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Green but not clean

Why a comprehensive review of
Green Box subsidies is necessary

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Introduction

Green Box subsidies, by definition of the World Trade Organisation (WTO), are not allowed to distort trade. This is why, under the terms of the Agreement on Agriculture (AoA), countries may provide as many Green Box subsidies as they like. ActionAid, CIDSE, and Oxfam believe, as this briefing note will show, that the EU and the USA are using this provision to continue to give support that is manifestly trade-distorting, thereby causing serious damage to farmers in developing countries. At least \$40bn of Green Box payments annually are likely to be trade-distorting and therefore break WTO rules.¹

A full examination of the Green Box is urgently needed. If subsidies are found to be trade-distorting, this demonstrates that stricter criteria need to be imposed, and subsidies that do not meet them must be removed from the Box and, if necessary, cut. Only subsidies that have a genuine social, environmental, or rural development purpose should be classified as Green Box, and thereby escape reduction commitments.

In the Doha Round, rich countries have spent very little time looking to pro-development outcomes, but a great deal of time finding creative ways to circumvent agreements. For instance, while Europe is now the biggest user of the Green Box, the USA wants to expand the criteria for the Blue Box,² allowing it to include support that is clearly trade-distorting. When it comes to subsidies, both trade superpowers are behaving in a totally unacceptable manner, particularly during a round of negotiations that is supposedly dedicated to development.

Green Box misuse

The Doha mandate clearly states that domestic support that enables farmers to sell their produce at a price below the full cost of production should be 'substantially reduced'. Because Green Box payments are 'non or minimally trade-distorting', they are excluded from this reduction commitment. But the EU and the USA, instead of complying with their WTO commitments, are simply shifting subsidies from the Amber and Blue Boxes and hiding them in the Green Box. This allows them to maintain, and even increase, the high levels of support they provide, which largely goes to agribusiness. In other words, it is the richest countries, not the poorest, who will be getting the 'round for free'.³

There are other, equally pernicious implications of this box-shifting. In the trade negotiations at the WTO, rich countries are using the false claim that they have already reduced damaging support as a means of leveraging more concessions from poor countries in market access negotiations.

WTO members have already agreed to a review of the Green Box criteria, to ensure that the subsidies categorised there are indeed non or minimally trade-distorting: this was one of the

¹ European payments for the most problematic Green Box measures, direct payments, and investment aids are expected to be €30bn from 2007 onwards: €25bn in direct payments (made up of €16bn arable crops area payments, €4.8bn milk payments, and 50 per cent of the €9.7bn livestock payment because many countries have opted for partial decoupling in this sector – note that this is still a conservative estimate); plus €5bn investment aids. The USA is likely to continue with its \$4bn direct payments, so at current exchange rates, these subsidies alone would add up to \$40bn.

² See G. Kripke (2005) 'A Little Blue Lie: Harmful Subsidies Need to be Reduced not Redefined', Oxford: Oxfam International, available at www.oxfam.org.uk/what_we_do/issues/trade/bn_bluebox.htm.

³ See ActionAid (2004) 'Five Reasons Why a Comprehensive Review of Green Box Subsidies is Required Within the WTO'; Cafod (2001) 'Proposal for a "Development Box" in the WTO Agreement on Agriculture'; L. Stuart and G. Fanjul (2005) 'A Round for Free: How Rich Countries are Getting a Free Ride on Agricultural Subsidies at the WTO', Oxford: Oxfam International, available at www.oxfam.org.uk/what_we_do/issues/trade/bp76_modalities_and_dumping.htm.

provisions of the July 2004 Framework Agreement. Moreover, the G20 put out a proposal back in June 2005 detailing why a review is urgently needed.⁴

However, to date the EU and the USA have refused to act. The response of rich country trade officials has demonstrated a false logic of disturbing proportions: yes, there will be a review, but it will only be to check that the criteria are being correctly implemented, and will not look at whether the criteria are being met. Therefore, they say, a review would not result in any substantive changes to the Green Box.

As this paper outlines, there are increasing grounds to believe that a meaningful Green Box review would show that many current Green Box subsidies do not meet the criteria of not distorting trade and that, in some instances, rich countries are violating even these weak criteria. Agricultural negotiations should urgently address this missing gap in the subsidy debate. Green Box criteria should be made stricter, and subsidies that still distort trade should be ejected immediately from the Box's safe harbours.

