Exposure of U.S. Farm Policy to Challenge under WTO Rules: A Powerpoint Summary

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Presentation Outline…

- U.S. Farm Policy Overview
- U.S. Commitments in the WTO
- Are More WTO Challenges Likely?
  - Criteria to Challenge
  - Current WTO Cases
  - How to Respond to a Negative Ruling
- Can Exposure of U.S. Farm Policy to WTO Challenge by Minimized?

U.S. Domestic Farm Support

- History and Evolution of Farm Subsidies
- Federal Cost of Farm Subsidies
- Impact of Farm Subsidies on Farmers, Consumers, & World Trade

History of Farm Support

- **Farm Support Originated in 1930s**
  - **Reduced consumer purchasing power created commodity surpluses**
  - **Intended as temporary programs to remove supplies and reduce production (crop focus since farms were diversified crop/livestock**
- **Permanent Statutes Periodically Modified by Farm Bills**
- **Evolution Toward Payments and No Supply Management**

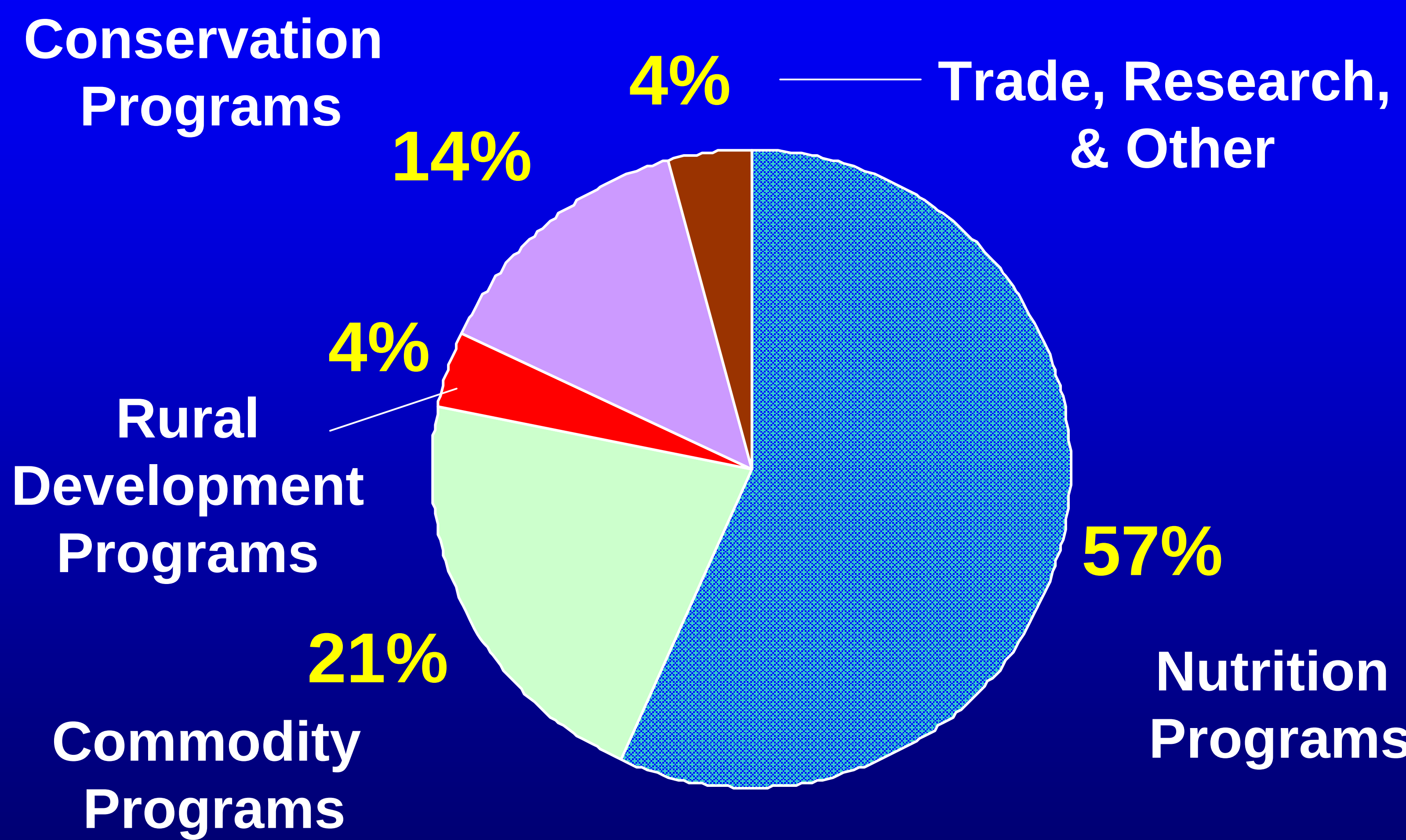
U.S. Farm Policy Evolution

- **Pre-1915: Expansion Era**
  - ➡ **Fed policies designed to facilitate westward expansion**
- **1915 to 1933: Surpluses Begin**
  - ➡ **Agr production outpaces demand, but policies slow to emerge**
- **1933 to 1940: Depression Era Policies**
  - ➡ **Fed gov't begins major agricultural programs**
- **1941 – 47: Wartime Emphasis on Production**
- **1948 – 72: Focus on Acreage Policies**
  - ➡ **Voluntary vs mandatory controls**
- **1972 – 74: Rapid Structural Adjustments**
  - ➡ **Shortages; high prices & inflation; fear of resource depletion**
- **1975 – 85: Strong Government Support**
  - ➡ **High support levels lead to large stocks and high gov't costs**
- **1986 – 96: Budget Driven Program Reductions**
  - ➡ **Gov't payments replace supply management**
- **2002: Expanded Government Support**

Spectrum of Policy Tools

- **Farm Price & Income Support**
  - ➡ Nonrecourse commodity loans (price guarantee)
  - ➡ Counter-cyclical target-price-linked payments
  - ➡ Direct, decoupled payments
  - ➡ Risk mitigation: crop insurance; disaster payments
  - ➡ Agricultural Credit
  - ➡ Agricultural research, extension, and education programs
- **Supply Controls**
  - ➡ Import restrictions—duties, tariff rate quotas (milk products, sugar)
  - ➡ Domestic supply control (sugar)
- **Demand Enhancement**
  - ➡ Domestic food assistance programs
  - ➡ Foreign food aid and export programs
- **Conservation Programs**
  - ➡ Long-term land retirement programs
  - ➡ Working land programs
- **Rural Development Programs**
  - ➡ Infrastructure programs

USDA's Spent $93.5 Billion in 2006*



***$130.3 billion program level. Conservation includes Forestry Outlays.**
Source: USDA, FY2008 Budget Summary.

U.S.D.A. Spending: Mandatory vs. Discretionary

Mandatory Spending (entitlements): ~75%

Commodity price & income support; conservation programs; food stamps & child nutrition

- Outlays governed by eligibility
- Outside of control of direct appropriations
- CCC* acts as USDA's bank
  - ➡ CCC can borrow up to $30 billion
  - ➡ CCC account is replenished by annual appropriations

