GREEN BOX MYTHOLOGY:

THE DECOUPLING FRAUD

STUDY PREPARED FOR

DAIRY FARMERS OF CANADA

by

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CONTENTS LIST

INTRODUCTION

1. This report is the first in a series which Dairy Farmers of Canada commissioned Grey, Clark, Shih and Associates, Limited (GCS) to prepare to analyze potential costs and benefits to Canadian Agriculture from the Doha Round of Multilateral Trade Negotiations. GCS has also been asked to prepare a report identifying future policy options for Canadian agriculture and for WTO rules.

2. As negotiators and Ministers return to Geneva for yet another attempt to rescue the negotiations, it is clear that the principal focus of many is inadequate offers by the U.S. and E.U. to effectively reduce and discipline trade and production distorting support. Many participants have urged drastic subsidy reform. This is perhaps the most important issue in the negotiations for Canadian Agriculture.

3. This report analyzes the accuracy of U.S. and E.U. claims that most of their domestic support is trade and production neutral or non-distorting. It assesses the scope for developing income support programs which can meet WTO criteria.

4. It concludes that E.U. and U.S. claimed green box support does not qualify as such. It concludes that claimed green support can only be non-distorting if it requires cessation of production.

SUMMARY AND OVERVIEW

1. As the Doha Round negotiations enter a crucial phase, it is important to examine the various aspects of the potential agreement. Our focus is agricultural trade – and the focus of this report is to explore and expose the myths and realities of the various proposals to reduce domestic support.

2. In an earlier paper we reviewed the failures of the Uruguay Round for Canadian Agriculture and Agri-food producers.[1] The purpose of this paper is to identify potential problems with the balance of concessions in Doha Development Agenda negotiations in order to persuade negotiators to ensure history does not repeat itself.

Exempt and Distorting Support

3. During the Uruguay Round negotiators had to find ways to distinguish farm supports as between trade and production distorting and non-distorting, i.e., which programs and other forms of support were sufficiently trade and production neutral into the so-called "Green Box" and be exempt from reduction formulae.

4. "Decoupling" of support from production decisions was promoted as a means by which WTO Members could provide support to their producers without distorting trade or affecting production decisions.[2] The theory was that by severing the ties between the provision of support and production, producers would be free to produce and sell in

[1] Peter Clark. "Undelivered Promises and Betrayals of the Uruguay Round", September 2005 (www.greyclark.com)
[2] While the focus of this report is on decoupled support, we also address other aspects of box shifting, i.e., amber to blue, de minimis support and unreported support. The underlying premise is that all support is distorting.

response to market signals alone, as if there was no support at all. It was generally believed that the free play of market forces would reduce production and increase prices.[3]

5. That, at least was the theory. And the 1996 U.S. Farm Bill experimented with this approach. The premises and assumptions used to sell "decoupling" were flawed and it soon became apparent that the experiment was not working. At the same time, the results of the E.U.'s 1992 CAP Reform reinforced this conclusion.[4]

6. The specific WTO provisions addressing decoupled income support are one of several policy specific programs listed in Annex 2(6) to the WTO *Agreement on Agriculture* (AoA). Decoupled income support programs meeting the prescribed criteria are exempt from the domestic support reduction commitments set out in each Member's Schedule. Thus, the WTO implicitly recognizes that it is possible to introduce or maintain non-trade or production distorting decoupled support programs or, at least, to implement programs that have, at most, minimal trade or production-distorting effects.

7. To be considered "green", decoupled income support must meet the following conditions:

> "(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 base period.

[3] Phillip Evans and James Walsh. "The EIU guide to the New GATT", Economist Intelligence Unit, London, 1994, p. 69

[4] Jacques Berthelot. "Rough Estimate of feed subsidies going to E.U. and U.S. exported meat", December 25, 2005 (http://solidarite.asso.fr)

(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."[5]

8. "Green", decoupled income support must also meet the fundamental requirements of Annex 2(a) that is, the measures must have "no or at most minimal, trade-distorting effects or effects on production."

The Problem

9. The U.S. and E.U. have been shifting much of their support out of the amber box, which is subject to Aggregate Measure of Support (AMS) reduction, into blue and green boxes primarily to avoid reductions. In return for reducing their AMS, both are seeking major concessions on market access and in other aspects of the negotiations from other participants. Because global agriculture is already experiencing a very serious income crisis, further market opening without securing very substantial, real and enforceable subsidy reductions and disciplines will simply exacerbate the farm income crisis.[6]

10. While, at times the U.S. and E.U. have questioned the legitimacy of each other's box-shifting, both claim that their efforts to decouple support, made effective through the 2002 Farm Bill and the 2003 and earlier CAP Reforms, have converted their existing trade distorting programs into non-trade distorting support. E.U. Trade Commissioner Peter Mendelson has claimed that, as a result of the 2003 CAP Reform, 90% of E.U. support is non-trade distorting.[7]

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[5] World Trade Organization. Text on the Uruguay Round, *Agreement on Agriculture*, Annex 2, January 1994

[6] Ben Lilliston. "Close to the Wind: Navigating the WTO Hong Kong Ministerial", Minnesota, USA, November 2005, p. 10

[7] Peter Mandelson. "NGOs misrepresent what E.U. asks of poorer nations", Letter to the Editor, Financial Times, June 5, 2006

11. This box shifting has been heralded as potentially sweeping reform – as liberalization which has never before been achieved – but it does not and will not reduce the very generous spending which has encouraged overproduction and low prices. We also conclude that domestic support has replaced direct export aids. Notwithstanding such re-packaged support being advertised as "decoupled", it will continue to distort trade and production leading to continuing global surpluses and depress prices on world markets.

12. In repackaging and re-colouring their export subsidies and amber box support the U.S. and E.U. are engaged in what is potentially the biggest shell game in trade negotiating history. Billions of dollars and billions of euros of support are being and will be shifted from box to box in order to avoid real reductions in support while appearing to cut more than half of the highly inflated AMS.

13. The roots of abuse of green and blue box designations go back to:

- the non-self policing nature of the WTO;
- the Blair House Accord and the resulting Peace Clause and creation of the Blue Box.[8]

14. The WTO is not a self-policing organization:

- it is left to members to designate the nature (box) of their support;
- unless challenged, these designations will stand;
- notifications are notoriously late.

15. On the abrogation of responsibility for verifying the accuracy of subsidy notifications, Gabrielle Marceau of the WTO Secretariat (Dispute Settlement Unit) explained:

> "The WTO has neither the resources nor the skills to act like "the regulator" of these notifications. It is up to each Member to do these notifications… that is the very spirit of the whole disputes settlement system of the WTO: every member country acts as a guard dog of the system."[9]

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[8] The Blue Box was created as an accommodation to the E.U. on a take it or leave it basis as part of the Blair House Accord.

[9] Jacques Berthelot. "The Empty Promise and Perilous Game of the European Commission to Slash its Agricultural Supports", November 3, 2005. He attributes this comment to Ms. Marceau, in an internet forum on February 27, 2001.

16. The approach suggested by Ms. Marceau could be managed by those with the resources to do it if they were so inclined. Many developing countries could not because they lack the resources. And the "clean hands" principle would limit such challenges to those without sin – and those whose governments (unlike Canada) are willing to try to enforce their rights. The limits imposed by the Peace Clause have been another disincentive.

17. The "Blair House" accord resolved U.S. and E.U. differences over agriculture and paved the way for bringing agriculture more completely into the GATT/WTO system – and, indeed, for the conclusion of the Uruguay Round. While the accommodations of the Blair House Accord were pivotal in catalyzing important moves in agriculture, both parties recognized the political sensitivity of their concessions and agreed to a Peace Clause[10] which is found in Article 13 of the AoA. (Congress is seeking to review the Peace Clause.)

18. The U.S. wants a Peace Clause to provide litigation protection in the Doha round. In a recent press conference, Deputy USTR Jason Hafemeister explained the U.S. position:

> "Jason, how important is it for the United States to have a peace clause in the final agriculture deal? And can you accept a final Doha deal without the peace clause?
>
> Mr. Hafemeister: It's important. We are going to engage in a serious process of domestic reform at home and will lock it in in a Farm Bill, something that is a long term endeavor for our Congress and our producers. So having some certainty about what the allowed support measures are in the WTO is quite important. Consequently we're looking for a type of a peace clause to provide that.
>
> In our opinion, the depth of cut that we're talking about should deal with a lot of the concerns that other people have about trade distorting effects, so with these types of reductions it certainly seems reasonable that we would have some litigation protection." [11]

[10] Ben Lilliston. "*Close to the Wind: Navigating the WTO Hong Kong Ministerial*", Minnesota, USA, November 2005, p. 15. A Peace Clause would grant agricultural subsidies a privileged place in the WTO, even if the subsidies are found to nullify and impair another member's benefits from signing a round of agreements.

[11] Press Briefing with Jason Hafemeister, Deputy Assistant USTR; U.S. Perspective on Ongoing Agricultural Negotiations, Friday, June 16, 2006 (World Trade Organization Centre William Rappard, Geneva)

19. In this climate there has been little dispute settlement or criticism of policies between the USA and E.U.

20. This is why the U.S. and E.U. have had a "free ride" in exercising their seemingly unfettered ability to self-designate their support programs and declare support to be non-trade distorting, and thus exempt from AMS reduction. Indeed, much of what the U.S. and E.U. promise in the Doha negotiations has been done, or can be done through self designation of support as blue or green.

21. As Jacques Berthelot[12] points out the difference between applied and achieved total AMS for the E.U. meant that in 1995 the AMS had been reduced by 36.46% "almost twice the reduction (20%) required for the whole period 1995-2000."[13]

22. Berthelot goes on to demonstrate that the continuous shift of E.U. support since 1992 from Amber to Blue to Green will, with the 2003 CAP reform, reduce by €48.4 billion the applied total AMS relative to the allowed total AMS of €67.2 billion – a total reduction of 72%.[14]

23. Berthelot explains too how the elimination of intervention prices reduces AMS – but creates opportunities for de minimis support to a number of products, i.e., beef and possibly sugar.[15]

24. In another detailed critique of the U.S. proposals Berthelot explains that in 1996 the U.S. total applied AMS was already reduced by 74% in relation to the allowed AMS of the base period – which was to be reduced by 20% in the 6-year period 1995-2000.[16]

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[12] Jacques Berthelot is a rural economist, member of Solidarite, a French Non Governmental Organization and an associate researcher at the Laboratoire Dynamiques Rurales
[13] Jacques Berthelot. The Empty Promise and Perilous Game of the European. Commission to Slash its Agricultural Supports", November 3, 2005, para. 4
[14] Ibid., para. 10
[15] Ibid., para. 17
[16] Jacques Berthelot. "The King is Naked: The Impossible U.S. Promise to Slash its Agricultural Supports," November 7, 2005, para. 5

25. Berthelot explains that this occurred because during the 1986-88 base period, U.S. farm support was based primarily on deficiency payments which were eliminated in the 1996 Farm Bill.[17] The real level of support did not decrease indeed the 1996 Farm Bill also removed supply management and regulating rules which prevented excessive price declines – it shifted from the amber box to the blue and green boxes.

Decoupling Does Not Eliminate Distortion

26. Canadian Federation of Agriculture President Bob Friesen recently told the House of Commons Standing Committee on International Trade:

> "On domestic support it looks positive that we will finally be able to get the U.S. to at least significantly reduce their amber expenditures. The concern we have is that they will simply move money around into either a blue box or a green box. Of course, some of their green box programs are as trade distorting as any amber program. We would really like to see a re-definition of green box programs. We do know that our negotiators are working on that and clearly we support them.
>
> We also want to make sure that our production insurance programs can be put into the green box as well and we continue to push on that one. The concern there is on product specific support and they want to cap them based on historical spending. If that happens the U.S. is going to be capped at some very high levels for some of their commodities and Canada, because Canada historically hasn't provided much commodity specific support, would be capped at a very low level and that would simply institutionalize that disparity."[18]

27. An extensive review of the literature[19] establishes that access to direct and single farm payments encourages production and further investment in productive facilities. Producers with access to guaranteed income face fewer risks and have the ability to incur more debt at preferential rates. Producers are free to use this revenue stream as a base income and to supplement it with market revenue with little or no regard for real cost of production. The guaranteed income stream and reduced risk facilitate the consolidation

[17] Jacques Berthelot. Ibid., para. 6
[18] House of Commons Standing Committee on International Trade. Testimony (unofficial blues) of Bob Friesen., President, Canadian Federation of Agriculture, June 12, 2006
[19] A bibliography is attached to this report.

of production into fewer larger units that, in turn, increases the volume of competitive production through greater economies of scale.

28. Other WTO Members and commentators from academic and non-governmental organizations have been questioning the "greenness" of U.S. and E.U. programs, and "decoupling" overall for several years. The G-20 have called for a review of decoupled support to ensure that any support provided meets the WTO requirements and that it not be trade or production distorting.[20]

29. According to the World Bank:

> **"**Direct payments also help cover fixed costs, allowing farmers to cross-subsidize production at market prices."[21] and,
>
> "Direct payments allow banks to make loans that they otherwise would not and allow farmers with specialized skills to stay in agriculture."[22]

30. G-20 has argued:

> "There is an ever-present risk that, although intended to be decoupled, direct payments may indeed be "re-coupled" through updating of base areas and yields. This situation requires fixing and the notion of "fixed and unchanging" addresses this concern."[23]
>
> "In the presence of distorting payments, "green" policies do not properly perform their function. On the contrary, their neutral nature is being abused and they merely follow the general orientation of the distorting policy. As a consequence, "green" money is merely added to "blue" and "amber" monies and becomes undifferentiated in relation to them."[24]

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[20] WTO document JOB (06)/145 Committee on Agriculture, Special Session, "G-20 Comments on the Chair Reference Paper on Green Box", May 16, 2006
[21] John Baffes & Harry De Gorter. " Disciplining Agricultural Support through Decoupling, , World Bank Policy Research Working Paper (3533)", March 2005, p. 33
[22] Ibid., p.33
[23] WTO document JOB (06)/145 Committee on Agriculture, Special Session, "G-20 Comments on the Chair Reference Paper on Green Box", May 16, 2006
[24] WTO document JOB (06)/145 Committee on Agriculture, Special Session, "G-20 Comments on the Chair Reference Paper on Green Box", May 16, 2006

31. Berthelot considers that the G-20 criticism does not go far enough. He explains:

> "All agricultural subsidies, the green ones included, bring a price support to producers. Indeed, all depends how we interpret "price support" and "producers": the drop in agricultural prices permitted by direct subsidies such as the EU alleged green "single farm payment", the former US "production flexibility contracts" and now its "direct payments", and all the other domestic green, blue and amber subsidies have a clear impact on production and prices.
>
> - Green and blue subsidies bring a price support to farmers since they can make do with prices lower than the average production cost.
> - The EU blue then green subsidies compensating the reductions in the prices of COPs (cereals, oilseeds and pulses) used as feed bring a large price support to farmers producing animal products (bovine, ovine, pig and poultry meats, eggs and milk).
> - All domestic subsidies bring an enormous price support to agri-food industries since the prices of their main inputs are reduced, increasing their competitiveness on the domestic market, at the export and import levels, reducing their need of export subsidies and tariffs." [25]

32. USDA Economic Research Service (ERS) notes:

> **"…**many countries have taken the position that, based on the experience with the URAA, the implementation of a minimally distorting payment has proven to be impossible. There are many conditions under which lump-sum payments can lead to production impacts."[26]

33. A review of the literature reveals many other criticisms of decoupled support as a disruptive trade and production distorting mechanism.

34. Ivan Roberts, an Australian economist, in an ABARE Report has argued, inter alia,

- "The categorisation of support methods in the WTO *Agreement on Agriculture* into three categories involving market access, domestic support and export subsidies is highly artificial, especially where price support is involved. That is because, in most instances, domestic support through price support depends for its effectiveness on market access limitations and/or export subsidies….. Also, export subsidies can be reduced, but replaced by much increased levels of domestic support that are structured in ways to make them exempt".[27]

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[25] Jacques Berthelot. "J. Berthelot's comments on the G-20 papers on blue, green and amber boxes, May 28, 2006" (G-20 Comments on the Chair Reference Paper on Blue Box, Committee on Agriculture, Special Session, (JOB(06)/146, May 16, 2006), (http://solidarite.asso.fr)
[26] United States Department of Agriculture, Economic Research Service. "Decoupled Payments - Household Income Transfers in Contemporary U.S. Agriculture", p. 1
[27] Ivan Roberts. "Three pillars of agricultural support and their impact on WTO reforms", abareconomics, p. 30

- "…it might be claimed that the structuring of support in these ways was merely to obtain exemptions from WTO domestic support disciplines and the support would be similarly distorting to coupled production support"[28]

- "Whether particular forms of support are considered to be exempt or nonexempt has become an issue of definitional subtlety rather than being a reflection of the fundamental effects of the support on production, prices and markets."[29]

35. The Estey Centre of the University of Saskatchewan noted:

- "Given that farmers are generally risk averse, even apparently fully decoupled direct payments including those to reduce risk or to compensate for climatic disasters would appear to have some impact on production through reducing revenue variance, through relaxing debt constraints, and by increasing wealth and moving farmers to less risk-averse regions of their utility functions."