What's in the box?

Currently, large amounts of subsidy and support are being sheltered in the Green Box. We estimate that the EU will report just under €50bn a year in Green Box payments, once reform of the Common Agricultural Policy (CAP) has been fully implemented in 2006-7.⁵ The USA currently reports \$50.7bn of Green Box payments annually.

Box 1: What is allowed in the Green Box?

To qualify as Green Box support, payments must not result in price support for producers, must not involve financial transfers from consumers, and must be provided through a publicly-funded programme. The following programmes are explicitly permitted:

- Provision of 'general services', including research, training, extension, marketing and promotion, and infrastructure such as water supply and drainage.
- Public stockholding for food security purposes and the provision of domestic food aid.
- Income insurance and safety net programmes and natural disaster relief.
- Structural adjustment through producer and resource retirement programmes and investment aids.
- Environmental and regional assistance programmes.
- And, most contentiously, decoupled income support.

In the case of the EU, much of the €50bn that will ultimately be spent on support to farmers is money that is simply being shifted from the Amber and Blue Boxes under the 2003 review of the CAP. If you are a poor farmer in Burkina Faso, the technical categorisation of the payments makes little difference if you are still facing unfair imports. It is the same money, going to the same place — it just has a different name.

Of course, some of this money is genuinely used to support broader social objectives related to agriculture, such as rural development and environmental protection. A large proportion of US Green Box spending — \$33bn — goes to domestic food stamp programmes, which are genuinely targeted at the needy and are unlikely to have a major impact on production. These kinds of subsidies should not be reduced — indeed, they are very necessary to protect livelihoods and to provide social safety nets. However, of the remaining Green Box support, the vast majority serves the interests of commercial farmers and agribusiness, and promotes dumping.

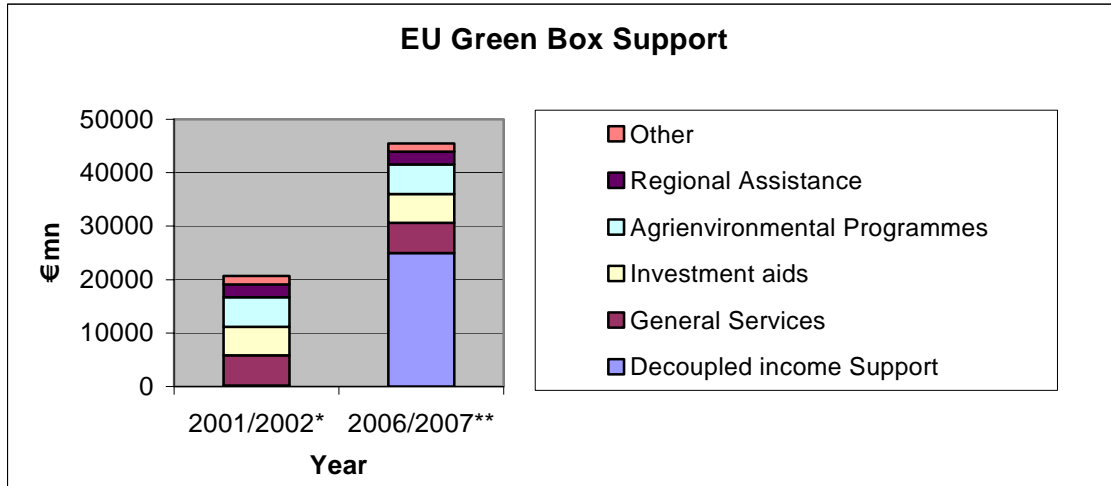
In the case of the EU and the USA, ActionAid, CIDSE, and Oxfam are concerned about the effects of so-called 'decoupled' income support, and in the EU of investment aid within the

⁴ G20/DS/Greenbox FINAL 02/06/05

⁵ See Annex D of L. Stuart and G. Fanjul (2005) 'A Round for Free' (*op cit*) for calculations for this figure.

