actionaid international

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THE EU AND AGRICULTURE, POST CANCUN

CURRENT POSITIONING, NEGOTIATING FLEXIBILTY AT THE WTO AND DEVELOPMENT

PURPOSE AND BACKGROUND

In mid 2003, the EU came forward with a new Common Agricultural Policy (CAP) reform agreement that will have significant implications for its negotiating position at the WTO. However, this agreement omitted certain products of particular interest to developing countries, such as cotton and sugar; only now – in mid 2004 – are reforms in these sectors being discussed and agreed amongst EU member states. The main purpose of this briefing is to summarize the present EU position on CAP reform, and to inform observers – particularly developing countries - how this translates into the EU's current position at the WTO, what flexibility the EU has in its negotiating stance through 2004 to the next WTO Ministerial and what are the development implications of these negotiating positions. This briefing focuses primarily on the defensive mechanisms that the EU will continue to use to protect its agricultural sector. These defensive mechanisms need to be opposed by other WTO members with policies that will deliver a genuine development round (see recommendations throughout this briefing). This briefing does not cover in any detail special and differential treatment for developing countries[1] nor does it cover the developmental impacts of EU 'protectionism'[2].

This briefing assumes that there will be no further major reform of the CAP prior to 2013 (the new CAP financial package now extends to 2013).[3] However, this is partly dependent on:

- The outcome of the WTO negotiations (particularly on export subsidies);
- The potential fallout from the WTO dispute panel ruling on cotton;
- The potential fallout from a future WTO dispute panel ruling on sugar (and any other disputes that are brought before the WTO).

The briefing will also provide evidence that the recent CAP reform agreement will bring few benefits to developing countries, despite new attempts by the Irish EU Presidency to convince developing countries otherwise. It also provides an opportunity to reflect on and assess the latest EU proposal (letter) sent to other WTO members on 9th May (see page 3). It reveals an increasing tendency by the EU to dress up proposals as 'movement' when in fact much of what the EU proposes is a repackaging and spinning of existing proposals tied to a string of conditions.

EXECUTIVE SUMMARY

Overall assessment: ActionAid believes that the key agricultural pillars for the EU at the WTO are now export subsidies and market access. If the EU is forced to agree an end date for the elimination of export

[1] ActionAid is planning to publish a report on market access reduction formulas and special products some time in the summer. ActionAid believes that only developing countries should have the flexibility to deal with price volatility and import surges through a special safeguard mechanism and should be available for all products. In addition, developing countries should have the long-term flexibility to exempt a self-selected list of agricultural products – special products (SPs) – from tariff reductions on the basis of a positive list approach on the grounds of concerns related to food security, rural development, poverty alleviation and livelihood conservation. They should be allowed to increase bound tariffs where these have been set at low levels.

[2] See ActionAid, 2002. *Farmgate: the Developmental Impact of Agricultural Subsidies.* London.

[3] Agra Europe now reports (23rd April 2004) that further CAP reforms in the dairy sector may be required by 2010 as the likely outcomes at the WTO would leave the EU with little room for manoeuvre around market access.

subsidies, it will only do so if it can extract as many trade-offs elsewhere. In return for eliminating export subsidies at the WTO, the EU may attempt – at the insistence of some member states - to limit market access into the EU to an absolute minimum or seek to find trade-offs in other non-agricultural sectors (as the EU is currently proposing in its trade negotiations with Mercosur[4]).

Why will the EU potentially now seek a trade-off in market access and not domestic support? Whilst the EU has, once again, recently proposed to make "*very significant commitments*" on domestic support at the WTO,[5] ActionAid would question if the EU has much negotiating flexibility above and beyond its current positions. And because the EU has relatively firm positions – with figures – for reduction commitments on both the amber and blue boxes as well as a position on the green box, the EU will find it difficult to retract these positions if a trade-off is required for the elimination of export subsidies.

In contrast, because the EU has yet to provide any concrete figures under the blended formula,[6] it is in the area of market access that the EU has some negotiating flexibility and may use it to claw back concessions. The European Commission has also made it clear that the current internal reforms would not deliver unlimited possibilities in the area of market access.[7]

Amber Box (AMS): Unless there is further major CAP reform within the next few years, the EU will continue to use amber box support until at least 2013 (covering dairy, livestock products and possibly sugar) and thus will have to retain it within the WTO. Yet, the EU could and should be able to offer a more substantial reduction in the AMS than the originally proposed 60%. The EU has already proposed the elimination of *de minimis* for developed countries.

Blue box: Following the 2003 CAP reform package, the EU will have to retain the blue box. There appears to be little, if any prospect that the EU could further reduce its proposal to cap blue box subsidies at 5% of the total value of EU agricultural production. Once capped, the EU would not accept further reductions.

Overall assessment of the EU letter (and Press Release) of 9th May 2004 to other WTO members

The European Commission has come forward with little positive to offer in its letter to other WTO members other than a re-packaging of existing positions.

