The July Framework
Failing the Development Agenda

a publication of
the Institute for Agriculture and Trade Policy (IATP)
trade information project
July 2005

Contents:

Abstract

The analysis focuses on annex a of the august 1, 2004 “decision of the General Council of the World Trade Organization” (WTO), better known as the July Framework. Annex A deals with the negotiations to renew the WTO Agreement on Agriculture. The analysis compares the proposals made in Annex A against the objectives for agriculture set out by governments at the fourth WTO ministerial conference held in Doha, Qatar in 2001.

This paper concludes the proposals in the annex will neither promote “a fair and market oriented world trade system” nor help to solve the most important needs of developing countries related to international agricultural trade. Both of these were objectives set out in the Doha mandate.

There are two main conclusions about the Framework. First, on its own terms, it proposes little that will constrain either U.S. or EU spending on agriculture. Nor does it seem likely to make much difference to tariff levels, although continuing negotiations may change that. Second, much more seriously, the negotiators’ focus on domestic support, market access and export competition continues to miss the real distortions in global agricultural trade—especially export dumping.

The analysis concludes with proposals for how better to promote a fair and market oriented world trade system. The three core measures required are: a ban on export subsidies, a ban on the export of products priced below cost of production prices, and measures to counteract the effects of oligopoly controlled markets. It is time to stop shuffling subsidies and forms of market support into

various boxes and to start negotiating rules that put trade distortions—but above all development—first.

Introduction

As governments work through another round of trade negotiations at the World Trade Organization (WTO), agriculture is yet again at the top of the agenda. Of course, agriculture is not just important to trade officials.

It is a vital economic sector for virtually all WTO members, and for many, especially the poorest developing countries, a vital source of employment and export income. The Uruguay Round Agreement on Agriculture (AoA) has failed to meet developing countries' needs and expectations. To date, the WTO's agricultural agenda has concentrated on maximizing market access and increasing the volume of commodity flows. The approach has done little to change the balance of trade between rich and poor countries, and little to address urgent development needs. Large volumes of commodities, sold at less than cost of production prices, continue to flood world markets, hurting both domestic agriculture and the export interests of developing countries.

The Institute for Agriculture and Trade Policy (IATP), which has tracked this problem for over a decade, shows that in the years 1997-2003, U.S. dumping of the five principal agricultural exports averaged 48 percent for cotton, 27 percent for wheat, 19 percent for maize, 19 percent for rice and 12 percent for soybeans.

The failure of the AoA to meet developing countries' needs and expectations left a number of them reluctant to satisfy developed countries' trade ambitions in other areas, such as services. Hoping to overcome developing country reluctance to engage in new negotiations, most developed countries pushed for a comprehensive new round of trade negotiations at the fourth WTO ministerial conference, held in Doha in November 2001. The promise to poor countries was that development issues would be a central priority for the new negotiations. Developing countries agreed and the Doha Agenda was born.

Yet the deadlines set in Doha to measure progress towards a new series of trade agreements— and towards addressing some real problems from the Uruguay Round agreements for developing countries—all passed without action. The fifth WTO ministerial conference, held in Cancún, Mexico, in September 2003, should have been a check-in at the mid-way point in negotiations. Instead it collapsed in failure with nothing agreed.

It took another year—until the early hours of August 1, 2004—for the WTO General Council to manage a breakthrough. WTO members decided on a "Framework for Establishing Modalities in Agriculture" (henceforth "the Framework") as part of a wider package of agreements on the various elements of the Doha Work Programme.

With Framework, WTO members had temporarily breached the negotiating impasse on the Doha Agenda.

The July Framework: Focusing on three pillars

The framework reflects the structure of the existing AoA: domestic support, market access and export competition. These areas are commonly known as the AoA's three pillars.

The Framework defines and to some extent limits the negotiations by adding detail to the few paragraphs on agriculture that were agreed as part of the Doha Agenda. The following analysis reviews the Framework proposals in each of the three pillars.