Green Box. In the EU, decoupled support is set to account for a projected €25bn of the €50bn notified in the Green Box, once the 2003 CAP reforms have been fully implemented. Investment aid, which is support given to farmers to modernise their farms, either in the form of a direct payment, or by subsidising interest payments, will remain at the current level of around €5bn (see Figure 1). In the USA, meanwhile, allegedly ‘decoupled’ income support currently accounts for \$4bn of the Green Box spend. Because it is concentrated in just a few products, its effect is greatly heightened, and expenditure is likely to continue at the current level. At current exchange rates, these two kinds of directly distorting payments given by the EU and the USA alone will add up to \$40bn a year.

Figure 1



* 2001/2 figures are latest EU notifications to the WTO.

** 2007 figures are an estimation of Green Box payments after full implementation of the Mid Term Review, assuming that payments other than decoupled income support remain constant (in line with EU budget forecasts for this period). It takes account of partial decoupling of area payments in France, and a conservative (50 per cent) estimate for livestock payments for many countries.

The Green Box and dumping

While the Green Box is supposed to provide a home only for non-damaging subsidies, in fact, by supporting farmers to keep growing more than they would otherwise be able to sell, much Green Box money encourages farmers to overproduce. This leads to dumping, or the selling of produce on world markets at prices lower than the cost of production.

Dumping causes massive harm to farmers in developing countries, who cannot compete with the cheap products flooding their markets. Hundreds of thousands of African farmers have been put out of business because of it. A study by the Australian government has shown that if the volume of subsidised EU and US dairy exports were to be halved, world dairy prices would be up to 34 per cent higher, for example, while US cotton subsidies caused Burkina Faso to lose the equivalent of 1 per cent of its GDP.⁶

⁶ See L. Stuart and G. Fanjul (2005) ‘A Round for Free’, *op cit*.

1. Dirty green: the suspect subsidies

So why is all this happening? In part, it is because of the type of payments currently being placed in the Green Box provide incentives to overproduce.

One example of this is the case of investment aid. According to the latest notification to the WTO, the EU spends more than €5bn a year on investment aid for farmers (although this is in significant part co-financed by the member states, and often by regional governments). In France for example, total spending on investment aid increased from €547m in 2001 to €711m in 2003.⁷

Investment aid takes different forms in different countries. In France and Germany it is used to a large extent to subsidise interest rates for farmers. French farmers, for instance, paid €274m less in interest in 2003 than they would have done without the assistance. Direct payments covering up to 50 per cent of farmers' investment costs are also frequently provided.

However, investment aid not only reduces current expenses, but also increases productivity and thereby reduces the costs of production, because the money is used to buy more modern and more efficient equipment.

The WTO demands that investment assistance is strictly limited to structurally disadvantaged farms and that only the amount necessary to remedy that disadvantage is given, according to clear and transparent criteria. But the EU regulation defining the criteria for investment assistance does not even mention disadvantaged farms. On the contrary, farms applying for investment assistance have to prove that they can be commercially successful. The new EU rural development regulation that will replace the existing one in 2007 does not alter these criteria.

Another example is decoupled income support. While ActionAid, CIDSE, and Oxfam recognise that decoupling is an improvement on the previous subsidy system, there is strong reason to believe that reform is a job not even half done, and that it will not stop the distortions of trade that lead to dumping.

A number of economists writing on the issue reveal that since decoupling was introduced — in 1996 in the USA and in 2005 in the EU — production has not gone down (indeed, in some products it is set to increase) and exports have not slowed.

Because the 2003 CAP reforms are only now being implemented, the effects on production and exports cannot yet be fully identified. However, according to forecasts by the FAO,⁸ the OECD, the universities of Iowa and Missouri,⁹ and the European Commission itself,¹⁰ the production and export of cereals, the EU's most exported commodity, will continue to increase even after the full implementation of the CAP reforms. According to the OECD, exports of wheat from the EU will only be around 5 per cent lower with the reform than they would have been without it. For coarse grains the impact is even smaller, although in the case of some products, such as beef, production is set to fall.¹¹ This is all the more worrying, as at the same time the EU's cereal farmers will receive around €14bn in decoupled payments, more than half of the total decoupled income support.

⁷Information provided by Ministère de l'Agriculture de l'Alimentation, de la Pêche et des Affaires Rurales, Direction des Affaires Finances: Installation et modernisation des exploitations.