- "Tying direct payments to past levels of inputs or outputs may affect current farm decisions, since it may persuade farmers to increase output in order to influence possible future base production/area data (such as in the 2002 U.S. Farm Bill, which gave farmers the opportunity to update their base acreages). Direct payments may also influence future output through new investments, or may protect some farm businesses from bankruptcy."[30]

36. Commenting on the 2003 CAP Reform, Berthelot noted:

> "The coupled nature of the SFP was attested by the European Commission's statement, premonitory of the CAP reform of June 2003, during the meeting of the WTO Committee on agriculture of February 7, 2001: "the representative of the European Communities… in respect of the Blue Box… stated that measures that were linked to production restraints should continue to be treated separately from Amber Box supports. If not, there was a danger that similar measures would be introduced under the Green Box", which was hardly a diplomatic manner to recognize that the green box generates the same trade distorting effects as the blue and amber subsidies, and that box-shifting did not pose any difficulty for the EU."[31]

[28] Ibid., p. 27
[29] Ibid., p 34
[30] Anna Strutt and Allan N. Rae. "The Current Round of Agricultural Trade Negotiations: Should We Bother About Domestic Support", Estey Centre Journal of International Law and Trade Policy, Vol. 4, Number 2, 2003/p.98-122, p. 103
[31] Berthelot's comments of the Chair's reference papers on the OTDS, AMS, blue box of May 24, 2006 and green box of May 30, 2006 (Chair's Reference Paper: Overall Reduction in Trade-Distorting Domestic Support, Committee on Agriculture, Special Session; Domestic Support, May 24, 2006)

37. Professor Darryl Ray of the University of Tennessee, too, has been an active and skeptical critic of decoupled support. He refers to:

> "… decoupled payments … are … planting flexibility on steroids. [32]

38. Professor Ray also claims that:

> "… economists … graduate-school-learned calculus approach to evaluate farmers' efforts to maximize their profits…is flawed." [33]

39. In this connection, he asks:

> "The question is: does the theory match reality? Does the theoretical result of a "no production effect" from decoupled payments accurately predict how farmers use information on anticipated fixed payments when they make acreage/production decisions? Do farmers ignore the knowledge that they will be receiving contract payments when making production decisions? Or, do they mentally convert the payment to cents per bushel or pound, add the result to the expected price or loan rate and use that sum to make production decisions? The payment also could have a "wealth effect" which loosens farmers' capital constraints, convincing bankers to lend required operating money or in other ways provides staying power for the farmer.
>
> So, are decoupled payments a "calculus issue" in which the lump-sum payments fall out of consideration or are they part of an arithmetic problem in which farmers consciously combine fixed payments, measured per bushel, with expected price when deciding what to grow?" [34]

40. It is our view that it is not possible to implement a decoupled income support program that does not violate WTO obligations. Beneficiaries are not required to cease production. They are entitled to choose to continue to produce while they simultaneously receive "decoupled" income support. In the E.U. beneficiaries are required to keep idled farm land or unplanted hectares in good condition for farming. In both the U.S. and the E.U. beneficiaries of decoupled payments are restricted with respect to other crops they may plant if they wish to maintain their benefits.

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[32] Daryll E. Ray. "Decoupled Payments: Are the Effects Explained by Calculus or Simple Arithmetic?", August 18, 2000
[33] Ibid.
[34] Ibid.

41. The situation is exacerbated by other "green" payments such as excessive crop insurance subsidies and un-notified support such as water for irrigation at prices far below commercial rates, permits production where none should or could exist without it exist. The California Rice Commission has admitted rice production in California would not exist without irrigation (subsides):

> "Irrigation is essential to rice cultivation. Although rice is grown in some parts of the world without benefit of irrigation, ***this would be impossible in California***."[35] (emphasis added)

42. Our analysis concludes that:

- further attempts at the "greening" of agricultural support will not reduce production, and will not increase prices and exacerbate the farm income crisis.
- U.S. and E.U. decoupled payment programs do not meet the specific WTO requirements and are not entitled to benefit from the exemption from domestic support reduction requirements on the basis that they are inconsistent with WTO obligations.
- the only valid decoupling support would in fact need to be coupled to an abandonment of production.

43. This latter conclusion will be quite alarming to farm groups. Governments would reject it as "welfare" and would be unwilling to extend this stigma to their farmers.

44. The New York Times on December 24, 2000, described just how generous support is for some U.S. farmers:

> "…the big harvest of government checks usually happens in the fall -- $40,000 for just being a farmer, another $40,000 for emergencies like bad market conditions, more than $100,000 for not making any money on what is grown, and $50,000 for taking other land out of production.
>
> Good crops or bad, high yields or low -- it hardly matters, the checks roll in from the federal government, the biggest payroll in farm country. By the end of the year, some farmers can receive up to $280,000 simply by having another miserable year of failure."[36]

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[35] California Rice Commission (Website - http://www.calrice.org/a_balance_sheet/chap2.htm)
[36] Timothy Egan. "Failing Farmers Learn to Profit from Federal Aid", The New York Times, December 24, 2000

45. According to former U.S. Agriculture Secretary Dan Glickman:

- federal subsidies are not so much about food supply as they are about keeping the least populated parts of the country afloat;
- support to farming has "become largely an income transfer program";
- without government support thousands of farmers (nearly 1 million) and businesses that depend on them would be broke in a year or two;[37]
- many of these payments are keeping large sections of rural America from "going down".

46. No one wants to see unemployed farmers; not the 2 million or more Mexican farmers who have been forced off their farms or farmers anywhere. No one wants to see ghost towns in the American heartland or farm families in Mexico, Africa or Asia forced to become urbanized with serious declines in their standards of living. Exporting misery and destitution to farmers next door and further away is not the proper answer to U.S. farm problems. Beggar thy neighbour policies did not work in the 1930s. They are not the answer today.

47. In summary, these payments:

- reduce farmer risk;
- create a base income;
- permit increased input use;
- improve creditworthiness and borrowing capacity;
- encourage investment and consolidation

All of these factors work to increase production.

48. Decoupled income support programs are trade-distorting whether or not they are designed or advertised to meet all of the conditions set out in Annex 2(6) to the WTO AoA. Experience has shown that they are both trade and production distorting contrary

[37] Ibid.

to the general requirements of Annex 2(1).[38] Because of the wealth effect, reduced risk and consolidation that flow from the guaranteed revenue stream, it is unlikely that the trade and production distorting effects of any decoupled income support program could ever legitimately be deemed to be minimal.

49. By declaring and notifying their programs as green decoupled support, the U.S. and the E.U. are able to maintain substantial subsidies to their farm sector that clearly violates their WTO obligations. These programs, if maintained, will not only affect developing country producers but producers in all WTO Member States who will be forced to compete with the U.S. and E.U. Treasuries rather than with U.S. and E.U. farmers.

Conclusion

50. Unless Annex 2 of the AoA is amended to introduce effective notification, surveillance and enforcement measures to ensure that only non-trade distorting support qualifies as "green" the U.S. and E.U. will continue to bilk the system. The stated intention of the WTO drafters was to allow decoupled support because it severed the link between production and support. In our view, the only way to effective achieve this objective, is to require that producers who accept decoupled support be required to cease or abandon production and be precluded from selling or renting their land for agricultural production. This would reduce production, help to increase prices and would make market access negotiation more meaningful.

51. Until this admittedly draconian change is introduced all support provided to producers, whether classified as coupled, partly decoupled or fully decoupled, should be included in AMS, dehydrated and made subject to rapid reduction and elimination. Anything else would be half measures or worse which will perpetuate disruption and the global farm income crisis.

[38] Ben Lilliston. "*Close to the Wind: Navigating the WTO Hong Kong Ministerial*", Minnesota, USA, November 2005, p. 4. "The U.S. refuses to address the criticism that its decoupled payments do not properly meet the minimally trade distorting criteria required for inclusion in the green box."

52. The U.S and E.U. have tied their proposals to reduce their AMS domestic support to substantially improved market access to other members' markets, and in the case of the E.U., to concessions in other areas of the negotiations, including additional disciplines on granting food aid, restrictions on the use of geographic indicators and further obligations on the export activities of state trading enterprises. But the seemingly sharp reductions to domestic support are not essentially box shifting, which will not reduce the incentive to produce, nor will it raise prices in world markets.

53. The U.S. Congress has refused to improve its offer on domestic support reductions unless there are

> "deep cuts in European Union and developing world farm tariffs, significant reductions in industrial tariffs in Brazil and other developing countries and enhanced access to the services markets of key trading partners."[39]

54. A recent IATP report underlines the need to approach U.S. demands and offers with considerable skepticism:

> "A new economic simulation of the U.S. agriculture proposal at the World Trade Organization (WTO) confirmed what NGOs and developing countries have been saying for months: the proposal has so many loopholes it may actually increase the allowable amount of domestic agriculture spending in the U.S. The new simulation exposed not only the emptiness of the U.S. proposal, but also the limited space that U.S. negotiators find themselves in as the Doha Round moves forward….
>
> …It found that under the U.S. proposal, U.S. agriculture spending could legally increase to $22.5 billion a year, from last year's estimated $19.6 billion, simply by re-categorizing existing payments. The shift in payments would be made from a further restricted Amber Box to non-product specific and product-specific *de minimis* payments and into an expanded Blue Box."[40]

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[39] Inside U.S. Trade. "Baucus Warns Lamy: E.U. Agriculture concessions Key to Success of WTO's Doha Round", News Release, U.S. Senate Finance Committee, June 13, 2006. House Agriculture Committee Chairman Bob Goodlatte, told Mr. Lamy, "We will not unilaterally disarm. Fair trade involves all parties participating equally and at this point we will need to see a more aggressive effort from our trading partners. Inside U.S. Trade, "Baucus, Goodlatte Tell Lamy U.S. Will Not Support Further Concessions In Doha Farm Talks", www.insidetrade.com (June 14, 2006)

[40] Institute for Agriculture and Trade Policy. "U.S. Boxed into a Corner at WTO", (Commentary), June 7, 2006

55. The U.S. argues that the analysis is superficial and ignores some important elements of double counting. Their response is included in a number of comments contained in a recent USTR media conference transcript. [41] Past experience has made other countries skeptical about these answers.

56. These entrenched attitudes, this culture of entitlement which is embodied in the U.S. (and E.U.) farm support policies explains why the Doha Round negotiations on agriculture are so hopelessly deadlocked. The blue and green boxes are in effect really amber. Those who do not have the same deep pockets to insulate their farmers as the USA and E.U. do will not give up real market access in return for smoke and mirrors. Any schoolchild knows that a combination of blue and green pigment results in amber. And this amber support is tinged with pink from the red of export funding which has been reduced only to become blue and green in its presentation but has the same effects as export subsides, including those prohibited by Article 9.1 (c) of the AoA.

57. There is widespread recognition of the need to reform domestic support. WTO DG Lamy has indicated that if there is to be movement in the agriculture negotiations, there must be improved offers on reducing domestic support.[42] Even usually silent China has urged the U.S. and E.U. to improve their.[43] Indian negotiators have indicated that it is U.S. unwillingness to mare on domestic support which is preventing even a modest gain in the negotiations. [44]

58. U.S. domestic support to corn and white beans has become an issue in the Mexican election. One candidate has pledged to abrogate tariff cuts – because U.S. subsidies create an unfair advantage over small scale mostly subsistence farmers.[45]

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[41] Press Briefing with Jason Hafemeister, Deputy Assistant USTR; U.S. Perspective on Ongoing Agricultural Negotiations, Friday, June 16, 2006 (World Trade Organization Centre William Rappard, Geneva)
[42] Frederic Tomesco. "WTO's Pascal Lamy says Time Running Out for Trade Negotiations", Bloomberg, June 5, 2006
[43] "Onus is on U.S., E.U. to Save WTO Talks: China", Reuters, June 2, 2006
[44] "U.S. biggest hurdle to Modest WTO Farm Deal: India", Reuters, June 15, 2006
[45] Mark Stevenson. "Mexico hopeful takes hard line vs NAFTA", Associated Press, June, 17, 2006

59. E.U. negotiator Commissioner Peter Mandelson has identified the real problem and the reason for the impasse.[46] He recently explained that:

> "The problem is the U.S. position, that they are offering to pay too little for what they are demanding in return and that has to be remedied… before we can unlock the possibility of a deal."

60. A more detailed and broader condemnation was recently issued by IATP:

> "The deterioration of WTO trade talks is not surprising. The whole premise of the Doha Round—deep tariff cuts and agricultural rules that ignore food security and livelihood concerns—is wrongheaded. Most countries are not interested in the radical tariff cuts being pushed by a few developed countries and still fewer developing countries; they cost too much monetarily in lost revenues and politically in lost jobs.
>
> As the U.S. House Speaker Tip O'Neil once famously said, "All politics is local." And negotiators are finding out that's true even at the WTO. The contradictions between promised benefits at the global level and more complicated realities on the ground are harder and harder to explain. People around the world are becoming aware of how the liberalization of trade and finance is affecting their daily lives. Cheap food, clothing or electronic goods are of little use to people who cannot earn a living in decent working conditions. The deregulated markets sought by free traders today tend to concentrate wealth and undermine public access to decision-making. The Doha Round needs a quiet burial. We need a fresh start toward devising a trading system focused on improving people's livelihoods and providing the space for poor countries to develop their economies." [47]

61. The message from many involved in the negotiations is that all support is distorting. Cash is fungible. The more cash available to the farmer, whatever the source, the more inclined the farmer will be to produce, and the better able he will be to finance his production. Failure to adequately address trade distorting support was a major failure of the Uruguay Round. The principal proposals before the negotiators in the DDA negotiations will not resolve these deficiencies and inadequacies of the Uruguay Round

62. Without automatic scrutiny and review of notifications by an a oversight committee or surveillance body and rigid and prompt notification deadlines these imaginatively contrived and deceptively reported programs and those which will appear in the 2007

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[46] "E.U. trade chief welcomes Bush signal on WTO round", Reuters, June 16, 2006
[47] Carin Smaller. "Why is the Doha Round Failing?", Institute for Agriculture and Trade Policy (IATP), (Commentary) May 12, 2006

Farm Bill are likely to exacerbate them. Market access concessions in this environment will not be cushioned by the greater stability which real and enforceable reductions and disciplines on domestic support would bring.

GREEN BOX MYTHOLOGY:

THE DECOUPLING FRAUD

63. Decoupling was promoted during the Uruguay Round as a means by which WTO Members could provide support to their producers without distorting trade or affecting production decisions. The theory was that by severing the tie between the provision of support and production decisions, producers would be free to produce and sell in response to market signals alone, i.e., support was a neutral factor in producer decisions.

64. It was most important for the USA and the E.U. that "green" status would mean that their massive support could be exempt from reduction commitments

65. Notwithstanding the apparent logic of the theory, experience has shown that decoupled support is far from production neutral. Indeed, decoupling itself, as practiced by the U.S. and E.U., generates market effects that provide a powerful incentive for producers to remain on the land or to consolidate into larger, more efficient units, and to continue producing.[48] There is abundant evidence that producers who benefit from decoupled payments will continue to produce and over-produce. The benefits received from decoupled payments simply permit farmers to treat the payments as base income and to sell their commodities at lower prices on both the domestic and export markets to supplement this base income.

66. It is important to understand that both the U.S. and E.U. concentrate their farm supports in feed grains and oilseeds. A variety of support programs, listed in the amber, green or blue boxes, or Single Farm Payments permit farmers growing grains and oilseeds to continue to produce without regard for their real cost of production.

