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June2003 CAP and multilateral agricultural negotiations at the WTO: Are they compatible?

Theoretically, the deadline for the current cycle of multilateral trade negotiations at the World Trade Organisation (WTO) is January 1st 2015. The failure of the 5th ministerial conference of Cancun in September 2003 makes it unlikely that the deadline will be observed. Agreeing on the agricultural dossier proved to be impossible. However, it is likely that there will be a new agricultural agreement and that this one will at least include additional commitments to the previous Uruguay Round Agreement on Agriculture (URAA), aiming to open up markets, reduce subsidized exports and lower domestic support when it has excessively distorting effects on trade. Moreover, it is possible that the agricultural agreement of the Doha Round is stricter than the URAA, for instance challenging not only the terms for granting domestic support but also its total level. The objective of this paper is to assess the European Union's (EU) room for manoeuvre at the WTO after the 1999 and 2003 Common Agricultural Policy (CAP) reforms (Agenda 2000 reform) and 2003 Luxembourg compromise).

At the opening of the Cancun Conference on September 10th, several developing countries rejected the WTO Secretariat's text of August 24th which was supposed to be the basis for talks. In their eyes, this text is much too favourable to the USA and EU interests. Other texts were put on the table, by 41 African countries on the one hand, on the other hand by a group of 21 developing countries including Argentina, Brazil, China and India. The ministerial "compromise" text was badly received, in particular by the signatory countries of both the above-mentioned texts, and on September 14th, the conference ended in failure.

The agricultural dossier in Cancun: opposition from the developing countries

To a large extent, the failure of the Conference was due to the refusal by developing countries to discuss the 'Singapore' issues (Trade facilitation, transparency of public procurement, investments and competition). Talks also failed because of the agricultural dossier, with the developing countries refusing to study the Singapore issues on the grounds that the agricultural propositions did not take their demands into account. On the agricultural dossier, the WTO secretariat's text of August 24th and the ministerial text of September 13th used the framework used at the Uruguay Round with distinct proposals on the three files about market access, export competition and domestic support. The same framework was used in the common United-States / European-Union proposition of August 13th. This proposal with no figures claimed that to translate the Doha Cycle objectives into reform modalities, it was necessary to return to the framework successfully used some years earlier during the Uruguay Round. In practical terms this bilateral arrangement was mainly seen as a manoeuvre aiming to avoid a challenge to the agricultural policies of both countries.

- As regards domestic support, the September 13th text suggests reducing the orange box supports (supports causing distortion effects on the major exchanges) and blue box supports (granted for control over supply and with no obligation of reductions in the Uruguay Round). Moreover it is planned to put an upper limit on the orange box supports for each product and review the inclusion criteria in the green box (box which contains authorized supports without limit on the grounds that distortion effects on trade are null, or at most minimal).
- As regards export competition, the text suggests reducing export subsidies, including export credits (which was not the case at the

Uruguay Round) and eliminating export subsidies at export for products of interest to developing countries.

- As regards market access, the text suggests continuing with customs duty reductions with lower obligations for developing countries, in particular, concerning considerations other than trading ones (economic development, national food safety and fight against poverty).

Though containing no proposal with figures, this text was rejected by almost all the developing countries which consider it inadequate in almost every respect. It does not meet their demands on the blue box withdrawal, the upper limit of the green box support, the elimination of all export subsidies, the exemption from obligations to reduce customs duties in developing countries for some products (called "special" products) and so on. Furthermore, it does not consider cotton as a specific product. Several developing countries, in particular the least advanced nations of the African continent, only left Cancun with the guarantee that agricultural policies in the United States and the European Union used in the cotton sector would be quickly reviewed in a sense which would put an end to their distortion effects on the World market. The text of September 13th did not satisfy them in this respect, in particular, because it suggested treating the problem by taking it from the market access angle for non-agricultural products (Chenaille and Tavernier, 2003).