First pillar: Domestic support

IATP sees the attempt to divide public support to agriculture into amber, blue and green boxes as misguided and unhelpful. The largest single trade distortion in agriculture is unmanaged production sold at less than cost of production prices, year after year, propped up by poorly managed income support payments and without reference to cheap and necessary tools to manage the difference between production potential and production output. This gap is routinely managed in most industrial sectors by the firms involved, but is less easy to manage in agriculture because millions of farmers in every country of the world are involved. Because we depend on food for our survival, there is a strong public interest in maintaining a greater output potential than we actually put to use, to have a safety net in case of crisis.

Current WTO rules discourage such a prudent approach, penalizing production-limiting efforts and public storage programs and favouring income support payments that distort trade without contributing to a solution for unmanaged and dumped production. The Framework proposal will expand this problem.

The Doha mandate calls for "substantial reductions" in trade-distorting domestic support, cutting levels of support allowed in the Amber Box, reducing the *de minimis*, and imposing a spending limit on the Blue Box. The Green Box is left more or less untouched, and despite a number of developing countries' wish for restrictions on the current Green Box, not much is expected in this area from this round. (See Appendix 1 for a description of these terms.)

Agriculture negotiations chairman Tim Groser's June 27 summary says some 82 percent of existing Amber Box support is spent by the E.C. (US$59.8 billion among the member states), U.S. (US$19.1 billion) and Japan (US$35.9 billion.) If WTO members want to see significant reductions in global levels of Amber Box support, obviously the focus has to be on these three countries. The high relative levels of support among a few other developed countries, such as Switzerland and Norway, are simply not that relevant in world trade terms.

Unfortunately, perhaps the most significant proposal in the Framework for new disciplines in the area of domestic support is to actually expand the criteria for programs that can be included in the Blue Box, which has weaker disciplines than the Amber Box. In the current AoA, only programs that limit production are eligible for Blue Box exemption. Specifically to accommodate changes to U.S. domestic support programs, the Framework now proposes to include "payments that do not require production" as well (paragraph 13). These would include price-related measures: specifically the counter-cyclical payments introduced by the U.S. in its 2002 farm legislation, which authorize payments to certain commodity producers when world prices drop below a predetermined threshold.

The Framework also includes a proposed cap on Blue Box spending that would limit eligibility to the equivalent of 5 percent of the total value of agricultural production. In the case of the U.S., this represents approximately U.S.$10 billion and for the EU, some €12 billion (US$15.5 billion). Analysis of the programs and spending involved make it clear that the 5 percent cap will not constrain current spending.

In fact, if governments decide to pass the expanded definition of the Blue Box into law, it would relieve the U.S. of a real and present pressure to reform its countercyclical payments, which are too large to fit in the Amber Box, where they properly belong.

The Framework calls for a 20 percent cut to the aggregate spending on three categories of domestic support: programs in the Amber Box, programs included in the *de minimis* threshold and Blue Box programs (under a newly expanded definition of the Blue Box.) The Framework proposes that those Members with the highest levels of domestic support should make the largest cuts to their spending. Governments are now negotiating exactly how to bring this about. A second measure proposes to reduce the threshold of the *de minimis* exemption without specifying to what extent (paragraph 11 of the Framework). There is still no agreed formula for the reduction of Amber Box spending.

No new measures have been agreed on for the Green Box. There is a call to review and clarify criteria for inclusion in this category to ensure it only includes payments with no, or at most minimal, trade distorting effects on production. But it does not seem likely that the concerns about the trade-distorting effects of decoupled income support, raised by many members and reinforced by studies put out by the Organization for Economic Cooperation and Development (OECD) and others, will be addressed.

Few changes for the U.S. and the EU subsidy system The majority of spending on domestic support in both the U.S. and the EU is counted in the aggregate measure of support (AMS).

Spending on each program is bound at a maximum ceiling (different for each WTO member). The Framework proposes that further reductions be made from the existing AMS bound level, which acts as a ceiling for spending on most kinds of domestic support programs.

When the AoA was first negotiated over 10 years ago, a number of WTO members found ways to inflate their AMS level well above their actual spending levels to retain the flexibility to increase domestic support payments in case that became necessary. The U.S. and EU were careful to do this.