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[48] Peter Clark. "Unchain your support: Exposing the decoupling myth", Newsmaker Breakfast, National Press Club, Ottawa, November 1, 2006

67. Grains and oilseeds are sold most years on world markets at less than cost of production. This disrupts producers in countries which are not able to match the subsidies of richer companies – and denies them access to export markets they might have based on comparative advantage, unskewed by government support. [49]

68. Because so called decoupled support is concentrated in grains and oilseeds, there is a widespread and pervasive downstream effect through provision of below cost and inexpensive inputs to downstream users, such as producers of beef, pork, ethanol and sweeteners. Access to lower-cost inputs makes these downstream users more competitive in their own markets.

69. The issue has recently been addressed in a Study by the Institute for Agriculture and Trade Policy. They conclude:

> "Multinational meatpacking companies, which procure large quantities of agricultural commodities through easily manipulated, nontransparent and increasingly exploitive contracts, have reaped record profits as commodity prices have collapsed."

IATP estimates that the benefits of below cost inputs are worth 7-10% of cost of production.[50]

70. The effects of E.U. grains support on livestock and meat have been explored in some depth by Jacques Berthelot. His analyses can be found at the IATP website. One suggests defacto export support to beef could increase. Berthelot notes reducing feed cost was one of the main objectives of the CAP Reform in 1992 and 1999.[51]

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[49] Oxfam Briefing Paper Number #76, "A Round for Free", June 2005 and Oxfam Briefing Paper #72, "Kicking Down the Door", April 11, 2005

[50] R. Dennis Olsen. "Below-Cost Feed Crops: An Indirect Subsidy for Industrial Animal Factories", Minnesota, USA, June 2006

[51] Jacques Berthelot. "The comprehensive dumping of the European Union's dairy produce from 1996 to 2002", January 31, 2006, (http://solidarite.asso.fr)
And Jacques Berthelot. "Feed subsidies to E.U. and U.S. exported poultry and pig meats, January 9, 2006, (http://solidarite.asso.fr)

71. Feed costs have benefited E.U. pigmeat exports to the point where in 2001 and 2002, export refunds represented only 12.4% of total subsidies to exported pigmeat.[52] These changes represent shifts from prohibited export subsidies to non-AMS support, but with the same effects – exports more than doubled since the 1986-88 base period, and the launch of the 1992 CAP Reform.[53]

72. Notwithstanding that WTO rules extend "green" status to qualifying decoupled payments, it is, in our view, impossible to decoupled income support programs which do not preclude continuing production such as the E.U. Single Farm (SFP) and the USDA Direct Payments that would not have more than insignificant production and trade distorting effects.

73. In Section III, "Is True Decoupling Possible?," we address in more detail the scope to meet Article 2.6 tests. In our view, it is difficult, if not impossible, to develop a decoupled income support program that in practice has no or negligible effect on trade or production. This is because:

1. Decoupled income support payments are made to producers who have the ability to choose to continue to produce for market. Both the E.U. and U.S. make decoupled payments to producers who have the right to choose to continue to produce. These producers can use the SFP or direct payments as an income base supplemented by sales into the market at market prices.

2. Producers have an incentive to maximize their revenue and, given the choice, will inevitably choose to work their land to maximize their revenue. Farming is a skill and, for many, a way of life. There is a strong desire to pass their farm on to their children. Given the choice between

[52] Ibid, p. 8
[53] Ibid, p. 7

farming the land and simply relying on the support payments, most farmers would choose to farm the land on order to maximize income.[54]

3. Neither the E.U. nor the U.S. allow beneficiaries to shift production to other crops without restriction. Neither permits beneficiaries to replace former crops with fruits or vegetables.[55] In the E.U. in some member states has introduced partial decoupling. There is a tendency to continue to continue producing what the farmer has always produced, unless the rules preclude them from doing so.

4. Money is fungible. Any support provided to producers will create an income flow which supplements market incomes, allowing them to produce more and to sell at low prices. The net result is that decoupled income support payments are simply another form of support that producers can rely on to support their production even if surplus conditions force them to sell at less than the cost of production. G-20 notes

> "The G-20 considers important that inputs and factors of production should not be required to be in agricultural use for farmers to receive income support. Indeed, the amendment is aimed at reinforcing the notion that income support is indeed decoupled from production."[56]

5. Decoupled support provides income that permits and encourages consolidation. The resulting larger, more efficient production units also tend to augment production. The literature reports instances in the E.U. conversion to the SFP has encouraged smaller, less efficient farmers to sell out to larger ones.

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[54] Peter Clark. "Unchain your support: Exposing the decoupling myth", Newsmaker Breakfast, National Press Club, Ottawa, November 1, 2006

[55] Jacques Berthelot. "The green box, a black box which hides the gold box", December 9, 2005, para. 2

[56] WTO Document JOB (06)/145 Committee on Agriculture; Special Session, "G-20 Comments on the Chair Reference Paper on Green Box", May 16, 2006

74. For example, Hennessy and Thorne reported that a survey of Irish dairy farmers revealed:

> "that, post decoupling, a significant number of farmers plan to use their decoupled payments to continue or expand economically non-viable production."[57]

75. There is no requirement, and no incentive, for farmers reviewing "decoupled" support in the E.U. or in the U.S. to abandon production. Thus, decoupled support is both trade and production distorting and cannot be excluded from support reduction commitments required by the WTO AoA.

76. In addition to claimed de jure decoupled support both the U.S. and E.U. provide support that is coupled to some degree. The E.U. permits "partial decoupling" and additional payments and the U.S. provides marketing loans, counter-cyclical payments, as well as direct payments. These payments directly support agricultural production by topping up revenues in weak markets – usually in periods of high yields. The existence of such supplementary programs simply adds to the guaranteed income flows and further insulates farmers from market signals.

77. G-20, in its comments on green box issues, explained:

> "In the presence of distorting payments, "green" policies do not properly perform their function. On the contrary, their neutral nature is being abused and they merely follow the general orientation of the distorting policy. As a consequence, "green" money is merely added to "blue" and "amber" monies and becomes undifferentiated in relation to them." [58]

78. Brian M. Riedl of The Heritage Foundation, an American think-tank, explains how subsidy programs can create greater distortions for production planning in the United States.

> "Another major problem that characterizes farm subsidy programs is that their very design is fundamentally flawed and makes no economic sense. Farm policy is based on the assumption that the market prices of crops are too low for farmers to earn sufficient revenue. Because food demand is relatively inelastic (i.e., not

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[57] Thia C. Hennessy and Fiona S. Thorne. "How Decoupled are Decoupled Payments?", November 2005, Vol. 4, p. 30

[58] WTO document JOB (06)/145G-20, Committee on Agriculture, Special Session, "Comments on the Chair Reference Paper on Green Box", May 16, 2006

very price sensitive), low prices are the result of an oversupply of crops on the market.

> Congress's remedy for low prices is counterproductive and ultimately aggravates the cause of the problem. As laid out in H.R. 2646 and S. 1731, the government's approach is to set a higher target price for farmers to receive, and then to supplement farmers' incomes by paying them the difference between the target prices and the low market prices. Not surprisingly, such subsidies provide farmers with an incentive to grow more, not less, of the oversupplied crops. In fact, farmers have responded to past subsidies by planting as many as 5 million acres more of the oversupplied crops, driving prices down further and necessitating even higher subsidies."[59]

79. The availability of support makes farmers more creditworthy. They will be able to borrow at more competitive rates to invest in new technology and processes, and consolidate into large production units. And the analysis never seems to consider changes in yields which flow from improvements in technology and farming practices (which are often funded by "green" government research grants).[60]

80. The extensive literature confirms our conclusion that decoupled support programs are not production neutral or discouraging; they support and can expand production, lead to greater trade distortion and lower prices. The move to decouple support through the 2002 Farm Bill and the 2003 CAP Reform has done little, if anything, to address trade distorting domestic support. Rather, this is part of a shell game that tries to disguise trade distorting support and defacto export subsidies as "green".

81. Jacques Berthelot has examined in great detail U.S. support programs and U.S. Doha Round proposals and the overall impact on the AMS. He concluded,

> "Reintegrating in the amber box the massive US cheatings in its past domestic supports notifications and the non-compliance of the present Farm Bill with the WTO rules would show that the king is naked.
>
> Without any reduction in *allowed* total AMS, the US had already in 2001 an *applied* total AMS higher than its *allowed* total AMS by $22.6 billion, so that

[59] Brian M. Reidl. "The Cost of America's Farm Subsidy Binge: An Average of $1 Million Per Farm", December 2001 (http://www.heritage.org/research/agriculture/BG1510.cfm)
[60] Daryll E. Ray. "Policy Pennings: Further Peculiarities of coupled and decoupled payments", Article #20, November 2002

implementing the proposed 60% cut would increase this deficit to $31.3 billion. The *applied* level of the overall trade distorting support exceeded already its *allowed* level by $22.3 billion and the proposed 60% cut would increase this deficit to $30.2 billion.

This is because the US has cheated massively on its feed subsidies, irrigation subsidies, farm loan subsidies, tax rebates on agricultural fuel. It is also because the production flexibility contracts payments, the fixed direct payments and the counter-cyclical payments should have been or should be notified in the amber box.[61]

82. Although this Report focuses on decoupled income support programs, and the fallacy that these programs can be trade neutral, it is important to note that these are simply one more form of support to ongoing production. Since money is fungible, any support provided to producers will be used to support production. The effect will be to create a guaranteed income base to improve cash flows, to reduce risk and insurance costs, to offset the cost of marketing and to offset the cost of inputs (seeds, water or feed grains). And as mentioned above, easier access to competitive financing encourages consolidation. The net result of all these programs is to support agricultural production. Oxfam has argued in several reports that by increasing base income to cover some portion of costs, these support programs encourage over-production that is then "dumped" onto world markets. Berthelot claims that decoupled support applies to all commodities produced with the result that they can all be "sued" for dumping at the WTO.[62]

83. Indeed, the simulation of the U.S. proposal on domestic support indicated that, in fact, the USA could ***increase*** its trade distorting support by 15%.[63] To be fair, Deputy USTR Jason Hafemeister has attempted to rebut these allegations, an analysis which he describes as superficial. He also suggests there is double counting of de minimis because commodities which receive other support cannot also benefit from de minimis. He stresses that the excess is arrived at on the basis of arithmetic potentials and not reality.

[61] Jacques Berthelot. "The King is Naked. The Impossible U.S. Promise to Slash its Agricultural Supports", November 7, 2005, p. 38
[62] Oxfam Briefing Paper #50, "Dumping without Borders: How U.S. agricultural policies are destroying the livelihoods of Mexican corn farmers", August 2003
[63] Institute for Agriculture and Trade Policy; Commentary. "U.S. Boxed into a Corner at WTO", Minnesota, USA, June 7, 2006

Given past experience more than a few in Geneva have received these assurances with considerable skepticism.

84. The U.S. wants a Peace Clause to provide litigation protection in the Doha round. In a recent press conference, Deputy USTR Jason Hafemeister explained the U.S. position:

> "Jason, how important is it for the United States to have a peace clause in the final agriculture deal? And can you accept a final Doha deal without the peace clause?
>
> Mr. Hafemeister: It's important. We are going to engage in a serious process of domestic reform at home and will lock it in in a Farm Bill, something that is a long term endeavor for our Congress and our producers. So having some certainty about what the allowed support measures are in the WTO is quite important. Consequently we're looking for a type of a peace clause to provide that.
>
> In our opinion, the depth of cut that we're talking about should deal with a lot of the concerns that other people have about trade distorting effects, so with these types of reductions it certainly seems reasonable that we would have some litigation protection." [64]

85. Shifting support money from box to box is a shell game. The reward for the players is the ability to paint programs green sheltering them from reduction. Since the programs at issue all have or contributed to the same production distorting effects, none of them should be considered "green". Calling them decoupled and labeling them "green" is an abuse of the WTO "honour" system.

86. In return for shifting their support out of the amber box (i.e., repackaging and recasting it and labeling it "green") so they can claim to be making significant reductions(when their formula cuts would actually permit increased spending), both the USA and E.U. are seeking major market access concessions from other WTO Members. Because global agriculture is already in an income crisis, further market opening without real subsidy disciplines will simply exacerbate existing problems.

87. The U.S. and E.U. are able to manipulate the system because there is no effective scrutiny of notifications. The accommodations made in the Blair House Accord that

[64] Press Briefing with Jason Hafemeister, Deputy Assistant USTR; U.S. Perspective on Ongoing Agricultural Negotiations, Friday, June 16, 2006 (World Trade Organization Centre William Rappard, Geneva)

paved the way for agriculture to enter the world trading system included the Peace Clause in Article 13 of the AoA. Implementation of obligations was not challenged – the political sensitivities led to a "laissez faire" approach to notification, and surveillance notifications are notoriously late, and there are no specific requirements. It was left to each Member to notify the extent and nature of their provision of domestic support.

88. One might wonder why the WTO Secretariat does not analyze and report on the timeliness and accuracy of notifications. Gabrielle Marceau of the WTO Secretariat (Dispute Settlement Unit) explained,

> "The WTO has neither the resources nor the skills to act like "the regulator" of these notifications. It is up to each Member to do these notifications… that is the very spirit of the whole disputes settlement system of the WTO: every member country acts as a guard dog of the system."[65]

89. The approach suggested by Ms. Marceau could be managed by those with the resources to do it. Many developing countries do not. And the "clean hands" principle would limit such challenges to those without sin – and those whose governments (unlike Canada) are willing to try to enforce their rights. This complacency and abrogation of responsibility is unacceptable. The U.S. and the E.U. have had a "free ride" in exercising and unfettered ability to self designate their support programs and to declare their support to be like a green and exempt from domestic support reduction commitments.

90. The approach suggested by Ms. Marceau could be managed by those with the resources to do it if they were so inclined. Many developing countries could not because they lack the resources. And the "clean hands" principle would limit such challenges to those without sin – and those whose governments (unlike Canada) are willing to try to enforce their rights. The limits imposed by the Peace Clause have been another disincentive.

91. The "Blair House" accord resolved U.S. and E.U. differences over agriculture and paved the way for bringing agriculture more completely into the GATT/WTO system – and,

[65] Jacques Berthelot. "The Empty Promise and Perilous Game of the European. Commission to Slash its Agricultural Supports", November 3, 2005. He attributes this comment to Ms. Marceau, in an internet forum on February 27, 2001.

indeed, for the conclusion of the Uruguay Round. While the accommodations of the Blair House Accord were pivotal in catalyzing important moves in agriculture, both parties recognized the political sensitivity of their concessions and agreed to a Peace Clause[66] which is found in Article 13 of the AoA. (Congress is seeking to review the Peace Clause.)

92. The U.S. and E.U. have learned to play the packaging and colorization game very well. Others might too if they could afford to provide such generous support. As Jacques Berthelot points out the difference between applied and allowed total AMS for the E.U. was so great that changes in the 1992 CAP Reform (after the 1986-88 base period) meant that in 1995 the AMS had been reduced by 36.46% "almost twice the reduction (20%) required for the whole period 1995-2000."[67]

93. Berthelot goes on to demonstrate that the continuous shift of E.U. support since 1992 from Amber to Blue to Green will with the 2003 CAP reform reduce by €48.4 the applied total AMS relative to the allowed total AMS of €67.2 billion – a total reduction of 72%.[68] This number is very close to the E.U. 70% reduction offer. This means that the E.U. wants the rest of the world to pay it for introducing CAP Reforms which it had to undertake because of budgetary concerns arising out of Enlargement.

94. Berthelot explains too how the elimination of intervention prices reduces AMS – but creates opportunities for de minimis support to a number of products, i.e., beef – and possibly sugar.[69]

95. In another detailed critique, this time of the U.S. domestic support proposals, Berthelot explains that in 1996 the U.S. total applied AMS was already reduced by 74% in relation

[66] Ben Lilliston. "*Close to the Wind: Navigating the WTO Hong Kong Ministerial*", Minnesota, USA, November 2005, p. 15. A Peace Clause would grant agricultural subsidies a privileged place in the WTO, even if the subsidies are found to nullify and impair another member's benefits from signing a round of agreements.
[67] Jacques Berthelot. "The Empty Promise and Perilous Game of the European. Commission to Slash its Agricultural Supports", November 3, 2005, para. 4
[68] Ibid., para. 10
[69] Ibid., para. 17

to the allowed AMS of the base period for more than the 20% reduction required in the 6-year period 1995-2000.[70]

96. These reductions in the amber box did not occur as a result of overzealous attention to subsidy reduction obligations. Rather, during the 1986-88 base periods, U.S. farm support was concentrated on deficiency payments. These were eliminated in the 1996 Farm Bill.[71] In addition, the 1996 Farm Bill also removed supply management and regulating rules which prevented excessive price declines and controlled program expenditures.[72] The level of support did not decrease after decoupling – it shifted from the amber box to the blue and green boxes.