Unlike the Uruguay Round which in the agricultural field was mainly reduced to an opposition between the European Union and the United States, the latter supported by the countries of the Cairn groups, the Cancun Conference brought opposition from almost all developing countries to both the agricultural giants, united, this time, by a common objective guaranteeing the compatibility of their respective agricultural policies with a future agreement at the WTO. There is great heterogeneity between developing countries, first within the group of 21 which includes countries as different as Argentina (exporting farm products and without much support for its agriculture) and India (favourable to the protection of its agriculture), and all the more so between the countries of this group and the poorest countries within the alliance of the African Union, the ACP group (African, Caribbean and Pacific) and the least advanced group. The extent of the final agreements to open up markets from the continued existence of the "refusal front" of developing countries reduces subsidized exports and domestic supports. It is important to emphasise that importing countries did not question the principle of distinct agreements on these three aspects. They essentially asked that agreement calculation modes should not be those studied during the Uruguay Round and that developing countries benefit from specific measures. The extent of the specific and differentiated treatment that they will be granted will depend on the capacity of developing countries to keep their unity in the face of the United States and the European Union.

It is in this general context that it is worth studying the compatibility of the CAP derived from the Agenda 2000 reform of 1999 and the 2003 Luxembourg compromise with the multilateral agricultural negotiations of the Doha Cycle. This analysis is developed by distinguishing successively between the three aspects of domestic support, export competition and market access.

CAP, WTO and domestic support

The European Union has had no difficulty in respecting the agreement or the reduction of 20% of the orange box domestic support over the 6 years 1995/96-2000/01 of the URAA. It seems that the European Union could have respected this agreement without any blue box, i.e. classifying the blue box aid into the orange box (table 1).

The 1999 reform more or less reduces the orange box support by a third

The 1999 reform, more particularly the fall in the intervention prices of cereals, beef, butter and skimmed milk powder enables the reduction of the orange box by 20 percentage points. The 2003 reform enables the reduction of the orange box by 620 additional million Euros, bringing room for manoeuvre up to more than 52%. In other words, today, within the Doha cycle, the European Union is able to accept a 52% reduction in the domestic support of the orange box.

So regarding the domestic support dossier presented at the WTO in January 2003 before the Luxembourg compromise, the community proposal is to keep the community definition of the three boxes unchanged and reduce only orange box support to 55% relatively to the final level fixed in the URAA. According to our calculations, the CAP derived from both reforms of 1999 and 2003 is barely compatible with this proposal since there is only 52% room for manoeuvre. However, with the future reforms of the various Common Market Organisations (CMO), which are little or not affected by the three CAP reforms of 1992, 1999 and 2003 (sugar, olive oil, tobacco some fruit and vegetables), it is easy to envision a cut in the orange box support when higher than 52%. It is likely that the European Commission (EC) integrated that element into its proposal. Furthermore, it is likely that the EC wishes to use this lever to overturn domestic reluctance to reform the above-mentioned sectors, a reluctance which, up to now had led to a postponement of these CMO reforms. In November 2003, the commission adopted reform proposals for tobacco, olive oil, cotton and barley that must be submitted to the European

Cabinet. In 2000, the support of these sectors included in the global support measure (GSM), represented 5.5% of the ceiling. In parallel, the sugar CMO reform was in progress. In 2000, this sector support itself represented 8.5% of the ceiling.

The 2003 reform will considerably reduce the blue box support

In 1999/2000, the blue box support stood at 19.8 billion euros. The 1999 reform, more precisely the increase in vegetal and animal direct aid increased this amount by about 3 billion euros. The 2003 reform, more precisely the transformation of direct aid into a farm single payment, will conversely reduce the blue box support to between 16 and 23 billion euros according to the degree of the decoupling kept (decoupling: partial versus total). The 2003 reform enables the European Union to accept a substantial fall in blue box support, an option which was not planned in the WTO community proposal in January 2003, an existing option of the bilateral initiative of the United States and the EU of August 2003. That one includes capping blue box support at 5% of the value of the agricultural produce and an obligation to reduce all supports counted in the orange box, the blue box and the *de minimis* rule (at the Uruguay Round, no-counted supports granted to a product if they represent less than 5% of the product value). However, the 2003 reform does not enable the EU to propose the immediate suppression of the blue box because some member States will likely choose partial decoupling. Particularly, the reforms in progress of some CMO (cotton for instance) re-supply the blue box.

