WTO Consistency of U.S. and New Zealand Agricultural Practices

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September 11, 2003

Grey, Clark, Shih and Associates, Limited, prepared a report that reviewed U.S. and New Zealand agricultural measures and considered the WTO consistency of those measures. The Report, which was completed on July 15, 2003, identified a range of measures that violated, or potentially violated WTO obligations. The Report also established that a range of measures now violate WTO obligations because of recent decisions by the WTO Appellate Body.

U.S. Measures

The Report considered U.S. domestic support programs and U.S. export subsidy programs. The U.S. is one of the largest users of subsidy and support programs in the WTO. These programs support prices, distort trade and encourage over-production that must be sold on the export market. Without these generous support programs, the United States would not produce the same quantities of agricultural products and would produce a different mix of agricultural products.

(a) Domestic Support Programs

The United States, like all WTO Members, has the right to provide domestic support up to the limits of its Aggregate Measure of Support (AMS) set out in its Schedule to the WTO. Currently, the U.S. AMS is set at USD $19.1 billion.

Like all WTO Members, the United States also has the right to exempt some domestic support from its AMS calculation. The exempt support measures, described in Articles 6 and Annex 2 to the WTO *Agreement on Agriculture*, include,

- decoupled income support
- non trade-distorting support
- measures that do not provide price support
- *de minimis* support

The Report reviewed U.S. domestic support provided through four programs,

- direct payments
- counter-cyclical payments
- non-recourse marketing loans
- irrigation programs

Direct Payments

The United States makes direct payments to producers on the basis of historical acreage or yield. But, the U.S. allows its producers to update these rates, thereby affecting the total payments that they receive. Consequently, the U.S. direct payment programs violate WTO obligations.

2002 – 2007 Direct Payments

Wheat	$0.52/bu
Corn	$0.28/bu
Grain Sorghum	$0.35/bu
Barley	$0.24/bu
Oats	$0.024/bu
Upland Cotton	$0.0667/lb
Rice	$2.35/cwt
Soybeans	$0.44/bu
Other Oilseeds	$0.0080/lb

Counter-Cyclical Payments

The United States introduced Counter-Cyclical Payments in 2002 to replace the *ad hoc* emergency payments adopted under the previous Farm Bill. The program provides support to producers when the "effective price" of the covered commodity falls below the "target price" for the covered commodity set out in the 2002 Farm Bill. The amount of the payment received by producers is the difference between the "effective price" and the "target price" multiplied by the producer's eligible production.

The Counter-Cyclical Payment program is trade-distorting, on the basis that it promotes the production of otherwise uneconomical crops, and provides price support. The "target price" used to determine the payments made under this program becomes the minimum price available on the market. USDA's Economic Research Service has recognized that this program provides price support.

Counter-Cyclical Payments

	2002/03 CY	2004/07 CY
Wheat	\$3.86/bu	\$3.92/bu
Corn	\$2.60/bu	\$2.63/bu
Grain Sorghum	\$2.54/bu	\$2.57/bu
Barley	\$2.21/bu	\$2.24/bu
Oats	\$1.40/bu	\$1.44/bu
Upland Cotton	\$0.7240/lb	\$0.7240/lb
Rice	\$10.50/cwt	\$10.50/cwt
Soybeans	\$5.80/bu	\$5.80/bu
Other Oilseeds	\$0.0980/lb	\$0.1010/lb

Non-Recourse Marketing Loans

Under this program, the United States makes loans to eligible producers secured against the crop that they produce. Although the intention is to give producers operating cash at the beginning of the year, the real effect of the program is to give price support. Producers can choose to repay the loans provided under the program or to forfeit their crop to the Commodity Credit Corporation in lieu of payment. Although the repayment terms are flexible (the terms are set to minimize stock accumulation by the U.S. Government and to ensure U.S. competitiveness), the program provides price support to eligible U.S. producers.