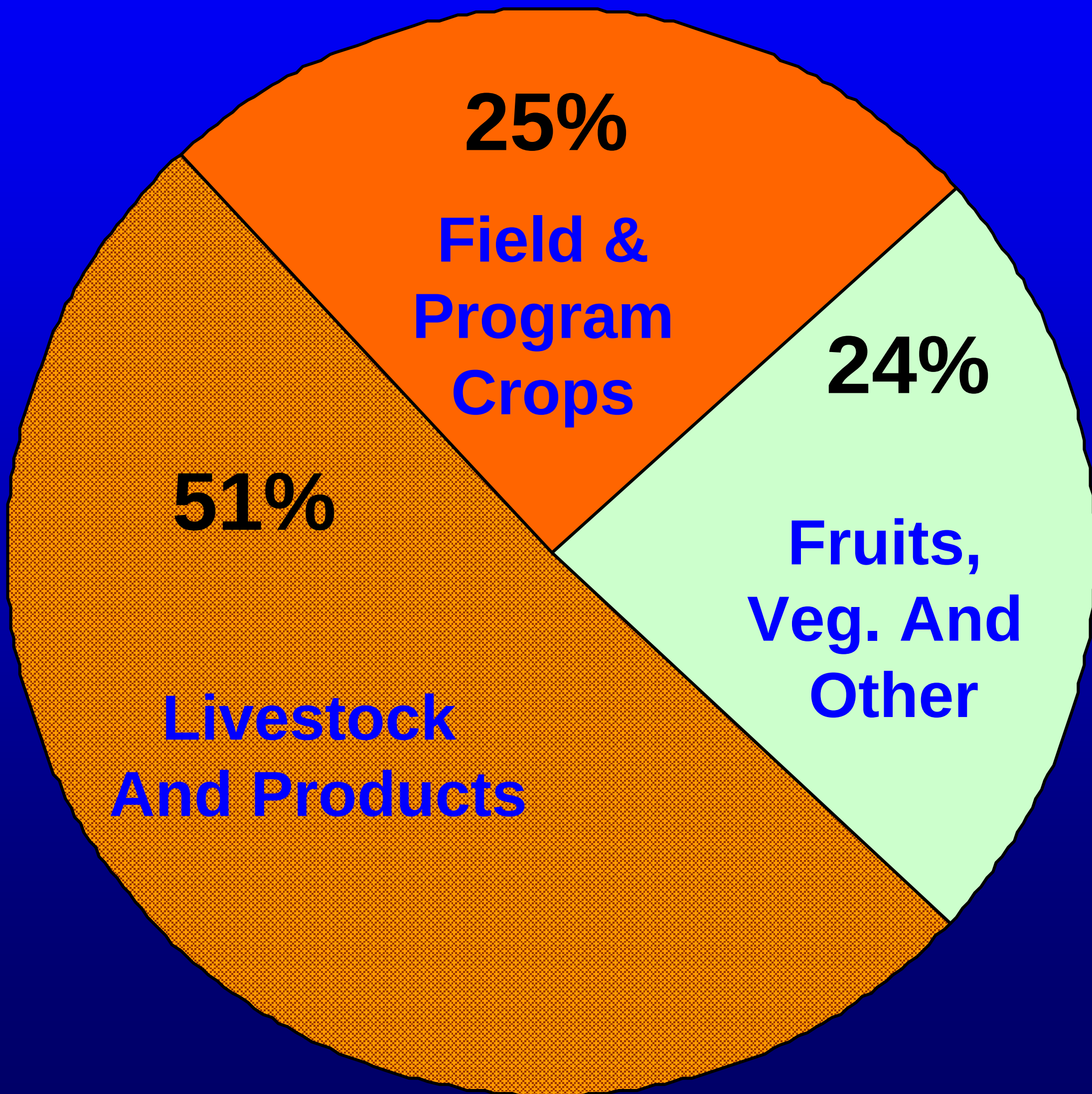
Discretionary Spending: ~25%

Agri credit; rural development funds; food aid; agri research; others

- Determined by funding in annual appropriations

*The Commodity Credit Corporation is a government-owned and operated entity created to stabilize, support, and protect farm income and prices.

U.S. Agricultural Sectors, Based on 2000-2005 Cash Receipts



2002-06 U.S. Commodity Rankings: Value of Cash Receipts* ($ Billions)

Rank	Commodity	Cash Receipts	U.S. Share
1	Cattle & calves	$46.1	20%
2	Dairy products	$23.9	11%
3	Corn	$20.0	9%
4	Broilers	$17.8	8%
5	Vegetables	$17.3	8%
6	Soybeans	$15.9	7%
7	Greenhouse/nursery	$15.9	7%
8	Fruits and nuts	$15.3	7%
9	Hogs	$12.8	6%
10	Wheat	$ 6.8	3%
11	Cotton	$ 5.3	2%
12	Hay	$ 4.4	2%
	U.S.	$225.9	100%

*USDA, ERS, Farm Income Database.

Mandatory Commodity Support

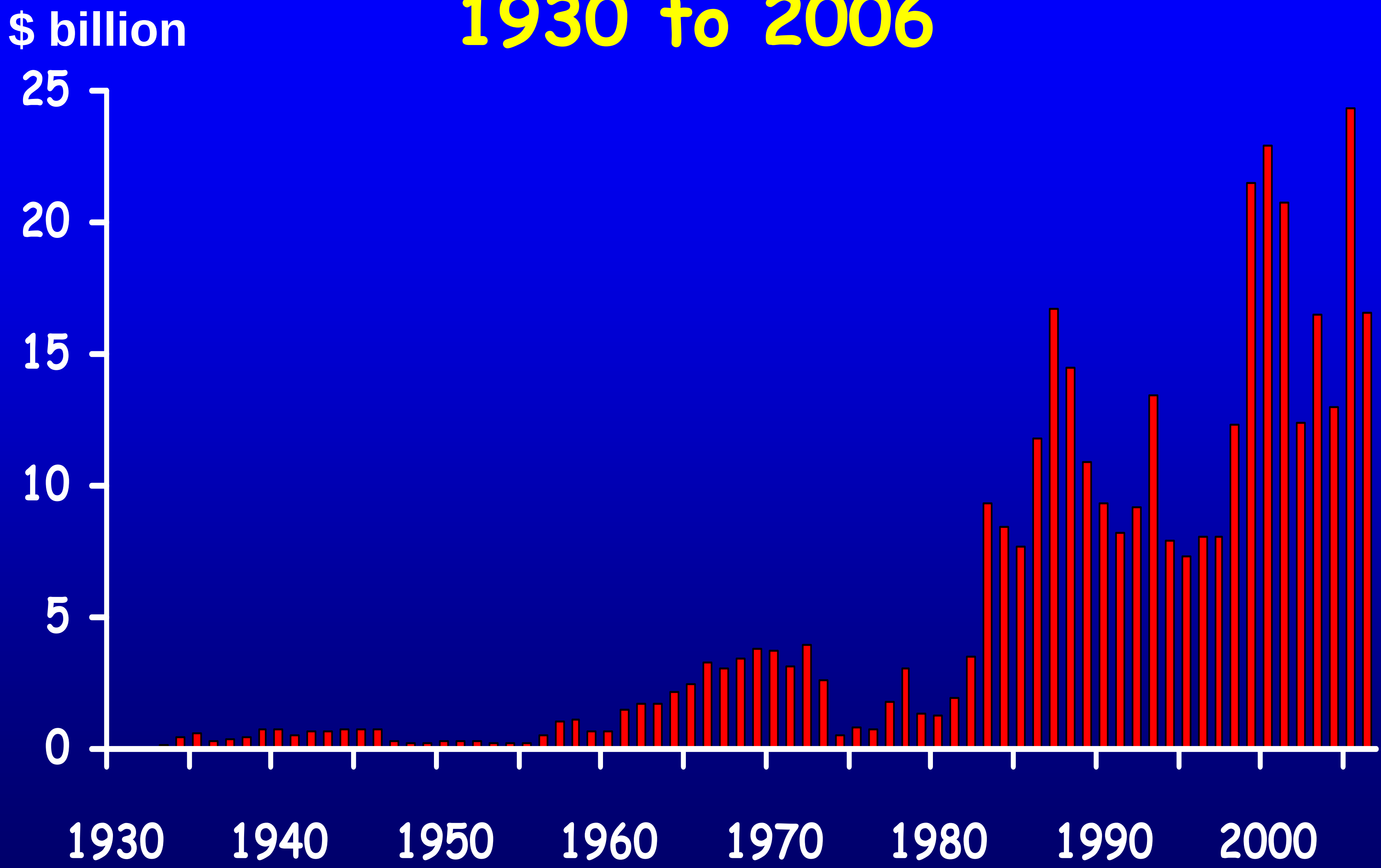
- **Covered Crops: FDP, CCP, ML with MLG/LDP***
  - ➡ Wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, peanuts, other oilseeds (sunflower seed, rapeseed, canola, safflower, flaxseed, mustard seed, crambe, sesame seed)
- **Other Crops: ML with MLG/LDP**
  - ➡ ELS cotton, wool, mohair, honey, dry peas, lentils, and small chickpeas
- **Milk:**
  - ➡ Import restrictions (TRQ) on butter and cheese
  - ➡ Export subsidies on butter and powdered milk
  - ➡ Federal purchases of products to maintain support price ($9.90/cwt)
  - ➡ Special CCP -- "Milk Income Loss Contract" (MILC) Program
- **Sugar:**
  - ➡ Import restrictions; domestic market allotments

*FDP = Fixed Direct Payment; CCP = Counter-Cyclical Payment; ML = Marketing Loan; MLG = Marketing Loan Gain; and LDP = Loan Deficiency Payment.