⁸FAO, Trade Policy Technical Briefing Note No.5, 'Domestic Support: Trade Related Issues and the Empirical Evidence', available at <ftp://ftp.fao.org/docrep/fao/007/j5012e/j5012e00.pdf>

⁹Food and Agricultural Policy Research Institute (2003) 'Analysis of the 2003 CAP Reform Agreement'.

¹⁰European Commission Directorate-General for Agriculture (2003) 'Reform of the Common Agricultural Policy: a Long-term Perspective for Sustainable Agriculture. Impact Analysis'.

¹¹OECD (2003) 'Analysis of the 2003 Cap Reform', available at http://www.oecd.org/document/47/0,2340,en_2649_33727_32040111_1_1_1_1,00.html.

The specific reasons why decoupled payments provide an incentive to overproduce and thus distort trade are explored in the next section.

2. Dirty green: implementation issues and impacts

There are many other concerns about the large amounts of money currently being notified as Green Box. These include the implementation issues of updating, planting restrictions, and requirements to keep land in good agricultural condition. These are followed by concerns about the wider impacts of the concentration of payments to small groups of producers and of accumulation.

With **updating**, farmers know that reference years on decoupled payments may be changed with time — as happened under the terms of the US Farm Security and Rural Investment Act — and that this may provide them with incentives to keep production levels high. Updating has constantly been raised by developing-country trade negotiators as a serious issue that needs to be addressed.

The next example is to be found in the **planting restrictions**. While EU or US farmers who receive decoupled income support are free to produce nothing at all if they so wish, in the USA legislation prohibits the planting of fruit, vegetables, or wild rice on farm land receiving such payments. In other words, there are planting restrictions that funnel production towards crops that are eligible for support. The WTO dispute panel sitting in judgement on Brazil's case against US cotton subsidies found that decoupled payments in the USA do not qualify for the Green Box because of these restrictions. The EU is fully aware of this decision, and yet it intends to include its Single Farm Payment in the Green Box, even though it contains restrictions on growing fruit and vegetables that are very similar to the US rules.

There is also the **requirement to keep land in good agricultural condition** in order to receive direct payments. The standards that have to be met to satisfy these requirements entail little more than adhering to already compulsory environmental and animal welfare legislation. In other words, provided they are not breaking the law already, farmers can meet the standards without having to change any of their practices. On the other hand, if they decide to produce nothing on that land, they are required to keep it open and prevent both erosion and coverage by trees and shrubs. To ensure this, they have to either shred or mow everything that grows on the land at least once a year. This means it is more remunerative for farmers to produce, even at a small loss, provided the loss is smaller than the costs of keeping the fallow land in good condition.

Box 2: The G20 proposal for Green Box reform

While decoupled income support is the main target of the G20 proposal, additional disciplines for most programmes are also called for.

- Decoupled income support should only be paid to farmers on low incomes, to avoid payments being used by larger farms to cross-subsidise production and invest in increased production.
- Such support should not be made in combination with trade-distorting support.
- Base periods should be fixed, unchanging, and notified, to avoid farmers maintaining high levels of production so that they are eligible for higher support after an update of the base period.
- At the same time, the G20 recommends the broadening of certain criteria to take account of specific development concerns. These include land reform programmes and the purchase or procurement of food from low-income and resource-poor farmers for domestic food aid and stockholding programmes.

The Africa Group has also supported a review of the Green Box.

A wider concern is the issue of **concentration**. The way in which Green Box subsidies are being allocated — and in particular decoupled income payments — means that they are more likely to lead to overproduction, and thus to dumping. They are being concentrated on just a handful of producers, which magnifies the effect of the support, as it allows those producers to realise economies of scale. Under the pre-2003 CAP, in the UK for example, just 2 per cent of farmers received 20 per cent of the money. Across the EU as a whole, the distribution of subsidies will change very little under the reformed CAP. The situation is even worse in the USA, where in 2003 the top 10 per cent of recipients received 68 per cent of the total payments.¹²

All the effects detailed above are likely to be even stronger when two types of support are provided together. This is the **accumulation** effect. For example, farmers whose support is changed to consist mainly of decoupled, but area-based, payments have to decide whether it is more profitable to give up production and bear the cost of maintaining the land in order to be eligible for the payment, or to continue production to cover at least part of the costs of land maintenance. But if investment aids are available, thus making production more remunerative, this option obviously becomes more attractive. At the same time banks are more likely to finance investments.