Export subsidies

The EU offers nothing new by agreeing to move on export subsidies and put them on the table. Pascal Lamy (Trade Commissioner) and Franz Fischler (Agriculture Commissioner), as they themselves acknowledge, have made this offer before. Both Commissioners have been forced into an embarrassing climb down with regards their previous offer to eliminate export subsidies on a list of products of interest to developing

[4] It is reported (Financial Times April 14th) that the EU would offer the four Mercosur countries improved agricultural market access to the EU in return for Mercosur lowering industrial tariffs, liberalising investment, and opening services and government procurement to EU suppliers.

[5] AgraEurope, 2004. EU says it will go further on export subsidy elimination. 23rd April.

[6] In January 2003, the EU proposal on tariff reduction was an overall average reduction of 36% with a minimum 15% reduction for each tariff line (as was the case in the Uruguay Round).

[7] AgraEurope, 2004. EU says it will go further on export subsidy elimination. 23rd April.

countries. This was firmly rejected by developing countries; as far as they are concerned, all export subsidies are on the table and the EU approach was just another attempt at divide and rule.

The latest (9th May 2004) offer on export subsidies by the EU is contingent on a string of concessions being reached elsewhere and reaching acceptable outcomes to the EU on domestic subsidies, market access and non-trade concerns (which is a particular concern to the EU). The EU is also insisting on 'parallelism' – that other countries also eliminate the subsidy component of their export regimes. Most importantly, nowhere does the EU commit itself to a specific end date for export subsidies which has been the key demand of developing countries.

Domestic Support

On amber box, the EU commits itself to large reductions (which is largely meaningless because it is already substantially below its Uruguay Round bound rate). It also proposes a reduction and a cap on blue box payments - the EU thus confirms that trade distorting blue box subsidies will remain, they will probably be capped at 5% of the total value of agricultural production (EU-US position of August 2003) but the EU would not countenance further reductions from this level. The EU proposes that the green box will remain free of restrictions with no reference to a tightening of criteria.

Cotton

On cotton there is very little, if anything for developing countries. In September 2003, the Commission proposed a set of reforms to the EU cotton sector that would provide producers with 60% decoupled income payments (green box) but the remainder would remain coupled to production (ie trade-distorting blue box subsidies). Member states have now agreed to this proposal with a slight modification (65% will be decoupled and 35% will be coupled). It is therefore slightly disingenuous for the EU to offer on 9th May that "*if possible,* [all countries should] *eliminate the most trade distorting domestic subsidies*".

Market access and S&DT

Whilst continuing to support the blended formula, the proposal recognises in vague terms that 'flexibility' should be afforded to cater for 'developing country sensitivities'. Special products and a special safeguard mechanism – as part of a package of special and differential treatment – do not warrant any mention despite their importance to developing countries.

Green box: The EU will not agree to a cap on the green box. If the EU agrees to any review, it will be largely superficial for tactical reasons so as to ensure that the criteria could not be tightened once open. As this briefing reveals, a comprehensive review of the green box is urgently required.

Export subsidies: Unless there is further major CAP reform within the next few years, the European Commission's own figures show that the EU will still be using large amounts of export subsidies for dairy, meat and possibly sugar products in 2013. These will continue to have devastating impacts on developing country markets. ActionAid thus believes that the EU will have great difficulty in agreeing an end date on export subsidies in these sensitive sectors before 2013. Any movement in this area by the EU will depend on 'full parallelism'.

Market access into the EU: Having proposed the blended formula within the EU-US Agriculture paper to the WTO, the EU has indicated that the Uruguay Round element (as opposed to the Swiss element) of the blended formula must be given significant prominence. In the current EU-

Mercosur trade negotiations, the EU appears to be willing to cut tariffs and expand quotas – but the EU has indicated that this may well result in less EU flexibility (cuts and quotas) in the WTO.

DOMESTIC SUPPORT

According to Mary Minch (International Director DG Agriculture in the European Commission), the EU is prepared to make "*very significant commitments*" on domestic support at the WTO.[8] However, ActionAid would question if the EU has much negotiating flexibility above and beyond its current positions. And because the EU has relatively firm positions – with figures – for reduction commitments on both the amber and blue boxes as well as a position on the green box, the EU will find it difficult to retract these positions if a trade-off is required for the elimination of export subsidies.

Amber box (or Aggregate Measure of Support)

Introduction and summary

The EU has some flexibility here from its original submission (Jan 2003) to the WTO in which it proposed a 55% reduction in the AMS from the final Uruguay Round (UR) bound rate (subsequently increased to 60%). The EU could and should be able to offer a more substantial reduction. However, unless there is further major CAP reform in the next few years, there is little opportunity to phase out AMS prior to 2013. By 2013, amber box support will continue to be an important component in the dairy, meat and possibly sugar sectors (depending on the outcome of current proposals to reform the EU sugar regime). The EU has already called for the elimination of *de minimis* for developed countries but has not come forward with proposals as to whether a product-specific AMS cap would be acceptable (as suggested in the Derbez text and by the US).

Background

The original EU proposal (Jan 2003) to the WTO proposed a 55% reduction in the AMS from the UR final bound rate. This was subsequently increased to 60% (the Harbinson text also called for a 60% cut in the AMS over five years from the UR final bound commitment). The US has called for a substantial reduction in the AMS but also a narrowing in the differential between the caps for the US, Japan and the EU.

