2002 FARM BILL PANEL: MEETING THE UNITED STATES WTO COMMITMENTS

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Abstract

The United States, along with other member countries of the World Trade Organization (WTO), has agreed to certain limits of on agricultural support and trade assistance as part of the Uruguay Round Agreement on Agriculture. This paper includes a discussion of the spending limits by category and their role in the adoption of new farm legislation.

Introduction

The United States, along with other member nations of the WTO, made commitments in 1994 under the Uruguay Round Agreement on Agriculture (URAA) that place certain constraints on domestic farm income support and trade programs. In general the nations agreed to reduce the amount of trade distorting domestic subsidies, reduce export subsidies and increase access to domestic markets. These commitments began in 1995 and were phased in through 2000, with existing commitments continuing in effect until the outcome of the new round of negotiations that were kicked off in Doha, Qatar in November 2001.

As Congress considers new farm legislation there is universal support among agricultural leaders to insure that new programs and policies conform to these existing international trade rules. This support covers the whole range of program commitments, but of most interest in the current debate is the level of farm income support. While the U.S. has so far met its commitments under the URAA, the large levels of emergency payments since 1997 have reversed the trend in declining program payments and increased concerns about our ability to continue to comply. In light of the prolonged downturn in agricultural prices and expectations for a slow recovery, there is concern that new programs may result in farm income support to producers that exceed current WTO spending limits.

The purpose of this presentation is to outline the issues related to the U.S. ability to comply with URAA domestic support commitments and provide some quantitative examples of where we are and why existing commitments may result in binding constraints on government program expenditures. First a detail breakdown of domestic support measures is presented. Next a brief overview of where the U.S. stands relative to other countries in regard to our expenditures on farm income support is provided. Unofficial estimates of future expenditures are then discussed in regard to existing WTO commitment levels. The presentation concludes with a discussion of why their might be a problem and what policy options may be available to address those problems.

Limits on Agricultural Support under the WTO Rules

Domestic support to agricultural producers under the provisions of the URAA is judged with respect to a detailed formula that leads to the calculation of a countries "Aggregate Measure of Support" (AMS). In the URAA, 28 countries agreed to bind their AMS and reduce it by 20 percent by 2000. Domestic support, for AMS purposes, were categorized into three basic classifications: Green box support, Blue box support, and Amber box support. The payments to producers resulting from programs that were classified as green box were exempt from AMS limitations because they were judged to be minimally production and trade distorting. Example of green box payments include certain environmental programs, programs that are of general benefit to the agricultural sector like research and extension and, importantly, direct payments to producers that are not tied to current production or market prices. Blue box support programs included those associated with some measure of supply control and were also exempt from AMS limitations. Blue box programs were discontinued in the U.S. by the 1996 Farm Bill, as deficiency payments linked to acreage set asides were abandoned in favor of production flexibility contract payments. Blue box program payments remain an important component of the EU agricultural support system. All support to agriculture that does not classify as green or blue box is included in the amber box and those payments are figured into the AMS calculation and subject to existing limitations.

Given that AMS limitations only apply to expenditures on amber box programs it is important to understand the associated accounting procedure for calculating a country's AMS and what is included in this category. The accounting detail of most importance is the *de minimis* exemption. This rule permits product specific support to be excluded from the AMS calculation if the total outlay is less than 5 percent of the value of that product's production. Developing countries are allowed the same exemption at the 10 percent value of production level. In addition, non-product specific support outlays may be exempted from the AMS calculation if they fail to exceed 5 percent of the total value of a country's agricultural production. This non-product specific exemption turns out to be the most important accounting rule, as it permits U.S. outlays to remain under existing commitment levels. In the most recent U.S. AMS calculations the major contributors were the peanut, dairy and sugar programs and loan deficiency payments for certain commodities.

Status of Payments in the U.S., the EU, and Japan

The vast majority of domestic support to agricultural producers occurs in three countries: the U.S., the European Union and Japan. In 1998 these three countries accounted for over 87 percent of the total domestic support for agricultural producer's world wide (Figure 1). Expenditures in the EU were measured at $98.1 billion (44%), the U.S. at $64.8 billion (29%) and Japan at $29.8 billion (13%). The categories accounting for domestic support varied among countries (Figure 2-4). In the EU exempt categories accounted for 46% of total support, in Japan exempt categories made up 80% of their support and in the U.S. exempt categories amounted to 77% of domestic support. In the U.S the de minimis exemptions accounting for another 7 percent of support while in the EU and Japan the de minimis exemption exclude less than one percent of total expenditures. Accordingly, amber box expenditures in 1998 represented 54, 20 and 16 percent of total domestic support in the EU, Japan and the U.S. respectively.

For purposes of meeting URAA commitments the interest of U.S. policy makers is focused on the level and composition of domestic support by category. In 1998 U.S. green box support payments totaled $49.824 billion and represent the bulk of domestic support as described above (Figure 5). Domestic food aid expenditures were the largest green box expenditure category at $33.487 billion primarily food stamps and child nutrition programs. General service payments were the next largest green box expenditure at $7.146 billion including such programs as the Agricultural Research Service, Cooperative State Research, Education and Extension Service and the Animal Plant Health Inspection Service. About $2 billion in green box payments go for conservation reserve program payments and other environmental programs. Natural disaster relief payments vary by year, but in 1998 totaled $1.4 billion. The direct support to producers in the form of Production Flexibility Contract payments amounted to $5.659 billion in 1998. A great deal of the discussion regarding new legislation focuses on programs that qualify for green box categorization, specifically environmental payments and direct income support decoupled from current production and prices in the form of continued PFC payments or some other mechanism.