The reduction methodology proposed by the Framework gives the U.S. and the EU a large degree of freedom to redefine and reorganize their domestic support programs, thus enabling

De minimis offers additional spaces for "painless cuts"

De minimis, with its 5 percent value of agricultural production threshold, establishes a large margin between actual spending levels and those allowed by the threshold. If the threshold is not lowered, the existing margin will allow the U.S. to fulfill 40 percent of its reduction commitments, and the EU 57 percent, without the need to reform their support programs. This margin will be even larger if product-specific payments are counted additionally to the non-product specific ones—as the U.S. has suggested.

them to preserve the current high levels of trade distorting support payments. In most cases, it is not actual spending that will be reduced so much as the ceilings on potential spending. The chart shows how by using the limits agreed in the AoA as the starting point, rather than actual spending, the flexibility for continuing high levels of domestic support in the U.S. and EU will persist.

If the Framework proposals pass into law, the new AoA would allow domestic support to reach levels similar to or even higher than the levels permitted at present. Using the data of the most recent notifications to the WTO it is possible to estimate approximate future levels of domestic support. The estimates show U.S. levels of domestic support would be allowed to reach a ceiling of US$31.3 billion as compared with actual expenditures of $21.6 billion in the marketing year 2001 and the EU levels the ceiling of €81.4 billion, compared with €66.6 billion during the marketing year 2000-01.

Revolution in the Blue Box

The Framework contains a revolutionary redefinition of the Blue Box. Pushed by the U.S., the proposed redefinition would expand the Blue Box to include programs that are not concerned with limiting production.

As U.S. Trade Representative (USTR) Robert Zoellick said at the time the Framework was agreed, this redrawn Blue Box would allow the U.S. to include its countercyclical payments. It is estimated that the maximum amount of countercyclical payments under the current farm bill would be around U.S. $7 billion a year, which would be well within the newly introduced 5 percent cap related to the value of agricultural production for the Blue Box.

The European Union currently spends some €22.2 billion in Blue Box payments. Recent reforms to the Common Agricultural Policy (CAP) are reducing this sum; the new domestic support programs meet the criteria for inclusion in the Green Box. For example, production-limiting payments have been replaced with payments for maintenance of rural infrastructure, reducing intensive production, and implementing food safety programs.

The decision of WTO members to leave Green Box payments unlimited, together with the large-scale shift in program spending under the new CAP rules, means the European Commission is unlikely to face spending constraints on its domestic support to agriculture under the proposed new AoA. Even if the CAP reform is not fully implemented on time (by 2008), the EU's Blue Box spending would only total an estimated €12.6 billion, and so would not seriously be challenged by the 5 percent cap proposed in the Framework.

The provisions of the Framework Agreement will lead to no substantial reductions on the agricultural programs of the U.S. and EU The finding by the U.S. Trade Representative at the time, Robert Zoellick, that "the 20 percent reduction [in overall domestic support] will not weaken [U.S.] ability to support our farmers" can be confirmed at this stage of negotiations.

Second pillar: Export competition

The AoA requires export subsidy programs to be cut. The agreement focuses on export subsidies, but also mentions other forms of export support including publicly financed state trading enterprises (STEs), food aid and export credits.

The provisions of the AoA did not prohibit the use of export subsidies altogether. As long as members made the required cuts, other countries could not challenge the continued use of export subsidies for agriculture (which are prohibited for other goods under the provisions of the Agreement on Subsidies and Countervailing Measures). This protection, spelled out in the due restraint clause, also known as the peace clause, expired in December 2003. The EU in particular relies heavily on export subsidies and is now under pressure to reach a new agreement on this issue, since, with the expiry of the peace clause, export subsidies are now more vulnerable to challenge through the WTO dispute system. In April 2005, a WTO dispute panel issued an appellate ruling supporting Brazil's challenge of the EU's use of export subsidies in its sugar program.

Elimination of all export subsidies

The Doha Declaration mandates a "reduction of, with view of phasing out, all forms of export subsidies" by "a credible end date." Paragraph 17 of the Framework employs the same wording and adds more detail on how to proceed. Apart from the more evident export subsidies, export measures with an "equivalent effect" are to be eliminated at the same time. Such measures include certain kinds of food aid and export credits—which are predominantly used by the U.S.