The EU-15's final bound UR commitment was 67.2 billion euros but from May 2004 the EU will include the ten new member states (increasing the final UR bound rate to 71.8 billion euros). According to the European Parliament, the latest estimate of EU-15 AMS is 28.6 billion euros (which would rise to 32.1 billion euros for EU-25). Following the 2003 reforms, this would fall to about 26 billion euros for EU-15 (and about 28.8 billion euros for EU-25). See table 1.[9]

Table 1: Current and projected amber box support in the EU

Billion Euros	EU-15	EU-25

[8] AgraEurope, 2004. EU says it will go further on export subsidy elimination. 23rd April.

[9] European Parliament, 2003. Report on the proposal for a Council Regulation on Establishing Common Rules for Direct Support Schemes under the CAP and Support Schemes for producers of certain Crops. May. Rapporteur, Arlindo Cunha. Page 93. http://www2.europarl.eu.int/omk/sipade2?PUBREF =-//EP//NONSGML+REPORT+A5-2003-

	Pre 2003 CAP Reform	Post 2003 CAP Reform	Pre 2003 CAP reform	Post 2003 CAP Reform
Final UR Bound Commitment	67.2	67.2	71.8	71.8
EU AMS	28.6	26	32.1	28.8
(of which sugar)	(6)			
Reduction from UR Bound	57%	61%	55%	60%

Even with the ten new members states, 28.8 billion euros is exactly 60% below the EU-25 final bound level. Further reforms are planned for other sectors, such as sugar, which should bring the AMS reduction well below 60%. The current EU-25 sugar AMS is probably about six billion euros;[10] depending on how far the EU reduces the internal sugar price, the full six billion euros would bring the total AMS reduction to about 70% below the EU-25 UR Bound commitment.

A commitment by the EU to reduce the AMS by 60% would, in effect, commit the EU to do very little in a new round on AMS that it is not already doing. At a meeting organised by NGOs in Geneva,[11] the European Commission effectively admitted this was the case and wanted 'credit' for going beyond their Uruguay commitments. This is disingenuous for three reasons.

- it misleads other WTO member states into believing that the 60% reduction is a substantial commitment to further cuts in the AMS.
- the EU is moving domestic support out of the AMS into other forms of trade distorting domestic support (ie blue and green box).
- during the Uruguay Round the EU negotiated favourable reference years and high final bound levels.

ActionAid's recommendations on the amber box

WTO members should agree that the amber box in developed countries should be phased out as soon as possible but with the full consultation with developing countries because of loss of preferences. *De minimis* in developed countries should be eliminated immediately.

Blue Box

Introduction and summary

There is little, if any current flexibility within the EU's negotiating position. The EU has to retain the blue box. As part of the EU-US agricultural WTO proposal of August 2003, the EU agreed to cap blue box subsidies at 5% of the total value of EU agricultural production but once capped, the EU would not accept further reductions. Until each EU-15 member state decides how to implement the 2003 CAP agreement (which will entitle each country to retain some coupled blue box subsidies), the EU will not wish to reduce this figure any (much) lower. This is further compounded by the fact that the ten new member states may also be entitled to some coupled blue box payments.

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[10] The latest submission by the EU to the WTO on domestic subsidy expenditure (2000/01) put the AMS for white sugar for the EU-15 at 5.8 billion euros.

[11] World Council of Churches, 2003. NGO Conference on the Harbinson draft modalities. Held at the World Council of Churches, Geneva 19-21/2 2003.

Background

Following ActionAid's investigation into the developmental impact of EU subsidies,[12] we would contend that blue box subsidies are as production and trade distorting as amber box subsidies. Yet the 2003 CAP reform package permitted the current EU-15 member states (and this may be extended to the newly acceding states) the option to retain some of their current coupled (blue box) payments. For example, each member state is permitted to retain up to 25% of their cereal payments as coupled whilst the remainder will have to be decoupled (green box). France, the largest cereal producer has taken up this option (see table 2) but some member states are still considering their options.

Table 2: Details on the remaining 'coupled' payments by sector.

SECTOR	PERCENTAGE OF REMAINING 'COUPLED' PAYMENTS	EU-15 COUNTRIES OPTING FOR 'COUPLED' PAYMENTS (some countries – such as Spain, Italy – have yet to announce) Most countries will have implemented the reforms by 2006.
Durum Wheat	Up to 40 per cent	
Cereals	Up to 25 per cent	France
Beef	**Option 1**: up to 100 per cent of the present suckler cow premium and 40 per cent of the slaughter premium, **<u>or</u>** **Option 2**: either up to 100 per cent of the slaughter premium or alternatively up to 75 per cent of the special male premium	Belgium, France, Austria, Portugal Denmark, Netherlands
Sheep and goat	Up to 50 per cent	France, Portugal
Dairy	Decoupled payments to be introduced from 2005	
Cotton	Up to 35 per cent	

Sources: http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/03/898|0|RAPID&lg=EN&display= and AgraEurope, April 21st 2004.