97. A simulation of the agricultural proposals being advanced at Geneva has confirmed that loopholes in the proposals will actually allow some Members, notably the U.S., to increase their trade-distorting support. The simulation, run on May 19, 2006found that,

> "… under the U.S. proposal, U.S. agriculture spending could legally increase to $22.5 billion a year, from last year's estimated $19.6 billion, simply by re-categorizing existing payments. The shift in payments would be made from a further restricted Amber Box to non-product specific *de minimis* payments and into an expanded Blue Box.[73]

98. Decoupled programs themselves, even if they are claimed to be fully consistent with a member's WTO obligations will distort production if they do not completely de-link production from support, i.e., they do not require producers to abandon production. If farmers can take the funds, and are not precluded from planting, there is a powerful incentive to continue production. The SFP and direct payment provide and income base which can be topped up with market returns and make production less risky and more profitable.

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[70] Jacques Berthelot. "The King is Naked. The Impossible U.S. Promise to Slash its Agricultural Supports", November 7, 2005, para. 5

[71] Jacques Berthelot. "The King is Naked. The Impossible U.S. Promise to Slash its Agricultural Supports", November 7, 2005, para. 6

[72] Daryll E. Ray. "What is it that distorts markets?", APAC Agricultural Analysis Centre, University of Tennessee, May 6, 2006

[73] Institute for Agriculture and Trade Policy. "U.S. Boxed into a Corner at WTO", Minnesota, USA, June 7, 2006

99. Other participants in the Doha Round, including the G-20, have questioned the "greenness" of the U.S. and E.U. programs, as well as the decoupling defence general.[74] They have called for a review of decoupling to ensure that any support provided through decoupled programs does not distort trade or production. Brazil has successfully challenged U.S. cotton subsidies.[75]

100. Canadian Federation of Agriculture President Bob Friesen has also expressed concerns about moves to simply shift support monies from box to box. He recently told the House of Commons Standing Committee on International Trade:

> "On domestic support it looks positive that we will finally be able to get the U.S. to at least significantly reduce their amber expenditures. The concern we have is that they will simply move money around into either a blue box or a green box. Of course, some of their green box programs are as trade distorting as any amber program. We would really like to see a re-definition of green box programs. We do know that our negotiators are working on that and clearly we support them.
>
> We also want to make sure that our production insurance programs can be put into the green box as well and we continue to push on that one. The concern there is on product specific support and they want to cap them based on historical spending. If that happens the U.S. is going to be capped at some very high levels for some of their commodities and Canada, because Canada historically hasn't provided much commodity specific support, would be capped at a very low level and that would simply institutionalize that disparity."[76]

101. Based on our analysis, and our review of the literature, we conclude that it is not possible to implement a WTO-consistent decoupled income support program which does not require that production be abandoned. Rather, all programs which permit continued production have trade and production distorting effects. USDA ERS, which published a Report in 2005, concluded,

> **"…**many countries have taken the position that, based on the experience with the URAA, the implementation of a minimally distorting payment has proven to be

[74] WTO document JOB (06)/145 Committee on Agriculture, Special Session, "G-20 Comments on the Chair Reference Paper on Green Box", May 16, 2006
[75] Report of the Appellate Body. United States - Subsidies on Upland Cotton - Ab-2004-5. World Trade Organization - WT/DS267/AB/R, March 3, 2003
[76] House of Commons Standing Committee on International Trade, Testimony (Unofficial Blues) of Bob Friesen., President, Canadian Federation of Agriculture, June 12, 2006

impossible. There are many conditions under which lump-sum payments can lead to production impacts."[77]

102. In considering the issues raised by decoupled income support, we reviewed the following:

I Decoupling and the Criteria in the WTO *Agreement on Agriculture* (AoA)

In this section we have reviewed U.S. and E.U. practices in the context of the rules and criteria in the WTO AoA that define WTO-consistent green box programs.

II Theory vs. Reality – U.S. and E.U. Decoupling Programs

In this section, we review U.S. and E.U. "decoupled" income support programs to assess their consistency with WTO rules and criteria. We conclude that neither U.S. nor E.U. programs are WTO-consistent.

III Is Decoupling Without Distortion Possible?

In light of our conclusion under II, we ask the broader question: is it possible to develop WTO-consistent decoupled programs i.e., non or negligibly distorting. Based on the analysis set out in this Section, we conclude that WTO-consistent decoupling is impossible if continuing production or sale of the land to other farmers is permitted. All decoupled programs except those which require abandonment of production and set aside of the land, will have trade and production distorting effects. Programs which permit continuing production fail to meet the fundamental requirements of Annex 2(1) of the *Agreement on Agriculture*.

[77] Mary E. Burfisher and Jeffrey Hopkins. "Decoupled Payments: Household Income Transfers in Contemporary U.S. Agriculture", Agricultural Economic Report No. (AER822) USDA, February, 2003. p.1

IV Current Negotiating Positions and the State of Play

In this section, we review the U.S., E.U., G-20[78] and G-10[79] positions on domestic support and green box as well as how WTO rules and procedures need to be amended to ensure that decoupled support programs do not distort trade and production. G-10 supports increased transparency and surveillance of blue box notifications.[80] It is interesting that despite Canada's recognition that it has paid more than $5 billion in emergency supplementary support in recent years, because of low prices created by domestic support policies, that Canada has not filed detailed position papers on this subject. Given the extensive Ministerial silence on this issue the absence of Canadian discussion papers is even more perplexing. In our view this is by far the most important issue for Canadian agriculture in the Doha Round.

I. Decoupling and the Criteria in the WTO Agreement on Agriculture

103. Decoupled income support, or decoupling, is addressed in Annex 2 of the WTO AoA and is designated a form of domestic support that is not subject to the domestic support reduction commitments set out in the Agreement.

104. Annex 2(6) of the AoA provides that to be deemed green and AMS reduction exempt, decoupled support must meet the following conditions:

> "(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.

[78] WTO document JOB (06)/145 Committee on Agriculture, Special Session, "G-20 Comments on the Chair Reference Paper on Green Box", May 16, 2006
[79] WTO Document "G-10 Proposal on Domestic Support", January 25, 2006
[80] Ibid.

(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." [81]

105. To be considered an exempt decoupled income support program for purposes of Annex 2(6), the program must meet all of the requirements of Annex 2(6) as well as the general requirements in Annex 2(1) that the program have no, or at most minimal, trade-distorting effects or effects on production.

106. Ivan Roberts, an Australian economist, in an ABARE Report has argued, inter alia,

> "The categorisation of support methods in the WTO *Agreement on Agriculture* into three categories involving market access, domestic support and export subsidies is highly artificial, especially where price support is involved. That is because, in most instances, domestic support through price support depends for its effectiveness on market access limitations and/or export subsidies….. Also, export subsidies can be reduced, but replaced by much increased levels of domestic support that are structured in ways to make them exempt".[82]

107. However, experience has proven that support structured or declared to be green does not meet these criteria. The WTO negotiators believed that support programs that de-linked production decisions from support through decoupling would not influence producer decisions on production and marketing of agricultural products. The WTO website notes that,

> "The Green Box also provides for the use of direct payments to producers which are not linked to production decision, i.e. although the farmer receives a payment from the government, this payment does not influence the type or volume of agricultural production ("decoupling")."

[81] World Trade Organization, Text on the Uruguay Round, *Agreement on Agriculture*, Annex 2, January 1994
[82] Ivan Roberts. "Three pillars of agricultural support and their impact on WTO reforms", March 2003, p. 30

108. The WTO rules are clear. Only those decoupled income support programs:

- do not distort trade, or at most have minimal trade distorting effects; and
- do not affect production,

are not subject to support reduction commitments if they fail to meet these tests. Decoupled income support programs are not exempt from subsidy reduction commitments.

109. Consequently, it should not be possible simply to declare that a program meets the requirements of Annex 2(6). Rather, it must be established that the program at issue meets the general requirements of Annex 2(1). Thus, it is evident that the WTO drafters did not envisage that all decoupled income support programs adopted by WTO Members would be consistent with WTO obligations.

110. Ivan Roberts explains the real motivation and purpose of decoupled designation:

- "…it might be claimed that the structuring of support in these ways was merely to obtain exemptions from WTO domestic support disciplines and the support would be similarly distorting to coupled production support"[83]

- "Whether particular forms of support are considered to be exempt or nonexempt has become an issue of definitional subtlety rather than being a reflection of the fundamental effects of the support on production, prices and markets."[84]

111. We concluded that the only purpose of introducing decoupled income support program is to secure exemption from the domestic support reduction commitments set out in each Member's Schedule to the AoA, and to ensure that agricultural producers are insulated from market conditions which could result in financial hardship.

112. USDA explains below why there are subsidies to U.S. farmers:

> "Domestic demand is no longer sufficient to absorb what American farmers can produce. Demand by well-fed Americans grows slowly with population growth. The promise of new, much faster growing markets lies overseas…As a result, the United States must consider its farm policy in an international setting, helping

[83] Ibid., p. 27
[84] Ibid., p 34

farmers stay competitive while pressing for unfettered access to global markets."[85]

113. The policy will not change – only the way in which the support is delivered

114. There are important reasons for providing very significant farm subsides in America.

115. The New York Times on December 24, 2000, described just how generous support is for some U.S. farmers:

> "…the big harvest of government checks usually happens in the fall -- $40,000 for just being a farmer, another $40,000 for emergencies like bad market conditions, more than $100,000 for not making any money on what is grown, and $50,000 for taking other land out of production.
>
> Good crops or bad, high yields or low -- it hardly matters, the checks roll in from the federal government, the biggest payroll in farm country. By the end of the year, some farmers can receive up to $280,000 simply by having another miserable year of failure."[86]

116. The 2002 Farm Bill increased direct support by 70% and raised the cap to $360,000. Administration efforts to reduce spending and the cap in 2005 fell far short of demands.

117. According to former U.S. Agriculture Secretary Dan Glickman:

- federal subsidies are not so much about food supply as they are about keeping the least populated parts of the country afloat;
- support to farming has "become largely an income transfer program";
- without government support thousands of farmers (nearly 1 million) and businesses that depend on them would be broke in a year or two;[87]
- many of these payments are keeping large sections of rural America from "going down".

[85] United States Department of Agriculture (USDA). Food and Agricultural Policy: Taking Stock for the New Century, p. 51 (http://www.usda.gov/news/pubs/farmpolicy01/fpindex.htm)
[86] Timothy Egan. "Failing Farmers Learn to Profit from Federal Aid", The New York Times, December 24, 2000
[87] Ibid.

118. No one wants to see unemployed farmers; not the 2 million or more Mexican farmers who have been forced off their farms or farmers anywhere. No one wants to see ghost towns in the American heartland or farm families in Mexico, Africa or Asia forced to become urbanized with serious declines in their standards of living. Exporting misery and destitution to farmers next door and further away is not the proper answer to U.S. farm problems. Beggar thy neighbour policies did not work in the 1930s. They are not the answer today.

119. And in Europe the object and purpose of the CAP is geared to self-sufficiency and income support. While the 2003 CAP Reform does decrease commodity-specific aid, quota systems and maximum guaranteed areas remain in place. Moreover, even those commodities that are decoupled are allowed to maintain, in many cases, some coupled payments.

120. Many commodities remain coupled, including: drying aid for cereals, durum wheat quality premium, protein crop supplement, crop-specific payments for rice, flax, potato starch processing, and dried fodder processing. Fruit, vegetable and wine payments are not affected by the reform. Nor is the sugar support scheme.

121. Intervention prices have been reduced for three commodities, rice (50%) butter (25%) and skim milk (SMP) (15%), but direct payments to compensate for lower prices will have been incorporated into the SFP. A cap on rice intervention was set at 75,000 tons. A declining cp on butter was set at 70,000 tons in 2004 with scheduled reductions to 30,000 in 2008. The milk quota was increased by 1.2%. Intervention for rye was abolished.

122. Financial discipline involves allowing the CAP budget to increase by 1% per year until 2008 and if violated, the SFP would be reduced by the same proportion. The CAP Reform of 2003 also included a “carbon credit” of 45 euros per hectare for the production of biofuels which E.U. farmers can use to continue to plant on set aside land.

123. In analyzing the 2003 CAP Reform, it is important to recognize that for many farmers money is fungible and that decoupling will not likely reduce production:

- Why, if dairy support is to be decoupled and replaced with SFP (income support), will it be necessary to maintain milk production quotas until 2014? Could it be because absent the quotas and overproduction penalties, surplus production would increase rapidly as it did in the period before quotas and super levies were introduced?
- Even if there is an SFP for dairy producers, why shouldn't they produce up to quota and supplement their income?
- A University of Tennessee study suggests that with or without subsidies, farmers will continue to farm. Therefore, if their revenues continue to be supported, will there be any incentive not to farm?
- Why would farmers, particularly those with capital investment in particular products like dairy, beef and swine, switch into other commodities?

124. The ability to convert amber box payments into green box payments was attractive to the E.U. but nothing had changed as the SFP system:

- will provide a basic income which permits a farmer to continue to produce what he knows best, with less income/market risk;
- will permit farmers to top up the SFP with market revenue;
- will encourage through sales and transfers to entitlements, the creation of larger units which will be able to compete even at lower prices which will result from phase out and removal of reference prices;
- the lower prices will make it more difficult for other countries to access European markets;
- the shift in the exchange rate between the U.S. dollar and the Euro will mean a continuing need for export subsidies.

125. The 2003 Reform is a re-packaging and re-orientation of the CAP which will increase the average size of farming units in the E.U. The direct payments will permit these larger and more efficient farms to compete profitably at lower references prices.

126. The 2003 E.U. reform will not solve the current farm income crises because it will not contribute in a meaningful way to stability on international markets. The decoupling efforts are partial and qualified and are not likely to be more successful at reducing production than U.S. "Green Box" programs. E.U. reforms will lower prices, not increase them.

127. The E.U. introduced these reforms to minimize the budgetary implications of enlargement to 10 new countries with smaller farming units. The farmers who will leave the farm because they cannot cope with lower reference prices will, in many cases, be older operators. They will be replaced by younger farmers who will have access to incentives that facilitate the consolidation encouraged by the new CAP regime.

128. This reform and revitalization of agriculture in the E.U. is not meant to reduce production. It will not guarantee improved market access, nor is it likely to increase prices.

129. Spain and France are encouraging rationalization into more efficient units with incentives to new farmers. In Spain 5,000 small dairy farms have been consolidated into 500 larger ones. In countries like Austria, where herd size is quite small, dairy will be undergoing significant change.

130. The political reality is that while E.U. agriculture will become more efficient, further reform will be resisted, particularly in those countries which have traditionally benefited most from the CAP. The politics of integration – so critically important to the E.U. – are being resisted and threatened by referenda defeats as Europeans who have benefited so much from the integration send messages to Brussels that their meddling in the economy and common regulations for 25 countries does not enjoy broad public support. This situation does not give the Trade and Agriculture Commissioners much flexibility.

131. In light of these policy objectives, while there may be reforms introduced from time to time, and delivery mechanisms may change, reduced production is not the main objective of the policies. Indeed there is logical disconnect between promises to reduce support and demands to secure unfettered access to global markets.

132. As U.S. negotiator, Deputy USTR Jason Hafemeister notes, others need to contribute much more. Senator Max Baucus, Ranking Minority Member of the Senate Finance Committee and House Agriculture Committee Chairman Bob Goodlatte, told Mr. Lamy:

> "We will not unilaterally disarm. Fair trade involves all parties participating equally and at this point we will need to see a more aggressive effort from our trading partners." [88]

133. And as U.S. farms groups have been adamant in rejecting Administration suggestions for deeper subsidy cuts.[89]

134. It is against these policies and imperatives and Farm lobby group demands that other WTO members must assess proposals to reduce domestic support.

135. While a Peace Clause would give the U.S. some litigation comfort – one might ask why, if they intend to do what they say, this is necessary? A new Peace Clause will, in our view, perpetuate problems of non-transparent notifications and ineffective surveillance.