Non-Recourse Marketing Loans

	2002/03 CY	2004/07 CY
Wheat	$2.80/bu	$2.75/bu
Corn	$1.98/bu	$1.95/bu
Grain Sorghum	$1.98/bu	$1.95/bu
Barley	$1.88/bu	$1.85/bu
Oats	$1.35/bu	$1.33/bu
Rice	$6.50/cwt	$6.50/cwt
Soybeans	$5.00/bu	$5.00/bu
Other Oilseeds	$0.0960/lb	$0.0930/lb
Peanuts	$395 per ton	$395 per ton

Irrigation Programs

The United States uses irrigation projects to support agriculture. These programs, which are used in the eleven Western U.S. States, are vital to agriculture because, without these programs, agriculture would not be possible or would not be possible at the current rates of production. These programs currently support agriculture grown on 16% of total U.S. cropland. These irrigated lands account for 49% of total U.S. crop sales. There is no question that irrigation is a vital component of U.S. agriculture.

The U.S. has developed irrigation projects over the past century. The infrastructure that makes up these projects is supported through U.S. Federal-Government loans and grants. The United States has notified the cost of these projects to the WTO.

Through these projects, the U.S. provides water for a number of uses, including agricultural production. Generally, water for agricultural use is provided at rates below the rates charged for other uses. The provision of this below-market rate water to agricultural producers is a subsidy. Although the U.S. must count the value of this subsidy against its AMS, it has not notified the value of these irrigation subsidies to the WTO.

The irrigation subsidies are excessive. Based on a review of the water rates charged by local authorities administering California irrigation projects, it is possible to estimate the total value of water for irrigation provided in the U.S. at up to USD $33 billion.

Domestic Support – Conclusion

The Report demonstrates that the U.S. domestic support programs distort trade and support prices and, along with U.S. irrigation subsidies, must be notified to the WTO and included in the U.S. AMS. If these programs are properly included, it is clear that the U.S. will have provided domestic support in excess of its WTO limits.

(b) Export Subsidies

The United States has the right to provide export subsidies up to the volume and value limits in its Schedule to the WTO. The total value of these export subsidy commitments amounts to USD $520.1 million per year. However, based on a review of U.S. export subsidy programs, the Report concludes that total U.S. export subsidies in 2001 were approximately USD $13 billion.

The U.S. provides export subsidies in the following programs,

- Dairy Export Incentive Program
- Export Enhancement Program
- Export Credit Programs
- Market Access Program
- *De Facto* Export Subsidies
- Article 9.1(c) Export Subsidies
- California Dairy Pricing

Dairy Export Incentive Program and Export Enhancement Program

The United States recognizes that these are both export subsidy programs and are limited by U.S. export subsidy commitments. These programs provide payments, referred to as bonuses, to support the export sale of U.S. agricultural products. The U.S. objective is to use these programs to the extent possible up to the bound volume and value limits in the U.S. Schedule.

Export Credit Guarantees

Through these programs the United States provides financing to support exports of U.S. agricultural products. The OECD, in a recent report on export credit programs, has noted that these are trade-distorting programs and that the United States is the world's largest user of these programs.

The financing available from the United States through these programs is provided at rates that are better than the rates commercially available to U.S. producers and exporters. By providing below-market financing and guarantees, the U.S. provides substantial export subsidies under this program.

Market Access Program

This program provides funding to U.S. exporters to offset their cost of marketing agricultural products in the export market. This program does not support general export promotion and advisory services that may be ordinarily provided by Government. By making payments to offset the cost of marketing, this program provides an export subsidy that benefits U.S. exporters.

De Facto Export Subsidies

Export subsidies are either *de jure* or *de facto*. *De jure* export subsidies are subsidy programs that are legally tied to export performance. *De facto* export subsides are subsidy programs that are not legally tied to export performance but are given with the expectation that they will support exports. The generous U.S. domestic support programs are *de facto* export subsidies because they are provided knowing that there is year over year over-production of the supported commodity that has to be sold on the export market.

U.S. soybean production is an excellent example of the use of domestic support as a *de facto* export subsidy. The U.S. is a major producer of soybeans. In 2002, the U.S. provided $2.2 billion in domestic support to U.S. soybean producers. Approximately 50% of the U.S. soybean crop is produced for export. Exports of this magnitude are an ongoing feature of the U.S. soybean market.

U.S. officials are well aware of the nature of U.S. soybean production and its dependence on export markets. U.S. officials are also aware of the substantial degree to which U.S. soybean production benefits from domestic support programs and must be aware of the impact of those subsidies on producer planting decisions. Knowing that the domestic support programs encourage year-over-year surplus production of soybeans that must be exported, the continued provision of these domestic supports must be considered a *de facto* export subsidy.