All in all, both reforms of 1999 and 2003 enable the EU to take a relatively offensive stand on the domestic support dossier, by proposing or accepting substantial cuts in the supports of the orange and blue boxes. However, they do not consider the withdrawal of the blue box. This offensive position will be maintained only if the present ranking of the domestic support in the three coloured boxes is kept and in particular if the green box definition is still broad enough to include single farm payment, and if there is no upper limit on the green box aid. Failing that if single payment is ranked in the blue box, the EU will not be able to accept an upper limit, and *a fortiori,* a reduction in the aid in the blue box. In strictly economic terms, ranking the single payment in the green box is open to criticism if it is granted in addition to premiums which remain coupled with production factors, land (vegetable premiums) and livestock (ewe, goat and beef premiums) and also because some crops are forbidden. Furthermore, the Cancun Conference clearly showed that developing countries, supported by Australia and New Zealand, wanted all their orange, blue or green supports to be reduced and at the very least subjected to strict disciplines.

CAP, WTO and export competition

The agricultural agreement of the Doha cycle will certainly include new agreements to reduce subsidized exports, by considering not only direct export subsidies but also other forms of export incentives such as export credits or export monopolies.

The agreement reducing subsidized exports by 21% in volume over the 6 years of URAA application compelled the EU to reduce its subsidized exports of agricultural produce, notably poultry, pork meat and dairy produce. At the same time, the EU succeeded in developing non-subsidized exports of cereals, poultry, pork meat and dairy produce with high added value. An additional agreement reducing exports subsidized by an equivalent percentage, a fortiori higher than that granted at the time of the Uruguay round will be restrictive again. In the case of dairy products, the fall in the intervention prices of butter and skimmed milk powder should enable the development of non-subsidized exports of dairy products with higher added value, like what was done during the 6 years of application of the URAA, when there had been no fall in institutional prices in dairy products. In the case of beef meat, such non subsidized exports are almost impossible because of the gap between European domestic prices and rates on the various export markets. Yet this could be not too penalizing insofar as the 2003 reform should lead to a bigger extensification of beef production, a reduction in supply, and hence less recourse to subsidized exports in order to balance the community market. All the more since the new EU member states should be net importers of beef meat during the coming years for about 200,000 tons by 2010. In practice, it is mainly in off-soil productions, poultry and pork meat that the reduction restraints in subsidized exports should be less severe while these productions are among the least supported and the unitary amount of subsidy is obviously lower than what is, on average, granted to beef meat or dairy produce (Bureau et al., 2003; Chatellier et al., 2003).

In the end, it appears that the CAP derived from both the 1999 and 2003 reforms is compatible with a reduction in subsidized exports of a percentage equivalent to the percentage granted at the Uruguay Round but not with withdrawing all subsidies to exports over only a few years.

CAP, WTO and market access

The commitment to a customs duty reduction by 36% over the 6 years of URAA application was not restrictive for the EU. The community preference was maintained and there was no significant increase in European imports of agricultural products of the MAN (most advanced nations) under the normal system of common customs duties. Let us remember that custom

duty in the EU is still 220% for sugar, 163% for butter and 111% for beef meat.

Within the Doha Cycle, the EU may easily accept a new fall in the tariff barrier of a percentage equivalent to the percentage granted at the Uruguay Round without challenging the community preference. The community preference at the WTO is precisely to reduce customs duties by 36% over 6 years, with a minimum of 15% per tariff line. However, The EU suggests that the least advanced nations have free access to the agricultural markets of the developed and developing countries which do not belong to the group of the least advanced nations. It also suggests that developed countries take the "necessary measures" to guarantee that the developing countries' exports with no duties represent 50% minimum of the agricultural products from the developed countries. The implementation methods for the clause have not been specified. As regards tariff quotas with reduced duties, the EU just states the necessity of greater transparency and greater efficiency of these quota management modes, without making any concrete proposals on their levels or duties which would be applied inside the quotas.