II. Theory vs. Reality – U.S. and E.U. Decoupling Programs

136. The U.S. and E.U. are the largest single users of domestic support to agriculture in the world. Both have moved to decoupled income support as a means of painting their programs Green. Despite the claims that their programs are fully consistent with WTO

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[88] Inside U.S. Trade,"Baucus Warns Lamy: E.U. Agriculture concessions Key to Success of WTO's Doha Round", News Release, U.S. Senate Finance Committee, June 13, 2006. Inside U.S. Trade, "Baucus, Goodlatte Tell Lamy U.S. Will Not Support Further Concessions In Doha Farm Talks", June 14, 2006

[89] Inside U.S. Trade, "Schwab says U.S. Farm Trade offer in WTO could be improved or scaled back", Vol. 24, No.24, June 16, 2006

obligations, upon closer examination it is evident that neither the U.S. nor the E.U. have met the requirements of Annex 2(1) or 2(6) to the WTO AoA.

137. This section reviews U.S. and E.U. decoupling programs as examples of allegedly "green" programs that simply fail to meet the tests set out in the AoA.

138. This section will review the differences between the theory and reality of decoupling by considering decoupled income support adopted by the E.U. through its 2003 CAP Reform and by the United States through its 2002 Farm Bill. In both cases, the decisions to introduce decoupled income support was an exercise in form over substance demonstrating that in the WTO, truth in advertising is sadly lacking and can be replaced with smoke and mirrors.

A. The E.U. Experience

139. As part of Common Agricultural Policy (CAP) reform, the E.U. introduced a new system of single farm payments in 2003 to cut the link between support and production. This decoupling applies to a range of products including: durum wheat, protein crops, rice, nuts, energy crops, starch potatoes, milk products, seeds, arable crops, sheepmeat and goatmeat, beef and veal, grain legumes, cotton, tobacco, hops, and olives. With the exception of the new Members, the majority of common market organizations will become subject to this new system in 2005 or 2006.

140. Regardless of the intention, the actual impact of CAP reform on production and on market access is disappointing; indeed, underwhelming. Despite having adopted decoupled support, it appears that production of some important commodities will increase.

(i) E.U. Decoupled Payments

141. The E.U. has introduced limited decoupling through CAP Reforms since 1992 replacing reference prices with direct payments. The 2003 CAP reforms were advertised as allowing farmers to produce to market demand and to plan for the future while giving E.U. Members the flexibility to address their specific agricultural and environmental needs.

142. The central element of 2003 CAP Reform was the Single Payment Scheme(SFP) which established a system of decoupled income payments ("single farm payments") for European producers. Through the SFP the E.U. intended to cut the tie between production and support so that farmers had the freedom to produce to market demand.[90]

143. The E.U. Members were permitted to begin introducing the SFP beginning January 1, 2005 and were required to have it fully implemented by January 2007. The program would be reviewed within two years of its being implemented by all E.U. Members (i.e., by January 2009 at the latest).[91]

144. Under the 2003 CAP reform, each E.U. Member is permitted to provide payments to producers up to their National Ceiling, which is supposed to be equivalent to the total amount of direct payments received by farmers during the period 2000 – 2002.[92]

145. Farmers are eligible to receive payments if they have "eligible hectares" at their disposal and were actively producing when the E.U. Member implemented the SFP. "Eligible hectares" normally include all types of agricultural land except land used for permanent crops (excluding energy crops, e.g. short rotation crops) and forestry. Farmers may produce all crops with the exception of permanent crops, such as wine grapes, fruit and vegetables and some potatoes.[93]

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[90] Single Payment Scheme – The Concept (http://ec.europe.eu/comm/agriculture/capreform/infosheets/pay_en.pdf)
[91] Ibid.
[92] Ibid.
[93] Ibid.

146. Farmers do not have to produce in order to receive payments, as long as they maintain their land in good agricultural and environmental condition. Farmers must also meet other cross compliance standards, called statutory management requirements relating to the protection of the environment, protection of animal and plant health and animal welfare. Failure by farmers to respect these conditions can result in deductions from, or complete cancellation of, direct payments. [94]

147. E.U. Members may implement "partial decoupling" by maintaining some product-specific aids in their existing form if they believe that there may be a "disturbance" to agricultural markets or an abandonment of production will result from moving to the SFP. There is no time limit placed on "partial decoupling". In addition, E.U. Member states may grant "additional payments" to support agricultural activities that encourage protection or enhancement of the environment or that improve the quality and marketing of agricultural products. These "additional payments" may use up to 10% of the funds available under the national ceilings. These amounts are not in addition to the support available under the SFP so any decision to provide additional payments will result in reduced ability to provide "decoupled" SFP payments.

148. Clearly the E.U. is concerned that the shift to the SFP will leave E.U. agricultural vulnerable to market forces and declining production. This suggests that the allegedly neutral SFP is designed to maintain production at levels which existed under the previous regime- and if it does not there will be additional intervention to discourage farmers actually abandoning production. To address these concerns, the E.U. will rely on "partial coupling" and "additional payments" as a means of directing production through the use of coupled support programs. Decoupling like pregnancy either exists or it does not.

[94] Ibid

(ii) Criticism of CAP Reform

149. The Scheme and the single farm payments introduced by the E.U. demonstrate the myth of decoupling. The E.U. stated that it was introducing these programs to de-link production from support so that farmers would be free to make production decisions that respond to the market. However, the E.U. system remains production and trade distorting.

150. As noted above, producers who have the ability to choose to produce will likely continue to produce. Farmers will likely take action that maximizes their revenue. The E.U. requires that farmers maintain their land "in good agricultural condition" to be eligible to receive decoupled income payments. The farmers will incur some costs to maintain their land in this condition. The best way of demonstrating that the land remains "in good agricultural condition" is to keep it in production. Therefore, the E.U. decision to compel their farmers to maintain their land "in good agricultural condition" provides an even stronger incentive for them to continue farming.

151. E.U. Members implicitly recognize that their producers will continue to produce. The ability to rely on "partial decoupling" and to make "additional payments" demonstrates that Brussels intends to remain in a position to direct production through the use of subsidies. Not only will European farmers continue to produce, but they will be induced to continue if guaranteed revenue and market returns are not sufficient.

152. Devinder Sharma[95], a respected food and trade policy researcher, supports this analysis. He believes even with CAP Reform, European farm income remains largely unaffected. He explains his opinion in a June 13, 2006 opinion-editorial for India Together:

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[95] Devinder Sharma is an award-winning journalist, writer, thinker and researcher respected for his views on food and trade policy. His writings focus on the links between biotechnology, intellectual property rights, food trade and poverty. His forthcoming book, "Keeping the Other Half Hungry," is an incisive analysis of how the globalisation is accelerating the process of marginalisation of farmers in the Third World. He is a regular contributor to leading national print publications. He is keenly involved with AgBioIndia, a daily email bulletin to bring the politics of food, agriculture and trade to the people.

"Behind the complexities of the CAP structure and the reform process, the real intention is only to pacify the growing anger of the tax payers. With mounting outrage, tax payers have begun to ask uncomfortable questions about the necessity to maintain farm support. The entire exercise in the name of reforms is to make certain adjustments that hoodwinks the tax payers to believe that farming is multifunctional and also performs the important role of environmental protection. The subsidies are therefore being shifted from production to environmental protection. In reality, the EU Commission is not making any meaningful change in the farming systems that becomes more sustainable or environmentally safe.

The direct payments are not linked to environmental protection. Payments are made without any consideration of the environmental relevance of these crops, mainly in the arable lands which are under intensive and industrial farm practices. Except for a small set of 'rural development' measures that will bring in an additional diversion of 1.2 billion euros every year, the entire focus of European farming remains highly skewed and unsustainable. In fact, given the groundwater contamination and the destruction of soil structure and fertility, Europe's agriculture tops the global chart in environmentally unfavourable and highly unsustainable farming systems.

No wonder, EU support for environmental programmes is increasing. In 1998-99, EU made available 4,965 million euros under various environmental programmes, which increased to 5,458 million euros the next year. Environment subsidies alone are more than seven times what the Indian farm sector gets as state support. EU makes the highest provision for environmental protection programs, followed by Japan, Switzerland and USA. Interestingly, a significant proportion of these subsidies (especially in Germany) are provided under the MEKA programmes. Talking to German farmers, it becomes apparent that these subsidies are in reality a bonus payment. Farmers are not even sure of the purpose of these subsidies and are utilising these to write-off their expenses under other heads. In short, it is an additional income support that is being doled out to farmers.

Whatever be the impact of CAP reforms on domestic agriculture in Europe, the fact remains that the entire exercise is to reinforce the protective ring around European agriculture. Whether these subsidies are socially and environmentally justified is a matter of internal debate for the EU member nations but when such highly subsidised agriculture is linked to international trade, it brings in glaring inequalities in the trade regime negatively impacting the farmers in the developing world. EU agriculture subsidies (including the environmental subsidies) provide a cushion for the European farmer that insulates them from the volatility of the commodity markets. Whether the international prices fall or rise, European farm income remains largely unaffected."[96]

[96] Devinder Sharma. "Entitled to Subsidies!" *India Together*, June 13, 2006

153. The E.U. single farm payment program has been criticized on the basis that it does not meet all of the requirements for decoupling set out in the AoA. Jacques Berthelot has noted that the E.U. single farm payment program fails to meet three of the five requirements set out under Annex 2(6) to the AoA. Specifically, Berthelot noted,

> "a) [the single farm payment] is based on the amount of direct payments received from 2000 to 2002, a criterion not allowed by the condition a) of paragraph 6 ("*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 single farm payment] contradicts the condition 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*"): EU farmers cannot produce what they want since many productions are either forbidden (fruits and vegetables, and milk and sugar beet if he has no production quota) or capped (cotton, tobacco, olive oil and not beyond the milk or sugar beet quotas). Now, the only interdiction to grow fruits and vegetables has been enough for condemning the US direct payments as not decoupled.
>
> c) [the single farm payment] contradicts the condition d) (see above): EU farmers must show each year that they have eligible hectares to receive the SFP."[97]

154. Berthelot concluded that, as single farm payments cannot be ascribed to particular production, it must be applied to all production and contributes to reduce the cost of production of all E.U. products. He considered the single farm payment to be a "huge subsidy" that reduced the price of E.U. commodities to below their cost. Based on this analysis, Berthelot concluded that,

> "… all EU agri-food exports can be sued at the WTO on dumping grounds, even those which did not receive any export subsidy such as quality cheese or wines as long as their producers are receiving a SFP."[98]

155. While Mr. Berthelot makes a good point the issue is not "dumping" except in the dramatic sense which Oxfam and IATP uses it. These exports could be challenged under

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[97] Jacques Berthelot. "Berthelot's comments of the Chair's reference papers on the OTDS, AMS, blue box of 24 May 2006 and green box of 30 May 2006", Solidarite, 31 May 2006, Decoupled income support, para. 6

[98] Jacques Berthelot. "Berthelot's comments of the Chair's reference papers on the OTDS, AMS, blue box of May 24, 2006 and green box of May 30, 2006" (Chair's Reference Paper: Overall Reduction in Trade-Distorting Domestic Support, Committee on Agriculture, Special Session; Domestic Support, May 24, 2006), May 2006

Article 9.1(c) of the AoA as benefiting from export subsidies and the domestic support would be actionable subsides under Countervailing duty rules.

156. Swinbank and Tranter (2005) addressed the question; Does the new single payment scheme fit within the green box? They concluded that retention of the link between the payment and land farmed weakens the E.U.'s argument that these payments are truly decoupled. With respect to E.U. decoupled payments, they noted,

> "Both the SPS and the bond scheme appear to satisfy criteria (c), that production is unrelated to prices, and (e), that no production is required. However, the SPS scheme (but not the bond scheme) has difficulty with criterion (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." No doubt the EU would dispute our claim, but the insistence that SPS payments are tied to land that is "maintained in good agricultural and environmental condition" (Article 5) weakens the EU's case. An SPS payment in any year depends upon the amount of land "farmed" that year. Whether any WTO member would challenge the EU's use of the green box to shelter its SPS payments is another issue, to which we return briefly in our conclusion."[99]

157. Therefore, E.U. decoupled income support programs fail to meet the basic requirements of WTO AoA Annex 2(6) and fail to meet the general requirements in Annex 2(1). These programs have a direct affect on production by encouraging production. These programs have a direct affect on trade by encouraging offsetting production costs. The result is an incentive to over-produce for sale at subsidized prices. Rather than requiring production in response to market forces, E.U. decoupled income support continues to influence production.

158. The fact that the E.U. has the ability to use "partial decoupling" and "additional payments" simply exacerbates the problem created by decoupling. None of these E.U. programs are Green.

[99] A. Swinbank and R. Tranter. "*Decoupling E.U. Farm Support: Does the New Single Payment Scheme Fit within the Green Box?* (Volume 6 Number 1) Estey Centre Journal of International Law and Trade Policy, 2005

B. The U.S. Experience:

159. The United States maintains direct payment programs that suffer from many of the same deficiencies as their European counterparts and, likewise, are not legitimate decoupled income support programs. The U.S. cotton programs were considered, and condemned, by the WTO Appellate Body considering Brazil's challenge to U.S. cotton programs.[100] The Appellate Body reported in September 2004. The cotton programs are an example of the U.S. decoupled support programs overall. Therefore, the WTO findings concerning U.S. upland cotton programs are equally applicable to all U.S. decoupled support programs.

(i) U.S. Decoupled Cotton Support

160. Cotton producers benefit from subsidies provided by the U.S. through production flexibility contracts and through direct payments. Production flexibility contracts were established in the 1996 FAIR Act and applied to the 1996 through 2002 crop years. Direct payments were established in the 2002 Farm Bill.

161. The direct payment program provided support to producers based on historical acreages and yields. Eligible producers were required to enter into annual agreements to receive payments.

162. Support is made in the form of fixed payment rates on a per unit basis for 2002 through 2007. The payment rate for upland cotton was set at 6.67 cents per pound. Payments are made on 85% of the base acreage for each commodity multiplied by the applicable payment yield. The yield was based on the 1995 crop yield rate (if there was one).

163. Producers were given a one-time opportunity to elect the method of calculating their base acreage. A producer could elect to have the base average for all covered commodities

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[100] Report of the Appellate Body. United States - Subsidies on Upland Cotton - Ab-2004-5. World Trade Organization - WT/DS267/AB/R, March 3, 2003

calculated on the basis of the four-year average of planted acreage during the 1998 through 2001 crop years, plus the acreage that the producer was prevented from planting due to natural disasters during the period. Alternatively, the base acreage would be the three year average of the 1993 through 1995 crop years.

164. Subject to limitations concerning the planting of fruits and vegetables, producers receiving direct payments are permitted to plant any commodity or crop. Furthermore, producers must use the acreage for an agricultural or conservation purpose as a condition to receiving further payments. So long as the land is used for an agricultural or conservation purpose, and the producer does not plant excluded crops (i.e., fruits and vegetables) he can continue to receive direct payments.

(ii) Analysis

165. The Appellate Body in U.S. – Upland Cotton noted that decoupling of payments from production as required by Annex 2(6)(b) of the WTO AoA can only be ensured if the payments are not related to, or based upon, either a positive requirement to produce certain crops or on a negative requirement not to producer certain crops, or a combination of both.

166. The Appellate Body reviewed the U.S. programs and concluded that they violated Annex 2(6)(b) on the basis that they were related to production contrary to the requirements of that subsection.

167. The Appellate Body also concluded, at paragraph 342 of its Report, that direct payments are not decoupled within the meaning of Annex 2(6)(b), are not green box measures exempt from the reduction commitments by virtue of Annex 2 and are, therefore, not sheltered from challenge by virtue of paragraph 13(a) of the AoA.

168. In addition, producers have the right to update their base acreages from the historical base to the four year average of production between 1998 and 2001. Producers will choose to update their base acres if this results in larger support payments.

169. The fact that U.S. producers can choose to update their base acres also demonstrates that the U.S. direct payment programs do not meet the basic requirements for decoupled programs in Annex 2(6). Annex 2(6)(d) does not permit decoupled income support payments to be related to, or based on, factors of production employed in any year after the base period. By allowing producers to update their base acreages to a period following the base period, the U.S. has tied decoupled payments to factors of production employed in a year after the base period. Consequently, the U.S. program does not qualify as a decoupled income support program.

170. USDA ERS has noted that a majority of U.S. farmers have elected not to update their program base acres to 1998 to 2001 plantings. However, in general, producers have replaced low-payment base acres with high payment acres wherever possible.

> "They kept or expanded base acres for commodities with high payments, such as rice, cotton, and corn, and reduced bases acres for commodities with relatively low payments, such as wheat, sorghum, and barley. Base acres for oats, the commodity with the lowest per acre payments, were reduced the most."[101]

171. The U.S. direct payment programs fail to meet the WTO requirements. The WTO Panel considering Upland Cotton observed that producer flexibility payments and direct payments mean higher cash flow and greater wealth. U.S. producers that enroll under these programs obtain an entitlement to receive future payments, which increases their net wealth.