Major Commodity Programs

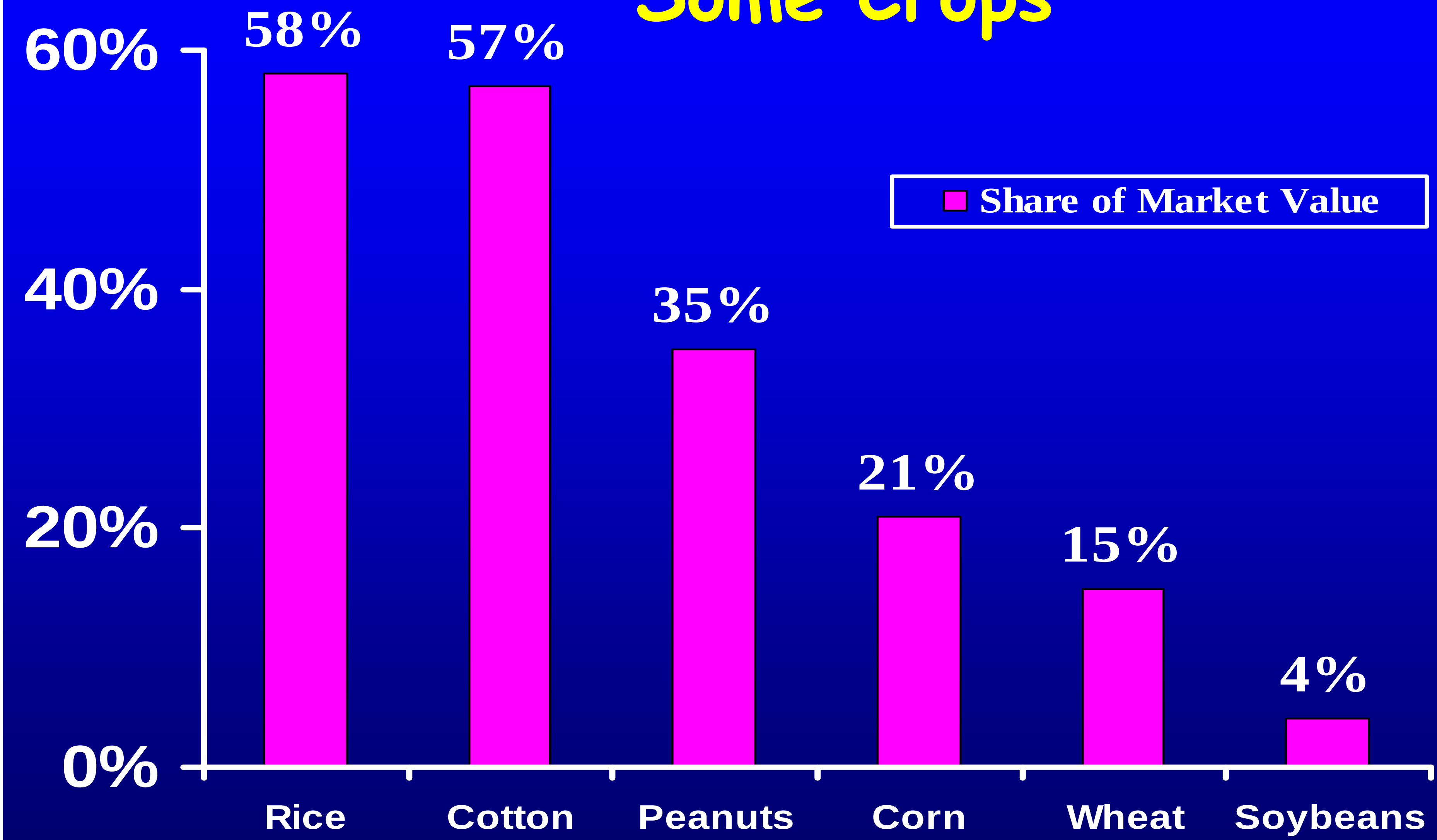
- **Fixed Decoupled Payments (FDP)**
  - ➡ **Planting restriction on fruits, vegetables, & wild rice**
  - ➡ **Payments made to historic "base acres & yields," not current plantings**
- **Counter-Cyclical Payments (CCP)**
  - ➡ **CCP linked to a target price adjusted for fixed decoupled payment**
  - ➡ **Payments made to historic "base acres & yields," not current plantings**
- **Marketing Loan (ML) with Special Repayment Provisions**
  - ➡ **9-month, non-recourse loan**
  - ➡ **"Fixed" loan rates serve as effective price floors**
  - ➡ **Special provisions for loan repayment (LDPs, Commodity Certificates)**
- **Crop Insurance Program**
  - ➡ **Premium subsidies**
  - ➡ **Underwrite large share of program losses**
- **Miscellaneous**
  - ➡ **Export promotion**
  - ➡ **Below-cost irrigation water**

Government Farm Commodity Payments, 1930 to 2006



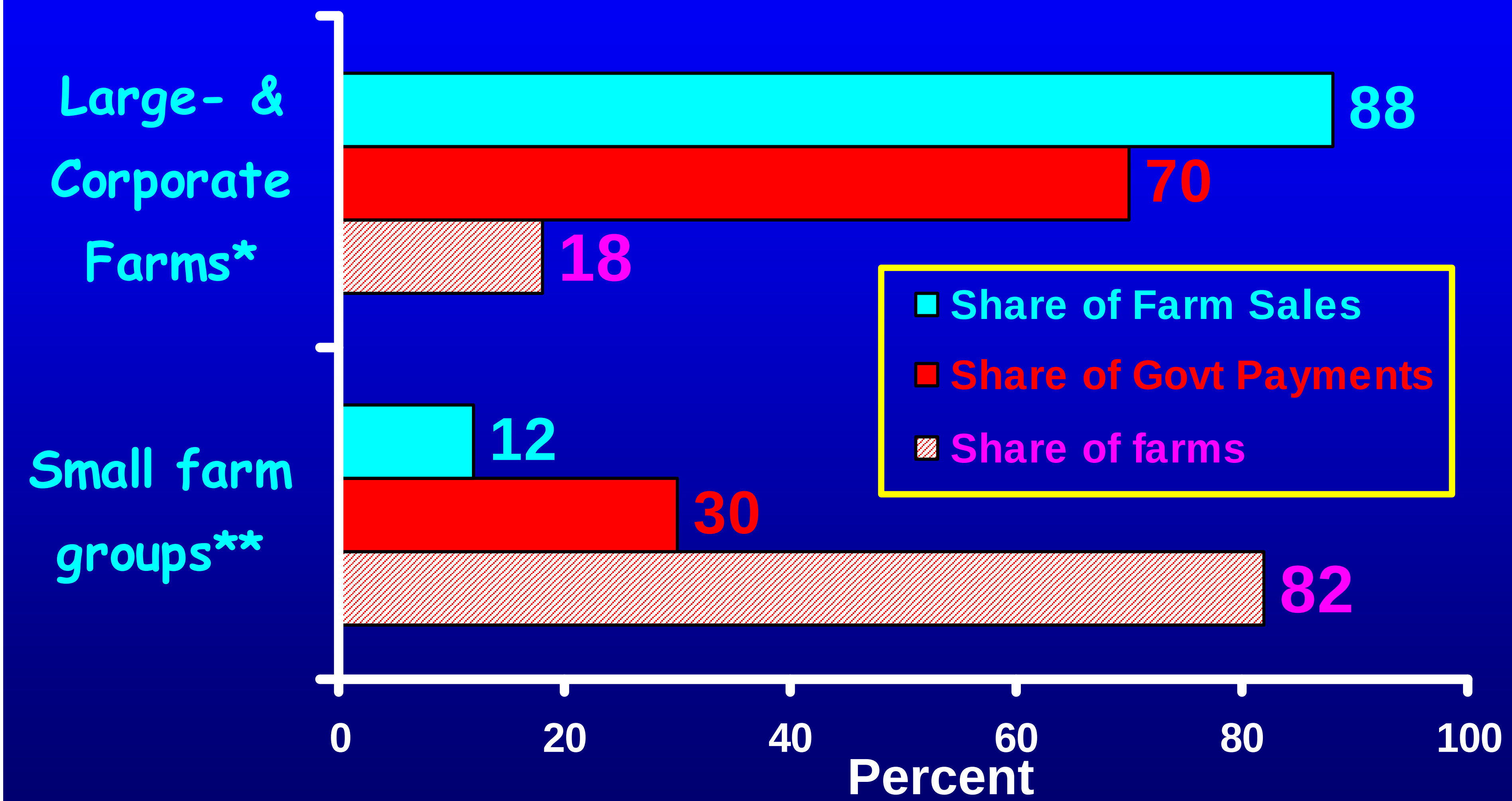
Source: USDA, FSA.

Gov't Payments are Large for Some Crops



Source: USDA, FSA for payment data; USDA, NASS for crop value;
Averages for FY03-FY06.