So, as result of the CAP final agreement of 2003, it is estimated that the EU will be able to shift about 70-75% of subsidies that are currently in the blue box into the green box. Currently blue box subsidies in the EU-15 amount to about 29.4 billion euros.[13] Following the 2003 reforms, the analysis goes as follows: "*As a working hypothesis, it might be assumed that roughly half the member states will take up the option of 25% coupled payments in the arable sector, while a majority decide to retain some coupled aids in the livestock sector. It could thus be supposed that the global amount of coupled (Blue Box) aid notified post-reform in the arable sector will be at 12.5% of the pre-reform level, while the level of coupled livestock payments stands at 50% of the pre-reform volume … If these assumptions are (approximately) correct, it would cut Blue Box notifications for crops to €2.2bn and for livestock to €5.95bn,*

[12] ActionAid, 2002. *Farmgate: the Developmental Impact of Agricultural Subsidies.* London.

[13] European Parliament, 2003. *Op cit.*

giving a total of €8.15bn – a reduction of about 75% compared with the pre-reform level.” [14] These assumptions are not too far off the mark although so far only one country – France – has opted for the coupled cereal option (admittedly the largest producer).

The EU-US joint agriculture paper and the Derbez text proposed that blue box payments should be capped at 5% of the total value of agricultural production. For the EU-15, the cap would be about 12.75 billion euros. The estimated expenditure of 8.1 billion euros falls well below this figure but some the largest producing states within the EU – such as Italy and Spain – have still to announce how far they will take the coupled options. The European Commission therefore requires some degree of flexibility in its negotiating position, not only on behalf of the current EU-15 member states but also the ten new members who may also be entitled to the coupled options as outlined in table 3. This is further complicated by the fact that Romania and Bulgaria could accede to the EU by 2007.

Conclusion

The cap on the blue box at 5% of the total value of agricultural production gives the EU-15 some ‘water’ between the proposed blue box cap level (about 12.75 billion euros) and current estimated expenditure (8.1 billion euros). The same is probably true of the EU-25 but figures for future blue box expenditure is difficult to calculate. The EU probably requires this ‘water’ given the uncertainty regarding the final actual expenditure. Therefore, there appears to be little, if any current flexibility within the EU’s negotiating position. In contrast, the EU may accept the concept of product specific disciplines within the blue box – an idea that was discussed at the various mini-WTO meetings in May 2004.

ActionAid’s recommendation on the blue box

WTO members should agree that blue box subsidies should be eliminated immediately.

Table 3: Current and projected blue and green box support in the EU[15]

Billion euros	Pre 2003 CAP agreement	Post 2003 CAP agreement	
	EU-15	EU-15	EU-25
Total value of ag production (TVAP)	250	255	c290
5% of TVAP		12.75	c14.5
Blue Box coupled payments	29.4	8.1 (2006)	)
Green box decoupled payments	0	21.3 (2006)	) c34.0 (in 2013)*

* The amounts in the blue and green box for the EU-25 are difficult to predict; in any event, the final total in 2013 is increasingly likely to be scaled back quite significantly because of recent proposals from the European Commission to revise down total EU spending during the period 2007-2013

Green Box

Introduction and summary

The EU will not agree to a cap on the green box. If the EU agrees to a review, it will be

[14] AgraEurope, 2003. A CAP reform agreement that – just about - delivers. 27th June.

[15] European Parliament, 2003. Op cit. Page 93.

largely superficial for tactical reasons so as to ensure that the criteria could not be tightened once open.

Background

The US has had decoupled green box payments since the 1996 FAIR Act; the EU has also spent a considerable amount of political capital within the recent 2003 CAP reforms to move some of its support out of the blue box into the green box.

Yet the EU is reluctant to either cap green box subsidies or to conduct a review of the criteria of green box subsidies. The EU appears to believe that a cap would be unacceptable for the following reasons:

- They are non-trade distorting and therefore should not be disciplined within the WTO;[16]
- The final amount of all EU green box subsidies is difficult to predict not only due to the new ten member states but new members will probably accede to the Union by the end of the decade.[17]

But if the EU is so convinced that its green box subsidies are non-trade distorting, why are they so reluctant for a review?[18] As AgraEurope states: "[A review] *gets to the heart of the confidence trick which underlies the entire agricultural subsidisation debate in the WTO.*"[19] ActionAid would contend that so-called decoupled payments – and future decoupled options in the EU – will continue to distort production and trade (with resulting impacts on developing countries) due to the following five interlinked reasons (and consequently, ActionAid believes that a comprehensive review is urgently required):[20]

1. EU decoupled subsidies would fail the following simple test. AgraEurope continues:

> "*The EU is effectively asking developing countries to accept that the 30 billion euros or so which the EU is proposing to pour into the [decoupled] Single Farm Payment scheme every year… will have no real influence on agricultural production and trade. At the very least, the question could be asked whether the level of EU farm production would be affected in any way if these subsidies were no longer paid (the answer of course is that it would be decimated – thus instantly challenging the assumption that they are production neutral.)*"[21]