The EU has the most difficult task in agreeing to the full and final elimination of export subsidies. The CAP's reliance on export subsidies has created large constituencies within the EU that are deeply resistant to reform.

The EU has also insisted that the negotiations take on other forms of export support more seriously than in the past. In the Framework, the EU secured a commitment that concessions on export subsidies would be met with similar concessions from others, particularly from the U.S. on export credits and food aid, and from Canada and Australia on single desk exporters. A single desk exporter means that producers are obliged to pool production of a given commodity and the pool monopolizes export sales.

EU insistence on parallel elimination of other programs that support exports at public expense raises complicated methodological problems.

The language in the Framework suggests there is some common denominator that makes it possible to compare EU export subsidies with the subsidy component of export credits mostly used by the U.S.; the subsidies associated with exporting state trading enterprises; and

> **Ruling of the cotton panel on export credits**
>
> Article 10.2 of the AoA calls for disciplines on the use of noncommercial export credit, but that they should be negotiated outside the WTO. The U.S. has successfully delayed any agreement in other forums on export credit use. In the recent dispute brought by Brazil against U.S. domestic and export support for cotton, the U.S. argued its export credit programs do not subsidize exports. When the U.S. lost the case, it appealed. Then USTR Robert Zoellick argued, "some aspects of the panel report belong in negotiation and not in litigation." With the appellate body confirming the original finding of the panel—that U.S.export credits worth US$1.63 billion were subsidizing exports of cotton—it remains to be seen whether other members will follow the idea of further negotiation, or use the successful litigation to uphold stronger rules.

the subsidy component in food aid practices. In practice, this is very difficult—perhaps impossible—to calculate.

For export credits the Framework proposes to restrict repayment periods to a maximum of 180 days. The U.S. sees this as a major concession and thereby considers the distorting effect of export credits to have been dealt with. But the issue may persist, as a recent WTO ruling on the U.S. cotton program suggested that other components of the export credit system could also be viewed as subsidizing exports. The U.S. Trade Representative has proposed changes to the export credit program to the U.S. Congress, with the intent of coming into compliance with the WTO ruling.

State trading and food aid still to be negotiated

The Framework includes state trading enterprises (STEs) in a negotiating structure that is focused on eliminating all forms of export support. The focus is on public monopoly power, rather than monopoly power more generally. Although STEs do not conform to free market principles, they have often delivered an outcome superior to that offered by the private oligopolies that otherwise tend to prevail in global commodity markets. A banning of STEs may therefore not eliminate market distortions but actually strengthen existing oligopolies, thereby increasing market distortions. For now, no WTO member has made proposals to consider the problem of private companies, several of which dwarf any STE in their scale of operations.

It is not clear what progress can be made on food aid. In 2003, as chair of the agricultural negotiations, then-Ambassador Stuart Harbinson proposed quite strong language to discipline food aid. The U.S., however, did not accept the language. The United Nations Food Aid Convention (FAC), if reformed to include both donor and recipient countries and strengthened with an expanded mandate, offers a possible venue to review food aid. The WTO could then follow the FAC's lead and ensure its rules support the regime FAC adopts. However, governments for now have chosen to leave FAC on hold and to make decisions at the WTO first.

Meanwhile, the proposals on food aid in the July Framework would scarcely affect current practice. If food aid displaces commercial sales but strengthens food security, it is not hard to argue for an exception to the trade rules. While many U.S. food aid practices are bad for development, the WTO is not equipped to make judgements in this area. The majority of food aid should be evolving into responding to emergencies, and arrangements are needed to ensure food aid is purchased locally in the recipient country, or as near to the final end users as possible. In most cases, cash is more effective than food in meeting development objectives. These reforms, however, should be supported by the WTO rather than led by rule-making that is above all about trade.

Third pillar: Market access

The Doha Declaration mandates "substantial improvements in market access" with some special and differential treatment (SDT) provisions for developing countries.

The Framework proposes to cut agricultural tariffs by a tiered formula that takes into account the different tariff structures of developed and developing countries (see paragraph 28 of the Framework). The actual coefficients for the tiered formula are now under heavy negotiation. The Framework proposes that reductions be applied to bound tariff rates (not the generally lower applied rate), that tariff cuts be larger for higher tariffs, and only least developed countries (LDCs) be exempt from cuts altogether.