California Export Measures

California administers the price of dairy products on the export and domestic markets. In administering these prices, California sets a lower price for some products, such as light sour cream, if they are sold on the export market than if they are sold on the domestic market. By setting a lower price for the export sale of these products, this program provides an export subsidy to support the sale of these products.

Article 9.1(c) Export Subsidies

Article 9.1(c) of the *Agreement on Agriculture* provides that "payments" by a third party made on the export of agricultural products that are "financed by virtue of governmental action" are export subsidies. The Appellate Body in *Canada – Dairy Exports* determined that a "payment" is made if agricultural products are sold for less than their total average cost of production. The

Appellate Body further noted that any government measure that *enables* a third party to make a payment finances that payment. Based on this interpretation, the U.S. provides Article 9.1(c) export subsidies to support the shipment of a range of commodity products.

USDA data demonstrates that U.S. grain corn, wheat, barley, sorghum, soybeans and oats are sold at prices below total average industry cost of production. Thus, the export sale of these products constitutes a "payment" for purposes of Article 9.1(c).

U.S. producers are able to sell at below total average cost of production because of the generous support that they receive from the United States through the various domestic support programs. Thus, these domestic support programs "finance" the "payments" made by U.S. producers. Therefore, based on the Appellate Body's findings, the U.S. provides Article 9.1(c) on the export sale of these commodity products.

The value of the Article 9.1(c) export subsidies is substantial and can be determined by comparing the sale price of the commodity product relative to its total cost of production. Based on this calculation, we find the following export subsidies and the degree to which those export subsidies exceed U.S. export subsidy bindings.

2001 Art. 9.1(c) Export Subsidies

Products	Export Subsidy	Over Bindings
Grain Corn	$778 million	$778 million
Wheat	$1.644 billion	$1.27 billion
Barley/Sorghum	$734 million	$692 million
Soybean	$1.08 billion	$1.08 billion
Oats	$822 million	$1.35 million

Total Value of U.S. Export Subsidies

The U.S. provides export subsidies well in excess of its WTO bindings. The U.S. objective is to fully utilize its Dairy Export Incentive and Export Enhancement Program. The total value of these programs is approximately USD $478 million. The U.S. Export Credits and Market Access Program provides approximately USD $3.3 billion in support per year. Through its *De*

Facto Export Subsidies, the U.S. provides approximately USD $6 billion in export subsidy support. Through its Article 9.1(c) export subsidies, the U.S. provides approximately USD $3.82 billion in export subsidies. The result is that the total value of U.S. export subsidies is approximately USD $13 billion – an amount that far exceeds U.S. export subsidy volume and value bindings.

New Zealand Measures

New Zealand provides export subsidies to support the sale of dairy products through Fonterra Cooperative Group Limited (Fonterra). When it was established, Fonterra was given the right to tie New Zealand dairy producers to it through shareholding arrangements. Fonterra was not reviewed by New Zealand's Competition Authorities during this process because of concerns that it would not meet competition requirements.

New Zealand uses Fonterra as its single-desk seller of dairy products. Fonterra is the largest dairy exporter in New Zealand (it is New Zealand's largest company). To ensure that it can successfully export, Fonterra has been granted the exclusive right, through licenses in effect until 2007, to export into high-value markets.

Fonterra uses its more remunerative sales into the protected higher value markets to cross-subsidize its sales into the lower value markets. By price differentiating between these markets, Fonterra uses its status as a *de facto* state trading enterprise to subsidize the sale of dairy products into lower value markets.

Fonterra also sells dairy products into the lower value markets at prices that are below its total average industry cost of production, thereby making a "payment" for purposes of Article 9.1(c) of the Agreement on Agriculture. This "payment" is "financed" by virtue of the exclusive access to the higher-value markets granted to Fonterra by New Zealand. Consequently, these below total average cost of production sales also constitute export subsidies.

New Zealand does not have the right to provide any level of export subsidy to support its shipment of any agricultural products. Consequently, the export subsidies granted by New Zealand through Fonterra violate its WTO obligations.