This proposal is obviously minimalist. It was considered as such by a majority of the WTO member States, United States included. The United States suggest using a system of customs duty reductions in order that after 5 years, no customs duties can exceed 25% (application of the so called "Swiss" system). Moreover, the United States suggest implementing this reduction from effectively applied customs duties, obviously lower and not from theoretical customs duties. The common proposal of the USA and the EU of August is half-way in between since some of the customs duties would be reduced in a linear way, with a minimum reduction percentage, while others would be reduced using the Swiss system. For the products considered as "sensitive", the possibilities of market access would be "increased" only through a linear reduction in the customs duties and the opening of tariff quotas with reduced prices, a vague enough expression not to be really restrictive. Yet for developing countries (up to a non-specified level), there would be free access to the markets of developed countries and an application of a special and differentiated treatment in developing countries with lesser customs duty reductions staggered over a longer time. In practice, from the EU point of view, the first concession, at the time of the "everything but arms" initiative, looks generously redundant with the concession previously conceded in a bilateral way with the 48 poorest countries of the planet.

The EU's cautious attitude on the market access dossier can easily be explained. For a majority of products, with the notable exception of cereals and oleaginous, the European domestic price is still much higher than the world price. Even though the direct price support decreased (cereals and beef meat) or is going to decrease (dairy products), it still remains high for the products that were not reformed (sugar) or only partially reformed (dairy products). Moreover, the control of imports and the selling-off of surplus over Third countries with the aid of subsidies enable the equilibrium of the community markets at higher domestic prices than world rates. Both reforms of 1999 and 2003 should result in production extensification, a reduction in supply and a strengthening of domestic prices (as a minimum, in relation to what would have happened without reforms), provided that there is not too big an increase in imports which would cancel out the positive effects on European rates of downwards adjusted supply. Besides, we note that on this matter the EU is in favour of keeping the special safeguard clause, a clause which permits the implementation of additional customs duties in case of too sudden an import increase or too big a fall in world rates.

Conclusion

The CAP that derived from both reforms of 1999 and 2003 is compatible with a new agricultural agreement at the WTO similar to the agreement consolidated at the Uruguay Round, *i.e.*, including an equivalent drop in the MAN customs duties, an equivalent reduction in export subsidies and an equivalent reduction in the orange box supports. Both reforms enable the EU to have an offensive position on the domestic dossier by suggesting and/or accepting a larger fall in the domestic support of the orange box (around 50%) as well as the domestic support of the blue box. They do not allow an immediate suppression of the blue box. This offensive position is only possible if classifying the single payment in the green box is not challenged and if there is no required discipline regarding the amounts of that box. In practice, the EU may now concentrate its action on its main Achilles' heel, the lower cost and price competitiveness of a majority of products, a weaker competitiveness which does not enable an excessively fast elimination of subsidies to exports and an excessive opening of the community market. Hence a negotiation strategy centred on the reduction only in export subsidies and a minimal opening of the community market, more specifically a control of that opening in the form of concessions (tariff quotas with reduced duties) essentially directed towards the least advanced nations. The future of the European agricultural model of Agenda 2000 and the Luxemburg compromise depend on the success of this strategy.

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For further information

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Frame 1: United States and domestic support at the WTO: slight room for manoeuvre

Support to agriculture is lower in the United States than in the EU, whether this support is assessed by SAP (support assessment to producers) or through commitments at the WTO. In 1999, the upper limit of the orange box was 20 billion dollars in the United States and 72 billion euros in the EU for almost equivalent agricultural productions in volume. The United States room for manoeuvre on the domestic support dossier, however, is smaller than the European Union's.

While maintaining a price system guaranteed through the *loan rate*, the direct aid to domestic support were decoupled by the 1996 American agricultural law. From 1998, urgent aid is granted to producers to cope with a fall in rates. The last USA notification to the WTO (1999) classifies this urgent aid in the orange box but does not enter it into the Global Support Measure (GSM) thanks to the minimis clause. In 1999, the notified GSM of the USA represents 85% of the authorized upper limit. Without the minimis clause, it would have exceeded this upper limit by 22% (Butault, 2004). The EU could have kept the same commitments without the blue box (table 1).