The option to avoid excessive market opening for sectors of particular national importance was also introduced with the concept of sensitive products, which any country could use. The number of eligible products and the criteria for their designation is still to be negotiated.

The Framework proposes that developing countries get longer implementation periods and lower tariff cuts as a form of SDT. Two other new ideas for SDT have also been included under the market access pillar: Special products and a special safeguard mechanism, both described below.

Special products are commodities that developing countries would designate, subject to an agreed list of criteria, as vital to their food security and the livelihoods of their most rural poor. The proposal is that such products would be exempt from tariff reductions. The idea is included in the Framework, but all the detail of how many products may be designated and on the basis of what criteria has yet to be agreed. For now, the Framework simply says, “an appropriate number of products” of concern to food

security, livelihood security and rural development will be granted “more flexible treatment” (paragraph 41). Clearly the nature and scope of this category will depend in part on the final terms decided for the more general category of sensitive products.

The second new SDT proposal is to create a special safeguard mechanism (SSM) for use by developing countries only (paragraph 42). This measure would provide immediate but temporary protection against sudden import surges, usually the result of a fall in world prices. The idea is similar to the existing special safeguard (SSG) included in the AoA, which is only available to some WTO members, few of them developing countries. The effectiveness of an SSM will widely depend on how large a safeguard can be used, what the trigger mechanism is, and how quickly it can be put in place.

Limiting market access

Market access is of course governed by more than just tariffs: tariff rate quotas, special safeguards, sanitary and phytosanitary standards, rules of origin, preferential agreements, and even voluntary standards within industry all complicate would-be exporters’ lives. Many world markets for agricultural commodities are dominated by a small number of firms, making barriers to entry even higher. The experience of the last ten years has shown developing countries and their exporting firms that market access is about a lot more than tariff reductions.

Preferential market access eroded

Preferential market access is not directly addressed in the Framework, but is one of the underlying contentious issues on the table. While the record of preferential treatment is at best mixed, for some countries the rules are a vital part of their export capacity. The value of preferential access has been steadily undermined by the proliferation of bilateral and sub-regional market access agreements. Further across the board tariff cuts, as proposed by the July Framework, will continue this erosion of such benefits as preferential access. Highly competitive agricultural producers such as Brazil and Argentina will benefit from this change, while the least developed countries would lose out. The countries affected, particularly members of the European Union's Africa, Caribbean and Pacific Group, have therefore actively sought to protect their rights through the negotiations. It is still unclear what they can protect in this round.

The prognosis

It is difficult to predict the exact impact the framework will ultimately have on trade in agriculture. There are too many details left out and too many things still to be negotiated. The heated debates and very slow progress on agriculture since the Framework was agreed reflect just how much work WTO members still have to do. Some general tendencies are nonetheless clear. The level of domestic support in the U.S. and the EU are not likely to decrease in real terms. The proposed reforms would not limit the trade-distorting impact of domestic support measures significantly. If the Blue Box is expanded as the U.S. wants, then allowed trade-distorting support could even increase. At the same time, an opportunity to introduce new tools to limit production will have been missed at a time when many experts, especially in the commodity arena, are looking again at ways to better control market volatility, overproduction and all the misery that entails, especially for small-scale farmers.

Export subsidies will be eliminated, but more likely in 10 to 12 years, than the three to five years now suggested by some WTO members. The difficulty of devising appropriate limits on the other forms of export support, such as export credits, STEs and food aid will slow this reform down.

The increase in market access, resulting from the tariff reduction formula still to be agreed upon, is the hardest to gauge. So much depends on the choice of formula. Between special products and sensitive products, market access provisions will at best be piecemeal. Developed countries tend to focus their support on a few products (and make their support extreme in those cases) and so may be better served by an approach that cuts most tariffs a lot but allows some products virtual exclusion. Developing countries, whose tariff structure tends to show far fewer extremes, and whose support is not so clearly targeted to favour one or two sectors within agriculture may benefit less from this piecemeal approach. In any case, as members of the African Union and others are saying, it is not more market access that is needed, so much as actual channels to sell exports in developed country markets. It will take a lot more than tariff reductions, especially on the scale likely at the WTO, to really change existing trade patterns.