2. Current green box payments in the US – and else where - suggest they distort production and trade.

Green box 'decoupled' direct payments have been a feature of the US subsidy regime since 1996 when the FAIR act

[16] AgraEurope, 2003. EU Ministers at sea on WTO future. 26th September 2003.
[17] Decoupled subsidies are only part of many other types of support that qualifies for green box status; for example agri-environment schemes, domestic food aid and inspection, marketing and promotion services also qualify.
[18] The EU's stance on a review depends on who who talk to in the Commission. DG agriculture does not want to touch it all whilst DG Trade and Ambassadors in Geneva have talks about a review would take place 'during negotiations' or at least 'engage in a debate'.
[19] AgraEurope, 2003. Lessons to be learnt from Geneva. 26th September 2003.
[20] This is taken from a larger ActionAid study on the green box which hopefully should be ready in June 2004.
[21] AgraEurope, 2003. Lessons to be learnt from Cancun. 26th September 2003.

introduced production flexibility contracts – PFCs – which ran from 1996 to 2002. Many believe that PFCs were not totally decoupled and distorted production for the following reasons:[22,23]

- Wealth effects; guaranteed payments were an annual flow of income that the farmer may invest in the farm operation, potentially increasing production.
- Any income that reduces income variability – and thus risk – will tend to increase output.
- The PFC programme ran from 1996 to 2002. The farmer may well have felt compelled to keep production and acreage high in case the base reference changed to more recent years. This is exactly what happened in 2002 when the programme changed under the US Farm Bill (the Farm Security and Rural Investment Act – FSRIA).
- The payments were not totally decoupled because, whilst a farmer did not have to produce anything to receive the subsidy, the farmer was not allowed to grow certain other crops – such as fruit and vegetables – on the land. The farmer thus has an incentive to keep growing the crops that were eligible for the programme.

Whilst production estimates are difficult given the limited data available, evidence from the US on PFCs suggests that these subsidies have increased the total planted acreage.[24] The Economic Research Service (ERS) predicts that under the PFCs the area of total plantings increased by between 225,000 to 725,000 acres.[25]

The 2002 US Farm Bill replaced PFCs with 'Direct Payments' (DPs) and this new programme appears to be slightly more flexible but there are <u>still</u> limitations on planting certain crops, for example fruit and vegetables (thus casting doubts as to whether DPs are totally decoupled). The ERS also continues to highlight some of the issues encountered under the PFCs: "*The economic impacts for DPs are similar to those for production flexibility contract payments under the 1996 Farm Act. DPs increase farm income. Since PFC payments increased producer wealth and could have facilitated additional investment, PFC payments likely led to slightly higher crop production… since producers have the option of updating base payment acres in 2002 from 1996 levels, and since new crops have been added to the program, farmers may have an incentive to continue producing crops and/or to expand production in order to maintain a production history in anticipation of future opportunities to expand payment acres.'*[26]

3. It is predicted that green box payments in the EU will continue to distort production and trade

Whilst it is too early to predict with any certainty what impact the EU decoupled payments will have on production and trade, most (but not all) models shows that

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[22] Gardner, B., 2002. *North American Agricultural Policies and Effects on Western Hemisphere Markets since 1995, with a Focus on Grains and Oilseeds*. Department of Agricultural and Resource Economics. University of Maryland, page 18. http://www.arec.umd.edu/Publications/papers/Working-Papers-PDF-files/02-12.pdf

[23] Andrews, N., R. Nelson, S Hagi Hirad and I. Shaw, 2002a *Grains Policies in a Global Market.* Abare Research Project, Report 02.8.

[24] Gardner, 2002. Op cit.

[25] ERS, 2000. *US Farm Program Benefits*. Economic Research Service/USDA. http://www.ers.usda.gov/publications/agoutlook/oct2000/ao275e.pdf

[26] ERS, 2004. *ERS Analysis – Direct Payments.* Economic Research Service/USDA. http://www.ers.usda.gov/Features/farmbill/analysis/directpayments2002act.htm

it will either make little difference on current EU production levels or in fact increase production in certain sectors - ie, that the decoupled payments will continue to produce surpluses in certain sectors which have to be sold (and often dumped) onto world markets. Table 4 shows four such models conducted for the European Commission.

Table 4: EU-15 cereal production 2002 and 2009 (after the introduction of the MTR reform proposals)[27,28,29]

	EU Production 2002 (mill tonnes)	Impact models – EU Production in 2009: CAPSIM	FAPRI	CAPRI	CAPMAT	Average increase	Projected EU15 consumption 2002-07
Soft Wheat	97.2	99.9	108.2	96.5	102.2	101.9 (+5%)	+4%
Maize	40.7	42.6	42.0	38.9		41.2 (+1%)	(+2%*
Barley	48.5	47.8	51.5	50.0		49.8 (+3%)	(
Durum wheat	9.2	8.8	9.6	7.0	9.8	8.8 (-4%)	
Rice	1.5		1.8	2.9	1.2	2.0 (+33%)	+0.5%
Rye	5.4		4.7	6.0	4.5	5.1 (-6%)	