The new 2002 American law keeps both mechanisms of the previous law (minimal prices guaranteed and decoupled direct aid). Furthermore, it ensures the continued existence of the direct aid by "transforming" it into contra-cyclic direct aid paid on a historic basis according to areas and reference yields, but dependent on world prices. Theoretically, this last characteristic should exclude them from the green box. It even could challenge the registration of the decoupled payments in the green box.

In this context, the bilateral compromise concluded between the USA and the EU takes on all its sense. For instance and conversely to the United States' first proposals, it no longer provides for blue box cancellation but only its upper limit. The USA could need that box to ensure the accounts of their support domestic policy with the WTO rules.

Table 1: Domestic supports in the European Union (1995/96-1990/00) in billion euros

	1995/96	1996/97	1997/98	1998/99	1999/00
Orange box upper limit (1)	78.672	76.369	74.067	71.765	69.643
Orange box declared (2)	47.5264	51.0090	50.1940	46.6830	47.8857
Blue box (3)	20.8455	21.5208	20.4428	20.5035	19.7921
Green box	18.7792	22.1304	18.1668	19.168	19.9305
Differential					
(1)-(2)	31.1456	25.3600	23.8730	25.0820	21.7573
(1)-(2)-(3)	10.3001	3.8392	3.4302	4.5785	1.9652

Source: Guyomard et Le Bris (2003)

Domestic support in the United States (1999, millions of USD)