172. Higher cash flow and greater wealth will reduce cost of production thereby affecting production decisions. The decision to produce at lower cost will have trade-distorting consequences. Thus, it is inevitable that these programs are both trade and production

[101] Edwin C. Young, David W. Skully, Paul C. Westcott and Linwood Hoffman. "Economic Analysis of Base Acres and Payment Yield Designations under the 2002 U.S. Farm Act", ERR-12, United States Department of Agriculture, Economic Research Service, September 2005

distorting. Faced with the ability to simultaneously receive decoupled income support payments and to continue to produce for sale, farmers will inevitably choose both to maximize their income.

173. Jacques Berthelot has noted that the net result of subsidies that are not provided to the production of any specific commodities is that they ultimately subsidize and offset the cost of all commodities. In this way, decoupled support payments subsidize all production.

> "All exported agri-food products may be condemned at the WTO on dumping grounds: since the supposedly decoupled nature of PFSc and direct payments does not permit to ascribe them to a specific product, they can be ascribed to all products of which they contribute to reduce the production cost, then the price below the full production cost without subsidy. Therefore all U.S. agri-food exports can be sued at the WTO for dumping, even those which did not receive any export subsidy."[102]

174. In light of the WTO decisions to condemn its direct payment and production flexibility contracts, the U.S. is concerned with the potential fall out. A Congressional Research Service Report on the Cotton Subsidy dispute reported that the U.S. cotton industry and government officials are concerned that the specific finding on the apparent failure of U.S. "decoupled" payments to meet WTO green box criteria leaves such programs open to future charges, and that third countries may feel emboldened by knowing how a WTO panel is likely to rule on such matters. The Report also noted that the E.U. is also likely to be concerned about this finding since the E.U.'s agricultural program (following agricultural policy reforms of June 2003) relies heavily on "decoupled" payments similar to those of the U.S. program.[103]

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[102] Jacques Berthelot. "The King is Naked. The Impossible U.S. Promise to Slash its Agricultural Supports", November 7, 2005, para. 55

[103] Randy Schnepf. "Background on the U.S.-Brazil WTO Cotton Subsidy Dispute", CRS Report for Congress, July 11, 2005, p. 15

III. Is Decoupling Without Distortion Possible?

175. Neither the U.S. nor the E.U. has implemented support programs that meet the basic requirements of WTO-consistent decoupled income support. The support provided by the U.S. and E.U. under their respective programs should not be considered Green and should not be exempt from support reduction commitments. The fact that neither the U.S. nor the E.U. have implemented WTO-consistent decoupled income support begs the question; is it possible to implement a decoupled income support program that meets the WTO requirements.

176. The WTO AoA permits decoupled income support programs that have little or, at most, minimal trade-distorting effects and no effect on production. The U.S. and E.U. have taken the position that their programs do not affect either trade or production because they de-link support from market decisions. That is, their producers are exposed to market conditions and will make production decisions to respond to the market rather than respond to the support program. Presumably, the U.S. and E.U. would take the position that decoupled support programs implemented by other WTO Members that meet this basic requirement would also be WTO-consistent.

177. Based on our analysis, it is our view that decoupled income support programs effect production and, as a result of their impact on production, will have trade-distorting effects. The underlying problem with the WTO approach to decoupled income support is that it leaves producers in place. Producers have the right to receive decoupled income support while continuing to produce and sell. Thus, the de-linking effect is a myth. While decoupled income support will not affect the decision to produce a particular commodity, they will provide government money that can be used to subsidize that production. Rather than ensure that producers make decisions in response to market conditions, decoupled income support continues to isolate producers from market forces. Isolating producers from market forces affects their production decisions and, by extension, affects trade. Consequently, it is impossible to establish a decoupled income support program that meets the requirements in Annex 2 to the WTO AoA.

178. The following factors lead to the conclusion that decoupled income support provides an incentive for producers to remain in production and isolates them from market forces. These factors are:

1. Producers will continue to produce
2. Wealth Effects
3. Risk/Insurance Effect
4. Land Allocation Effect
5. Sector Consolidation
6. Accumulation Effect

179. In considering these factors, it is important to bear in mind that money is fungible. Any monies provided to producers through decoupled income support programs may be used by producers for a range of purposes. This money will not be somehow distinguished from other money held by the producer so that it is not used to support ongoing production. Once it has been received by the producer, this money can be used to subsidize any ongoing production. The notion that this support can be de-linked from production or production decisions is simply wrong.

180. It is also important to note that, the fact that decoupled support will affect producer decisions has not only been accepted by critics and commentators. The USDA Economic Research Service (ERS) has also considered decoupling and determined that there are many avenues through which decoupled payments may influence agricultural production and markets. In a report entitled "Influences of Decoupled Farm Programs on Agricultural Production," USDA ERS notes that,

> "Four mechanisms are discussed in the remainder of this paper, including effects through producers' wealth and investment, effects through sector consolidation, effects through program eligibility and payment basis considerations, and effects through ad hoc programs and changes in producer expectations over time.
>
> While these mechanisms of influence for decoupled payments are discussed separately in this paper, farm programs typically encompass multiple features that have potential market impacts, with individual mechanisms often overlapping. Additionally, although these mechanisms are discussed here in the context of

> decoupled programs, coupled programs may also influence production through these mechanisms, in addition to the more direct effects that coupled programs have through their augmentation of returns from the marketplace. Also, many farm programs are only partly decoupled, having both coupled and decoupled properties. Further, for some programs the degree of being coupled or decoupled may change over time, particularly if the program alters farmers' expectations of future program benefits.[104]

181. While the USDA ERS noted that "most effects of decoupled programs seem to be relatively small", it concluded that,

> Most decoupled programs create incentives to increase aggregate production, although the mix of crops planted is based on market signals because decoupled program benefits do not depend on market conditions or the farmer's production, and per-unit revenues among competing crops are not changed. There is a need for further research into the effects [105]

182. Thus, the USDA has concluded that decoupled income support programs affect production by creating incentives to produce. This U.S. position validates criticisms made by other commentators that are reflected in this Report. This also raises the more difficult question of how the U.S. can simultaneously recognize the production-distorting effects of decoupled support programs while claiming that their programs can meet WTO obligations.

183. Finally, we cannot overlook the fact that decoupled income support programs do not exist in a vacuum. Rather, these programs are part of a broad, often interconnected, web of support and subsidy programs. For the U.S., the subsidy programs included product-specific counter-cyclical payments, crop insurance subsidies, farm loans provided at preferential rates, and irrigation subsidies that included both support for irrigation infrastructure and the subsidized water itself. As long as producers benefit from a range of subsidies, it is impossible to credibly claim that decoupled payments somehow stand outside the system and are market-neutral. The fact is that producers benefiting from other subsidies directly tied to production will use the guaranteed revenue stream gained from decoupled income support to further offset the cost of their production. Considered

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[104] Paul C. Westcott and Edwin C. Young. "*Influences of Decoupled Farm Programs on Agricultural Production*", USDA Economic Research Service
[105] Ibid.

as one of a range of available subsidies, decoupled income payments are not market-neutral but are a further example of a trade and production distorting subsidy.

(i) Producers will Continue to Produce

184. Annex 2(6)(e) to the WTO AoA provides that no production shall be required to receive decoupled income support payments. This, and the other subsections of Annex 2(6)(e), seek to de-link decoupled support from production and marketing decisions. The fact that no production is required is not equivalent to a requirement that producers must abandon production to receive the payment. Producers are left with the choice of continuing to produce. Faced with that choice, producers inevitably choose to continue to produce while simultaneously accepting the decoupled support payments.

185. Professor Daryll Ray, who has considered the issue of whether producers receiving direct or decoupled payments will remain on the land, has noted that the central problem with decoupling is that the agricultural land remains in place. Professor Ray noted that farm payments were originally coupled to production. Farmers received more if they produced more. For acreage reduction programs, farmers received more the more they agreed not to produce. However, these programs resulted in farmers farming the program and not making production decisions based on market prices and conditions. Decoupling was advanced as a means of providing stability without interfering with planting decisions or marketing decisions.[106]

186. However, Ray noted that following adoption of the 1996 (Farm Bill) Freedom to Farm Act, it was not clear whether decoupled payments were really decoupled. While decoupled payments are decoupled from the decision of which crop to plant, when it comes to total acreage allocated to crop production, it is clear that farmers plant all of their acreage every year. They have not responded to decoupled payments and the low

[106] Daryll E. Ray. "Yes, Decoupled, but Decoupled from What?", University of Tennessee, November 1, 2002 (http://agpolicy.org/weekcol/117.htm)

price market signals by reducing total crop acreage. It appears that with respect to total acreage planted to crops there is little difference between coupled and decoupled payments. Ray noted that,

> "The difference comes not in how much acreage is planted, but rather who owns and farms the land. My conclusion is that, while payments are decoupled from how much acreage is planted, they are not decoupled from a) who farms the land, b) what the value of the land is and c) how much cash rent is charged. The payments do allow farmland to retain or even increase its value. Payments, whether coupled or decoupled, also allow more individual farmers to remain on the land. Without payments, as farmers went belly up, their neighbors would purchase the assets, possibly at a lower value, and keep the essential asset, land, in production. It is possible that the land values would drop until they matched agricultural land values in developing countries like Brazil.[107]

187. Ray concluded that,

> "Life is not as simple as we wished it were and the distinction between coupled payments and decoupled payments is not as clear as we once thought it was. As we modify farm policy in the future we need to look at how farmers behave and not at how economists and policy makers think they ought to behave."[108]

188. In our view, farmer behaviour is largely predictable and logical. Farming is a business as well as a skill. Most farmers not only want to pass on their farms, and farming skills, to their children, they also want to maximize the profits generated by their farm businesses. Farmers are not required to abandon production to receive decoupled income payments – they are not faced with the choice of farming the land or farming the program. Rather, farmers can choose to do both. Faced with this choice, and the desire to maximize returns and to pass on the business as a going concern, farmers will inevitably choose both options. Deciding to produce for sale on the market will allow producers to realize profits on their farming enterprise. Simultaneously taking the decoupled support payments will also increase their revenue. In the absence of a prohibition on farming, it is our view that farmers will simultaneously produce for sale and accept decoupled payments.

[107] Ibid.
[108] Ibid.

189. We have come to this conclusion based on a consideration of decoupled income support that simply meet the minimum WTO requirements. The incentive to produce will also depend on the range of programs maintained by WTO Members and by the specific means by which WTO Members implement their decoupled programs.

190. If WTO Members continue to provide fully or partially coupled support programs, producers will have an added incentive to remain in production. Decoupled support is not tied to production of any particular commodity and is not limited by price, market conditions or overall production of any particular commodity. Rather, producers may use decoupled income support in any manner that they see fit. For producers that receive fully or partially coupled support to encourage production of specific commodities, decoupled income support will provide an additional incentive to continue to produce. The decoupled support will further offset the cost of production of those commodities allowing the producer to over-produce, or to undercut prices by reducing cost of production, or both.

191. Decoupled programs that require producers to be in a position to produce also provide a powerful incentive to remain in production. An example is the E.U. single farm payment programs which require that farmers maintain their land “in good agricultural condition” as a condition for eligibility to receive decoupled payments. Farmers will incur costs to ensure that their land is “in good agricultural condition”. Rather than simply incur these costs, it is far more likely that producers will choose to produce for sale to offset the costs associated with maintaining the land “in good agricultural condition”.

192. The impact of decoupling on E.U. agriculture is not simply theoretical. Producer decisions to continue production as a direct result of decoupled support has been found in a study on Irish producers. The study notes,

> “The survey data on Irish farmers' production plans post decoupling to the optimal outputs predicted by a farm-level profit maximization model. The results show that, post decoupling, a significant number of farmers plan to use their

> decoupled payments to continue or expand economically non-viable production. This is the reverse effect of what decoupled payments are attempting to do."[109]

193. Consequently, it is our view that producers will choose to continue to produce while simultaneously accepting decoupled income support programs. In light of this conclusion, it is our view that decoupled support must be considered support to production.

(ii) Wealth Effects

194. The wealth effect refers to the impact of ongoing support on producer decisions. Because decoupled payments help producers cover fixed costs, it allows them to stay in business when they would otherwise be forced to withdraw from farming or declare bankruptcy.

195. The wealth effect has particular impact on large, competitive farms where fixed costs are reduced to a minimum through economy of scale effects. "Due to the highly regressive nature of U.S. and E.U. subsidy distribution, this is precisely the class of farm that attracts most subsidies." [110]

196. USDA ERS has concluded that the wealth effect takes three potential forms: direct, wealth-facilitated increased investment and secondary wealth effect resulting from the increase in investment. Direct wealth effect refers to increases in agricultural production resulting directly from receipt of the decoupled payment. USDA ERS notes that,

> "… if payments raise producers' wealth and lower their risk aversion (as indicated by the Chavas and Holt results), they may take on more risk in their production choices. This may entail a choice to increase overall production and may also change the mix of production, perhaps switching to riskier crops with higher mean (but more variable) expected returns."[111]

[109] Thia C. Hennessy and Fiona S. Thorne. "How Decoupled are Decoupled Payments?", Vol. 4, November 2005
110 Oxfam Briefing Paper #76, "A Round for Free", June 2005
[111] Paul C. Westcott and Edwin C. Young. "*Influences of Decoupled Farm Programs on Agricultural Production*", USDA Economic Research Service, p. 7

197. Wealth-facilitated increased investment refers to producer decisions to increase agricultural investment facilitated by the support received through decoupled payments. This investment will not simply reflect the value of the decoupled payments, but lenders may be more willing to make loans to farmers because the decoupled payments give producers guaranteed income streams and lowers the risk of default. "Greater loan availability facilitates additional agricultural production by allowing farmers to more easily invest in their farm operation."[112] Direct payments allow banks to make loans that they otherwise would not make.[113]

198. USDA ERS also points out that the lower cost of capital associated with lower risk could also increase the level of investment and the overall level of farm output.[114]

199. The G-20 has also commented on the wealth effect of decoupling. They note that in 2000 to 2001, U.S. decoupled payments were worth approximately $4.5 billion USD per year and E.U. decoupled payments were worth approximately $500 million Euros. The G-20 considered that such a large amount of money expected to support production would be likely to distort trade. These monies would be used to cross-subsidize production by allowing farmers the ability to cover their fixed and variable costs. The G-20 also noted that these wealth effects also isolated farmers from market signals by incorporating these payments permanently into farmer cash flows.[115]

200. Secondary wealth and investment effects refer to the impact of increased investment in the farm sector that increases agricultural output and opens further avenues to wealth. Decoupled income used for investment in agricultural production will result in increased agricultural output at lower costs. Thus, decoupled support will have a multiplier effect leading to even greater production over the long term.

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[112] Paul C. Westcott and Edwin C. Young. "*Influences of Decoupled Farm Programs on Agricultural Production*", USDA Economic Research Service, p. 7

[113] John Baffes & Harry de Gorter. "*Disciplining Agricultural Support through Decoupling*", World Bank Policy Research Working Paper, 3533, March 2005, p. 33

[114] Paul C. Westcott and Edwin C. Young. "*Influences of Decoupled Farm Programs on Agricultural Production*", USDA Economic Research Service, p. 8

[115] WTO document G20 /DS/Greenbox, "G-20 Review and Clarification of Green Box Criteria", June 2, 2005 (http://www.tradeobservatory.org/library.cfm?refID=73230)

201. The wealth and investment effects directly affect producer decisions and ultimately affect production and trade. Guaranteeing producers an income stream decreases or eliminates the risks associated with production and insulates producers from the market. As a result of being insulated from market forces, producers do not respond to the market signals. Consequently, through the wealth and investment effects, decoupling supports decisions that favour production by allowing producers to make decisions that they would not otherwise make if they did not receive support.

202. Therefore, as a result of the wealth and investment effect, it is our view that decoupling does not de-link support and production decisions. Rather, decoupling facilitates production by reducing risk, underwriting costs and encouraging greater investment. Moreover, as noted in Section 1 above, decoupling encourages production of all commodities because the support is not tied to specific commodities. By encouraging production of any commodities, decoupling also has trade-distorting effects because the production will be sold on the market.

203. Therefore, it is our view that, as a result of the wealth and investment effect, decoupling fails to meet the basic requirements of Annex 2(1) that Green domestic support programs have no effect on production and have no, or at most minimal, trade-distortion effects.