* Coarse Grains (Maize, barley, oats etc)

This is confirmed in an assessment conducted by the EU.[30] EU-15 cereal production is expected to show a moderate increase - 217 million tonnes in 2004 to 223 million tonnes in 2010 – although the Commission argues this surplus could be absorbed by internal EU demand. An OECD study reveals a similar trend.[31]

In terms of specific sector studies, one of the most recent surveys was conducted in the UK dairy sector[32] and summarised by AgraEuropa:[33] "*The European Union's new direct payments for dairy farmers which come into operation in 2005 are likely to act as an incentive to increased efficiency, will stimulate the consolidation and enlargement of dairy holdings – and will maintain production at current levels.*" The basis for this conclusion is as follows. Despite the fact that EU farmers do not have to produce anything to get the new decoupled payments, the authors assume that farmers do not respond in an economically rational manner – they are determined to remain in farming despite low returns. Their likely policy response is thus to "*treat the direct* [decoupled] *payments as coupled if that is necessary to achieve their ambitions* [ie remain in farming]".[34] It is thus expected that farmers will include the financial payments as part of their revenue, thus influencing their production decisions and potentially using the new decoupled payments to bridge the

[27] Goodison, P. Some Critical Reflections on the Impact Assessment Studies of the CAP MTR Proposals. ERO, Brussels.
[28] European Commission, 2003d. *CAP Reform: Impact Analyses of the Mid-term Review Proposals.* http://europa.eu.int/comm/agriculture/publi/reports/mtrimpact/index_en.htm
[29] OECD, 2001. *OECD Agricultural Outlook 2001-2006*. Organisation for Economic Co-operation and Development. http://www1.oecd.org/publications/e-book/5101061E.PDF
[30] European Commission, 2003. *Reform of the CAP: Mid Term Prospects of Agricultural Markets and Income in the EU 2003-2010*"http://europa.eu.int/comm/agriculture/publi/caprep/prospects2003b/fullrep.pdf
[31] OECD, 2004. Analysis of the 2003 CAP Reform. Paris.
[32] Colman, D. and D. Harvey. *The Future of UK Dairy Farming*. http://www.defra.gov.uk/foodrin/milk/colman-harveyreport.pdf
[33] AgraEurope, 2004. New EU Dairy Aid Payments will Boost Milk Production. 6th February.
[34] Colman and Harvey, op cit.

gap between low prices and higher costs of production.

It is also predicted that there will be little change in the production of cotton under a recent agreement. In September 2003, the Commission proposed a set of reforms to the EU cotton sector that would provide producers with 60% decoupled income payments (green box) but the remainder would remain coupled to production (ie trade-distorting blue box subsidies). Member states have now agreed to this proposal with a slight modification (65% will be decoupled and 35% will be coupled).

The original cotton proposal by the Commission was severely criticised by the Dutch Ministry of Foreign Affairs: "*From the perspective of poverty reduction, this reform proposal is seriously inadequate because it will have little or no effect on the volume of subsidised cotton production within the EU, and will therefore continue to disadvantage more efficient cotton producers in many developing countries.*"[35] The slightly different agreement reached by the EU member states in April 2004 will have done nothing to allay these fears.

A further concern of the EU system is that the reference years for the EU decoupled payments (2000-2002) are even more recent than in the US effectively tying it to recent production (most EU member states have opted for this proposal). But what impact this will have on production is difficult to gauge since the new EU system will not become effective until 2005 at the earliest. But similar to the US system, farmers may feel compelled to keep production high in order to have a production history in case the system changes in the future.

4. The interaction with other policies (ie supplementary trade distorting amber and blue box subsidies) will have an impact on 'decoupled' green box payments.

When production flexibility contracts were introduced into the US in the 1996 Fair Act, they appeared to be minimally distorting in that they were not related to current production volumes, areas or prices. However, PFCs were supplemented by massive emergency payments which were paid when prices fell: "*the provision of these emergency payments calls into question whether the production flexibility contracts themselves remain decoupled …. Farmers are still responding to government policy rather than to undistorted market prices. Consequently the system as a whole is not decoupled.*" [36]

This remains an important consideration in both the 2002 US Farm Bill and the 2003 EU CAP reform. In the former, direct payments (green box) sit along side counter cyclical payments (amber/blue box), loan deficiency payments and marketing assistance loans (amber box). In the 2003 EU Cap reform, direct decoupled payments (green box) will sit alongside direct coupled payments (blue box), price support (amber box) and export subsidies. It would thus appear impossible that green box subsidies are decoupled given the additional influence on farmers' decisions from blue and amber box support.

5. Dumping will continue from the EU

If the future projections for, say, increased cereal production in the EU by the European Commission and others are

[35] Netherlands Ministry of Foreign Affairs, 2003. Assessing the Commission's Cotton Reform Proposals from the Perspective of Development C0operation. Preliminary non-paper, October.