Overall, the Framework fails to address the development issues that were given as the rationale for the Doha round of negotiations.

10 ways to fix agricultural trade

Agricultural production is too important to be left to commercial export sectors to decide. Agriculture is vulnerable to unpredictable natural and climatic conditions, making year-to-year output very variable. Agriculture is vital for development, rural livelihoods and food security. Trade rules have to leave governments sufficient flexibility to meet these priorities adequately.

If WTO members are interested in real agricultural trade reform that puts the well-being of farmers at the center, then they should consider the following ten steps:

1. Dumping of agricultural overproduction must be forbidden and an effective monitoring system be created inside the WTO.

2. Introduce periodical and timely notifications of complete cost of production numbers for all exported crops in order to enable the functioning of such a monitoring system.

3. Target real trade distortions. Instead of judging national programs by how much they cost, trade negotiators should discipline the trade-distorting impact of those programs.

4. Establish new criteria for subsidies. Many agricultural subsidies are problematic, but
not all result in unfairly traded exports. Subsidies should be evaluated against the costs and benefits they confer.

5. Allow state trading enterprises. Export state-trading enterprises offer a competitive counterweight to concentrated export markets.

6. Increase transparency in commodity markets. Governments need to improve dramatically the transparency in international commodity markets.

7. Regulate market concentration. Vertical and horizontal concentration in global commodity markets is a primary cause of market distortion.

8. Safeguard food security. Special products (crops related to food security) and the creation of a special safeguard mechanism to protect against import surges should be adopted.

9. Reform food aid. The WTO should instruct members to follow food aid norms of a revamped Food Aid Convention.

10. Democratize the process. Good agreements from bad process are nearly impossible. The WTO needs clear rules for official negotiations that guarantee effective participation of all 147 members.

Appendix: The four categories of domestic support in the AoA

The AoA determined that all public support to agriculture should be cut with four exceptions. Those exceptions are:

1. The Green Box

Programs judged to be “at most minimally trade-distorting” are given an exemption from spending cuts in the Green Box. Green Box programs include support to environmental programs, research and development funding, publicly funded insurance programs and income support payments to farmers that are not linked to production (that do not depend on how much of a given commodity the farmer produces).

2. Article 6.2 allows developing countries to be exempt from reductions in domestic support programs that meet development needs, particularly for low-income farmers.

3. The Blue Box

The Blue Box exempts from cuts any program that is tied to a fixed level of production (per acre or per head of livestock). These payments accounted for signifi cant levels of both EU and U.S. spending at the time the AoA was signed. In 1996, the U.S. more or less stopped payments to farmers that were linked to production-limiting criteria and for most of the time that the AoA has been in force, the U.S. has not made use of the Blue Box exemption.

4. De minimis

The *de minimis* rule says that if total support to a specifi c product is less than 5 percent of the total value of that product, then that spending does not have to be included in the total to be reduced under the provisions of the AoA. Similarly, if programs for agriculture in general amount to less than 5 percent of the total value of agriculture to the economy, then that support is also not counted.

The threshold was set at 10 percent for developing countries, and only a handful come anywhere close to that level of support, effectively giving most (not all) developing countries the right to continue existing spending levels without constraint. The threshold is more generous than it might seem to developed countries as well. The U.S. and EU do not support all their agricultural sectors so the spending allowances can be focused on those sectors that do get support. For example, U.S. government support is concentrated on commodities that comprise only about a quarter of the total value of U.S. agricultural production.

Anything that does not fit within one of the exemptions listed above is classified in the Amber Box.

These programs are scheduled for reduction under the AoA. Such programs are assigned a monetary value by an indicator called the aggregate measure of support (AMS). There is a great deal of literature available that documents how and why the disciplines made law under the AoA achieved little material difference to spending on domestic support for agriculture. It is worth noting, though, that the AoA did shape the very major reforms of agriculture that both the U.S. and the EU have undertaken since the AoA came into effect.