Larger Farms Make Most Farm Sales And Get Most Government Payments



***Family farms with sales > $100,000; corporate farms, cooperatives; and manager-operated.**
****Limited-resource, retirement, residential/lifestyle, and farms with sales < $100,000.**
Source: USDA's *Agricultural Resource Management Study, 2002.*

Effects of Farm Support on Farm Sector

- Subsidies create more stable revenue stream for supported commodities
- Subsidies raise cash income for some farmers
- Benefits are partially capitalized into land prices and rents
- Volume-based support facilitates farm consolidation

Effects of Farm Support on U.S. Economy, Consumers, World

- Encourages more use of land, water, machinery for cotton, grains, oilseeds
- May have dietary impact by lowering prices for subsidized commodities compared to other commodities
- Foreign suppliers disadvantaged in U.S. and other markets because of more U.S. production or import barriers

U.S. Farm Policy Observations

- Farm policy is delicate balance among special interests, making change difficult
- Agricultural policy derives enormous power from design of the U.S. Senate
  - Sparsely populated Plains & Mountain States — agriculture has strong voice from each state's two Senators
- Regional differences typically more important than partisan differences
  - Northern (wheat, soybeans, corn) vs
  - Southern (cotton, rice, peanuts)
- Livestock vs field crops: policy disputes when feed prices are high (corn for ethanol)
- Urban food assistance is major component in farm policy

U.S. Commitments in the WTO

- Specific Policy Commitments
  - Quantity and/or Value Limits on use of support*
    - Domestic Support outlays
    - Export Subsidies
    - Market Access (tariffs and quotas on imports)
- Rules of Behavior
  - Agreement on Agriculture (AA)
  - Agreement on Subsidies and Countervailing Measures (SCM)
  - Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU)

*Specific limits are defined in each Country's Schedule of Commitments as agreed to at the Uruguay Round of multilateral trade negotiations that culminated in the January 1994 creation of the World Trade Organization (WTO).

In the WTO, Farm Policy is Characterized by its Market Impact

- **AMBER BOX –market distorting policies**
  - ➡ **Includes: most income and price support programs**
  - ➡ **Bounded by a ceiling of $19.1 Billion**
  - **De Minimis Exclusions:**
    - ➡ **Non-Product Specific (NPS): 5% of Total Production Value**
    - ➡ **Product Specific (PS): 5% of Specific Production Value**
- **BLUE BOX -- production reducing policies**
  - ➡ **Includes: land set-aside and herd reduction programs**
  - ➡ **unbounded, but must adhere to qualifying rules**
- **GREEN BOX – non/minimally distorting policies**
  - ➡ **Includes: conservation, research, extension, decoupled DP, etc.**
  - ➡ **unbounded, but must adhere to qualifying rules**