This effect is set to be even stronger if Green Box measures, and especially decoupled payments, are combined with other, more trade-distorting instruments. The most blatant example of these is 'partial decoupling'. In the EU, member states have the option to keep part of the payment linked to crop and livestock production. Up to 25 per cent of the payments for arable crops, and 50 to 100 per cent of animal payments, may remain linked, or coupled. France and Spain have both made use of this option in the case of area payments. Cereal farmers who stop production, or shift to livestock production, for example, receive only 75 per cent of their previous payments, and have to cover the costs of keeping the land in good condition. If they continue production, however, they receive 100 per cent of the payments, plus the income from marketing their crops. The second option would obviously be attractive if the variable costs of production were reasonably compensated by crop prices. This is particularly likely in France, Europe's largest and arguably most competitive cereal producer.

As the World Bank has pointed out, 'the co-existence of coupled and decoupled programmes means that incentives to overproduce remain'.¹³

One of the G20's recommendations for reform of the Green Box criteria is that Green Box support should not be allowed in combination with other trade-distorting support, to avoid magnifying incentives for overproduction.

Conclusions and recommendations

This analysis begins to explain why the EU and the USA are resisting a meaningful review and clarification of the Green Box criteria. While decoupled income payments are potentially a legitimate way to support agriculture, if the current measures were indeed as minimally trade-distorting as they claim, neither would have anything to fear from such a review. But, as this paper shows, the trade-distorting effects of a number of Green Box measures are far beyond 'minimal'. **Europe proffers its previous reforms — which certainly did have a significant impact on internal markets but which will not impact upon levels of exports — as an excuse for not undergoing further reform.** Again, the logic is false, and

¹² Subsidies payments. Source: Environmental Working Group: www.ewg.org/farm/progdetail.php?fips=00000&yr=2003&progcode=total&page=conc (last checked by the author October 2005).

¹³ Quoted in A. Aksoy and J. Beghin (eds.) (2005) *Global Agricultural Trade*, Washington DC: World Bank.

particularly so during a development round, when Special and Differential Treatment is supposed to be a driving factor.

There are very serious reasons to be concerned about the way in which rich countries are implementing Green Box payments. We know that there are ways in which the Box could be made cleaner. Both the EU and the USA need to start making these changes now.

Review of current green box payments

- There must be a full and urgent review of the Green Box to ensure that the criteria of 'non or minimally trade-distorting' measures are being met by all subsidies notified therein. This review should be conducted by an independent body such as the Food and Agriculture Organisation (FAO), and its results should be made publicly available.
- If the review shows that certain measures are not 'non or minimally trade-distorting', they should be excluded from the Green Box.

Tightened criteria

- Green Box payments should only be allowed when payments provide clear benefits for society, that is when directed at small farmers, sustainable agriculture, environmental protection, rural livelihoods and development, food security, or poverty reduction. The G20 paper contains some useful proposals on this, such as making payments in relation to land reform programmes.
- Income support should primarily be granted to family farming.
- Strict ceilings on the amount that an individual farm can receive should be imposed in order to avoid the effects of economies of scale.
- The accumulation of payments should be disciplined. Products that benefit from a specified amount of trade-distorting support (Amber and Blue Box) should not be produced on land that benefits from, for example, decoupled income support and investment aids. This would ensure that payments made under 'partial decoupling' would not qualify as Green Box support.
- Base periods should be fixed, unchanging, and notified.

Increased transparency

- Countries should state what the objective of the support is at the time of notification. Without this information, notification should not be possible.
- Countries providing Green Box support in excess of a specified share of the total value of agricultural production should be obliged to report the average costs of production, and the export prices of commodities that are produced on land benefiting from this type of support. If costs are higher than export prices, they should be obliged to stop exports of these products, as this constitutes dumping.
- There should be no renewal of the peace clause so countries can challenge Green Box payments when they are not minimally trade-distorting.

In the longer term, the box system itself should be reviewed. However, in the short term, we believe that these strictures should turn the Green Box into what it is supposed to be: a vehicle for sustainable support, not a place to hide trade-distorting payments.

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