[36] ABARE, 2002. Global Grains Policy and WTO Agricultural Negotiations.

correct, then there is little doubt that a substantial proportion of cereal exports from 2005 will continue to be dumped despite decoupling. This is because, currently (mid 2004), many arable products are still being sold at less than the cost of production (see table 5) and ActionAid would contend that decoupled subsidies are very likely to be used by EU producers – particularly in the short to medium term - to cover the continuing difference between higher costs and lower domestic and world prices.

Table 5: The Difference between farm and export prices in the UK and cost of production[37,38]

£/tonne	UK ex-farm price Mid May 2004	UK export prices Mid May 2004	UK cost of production 2004
Wheat	88-95	79 (feed wheat)	105
Barley (feed)	75	78	130
Rape	200	-	240

The UK is one of the more efficient arable producers in the EU

Advocates of decoupling will argue that, in the longer-term, producers may well decide not to produce if the cost of production continues to be higher than farm gate prices and instead just keep their land in good agricultural order (but still receive decoupled subsidies). However, the study by Colman and Harvey (see above) on the future of dairy farming in the UK under a decoupled system casts some serious doubt on this assessment.

ActionAid's recommendation on the green box

For all the above reasons, an on-going review of the green box is urgently required with a view to the tightening of green box criteria.[39]

EXPORT SUBSIDIES

Introduction and summary

Together with market access, ActionAid believes this has become the key negotiating pillar for the EU. If the EU is forced to agree an end date for the elimination of export subsidies, it will only do so if it can extract as many trade-offs elsewhere. In return for eliminating export subsidies at the WTO, the EU may attempt – at the insistence of some member states - to limit market access into the EU to an absolute minimum or seek to find trade-offs in other non-agricultural sectors.

Unless there is further major CAP reform within the next few years, the European Commission's own figures show that the EU will still be using large amounts of export subsidies for dairy, meat and possibly sugar products in 2013. These will continue to have devastating impacts on developing country markets. ActionAid thus believes that the EU will have great difficulty in agreeing an end date on export subsidies in these sensitive sectors before

[37] Nix, J. 2003. Farm Management Pocketbook. 34th (2004) Edition. Imperial College London, Wye Campus.
[38] HGCA, 2004. Home Grown Cereal Authority web site. http://www.hgca.co.uk/

[39] ActionAid proposes that green box subsidies should be, as far as possible, fully decoupled from production (for example, making a complete break from historical reference years) and targeted at the delivery of public goods (for example, conserving the environment, enhancing rural development, promoting more sustainable agricultural practices and supporting small-scale producers).

2013. Any movement in this area by the EU will depend on 'full parallelism'.

Background

The EU's Final Agreement on CAP in 2003 is predicted to have a limited impact on export subsidies. In the absence of any further reforms over the next few years, the following amounts of export subsidies in some sectors are forecast in Table 6. Without further reform, the EU will still be using large amounts of export subsidies by 2013 particularly in the sensitive sectors dairy, meat products and possibly sugar.

Table 6: EU export subsidies to 2013[40]

Million euros	2004	2013+
Dairy	1,400	>620
Beef and veal	480@	375
Sugar	1,200*	??#
Cereals (excl rye)	125	130
Rice	33	0

@ This quoted figure is well above the 2004 budget for beef export refunds at 286 million euros.
\+ Assumes no further reform in the dairy, beef and cereal sectors following the 2003 Agreement. The exact amounts in this column will be heavily influenced by the $-Euro exchange rate and also the difference between the world price and EU internal price in 2013
# Depends on the agreement for reform of the sugar sector; proposals are currently being considered by the member states
* 2001 figures

There is thus little current prospect that the EU can agree an end date prior to 2013 for these products. One possible option is that the EU will adopt a two-pronged approach. Agree to an end date for products that have already been reformed – wheat, oilseeds, olive oil, tobacco and possibly rice – whilst agree to a 'commitment' to negotiate an end date for the other products. A second option is that the EU sets different end dates for all products – but it is likely that the end date for some sensitive products – dairy, meat and possibly sugar - might have to be set as late as 2020.[41] Whether this would be acceptable to other WTO members is another matter and it would entail major reforms to the current CAP agreement which is envisaged to run until 2013.

However, for any of this to occur the EU is still insisting on 'full parallelism' – that other countries also fully eliminate the subsidy component of their export regimes – and reaching acceptable outcomes to the EU at the WTO on domestic subsidies, market access and non-trade concerns (which is a particular concern to the EU). However, the International Trade Daily reports that: "*Some officials have suggested that parallelism may be a strategy by Brussels*

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[40] European Commission, 2003. *CAP Reform – A long-Term Perspective for sustainable Agriculture.* Annexes to Coucil Regulations COM (2003) 23 final. Pages 151 to 153. http://europa.eu.int/comm/agriculture/capreform/memo_en.pdf

[41] AgraEurope also makes the following observation: "*Even by the most optimistic political timescale, the Doha Round agreement is unlikely to be signed and sealed before 2006, with any resulting Agriculture Agreement coming into force from 2007 and 2008 … there will also inevitably be a phasing out period for export subsidies, extending probably for at least six years. That means it would be* **[at least]** *2014 before export subsidisation finally becomes a thing of the past*" (our emphasis). AgraEurope, 2004. EU Offer on Export Subsidies Heralds End of an Era for CAP. 14th May 2004.

to impose conditions which it knows will be difficult for the US to accept, thus allowing it to avoid blame for failing to move on the export subsidy issue".[42]

ActionAid's recommendation

All forms of export subsidies – for example export refunds and credits – should be eliminated immediately.