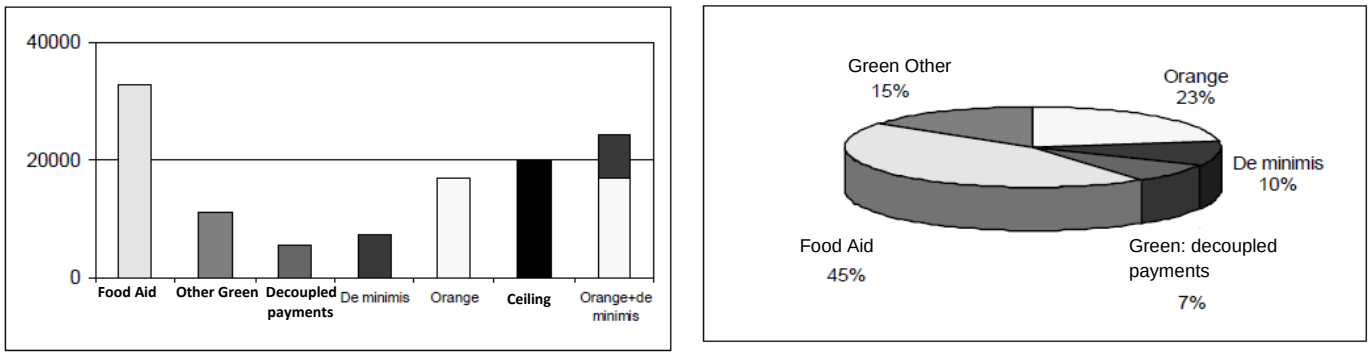
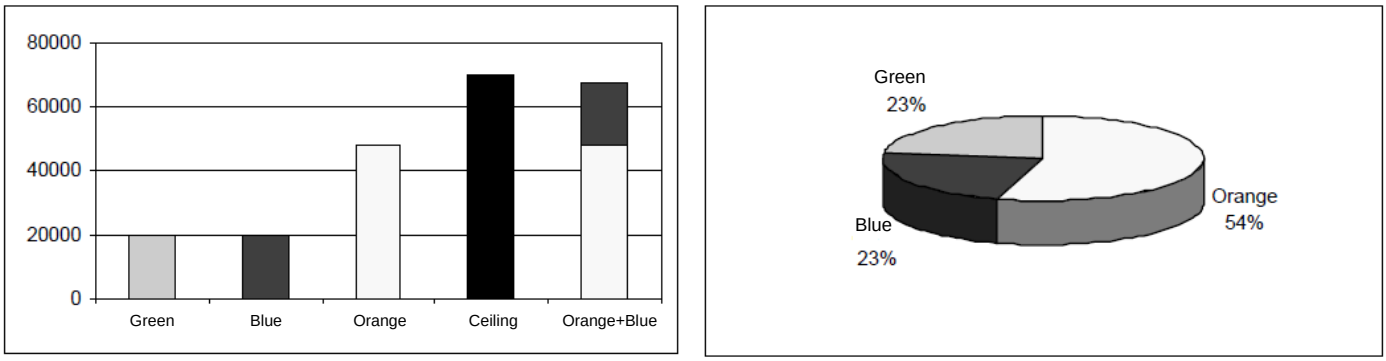
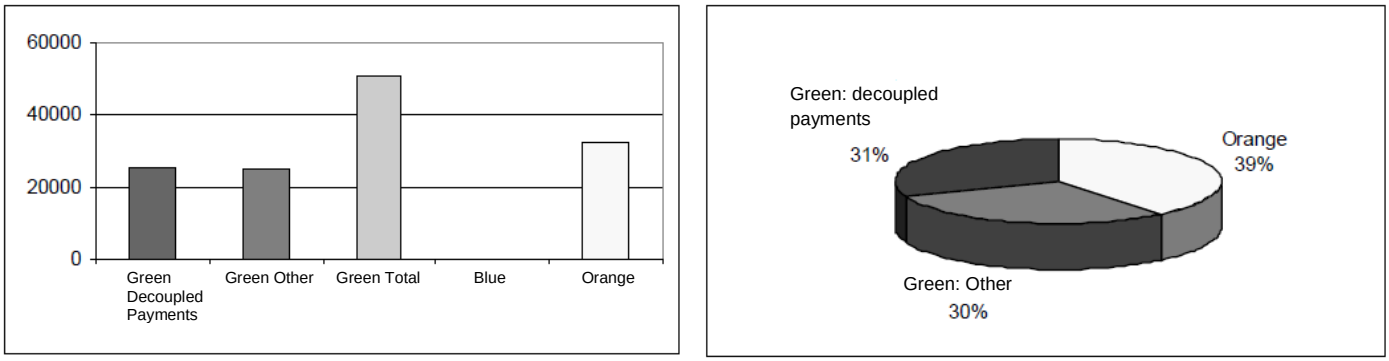
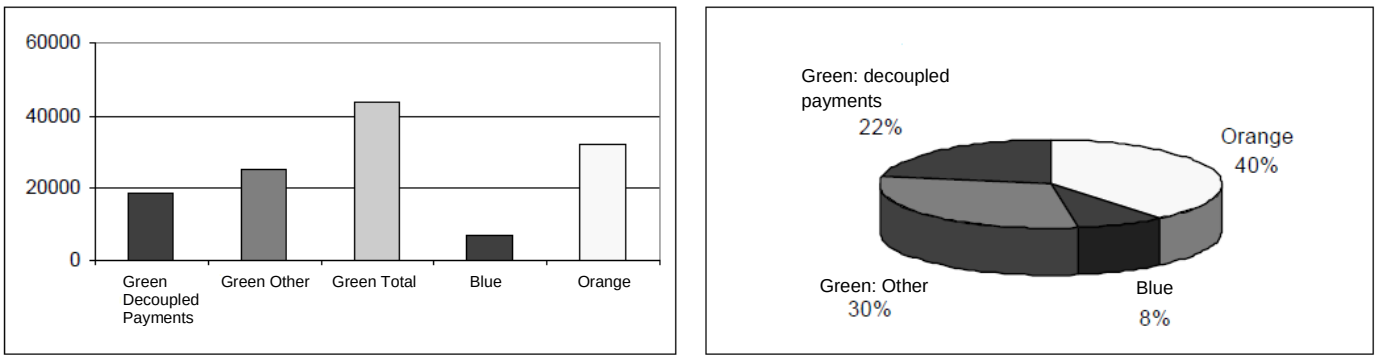


Figure 1: Domestic support in the European Union by box

Panel a: declaration 1999/2000 (million euros)



Panel b: 2003 reform under the hypothesis of a total decoupling (million euros)



Panel c: 2003 reform under the hypothesis of a partial decoupling (million euros)