WTO Policy Categories

GREEN BOX

Non- or only minimally market distorting policies

Limit: none

De Minimis Exemptions–PS & NPS

Market distorting policies but small and benign

Limit: $10 Billion each

BLUE BOX

Market distorting policies, but with production-limiting features

Limit: none

AMBER BOX

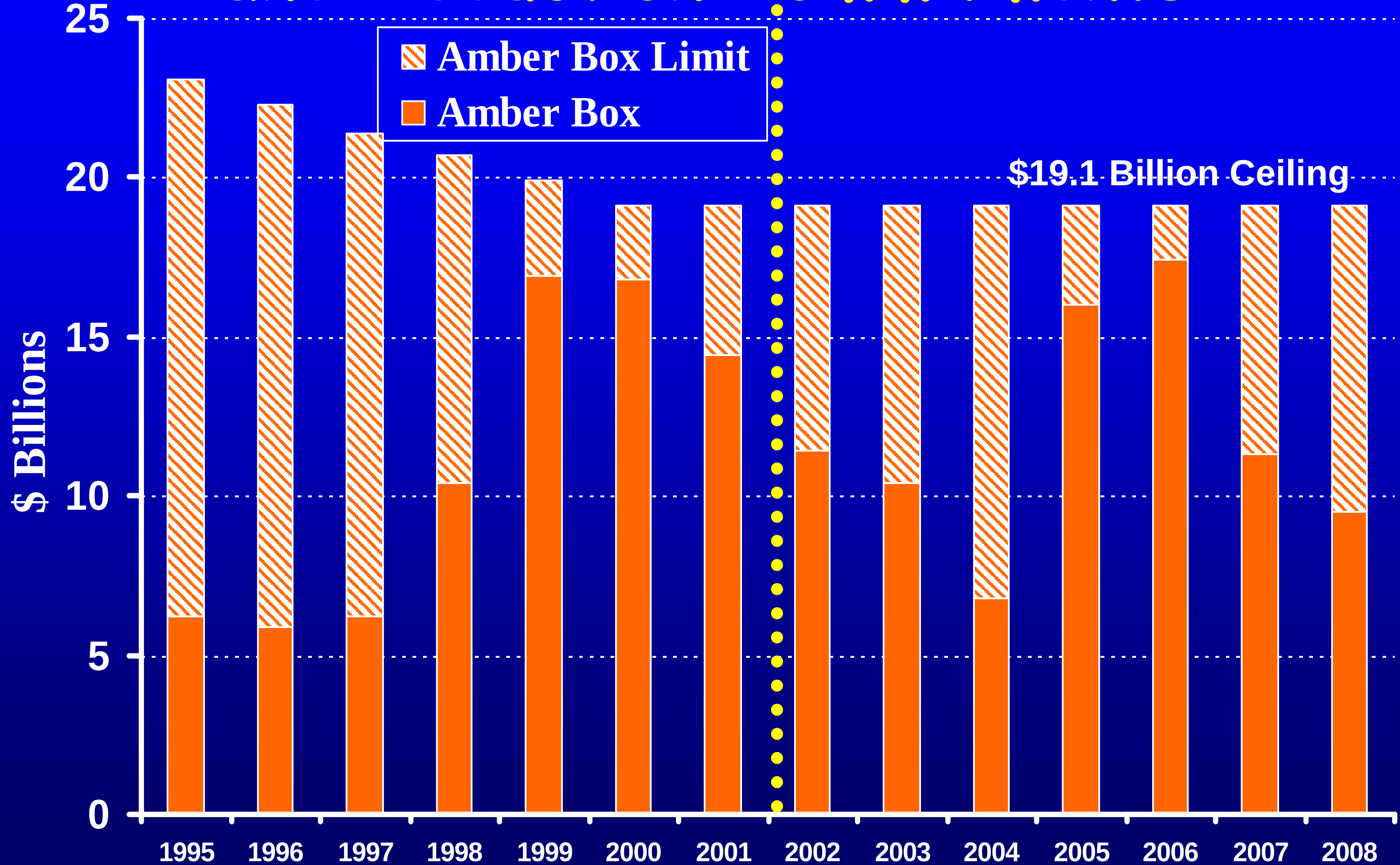
Market distorting policies

Limit: $19.1 Billion

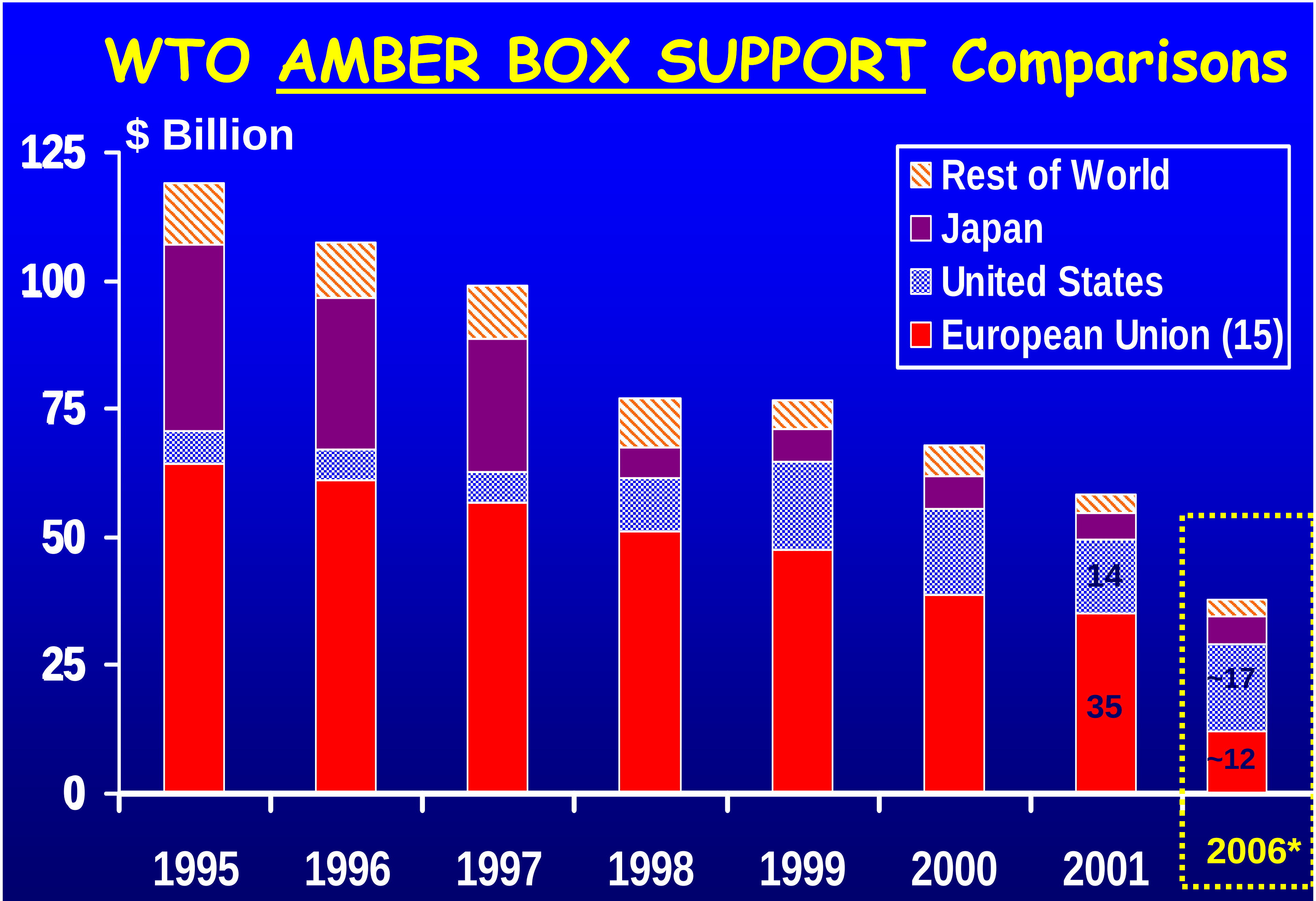
Distortive ⟷ Non-Distortive

Spectrum of Policy Choices

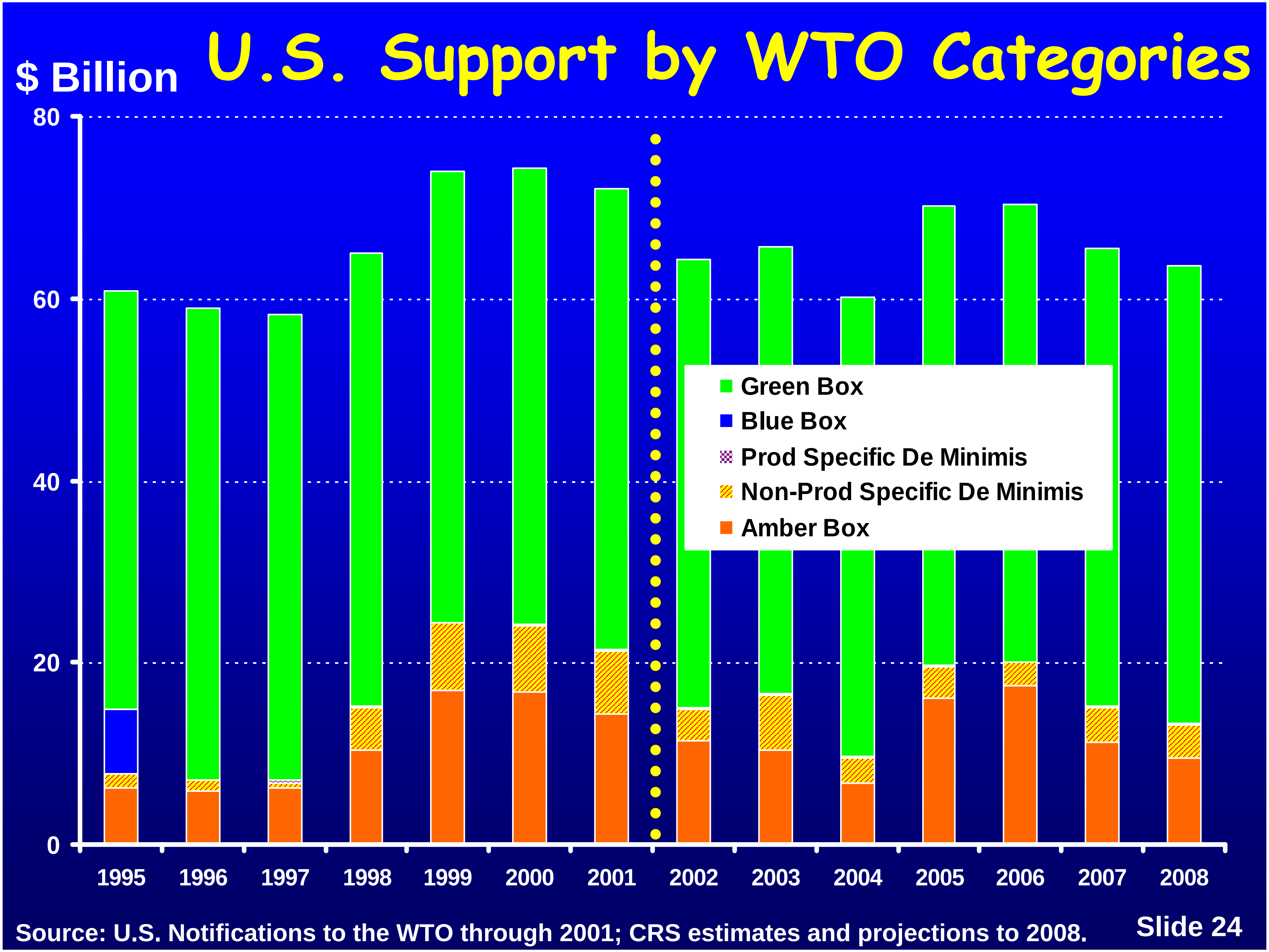
U.S. Amber Box Domestic Support and Reduction Commitments



Source: U.S. Notifications to the WTO through 2001; CRS estimates and projections to 2008.



Source: U.S. notifications to the World Trade Organization. *2006 is projected by CRS and reflects the EU's 2003 CAP Reform which has decoupled nearly 80% of EU farm support.