MARKET ACCESS INTO THE EU

Introduction and summary

Together with export subsidies, ActionAid believes this has become the key negotiating pillar for the EU. If the EU is forced to agree an end date for the elimination of export subsidies, it will only do so if it can extract as many trade-offs elsewhere. In return for eliminating export subsidies at the WTO, the EU may attempt – at the insistence of some member states - to limit market access into the EU to an absolute minimum or seek to find trade-offs in other non-agricultural sectors. In any event, The European Commission has already made it clear that the current internal reforms to the CAP would not deliver unlimited possibilities in the area of market access.[43]

Having originally proposed the blended formula within the EU-US agriculture paper to the WTO, the EU has indicated that the UR element (as opposed to the Swiss formula element) of the blended formula must be given significant prominence. In the current EU-Mercosur trade negotiations, the EU appears to be willing to cut tariffs and expand quotas – but the EU has indicated that this may well result in less EU flexibility (cuts and quotas) in the WTO.

[42] International Trade daily, 2004. EU-US Rift on Parallelism Emerges on WTO Export Subsidy Agreement. 17th May.

[43] AgraEurope, 2004. EU says it will go further on export subsidy elimination. 23rd April.

Background

The UK Government has confirmed ActionAid's view that predicting the degree of flexibility that the EU has on market access is difficult given the complexities surrounding the blended formula, the interaction between tariff levels and tariff rate quotas and the sheer volume of tariff lines. Any flexibility is also currently being affected by the on-going EU-Mercosur trade talks. However the G20 has rejected the blended approach and, it is reported, will be coming forward sometime in June 2004 with their own banded or tiered proposals for market access.

Currently, the EU continues to support the blended formula but so long as the UR element (as opposed to the Swiss formula element) of the blended formula is given significant prominence. In response to US suggestions that the number of tariff lines under the UR formula element would be restricted to 2-3% for developed countries, the EU responded that the percentage would have to be in double figures.[44]

The trade negotiations between the EU and Mercosur continue but the Commission has indicated if "*extra* [tariff] *quota is granted in bilateral talks much less can be put on the table in the Doha Round*".[45] Tariff cuts within the EU-Mercosur deal are also being planned. What the Commission appears to be offering to Mercosur is a banded approach:[46]

Table 7. Possible Market Access Scenarios into the EU

[44] AgraEurope, 2004. Market access – the key to unlock the WTO Doha Round. 8th April.

[45] AgraEurope, 2004. EU, Mercosur set to swap trade offers. 16th April.

[46] AgraEurope, 2004. No progress on Med Products at EU Farm Council. March 26.

Products
Mercosur banded offer ? WTO
blended offer ?

Sensitive products Dairy, meat, sugar
No reduction of EU tariff + UR
formula and/or

strict quota protection[47] TRQs
Moderately sensitive Mostly other EU
TRQ would apply UR
and/or Swiss formula
Agr goods
and/or
expanded TRQs
Least sensitive Mostly non-EU
Tariff cuts without quota Swiss
formula
Agr goods
restrictions without
quotas

ActionAid's recommendations

Developed countries should offer immediate duty free and quota free access to all products from LDCs. Tariff regimes should be simplified, tariff escalation should be eliminated and tariff peaks reduced. However, market access must work in favour of development and the poor. In part, access should favour small-scale farmers, add value, bring benefits to low income producers and workers, and promote sustainable agriculture (particularly the impacts on the environment). The developed world and international donors should support developing countries to achieve these goals.

CONCLUSIONS

ActionAid believes that the key agricultural pillars for the EU at the WTO are now export subsidies and market access. If the EU is forced to agree an end date for the elimination of export subsidies, it will only do so if it can extract as many trade-offs elsewhere. In return for eliminating export subsidies at the WTO, the EU may attempt – at the insistence of some member states - to limit market access into the EU to an absolute minimum or seek to find trade-offs in other non-agricultural sectors.

Why will the EU potentially now seek concessions in market access and not domestic support? Whilst the EU has, once again, recently proposed to make "*very significant commitments*" on domestic support at the WTO, ActionAid would question if the EU has much negotiating flexibility above and beyond its current positions. And because the EU has relatively firm positions – with figures – for reduction commitments on both the amber and blue boxes as well as a position on the green box, the EU will find it difficult to retract these positions if a trade-off is required for the elimination of export subsidies.

In contrast, because the EU has yet to provide any concrete figures under the blended formula, it is in the area of market access that the EU has some negotiating flexibility and may use it to claw back concessions. The European Commission has also made it clear that the current internal reforms would not deliver unlimited possibilities in the area of market access.

[47] In contrast, the Financial Times (April 14 4004) says that the EU is 'expected' to offer limited access improvements to sensitive products – dairy, beef and sugar – by increasing import quotas.