The payments that fall into the category of amber box non-product specific play an important role in support of U.S. agricultural production. Because of the recent increase in this category of spending it also causes the most concern over the U.S. ability to continue to comply with URAA commitments. In 1995-1997 amber box, non-product specific payments to producers amounted to no more than $1.4 billion in any one year, with the de minimis exemption level of 5 percent amounting to around $10 billion (Figure 6). As a result non-product specific payments were well below the level where they might be counted against the U.S. overall AMS commitment. Beginning in 1998 that picture changed somewhat. With the USDA decision to include emergency loss assistance payments in the non-product specific category, the overall payment level increased to $4.6 billion in 1998 and is expected to be reported at $7.4 billion for 2000. With the overall value of U.S. agricultural production still around $200 billion, total non-product specific category expenditures remain below the de minimis trigger, but are clearly much closer than in the earlier years of the URAA. With a continued depression in agricultural prices the future level of expenditures in this category is of crucial importance in adhering to existing AMS spending limits.

The other program spending that creates concern with regard to U.S. commitments is commodity price support and transfers directly related to commodity production, such as marketing loan payments. These program payments have made up the AMS subject to URAA commitments since the agreement has been in place. Prior to the downturn in agricultural crop prices in late 1997 the U.S. reported an AMS that consisted entirely of support related to the dairy, peanut and sugar programs (Figure 7). Beginning in 1997 a small increase in the reported AMS was associated with payments to cotton, as other commodity specific payments were exempt under the de minimis rule. In 1998 non-exempt commodity specific payments increased the U.S. AMS by $3.8 billion. Additional direct assistance also contributed around $790 million to the 1998 reported total of $10.391 billion. At this time it is expected that the notification for 1999, 2000 and 2001 will also include substantial amounts attributable to non-exempt commodity specific payments resulting in overall AMS levels in the range of $15 to $16 billion.

If current estimates of future AMS notifications are correct the U.S. will remain below its current commitment level of $19.103 billion (Figure 8). This is due in large part because of the non-product specific de minimis exemption. If current estimates of those monies attributable to the non-product specific category were included in the AMS calculation the U.S. would be in excess of its current commitment by over $2 billion in 1999 and 2000. Therefore, structuring programs such that future non-product specific support remains below the existing de minimis trigger is critical to the consistency of future U.S. farm policy with WTO obligations.

WTO Spending Limits in the Farm Bill Debate

Estimates of current farm program alternatives suggest that given current rules the U.S. will be able to remain in compliance with its domestic farm program spending obligations under the URAA (Figure 9-10). If these estimates are correct it begs the question of why so much attention has been placed on caution not to design programs that result in budget outlays that exceed U.S. international commitments. The answer to that question is found in the nature of the assumptions that are behind the current estimates of expenditures under farm program alternatives.

Existing estimates of outlays under alternative farm program proposals are conditioned on various baseline price scenarios. A review of alternative price forecast provided by USDA and FAPRI indicate gradual price recovery with trend line growth in program commodity prices through the life of the proposed farm legislation (Figure 11). If these predictions are correct, then there would be no problem for the U.S. to remain in compliance with existing obligations for the level of domestic support and have room to deal with possible reductions that may result from current negotiations. If, on the other hand, current price forecast turn out to be in error, like those that were used to estimate the expense of the 1996 farm bill, the ability to remain in compliance with existing commitments and/or further reductions may become problematic. For example under current counter cyclical income support proposals, if prices were to decline again to the levels experienced for most major program crops in 1999, the de minimis trigger level for non-product specific program outlays would be exceeded resulting in a total AMS in excess of the $19.103 cap (Figure 12). Some analyst have put the probability of exceeding current spending levels under proposed new programs by the House and under consideration in the Senate at about 30 percent.

Policymakers thus find themselves faced with the problem of balancing their desire to have farm legislation that is consistent with existing WTO commitments and new programs that have the potential to result in outlays in excess of current limits. The alternatives available to deal with this problem are limited. Both the House and Senate would establish a “circuit breaker” provision that would allow the Secretary of Agriculture to make adjustments to program payments if failure to do so would result in outlays in excess of WTO limits. While this provides a remedy it places a difficult political burden on the Office of the Secretary. Other alternatives under consideration include restructuring payments into green box categories, or simply allowing for policy makers to reconsider farm legislation in the event the U.S. finds itself in violation of existing or future international agreements in respect to domestic support.

How this issue is resolved during the current farm bill debate will likely influence the methods of providing support to domestic producers, if not the magnitude of such support. In addition the outcome of this debate will be important to U.S. trade negotiators in the current round of multilateral agricultural trade rules. A strong policy to insure U.S. compliance with its existing commitments will enhance the position of negotiators in debates on further reductions in trade distorting programs and policies. Overall policymaker’s struggle to design programs and policies that comply with the provisions of the URAA is another demonstration of the increasing importance placed on global markets for U.S. agricultural products and need to abide by the rules that govern trade in those markets.