U.S. Support by WTO Categories
$ Billion
80
60
40
20
0
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
Green Box
Blue Box
Prod Specific De Minimis
Non-Prod Specific De Minimis
Amber Box
Source: U.S. Notifications to the WTO through 2001; CRS estimates and projections to 2008.
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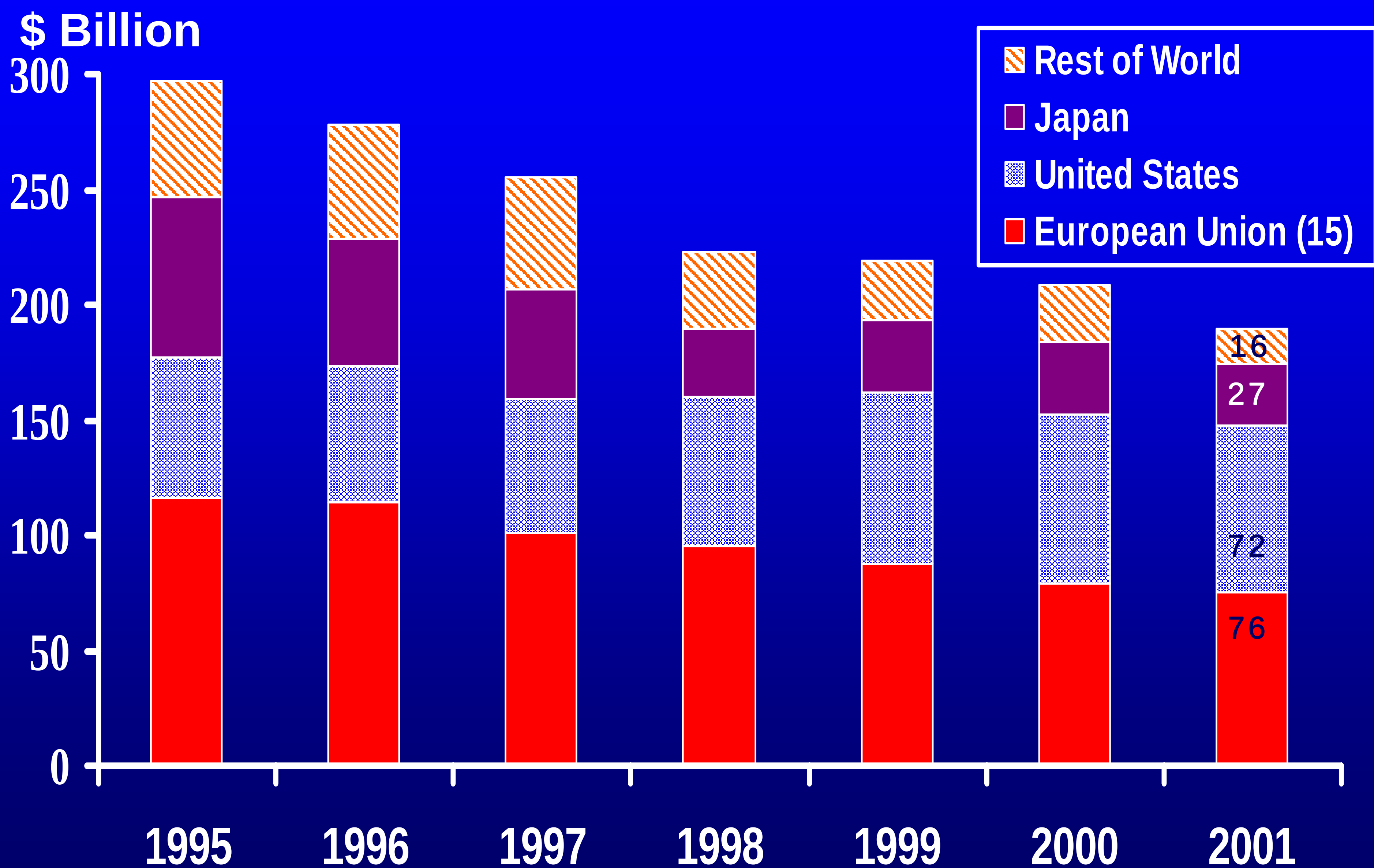
WTO TOTAL FARM SUPPORT Comparisons



Source: U.S. notifications to the World Trade Organization.

Are More WTO Challenges Likely?

Four Reasons Why Not…

1. **Human and Institutional Capital**
   a. Monitoring trade issues
   b. Fact-intensive legal case
2. **Cost in $$ and Time**
   a. Sept. 27, 2002, Brazil requested consultations
   b. March 3, 2005, WTO Appellate Body issued final ruling
   c. WTO Compliance Panel still deliberating…
3. **Geopolitical Concerns may trump Agriculture**
   a. Political interests
   b. Non-agricultural economic interests
4. **Unsuccessful challenge legitimizes the policy being challenged**

Are More WTO Challenges Likely?

Three Reasons Why…

- “Peace Clause” expired on January 1, 2004,
  - Had provided degree of protection from WTO challenges
  - “Serious prejudice” charge has become available
    - Lowers the threshold needed to win a WTO case
- Brazil’s successful challenge of U.S. cotton program
- Doha Round of WTO trade negotiations has shown little progress or chance of success

What is the "Serious Prejudice" Charge?

Agreement on Subsidies and Countervailing Measures (SCM) Actionable Subsidies are defined as:

- **SCM Article 5(c): those subsidies which cause <u>adverse effects</u> to the interests of other Members**
  - Injury
  - Nullification or impairment of benefits
  - Serious Prejudice

Previously, trade remedy cases required proof of injury.

- **SCM Article 6.2: <u>Serious prejudice</u> arises if the effect of the subsidy is to:**
  - Displace or impede imports of like products
  - Displace or impede exports of like products
  - Significant price undercutting
  - Increase in world market share of subsidizing Member

"Serious Prejudice" is not as well defined and is open to Panel interpretation.

In the Brazil cotton case, evidence of 3 criteria led to a successful "Serious Prejudice" ruling:

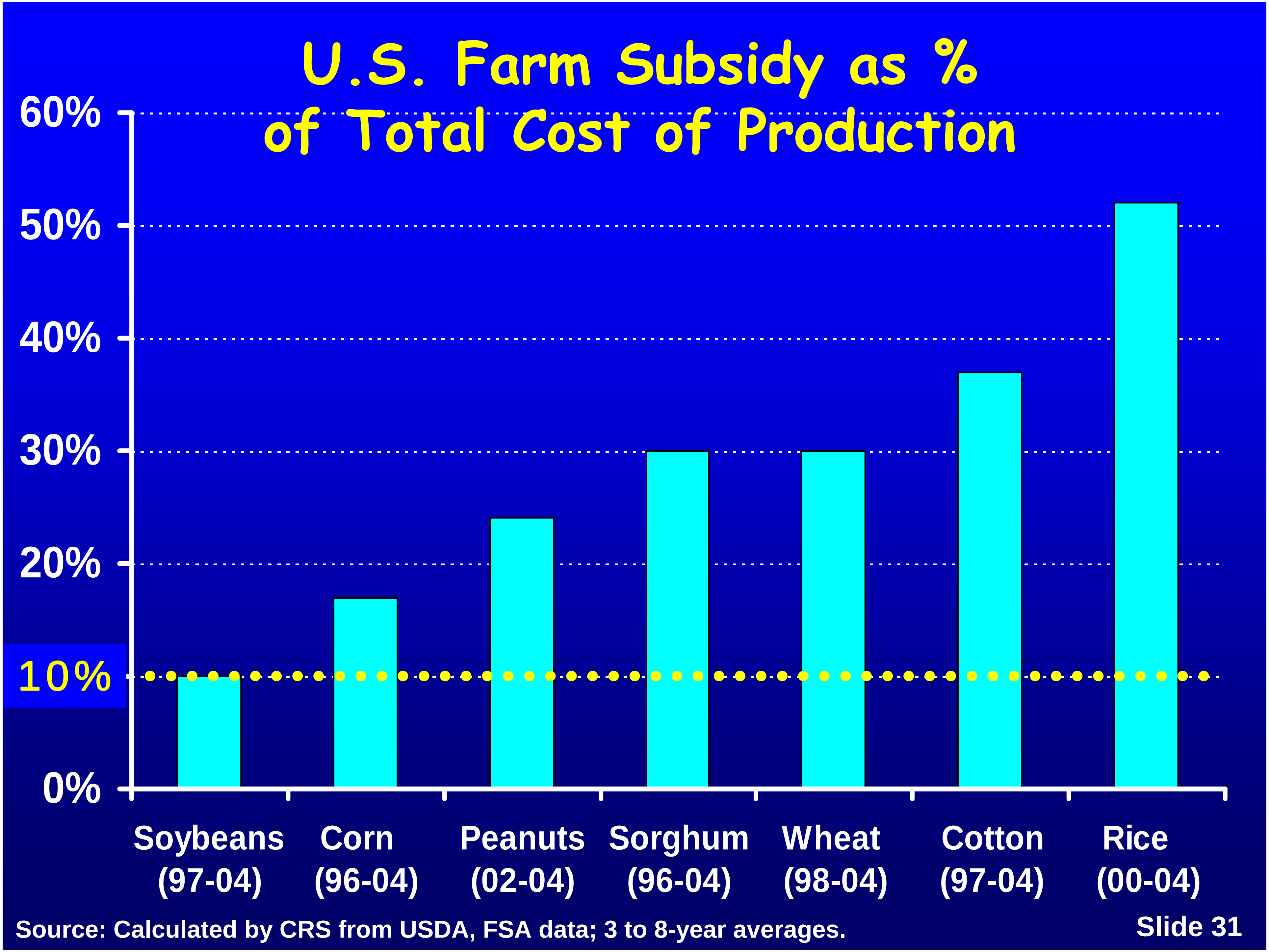
1. **Subsidies are large in Magnitude:**
   - Share of returns
   - Important determinant in covering Costs of Production
2. **Relevance of commodity to world markets:**
   - Share of production
   - Share of trade
3. **Causal relationship between subsidy and adverse effect**
   - Price suppression
   - Trade displacement

What Constitutes Serious Prejudice?

Brazil's former Sec. of Trade & Production, Ministry of Agriculture, Pedro Camarga Neto suggests the following criteria:

- "Serious Prejudice" occurs when a commodity receives trade-distorting subsidy of:
  - Over 10% of its cost of production, and
  - Has an international market share of at least 2%.

- U.S. commodities appear vulnerable with:
  - 15 to 20% of its cost of production, and
  - International market share of at least 10%.