(iii) Risk/Insurance Effect

204. The risk/insurance effect is related to the wealth effect in that it is based on the guaranteed income flow resulting from receipt of decoupled income payments. The guaranteed income flow will increase an insurance effect that changes the producer's perception of risk. The greater than income received through decoupled payments, the more willing the producer will be to take on greater risks, including expanding agricultural production.[116]

[116] Oxfam Briefing Paper #76, "A Round for Free", June 2005

205. The G-20 has also noted that providing farmers with a permanent cash flow through decoupled income support reduces risk.[117] Although unstated, the net result of reduced risk is a willingness to take action that would otherwise be considered too risky.

206. The Estey Centre of the University of Saskatchewan noted:

i. **"**Given that farmers are generally risk averse, even apparently fully decoupled direct payments including those to reduce risk or to compensate for climatic disasters would appear to have some impact on production through reducing revenue variance, through relaxing debt constraints, and by increasing wealth and moving farmers to less risk-averse regions of their utility functions."

ii. "Tying direct payments to past levels of inputs or outputs may affect current farm decisions, since it may persuade farmers to increase output in order to influence possible future base production/area data (such as in the 2002 U.S. Farm Bill, which gave farmers the opportunity to update their base acreages). Direct payments may also influence future output through new investments, or may protect some farm businesses from bankruptcy."[118]

207. Reducing the risk associated with production insulates producers from market forces. Therefore, production decisions made by producers will be influenced by the decoupled support payments rather than by market forces. In these circumstances, it is our view that the risk/insurance effect generated through decoupling will distort production and, by extension, have trade distorting effects.

208. Therefore, it is our view that, as a result of the risk/insurance effect, decoupled support programs do not meet the basic requirements of Annex 2(1) that Green domestic support programs have no effect on production and have no, or at most minimal, trade-distortion effects.

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[117] WTO document G20 /DS/Greenbox, "G-20 Review and Clarification of Green Box Criteria", June 2, 2005 (http://www.tradeobservatory.org/library.cfm?refID=73230)

[118] A. N. Rae and A. Strutt. "The Current Round of Agricultural Trade Negotiations: Should We Bother About Domestic Support", Estey Centre Journal of International Law and Trade Policy, Vol. 4, Number 2, 2003/p.98-122, p. 103

(iv) Land Allocation Effects

209. The land allocation effect refers to the producer's expectation that the support programs will be changed and updated over time. As farmers know that the payment reference year may be updated, as happened under the U.S. 2002 Farm Bill, they may want to keep up production levels. If farmers believe that larger payments could result from increased production, they may choose to increase production in anticipation of larger payouts. If producers are required to be in a position to produce as a condition of eligibility, as the E.U. system requires, they may choose to produce to maintain their eligibility, thus cultivating land that they would otherwise have left fallow.

> "If … farmers had reason to believe that they could update bases on which their 'decoupled' payments were made, to obtain larger future payments, the support arrangements would continue to encourage production. Of if farmers believed that they would lose future payment entitlements if they reduced plantings or production, they would have reason not to reduce plantings or production, even if market prices fell greatly."[119]

210. U.S. farmers likely face a strong incentive to continue to produce in anticipation of changes in future support programs. U.S. farm support has tended to be changed in each successive farm bill (i.e., every five years or so). In 2002, farmers were given the option of updating their area bases for both decoupled payments and coupled counter-cyclical payments. As a result of these changes, U.S. farmers have a reasonable expectation of greater benefit in future and are more likely to continue to produce in anticipation of receiving continued support.[120]

211. Through the land allocation effect, decoupled support programs encourage production in anticipation of future support payments rather than in response to market forces. Through this incentive to plant, decoupled support influences production decision and, by extension, distorts trade.

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[119] Ivan Roberts. "Three pillars of agricultural support and their impact on WTO reforms", March 2003, p. 25
[120] Ibid., p. 26

212. Therefore, it is our view that, as a result of the land allocation effect, decoupled support programs do not meet the basic requirements of Annex 2(1) that Green domestic support programs have no effect on production and have no, or at most minimal, trade-distortion effects.

(v) Accumulation Effect

213. The trade distorting effects of decoupled payments are exacerbated when the payments are made to farmers who already benefit from other support programs. A farmer who receives a decoupled direct payment while producing a commodity crop that is also eligible for a loan rate will have an incentive to continue production of the original crop in order to keep both payments.[121]

214. The accumulation effect not only provides an incentive to continue farming, as discussed in Section (i) above, but provides an incentive to produce the specific crops that were formerly supported by the coupled payments. Thus, the accumulation effect encourages particular production and exacerbates the trade distorting effect of the coupled support.

215. In France and other European member states, where only partial decoupling has taken place, this is even more problematic. As the World Bank states, “the co-existence of coupled and decoupled programmes means that incentives to overproduce remain.”[122] In four decoupling cases examined by the World Bank, all either left some coupled support programs in place or added new ones. Eligibility rules need to be altered and clearly defined.

216. Although it is difficult to distinguish the trade and production effects of the coupled and decoupled support provided, it is clear that the accumulation effect leads to increased production and, by extension, to increased trade distortion.

[121] Oxfam Briefing Paper #76, “A Round for Free”, June 2005
[122] M Ataman Aksoy and John C. Beghin. “Global Agricultural Trade and Developing Countries”, World Bank, Editors, Washington, D.C, 2005, p. 7

217. Therefore, it is our stance that, as a result of the accumulation effect, decoupled support programs do not meet the basic requirements of Annex 2(1) that Green domestic support programs have no effect on production and have no, or at most minimal, trade-distortion effects.

(vi) Sector Consolidation Effects

218. Sector consolidation refers to the move to larger production units that can realize greater economies of scale through acquisition and consolidation. USDA ERS has noted the decoupled payments can affect agricultural production by influencing sector consolidation.

219. While it is possible that decoupling could slow sector consolidation by propping up smaller producers, it is also possible that it could speed sector consolidation by providing larger producers with monies that could be used to purchase smaller operations or to rent more acreage. Consolidation resulting from these acquisitions would be expected to raise aggregate production because larger operations are typically more efficient than smaller operations because of better management and greater economies of scale.[123]

220. USDA ERS concludes that decoupling likely only marginally accelerates consolidation trends that are already ongoing in the sector, and thus downplays the effect of these payments on aggregate yields and production. However, it is evident that decoupling supports sector consolidation and the increased production at lower cost that accompanies sector consolidation. The net result is that consolidation supported by decoupled payments will result in increased production at lower costs than would otherwise occur in absence of consolidation. Thus, decoupling will affect production and trade through the sector consolidation effect.

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[123] Paul C. Westcott and Edwin C. Young. "*Influences of Decoupled Farm Programs on Agricultural Production*", USDA Economic Research Service, p. 10

221. Therefore, it is our view that, as a result of the accumulation effect, decoupled support programs do not meet the basic requirements of Annex 2(1) that Green domestic support programs have no effect on production and have no, or at most minimal, trade-distortion effects.

(vii) Conclusion

222. It is our view that it is impossible to implement a decoupled income support program that does not have production and trade effects. Because money is fungible and producers can choose to remain in production, decoupled income support provides a powerful incentive to produce and offsets the cost of that production. Market signals are masked, with the result that producer decisions are made in response to the decoupled payments rather than to the market. The objective of de-linking support from production is not only lost, it is unachievable.

223. By leaving producers in place, decoupled income support continues to support production. These programs are clearly not tied to production of a specific commodity, or to any market factors affecting that commodity. Rather, these programs become de facto tied to any commodity that the producer chooses to produce. As Professor Ray notes, “The question is not whether or not the payments are decoupled, but rather what are they decoupled from and what might they still be coupled to.”[124]

224. The G-20 has argued:

> “There is an ever-present risk that, although intended to be decoupled, direct payments may indeed be "re-coupled" through updating of base areas and yields. This situation requires fixing and the notion of "fixed and unchanging" addresses this concern.”[125]

[124] Daryll E. Ray. “Yes, Decoupled, but Decoupled from What?”, University of Tennessee, November 1, 2002 (http://agpolicy.org/weekcol/117.htm)

[125] WTO Document JOB (06)/145 Committee on Agriculture, Special Session, “G-20 Comments on the Chair Reference Paper on Green Box”, May 16, 2006

> "In the presence of distorting payments, "green" policies do not properly perform their function. On the contrary, their neutral nature is being abused and they merely follow the general orientation of the distorting policy. As a consequence, "green" money is merely added to "blue" and "amber" monies and becomes undifferentiated in relation to them."[126]

225. Berthelot considers that the G-20 does not go far enough. He explains:

> "All agricultural subsidies, the green ones included, bring a price support to producers. Indeed, all depends how we interpret "price support" and "producers": the drop in agricultural prices permitted by direct subsidies such as the EU alleged green "single farm payment", the former US "production flexibility contracts" and now its "direct payments", and all the other domestic green, blue and amber subsidies have a clear impact on production and prices.
>
> - Green and blue subsidies bring a price support to farmers since they can make do with prices lower than the average production cost.
> - The EU blue then green subsidies compensating the reductions in the prices of COPs (cereals, oilseeds and pulses) used as feed bring a large price support to farmers producing animal products (bovine, ovine, pig and poultry meats, eggs and milk).
> - All domestic subsidies bring an enormous price support to agri-food industries since the prices of their main inputs are reduced, increasing their competitiveness on the domestic market, at the export and import levels, reducing their need of export subsidies and tariffs." [127]

226. The market effects generated by decoupled income support which were addressed above, cannot be considered in isolation from each other. Rather these effects have a cumulative impact on producers and producer decisions.

> "Because payments increase farm operators' income and the expectation of fixed, future payments increases their wealth, increased income and wealth from PFC, as from any other source of income, have lasting effects on households' decisions about how much to spend, save and work. These household decisions can in turn change the supply of capital and labor in agriculture, and lead to changes in aggregate agricultural production. … PFC payments may indeed lead to additional on-farm investment if they give some farmers the necessary liquidity or collateral to make investments that they could not make without the program. Farmers who cannot purchase inputs (a liquidity constraint), who cannot borrow money at a competitive rate (a credit constraint), or who do not have enough land or equipment (a capital constraint) are likely to increase their farm investments if their incomes and land values are increased through PFC payments. For

[126] Ibid.

[127] Jacques Berthelot. "J. Berthelot's comments on the G-20 papers on blue, green and amber boxes, May 28, 2006" (G-20 Comments on the Chair Reference Paper on Blue Box, Committee on Agriculture, Special Session, (JOB(06)/146, May 16, 2006), (http://solidarite.asso.fr)

households operating under such constraints, increasing their incomes and land asset values is likely to increase their farm investment. … A simulation analysis of the PFC program, which can isolate the role of decoupled payments, showed that the decoupled payments by themselves account for an 8 percent increase in aggregate land value."[128]

227. The G-20 has proposed that the specific requirements that must be met for programs to qualify as decoupled income support be amended to ensure that these programs are not trade and production distorting. In a May 16, 2006 paper, the G-20 stated that green policies do not properly perform their functions and noted that they are being abused. The G-20 considers it important that inputs and factors of production should not be required to be in agricultural use for farmers to receive support, there is a need to ensure that the meaning of "agricultural use" is clear.[129]

228. Others have also addressed this concern. In comments on proposed amendments to Annex 2(6) to the WTO AoA, it was explained that assurances that inputs are not required to be in agricultural use in order to receive payments is not to be understood as an opposition to using "best farm practices", but refers to the objective that land must not be in "commercial agricultural use".[130]

229. Tim Rice of ActionAid International points out five reasons why a comprehensive review of Green Box subsidies is required within the WTO. The five arguments are:

1. "Green box 'decoupled' payments in the U.S. distort production and trade because of wealth effects, risk reduction, planting flexibility restrictions and keeping a production history should the system change. Production has remained high.
2. It is predicted that green box 'decoupled' payments in the E.U. will continue to distort production and trade – that high levels of production will remain with some farmers potentially treating the new payments as coupled.

[128] Mary E. Burfisher and Jeffrey Hopkins. "Farm Payments: Decoupled Payments Increase Households' Well-Being, Not Production", United States Department of Agriculture, Economic Research Service, February 2003
[129] WTO Document JOB (06)/145 Committee on Agriculture, Special Session, "G-20 Comments on the Chair Reference Paper on Green Box", May 16, 2006
[130] Jacques Berthelot. "Berthelot's comments of the Chair's reference papers on the OTDS, AMS, blue box of May 24, 2006 and green box of May 30, 2006" (Chair's Reference Paper: Overall Reduction in Trade-Distorting Domestic Support, Committee on Agriculture, Special Session; Domestic Support, May 24, 2006), May 2006

3. The interaction with other policies (i.e. supplementary trade distorting amber and blue box subsidies) will have a 'coupling' effect on 'decoupled' green box payments.
4. If the E.U.'s decoupled payments were taken aware, E.U. farming would be decimated – thus instantly challenging the assumption that they are production neutral.
5. Dumping from the E.U. will continue." [131]

230. Oxfam, an organization concerned with subsidization that results in "dumping" of agricultural products onto developing country markets, has also considered decoupling and its effect on "dumping". "Dumping" in this case refers to the use of any subsidies (export or domestic) to such a degree that they encourage over-production of the agricultural commodity and its export sale at low prices. In this sense, "dumping" is roughly equivalent to *de facto* export subsidies.

231. Oxfam considers that the decoupled payments are trade-distorting. Oxfam notes the WTO logic that cutting production-specific support eliminates distortion in world markets by removing the incentive to overproduce. However, Oxfam considers that the way payments have been implemented has cancelled out much of the non-distorting effect.[132]

232. Although Oxfam considers decoupling to be a step in the right direction, progress toward complete decoupling has been too slow. Decoupling continues to support "dumping" because it is simply another form of government support that is used to offset the cost of production so that commodities may be sold on international markets at artificially low prices; at times below full cost of production. Oxfam considers that, "Full decoupling will only occur when payments allow farmers to leave the land altogether, and tackling dumping will require additional measures."[133]

233. Considering the impact of decoupling on E.U. production, Berthelot has concluded that all E.U. commodities could be subject to anti-dumping investigations because of the

[131] Tim Rice. *"5 Reasons Why a Comprehensive Review of Green Box Subsidies is Required within the WTO"*, ActionAid International, Final Discussion Paper, June 28, 2004
[132] Oxfam Briefing Paper #76, "A Round for Free", June 2005
[133] Ibid.

effect of decoupling, which he considers constitutes a "huge subsidy" that reduces the price of all E.U. commodities to below their cost of production.

> "… all EU agri-food exports can be sued at the WTO on dumping grounds, even those which did not received any export subsidy such as quality cheese or wines as long as their producers are receiving a [single farm payment]."[134]

234. In our view, analysis of decoupling in light of the WTO obligations leads to the conclusion that decoupled income support programs could only meet the WTO requirements of not being trade or production distorting if farmers benefiting from these payments agree to withdraw from production. By allowing farmers to choose to continue to produce while simultaneously accepting these support payments will inevitably lead to increased production and to marketing decisions that will have trade distorting effects.

235. We recognize that Annex 2(1) to the WTO AoA permits decoupled payments that have minimal production or trade-distorting effects, but we do not consider that this limited permission to affect the market will give any realistic cover to decoupled income support programs. Beyond the difficulty of defining "minimal", it is our view that it is unlikely that the effects generated by decoupled income support would be, to any degree, minimal.

