulation modelling suggests that reductions in market access barriers are potentially a much more important source of gains to trading countries than reductions even in trade-distorting domestic support (Anderson et al., 2006; Hoekman et al, 2002; Hertel and Keeney, 2006), suggesting that the contribution of tighter restrictions on Green Box measures would be even more limited. The analysis of payments up to 2001 highlighted that the great majority (72%) of Green Box payments are either general services to agriculture or domestic food aid which are relatively uncontroversial.\footnote{But some US farmers have complained about Brazil’s highway subsidies because of the way new roads open up the interior and encourage greater agricultural production.} Expenditure on decoupled income supports may be self-limiting for political economy reasons. Tightening Green Box criteria could have the paradoxical effect of making countries more reluctant to agree to disciplines on explicitly trade-distorting policies in the Amber and Blue Boxes. For these reasons, I do not favour either a general ceiling on Green Box expenditures or a specific ceiling on decoupled income supports, provided that the policy-specific criteria are sufficiently tightened to minimise their likely trade-distorting effect. With respect to decoupled income support, dampening the expectations effect by removing the ability to update the payment base based on producer’s current behaviour is the most important change to be made. For safety-net programmes, establishing disciplines on crop insurance programmes which are not necessarily linked to natural disasters would be a valuable improvement.

The second group of programmes are those which are designed to achieve non-farm income objectives but which may, either unintentionally or by design, encourage additional production. One issue here is whether the policy-specific criteria are sufficient to prevent these programmes being captured by producer interests in a way which would magnify the trade-distorting impacts. A useful improvement would be to require countries using these programmes to provide concrete evidence of the problem that the programme is designed to address, to set out quantifiable objectives, and to demonstrate that they have in place the ability to monitor and evaluate programmes against these objectives.\footnote{The G20 proposes an amendment to paragraph 5 which would go some way towards this objective, but the language does not appear entirely satisfactory.}

Those who advocate that the Green Box criteria should accommodate payments for the wider multifunctional benefits of agricultural production can pursue a number of strategies under current Annex 2 rules. One strategy would seek to affirm that the concept of an environmental programme in paragraph 12 encompasses socially-constructed natural environments as well as the physical environment itself. To meet the eligibility conditions, payments to producers could not exceed the cost of maintaining those environments and, possibly – see next paragraph – not be more than minimally trade-distorting. In the case of the latter argument, it might be argued that such measures are not trade-distorting in the meaning of the fundamental requirement in Paragraph 1 in any event. The alternative would be to introduce a new direct payments programme under paragraph 5, but this would have to meet the much stricter criterion of paragraph 6(e) that no production can be required to receive such payments. As no specific
negotiating proposals have been put on the table to deal with multifunctionality concerns, it is hard to know what specific changes in Annex 2 criteria would be sought by its proponents.

There remains a basic tension in the Annex 2 criteria in the treatment of programmes justified as correcting a market failure and the fundamental requirement that all Green Box programmes can have no more than minimally trade-distorting effects. Is it the case that the market-correcting policies will always be deemed to have no more than a minimally trade-distorting effect, given that the latter is nowhere defined? This question is further complicated by the uncertainty about the relationship between the fundamental requirement and the basic and policy-specific criteria set out in Annex 2. The US and EU argue that the purpose of this requirement is simply to inform the basic and policy-specific criteria set out for each measure. Others argue that it is free-standing criterion in its own right. Which way this argument plays out clearly has a bearing on the weight which the policy-specific criteria must bear in limiting the consequential trade distortion of Green Box measures.

Developing countries have argued that the Green Box criteria were formulated with developed countries in mind and are not necessarily adapted to the problems of developing countries. Developing countries have considerably flexibility to introduce payments programmes either under the de minimis provisions of the Amber Box or Article 6.2 exemptions, so the need for significant alterations to the Green Box criteria can be questioned. For most developing countries, the main constraint on introducing Green Box measures is their financing capability, not Annex 2 rules. Nonetheless, it is likely that a number of specific rule changes to Annex 2 proposed by developing countries would be generally acceptable in any final agreement.

EU policy reforms, with respect both to Pillar 1 and Pillar 2, were clearly drafted with WTO criteria in Annex 2 in mind. There remain some doubts, however, as to whether they are fully compatible with Green Box status. With respect to the Single Farm Payment, the programme would appear vulnerable because of the accompanying production restrictions, and could also be challenged on the grounds that it requires land to be kept in good agricultural and environmental condition. With respect to rural development measures, EU investment aids could be challenged because they are not specifically related to overcoming objectively determined structural disadvantages. Its new animal welfare payment could also be subject to challenge.

A final issue concerns improvement in the notification process itself. The current system has two principal defects. First, categorising and reporting exempted subsidies is largely self-policed and each member country has some discretion in determining whether a subsidy is green or amber. Second, there are long delays in the notification process and the WTO has no mechanism to enforce compliance. This undermines the ability of WTO members to enforce their rights under the URRA if another member that they suspect of non-compliance with policy commitments has failed to keep up with annual notifications.  

The Chair’s Green Box Reference Paper notes that it is generally accepted that appropriate monitoring and surveillance procedures will need to be established (WTO, 2006b). One suggestion is for a new Sub-Committee on Monitoring and Surveillance to undertake various tasks comprising of a review of notifications, peer review, assessment and evaluation, reporting and surveillance. Another proposal is to enhance the existing format of notifications and ensure timely submissions, including by means of a penalty in Current Total AMS for Members with

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12 For example, it would be important for a country contemplating a challenge to the EU’s new scheme of animal welfare payments to know whether this will be notified as an agri-environment scheme under paragraph 12 or as a direct payment scheme under paragraph 5.
overdue notifications. Also, in addition to a regular review of notifications by the Committee on Agriculture, in-depth examinations of each Member's notifications would be carried out on a rolling basis, with the three Members with the highest amounts of support being reviewed every year. Such changes would go a long way to improving the monitoring of domestic support commitments in the Green Box.

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Figure 1. Composition of total domestic support, 1995-2001

Source: Computed from data in Schnepf, 2005

Figure 2. Main providers of domestic support, 1995-2001

Source: Computed from data in Schnepf, 2005
Figure 3. Importance of different boxes in support by country, 2001

Source: Computed from data in Schnepf, 2005

Figure 4. Country shares in Green Box expenditure, 1995-2001

Source: Computed from data in Schnepf, 2005
Figure 5. Relative importance of Green Box measures, 1995-2001

Source: Author’s calculations based on WTO notifications

Figure 6. Green Box expenditure relative to the value of agricultural production, 2001