U.S. Farm Subsidy as %
of Total Cost of Production
60%
50%
40%
30%
20%
10%
0%
Soybeans (97-04)
Corn (96-04)
Peanuts (02-04)
Sorghum (96-04)
Wheat (98-04)
Cotton (97-04)
Rice (00-04)
Source: Calculated by CRS from USDA, FSA data; 3 to 8-year averages.
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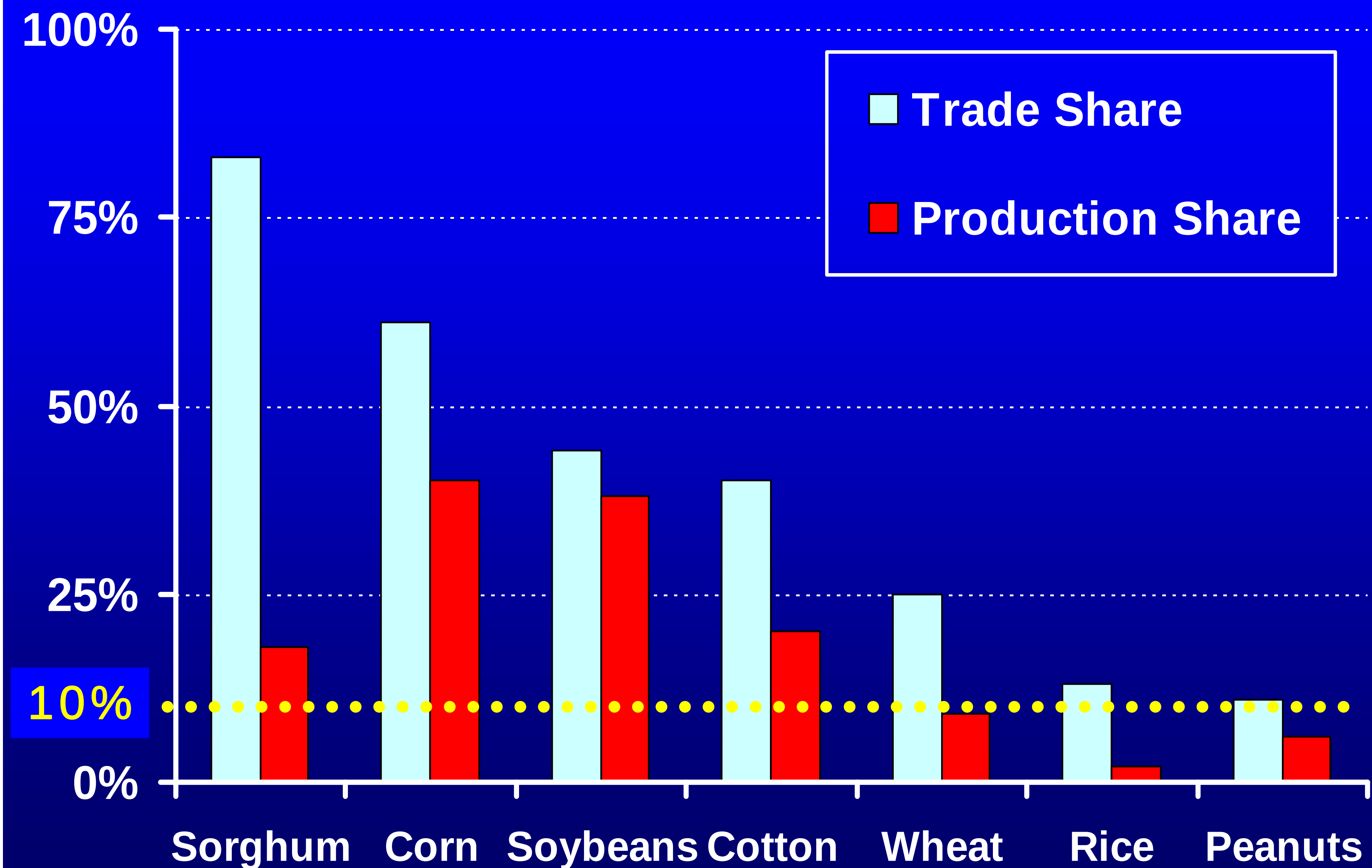
U.S. Share of: World Production & Trade



Source: Calculated by CRS from USDA, FSA data; 1996 – 2005 averages.

Current WTO Challenges of U.S. Farm Policy

- Brazil cotton case
- Canada corn case

Brazil WTO Case Against U.S.Cotton

Resolved:

1. **Eliminated prohibited subsidies under Step 2**

Remain to be resolved:

2. **Export subsidy component of agr. export credit guarantee program**
3. **Serious Prejudice causing “Adverse Effects”**

Vulnerability:

4. **Planting restrictions on base acres for Direct Payment program**

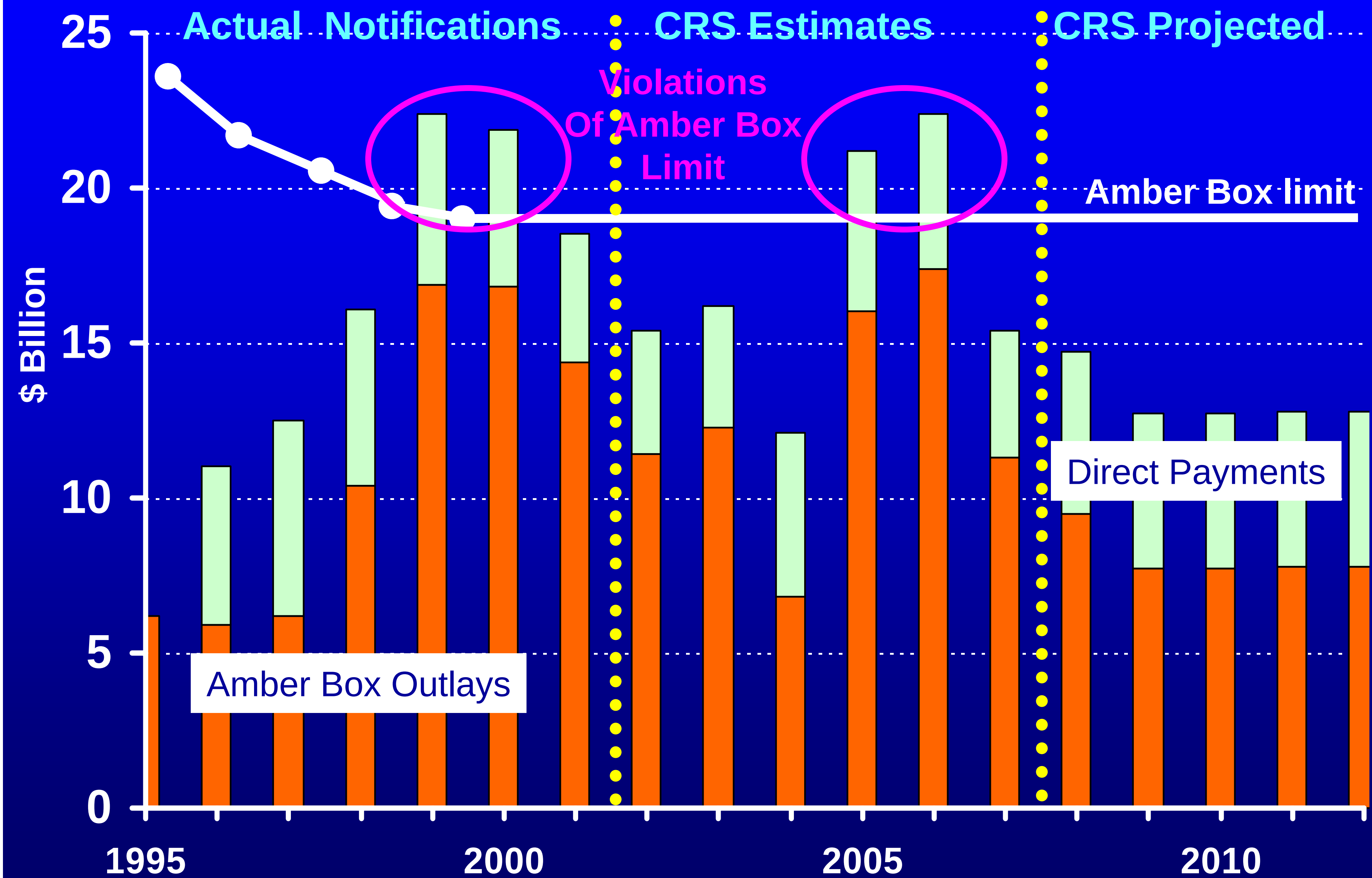
Canada WTO Case Against U.S. Corn

Status: Consultations failed to resolve issues, so Canada is asking for a Panel

Issues:

1. Export subsidy component of agr. export credit guarantee program
2. Planting restrictions on base acres for Direct Payment program causes U.S. to violate its Amber Box Limit
3. Serious Prejudice causing "Adverse Effects"; charges dropped

U.S. Amber Box With & Without Direct Payments



Source: Calculated by CRS from USDA, FSA data; 3 to 8-year averages.