IV Current Positions and the State of Play

236. The U.S. and E.U. have maintained trade distorting support programs because the AoA has permitted them to subsidize and their own farmers make it politically difficult for them not to subsidize. USDA explains subsidies to U.S. farmers as follows,

> "Domestic demand is no longer sufficient to absorb what American farmers can produce. Demand by well-fed Americans grows slowly with population growth. The promise of new, much faster growing markets lies overseas…As a result, the United States must consider its farm policy in an international setting, helping

[134] Jacques Berthelot. "Berthelot's comments of the Chair's reference papers on the OTDS, AMS, blue box of May 24, 2006 and green box of May 30, 2006" (Chair's Reference Paper: Overall Reduction in Trade-Distorting Domestic Support, Committee on Agriculture, Special Session; Domestic Support, May 24, 2006), May 2006, para. 6

farmers stay competitive while pressing for unfettered access to global markets."[135]

237. In commenting on the 2003 CAP Reform, Berthelot noted:

> "The E.U. also maintains trade distorting subsidy programs. The coupled nature of the SFP was attested by the European Commission's statement, premonitory of the CAP reform of June 2003, during the meeting of the WTO Committee on agriculture of 7 February 2001: "the representative of the European Communities… in respect of the Blue Box… stated that measures that were linked to production restraints should continue to be treated separately from Amber Box supports. If not, there was a danger that similar measures would be introduced under the Green Box", which was hardly a diplomatic manner to recognize that the green box generates the same trade distorting effects as the blue and amber subsidies, and that box-shifting did not pose any difficulty for the EU."[136]

238. Decoupled support programs are being considered as part of the Doha Round agriculture negotiations. More importantly, WTO Members (particularly the U.S. and the E.U.) are relying on claims of decoupling to protect their support programs from further reduction. In exchange for their efforts to eliminate trade distorting subsidies, the U.S. and E.U. are seeking additional market access. By declaring their support programs to be decoupled and green, the U.S. and E.U. are seeking to protect substantial WTO-inconsistent farm support. If these programs are maintained, they will not only affect developing country producers but all WTO Member producers will be forced to compete with the U.S. and E.U. Treasuries rather than with U.S. and E.U. farmers.

239. Professor Daryll Ray of the University of Tennessee, too, has been an active and skeptical critic of decoupled support. He has said that:

> "While decoupled payments sound like just another name for planting flexibility, it's more inclusive than that. From the perspective of many economists, decoupled payments is planting flexibility on steroids. It not only includes the idea of farmers planting whatever they want, but, just as importantly, it explicitly includes not planting anything at all.

[135] United States Department of Agriculture (USDA). Food and Agricultural Policy: Taking Stock for the New Century, p. 51 (http://www.usda.gov/news/pubs/farmpolicy01/fpindex.htm)
[136] Jacques Berthelot. "Berthelot's comments of the Chair's reference papers on the OTDS, AMS, blue box of May 24, 2006 and green box of May 30, 2006" (Chair's Reference Paper: Overall Reduction in Trade-Distorting Domestic Support, Committee on Agriculture, Special Session; Domestic Support, May 24, 2006), May 2006

Thus, with decoupled payments, economists expect the total acreage of major crops to fall in response to a decline in the prices of all major crops, in addition to observing changes in the crop mix if the prices of some crops change more than others. Hence, supply of the major crops should be more responsive to changes in general price levels when payments are decoupled."[137]

"The theory is clear. When these economists apply their graduate-school-learned calculus approach to evaluate farmers' efforts to maximize their profits, any lump-sum direct payment literally falls out of the decision-making equation. Accordingly, it makes no difference whether farmers receives lump-sum payments of one dollar, one hundred dollars, one hundred thousand dollars or no payment at all, their production decisions - based on prices - is the same; and, if variable costs aren't covered, they will not plant at all." [138]

"The question is: does the theory match reality? Does the theoretical result of a "no production effect" from decoupled payments accurately predict how farmers use information on anticipated fixed payments when they make acreage/production decisions? Do farmers ignore the knowledge that they will be receiving contract payments when making production decisions? Or, do they mentally convert the payment to cents per bushel or pound, add the result to the expected price or loan rate and use that sum to make production decisions? The payment also could have a "wealth effect" which loosens farmers' capital constraints, convincing bankers to lend required operating money or in other ways provides staying power for the farmer.

So, are decoupled payments a "calculus issue" in which the lump-sum payments fall out of consideration or are they part of an arithmetic problem in which farmers consciously combine fixed payments, measured per bushel, with expected price when deciding what to grow?" [139]

240. We conclude that:

- the U.S. and E.U. programs fail to meet the specific requirements for decoupling set out in Annex 2 to the WTO AoA, and
- it is not possible to implement a decoupling program which does not prevent production that is actually consistent with WTO obligations.

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[137] Daryll E. Ray. "Decoupled Payments: Are the Effects Explained by Calculus or Simple Arithmetic?", August 18, 2000
[138] Ibid
[139] Ibid

241. The U.S. and the E.U. will no doubt stand by their claim that the majority of their support is non-trade distorting and that such green support should not be subject to further reduction through the Doha Round. The E.U. is unlikely to accept reform beyond the limits of its 2003 CAP Reform. E.U. Trade Commissioner Peter Mendelson has publicly taken the position that as a result of CAP Reform, 90% of E.U. support is now non-distorting. Both the U.S. and the E.U. are under political pressure from their farmers to maintain support in some form.

242. Former U.S. Agriculture Secretary Dan Glickman has stated that federal subsidies is an "income transfer program" intended to support farming and to keep the least populated parts of the country afloat by supporting the nearly 1 million farmers and the businesses that depend on them. Without this support, these businesses would fail and rural America would go downhill.[140]

243. But rather than create programs that actually de-link support and production, the big subsidizers have chosen to play a shell game that tries to hide production distorting subsidies under the Green Box. The World Bank has described the political imperatives and motives for the shell game as follows:

> "The outcome of [decoupling] programs has not been encouraging. The primary motivation for decoupling is to compensate farmers with transitional assistance to free markets while at the same time making it politically palatable and transparent. As the paper concludes, politics play an important role in the move towards decoupling. It would be politically unpalatable for Northern countries to take away all support from farmers given their political importance (and because so much of northern agriculture would be unprofitable without subsidies). In addition, governments are simply re-arranging subsidies between boxes to make them WTO compatible."[141]

244. The E.U. and the U.S. have claimed that their programs are non-trade distorting decoupled support in an attempt to maintain those programs through the Doha Round and going forward.

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[140] Timothy Egan. "Failing Farmers Learn to Profit from Federal Aid", The New York Times, December 24, 2000

[141] John Baffes & Harry de Gorter. "Decoupling Support to Agriculture: An Economic Analysis of Recent Experience", second draft May 9, 2003, p. 13

245. Developing country WTO Members too, have seen through this sham. The G-20 argues that, as a result of the presence of distorting payments, green policies do not properly perform their function. The intended neutral nature of green programs is being abused and distorted. As a result, "green" money is merely added to "blue" and "amber" monies and becomes undifferentiated in relation to them.[142]

246. The G-20 has called for called for a review of direct payments and decoupled support to ensure that support measures that are exempt from reduction commitments indeed have no, or at most minimal, trade-distorting and production distorting effects. The G-20 notes that close scrutiny is required because "developed countries are likely to transfer substantial amounts of support to those types of programs.[143]

247. Developing country Ministers have identified the actual costs of U.S. and E.U. domestic support to their producers. Bolivian Minister Saavedra Bruno's told his colleagues during the Cancun Ministerial,

> "To a large extent, Bolivia's agricultural sector is made up of peasants and indigenous people. How can we require of them, who are truly the poorest among the poor, liberalization which farmers in rich countries refuse to accept? How can we ask the under-developed countries to assume the cost of liberalization which developed countries are evading?"[i144]

248. Uruguayan Minister H.E. Dr. Didier Opertti Badan stated, at the Cancun Ministerial Conference, that,

> "This reform is no longer the wish or demand of a more or less broad group of countries. It has grown to an international outcry, impossible to ignore or to sidestep any more."[145]

249. Uruguay threatened to bring a WTO challenge against the U.S. for its rice imports but appears to have backed down after U.S. diplomatic interventions.

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142 Peter Clark. "Unchain your support: Exposing the decoupling myth, Speech by Peter Clark at the National Press Club of Canada", Ottawa, November 1, 2005

143 WTO document JOB (06)/145 Committee on Agriculture, Special Session, "G-20 Comments on the Chair Reference Paper on Green Box", May 16, 2006, para. 3

144 WTO document WT/MIN(03)/ST/83, Ministerial Conference, Fifth Session, "Statement by H.E. Dr Carlos Saavedra Bruno, Minister of Foreign Affairs and Worship (Bolivia)", Cancún, September 12, 2003

145 WTO document WT/MIN(03)/ST/25, Ministerial Conference, Fifth Session, "Statement by H.E. Dr Didier Opertti Badan, Minister for Foreign Affairs (Uruguay)", Cancún, September 11, 2003

250. Rice prices have been depressed by exports from an unlikely source – the U.S.[146] There are green subsidies to rice in the form of their share of irrigation infrastructure which Berthelot claims is worth $54.2 billion, and up to $15 billion for cheap water.[147] But here is also a very significant amount of below commercial cost water provided to U.S. farmers. $10 billion a year is a conservative estimate.[148]

251. The California Rice Commission has admitted that subsidies to irrigation are essential to continued rice production in the state.

> "Irrigation is essential to rice cultivation. Although rice is grown in some parts of the world without benefit of irrigation, ***this would be impossible in California***."[149] (emphasis added)

252. By continuing to support production, and over-production, U.S. and E.U. so called green and blue payments hurt developing country farmers the most through the "dumping" identified by Oxfam. Although the impact of these programs is most acutely felt by developing country members, no producers who produce or trade in grains, oilseeds, cotton and rice and downstream industries which use these subsidized inputs are exempt.

253. If conversion of support from coupled to decoupled payments actually has a beneficial effect on production and trade, the effect should have been evident by now. The United States "green box" decoupled payments have been a feature of the U.S. subsidy regime since production flexibility contracts were introduced in the 1996 FAIR Act. While production estimates are difficult to ascertain, given the limited data available, evidence available from U.S. sources suggests that production flexibility contracts resulted in an increase in the total area planted. The USDA ERS estimated that the total area planted under production flexibility contracts would increase by between 225,000 and 725,000

[146] Peter Clark. "Beggar Thy Neighbour Subsidies: Repairing the Collateral Damage: Trade Policy and the farm income crisis in the context of WTO negotiations", WTO Public Symposium, Geneva, April 21, 2005
[147] Jacques Berthelot. "The King is Naked: The Impossible U.S. Promise to Slash its Agricultural Supports," November 7, 2005, p. 20
[148] Grey, Clark, Shih and Associates. "WTO Consistency of USA and New Zealand Agricultural Practices," Canada, September 2003 (www.greyclark.com/DFC_WTO_NZ_US_Consistency.pdf)
[149] California Rice Commission (Website - http://www.calrice.org/a_balance_sheet/chap2.htm)

acres.[150] These estimates are consistent with the USDA ERS assessment that, "Most decoupled programs create incentives to increase aggregate production."[151]

254. There is no reason why we should expect any different result in the E.U. Grains producers began to receive direct payments in 1992. The 2003 CAP Reform converted most E.U. support to the SFP program which the E.U. claims is decoupled (but even its public terms indicates is not). In a letter to the Editor of the Financial Times, Peter Mandelson, the E.U. Trade Commissioner, claimed that as a result of the 2003 reform, about 90% of E.U. payments are now non-trade distorting.

255. Notwithstanding these claims, there has been no real discipline or reduction in E.U. production. Production maintaining and enhancing effects are endemic to all forms of support including the SFP and cannot be avoided.

256. This is not a "penny ante" con from the sidewalks of lower Broadway and "B" movies. The "shell game" being played out in Geneva, Washington and Brussels involves many billions of dollars and many more billions of euros in support that benefits American and European farmers and hurts everyone else.

257. Other commentators have been blunter in their assessment of the current state of play. Berthelot has made the following assessment of E.U. and U.S. support,

> "But, beyond this formal violation of WTO law, more important is the violation of its substance, due to the E.U. and U.S. massive cheatings in their agricultural domestic supports. Particularly through putting the most important inputs for animal products either in the green box (the U.S. flexibility contract payments and direct payments to feedstuffs) or in the blue box (the E.U. direct payments to COP – cereals, oilseeds and pulses – fed to E.U. animals, before their transfer to the alleged green SPF). In contradiction with [Agreement on Agriculture] Article 6.2, which exempt only [Developing Countries] from notifying in their amber box, the

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[150] Tim Rice. "*5 Reasons Why a Comprehensive Review of Green Box Subsidies is Required within the WTO*", ActionAid International, Final Discussion Paper, June 28, 2004

[151] Paul C. Westcott and Edwin C. Young. "*Influences of Decoupled Farm Programs on Agricultural Production*", USDA Economic Research Service, p. 14

'agricultural input subsidies generally available to low-income or resource poor producers'."[152]

258. In his comments on the Chair's Paper on Overall Reduction in Trade-Distorting Support, Berthelot has also offered the following insightful critique of E.U. 2003 CAP reform.,

> "In endorsing the E.U. cunning communication, the Secretariat lets the other Members accredit what is a huge myth: far from being driven by a market orientation, the new CAP is moving far away from it since the E.U. agricultural prices are less and less market prices, being more and more below the average production costs. So that the E.U. agri-food products are sold at prices much "less than their normal value" and are not the prices that would prevail "in the ordinary course of trade". In other words, the E.U. agricultural sector is no longer that of a "market economy" and the E.U. agri-food products could be prosecuted at the WTO using the procedure used by the E.U. itself against "non market economies". Besides, the SFP is not fully decoupled as the Appellate Body has shown for U.S. direct payments and for other reasons."[153]

259. With respect to the U.S. and E.U., Berthelot reaches the following conclusion,

> "There is an easy way to get the U.S. and the E.U. to adopt a policy of food sovereignty: make them stop cheating. This would entail huge cuts in agricultural subsidies. Farmers would not stand for it, and would soon force their governments to reform the CAP and the farm bill in such a way as to guarantee viable prices for agricultural produce, based on protection against imports."[154]

260. Berthelot is not alone in his assessment of the effects of U.S. and E.U. programs. Oxfam has also raised concerns with attempts to hide trade distorting subsidies.

> "Despite committing themselves to putting development at the centre of global trade talks, rich countries are still rigging agricultural trade rules against the poor. The USA and EU, in particular, have repackaged their agricultural subsidies so that they appear to be legitimate under WTO rules, allowing them to continue dumping products such as rice, corn, milk, sugar, and cotton at prices far below their true costs of production."[155]

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[152] Jacques Berthelot. "Berthelot's comments of the Chair's reference papers on the OTDS, AMS, blue box of May 24, 2006 and green box of May 30, 2006" (Chair's Reference Paper: Overall Reduction in Trade-Distorting Domestic Support, Committee on Agriculture, Special Session; Domestic Support, May 24, 2006), May 2006
[153] Jacques Berthelot. "Berthelot's comments of the Chair's reference papers on the OTDS, AMS, blue box of May 24, 2006 and green box of May 30, 2006" (Chair's Reference Paper: Overall Reduction in Trade-Distorting Domestic Support, Committee on Agriculture, Special Session; Domestic Support, May 24, 2006), May 2006
[154] Jacques Berthelot. "The WTO: Food for Thought", December 2005
[155] Oxfam Briefing Paper #72, "Kicking Down the Door", April 11, 2005

261. The bottom line is that real non distorting decoupled support is not possible given the current WTO rules and the inadequacies of the notification system and the absence of an effective surveillance or oversight system. The U.S. and the E.U. are simply trying to hide the full value of their current trade-distorting support by claiming that much of it is decoupled and green or blue- or neglecting to report it at all.

262. The message is that all support is distorting. Cash is fungible. The more cash available to the farmer, whatever the source, the more inclined the farmer will be to produce, and the better able he will be to finance his production. Failure to address trade distorting support was a major failure of the Uruguay Round. The principal proposals before the negotiators in the DDA negotiations will not resolve these deficiencies. Without automatic scrutiny and review of notifications by an a oversight committee or surveillance body and rigid and prompt notification deadlines these imaginatively contrived and deceptively reported programs and those which will appear in the 2007 Farm Bill are likely to exacerbate them. Market access concessions in this environment will not be cushioned by the greater stability which real and, enforceable reductions and disciplines on domestic support would bring.

263. The only effective solution is to demand real and substantive amendment to Annex 2 to the WTO AoA to ensure that decoupled income support does not distort trade and production. The only means of effectively ensuring this result is to actually sever the link between support and production by requiring that producers who accept decoupled income support abandon production. If as we expect this is not politically attractive, some other way will need to be found to offset the distortions and to prevent sham liberalization from being rewarded.

264. Unless and until this admittedly draconian change is introduced all support provided to producers, whether classified as coupled, partly decoupled or fully decoupled, should be included in AMS, dehydrated and made subject to rapid reduction and elimination. Anything else would be half measures or worse which will perpetuate disruption and the global farm income crisis

265. Doing nothing is not an option. To do nothing means accept a degree of manipulation of the system by the U.S. and the E.U. that will only be limited by what they believe they can get away with. There is an important and urgent need to ensure proper surveillance of subsidy notifications. Lack of resources is a poor excuse. It is an abrogation of responsibility and incompetent budgeting and resource allocation. The WTO agreements are contracts. It is impossible to write good faith into a contract.

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