Ways to Respond to a Ruling Against a Farm Policy

1. Eliminate the subsidy

2. Reduce the subsidy

3. Reduce the linkage between the subsidy and the adverse effect (decoupling)

4. Pay a mutually acceptable compensatory payment to offset the adverse effects

5. Suffer the consequences of trade retaliation

Examples of Potential WTO Compliance Issues in Current or Proposed Farm Policies

- **Crop insurance**
  - ➡ Notified as Non-PS De Minimis exempt
  - ➡ Lowering coverage to 70% loss qualifies for Green Box
- **Biofuel feedstock production on CRP land**
  - ➡ May not receive payment for production on "resource retirement" acres
  - ➡ USDA suggests reclassifying as environmental program
- **Updating farm program base acres and yields**
  - ➡ Direct payments would likely lose "decoupled" status even if planting restrictions are removed
- **Green payments**
  - ➡ May not act as bonus above costs of implementation
- **Revived Cotton User payments (4¢/lb.)**
  - ➡ New title: "Economic Adjustment Assistance to Users"

Ways to Minimize Exposure of U.S. Farm Policy to WTO Challenge

Reform policy in accordance with <u>Annex II</u> of the Agreement on Agriculture

- **“Green” farm policy**
  - **Conservation**
  - **Extension & Research**
  - **Decouple**
    - **Remove the linkage between the subsidy and producer behavior**
  - **Whole-Farm Revenue Insurance**
    - **Limited to maximum coverage of 70% of losses**
  - **For other possibilities see Annex II**

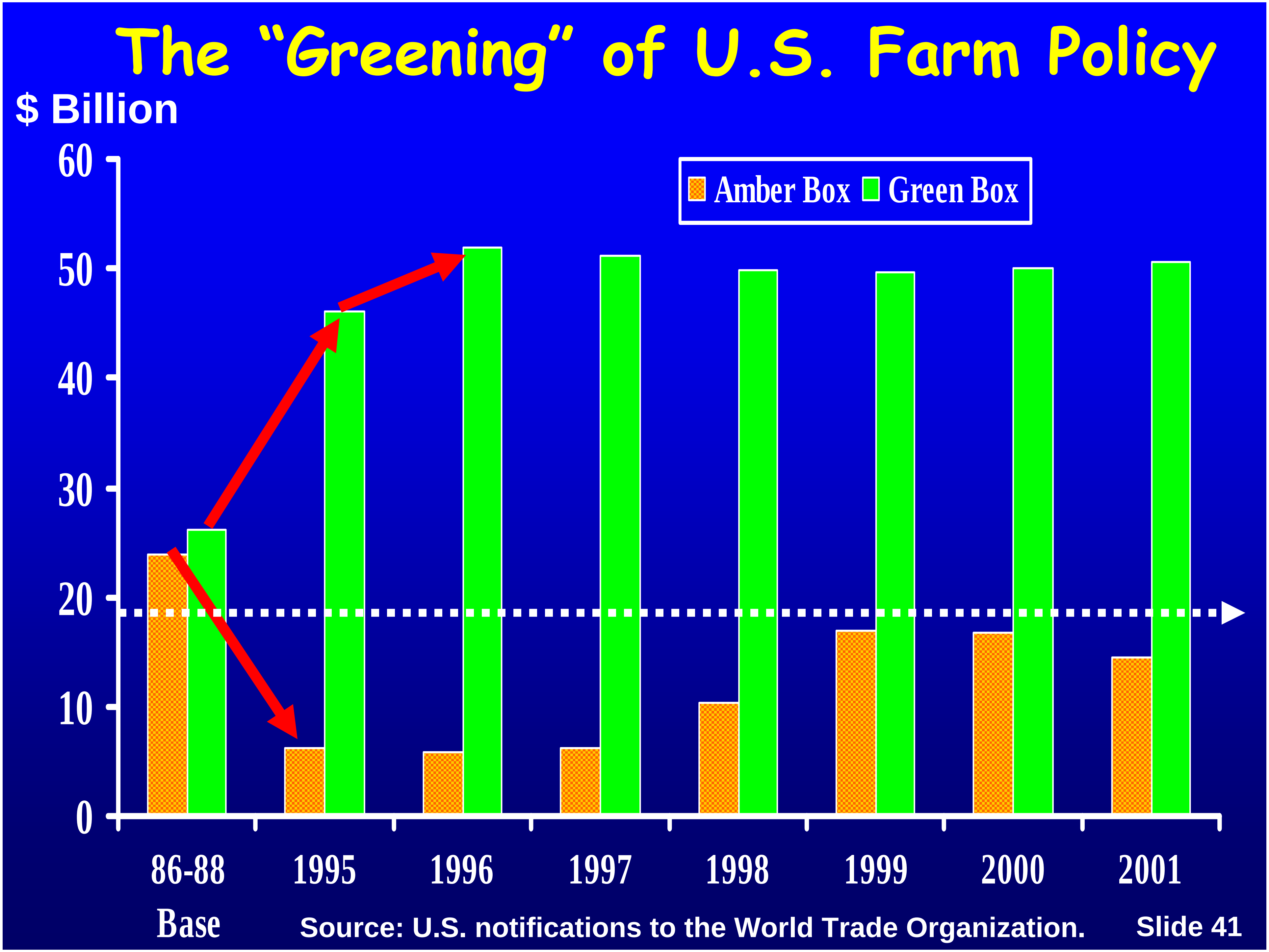
What Fits in the Green Box ?

A. Two General Criteria

1. Support must originate from a government program
2. Support must not provide price support

B. Policy Specific Criteria

1. General Services
2. Stockholding for food security
3. Domestic food aid
4. Direct payments to producers
5. Decoupled income support
6. Income insurance and income safety-net programs
7. Relief from natural disaster (including crop insurance)
8. Producer retirement (buyout) programs
9. Long-term resource retirement programs
10. Investment aids for structurally disadvantaged producers
11. Environmental programs
12. Regional development


The "Greening" of U.S. Farm Policy
$ Billion
60
50
40
30
20
10
0
Amber Box
Green Box
86-88 Base
1995
1996
1997
1998
1999
2000
2001
Source: U.S. notifications to the World Trade Organization.
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USDA's Proposals to Address Disputed Provisions in Current Policy*

1. **Modify export credit guarantee program to eliminate subsidy component**
2. **Remove planting restrictions on base acres under Direct Payment program**
3. **Reduce exposure to "serious prejudice"**
   a. **Revise Marketing Loan Program to reduce cost**
      i. **Lower loan rate ceilings and link to market conditions**
      ii. **Revise loan repayment mechanism to avoid "gaming" of program (use monthly average price & require same-month transfer of beneficial interest)**
   b. **Reduce CCP cost by making it revenue based**

***USDA proposals serve as examples of possible "technical fixes" short of major policy changes.**

For more information…

- **Current Legislative Issues: Agriculture**
  - ➡ **Agriculture and Trade Agreements**
  - ➡ **Agriculture Appropriations**
  - ➡ **Farm Sector Support**

WWW.CRS.GOV

- **CRS Reports**
  - ➡ **Potential Challenges to U.S. Farm Subsidies in the WTO: A Brief Overview (RS22522)**
  - ➡ **Potential Challenges to U.S. Farm Subsidies in the WTO (RL33697)**
  - ➡ **U.S.-Canada WTO Corn Trade Dispute (RL33853)**
  - ➡ **U.S. Agricultural Policy Response to WTO Cotton Decision (RS22187)**
  - ➡ **Dispute Settlement in the World Trade Organization: An Overview (RS20088)**
  - ➡ **Agriculture in the WTO: Limits on Domestic Support (RS20840)**
  - ➡ **Agriculture in the WTO: Policy Commitments Made Under the Agreement on Agriculture (RL32916)**
  - ➡ **Agriculture in the WTO: Member Spending on Domestic Support (RL30612)**
  - ➡ **WTO Compliance Status of the Conservation Security Program (CSP) and the Conservation Reserve Program (CRP) (RL34010)**