The EU minimal OTDS in the implementation period

Jacques Berthelot (jacques.berthelot4@wanadoo.fr),
Solidarité (http://solidarite.asso.fr/home/Agriculture06.php),
18 July 2008

I – What the official figures are saying

1) The EU offered the 28 October 2005 to cut its allowed Final Bound Total AMS (FBTA) of €67.159 billion as of 30 June 2001 by 70% at the end of the implementation period – i.e. to €20.147 billion – and its allowed overall trade-distorting domestic support (OTDS) by the same rate of 70%.

Given an average total value of production (VOP) of €222.577 billion in the base period 1995-2000, the product-specific *de minimis* (PSdm) and non product-specific *de minimis* (NPSdm) were of €11.129 billion. According to Canada's simulations of May 2006 – which have cheated on the definition of the allowed PSdm –, the allowed EU OTDS for the base period 1995-00 was of €110.305 billion: 67.159 (FBTA) + 11.129 (PSdm) + 11.129 (NPSdm) + 20.888 (BB) = 110.305

So that the allowed OTDS offer by the EU for the end of the implementation period would have been of €33.092 billion.

But the Revised draft asks (paragraph 3) that the EU OTDS be cut between 75% and 85%, i.e. should fall between €16.546 billion and €27.576 billion.

2) However the Revised Draft says also (paragraph 30) that the PSdm and NPSdm shall be reduced each to 2.5% (5% for both) of the VOP the first day of the implementation period. It says also (paragraph 39) that the EU BB should be reduced by the same rate as for FBTA, i.e. by 70%, to €6.266 billion.

3) So that, according to the sum of its 4 components, the EU OTDS should be reduced to €37.543 billion: 20.147 (FBTA) + 5.565 (PSdm) + 5.565 (NPSdm) + 6.266 (BB) = 37.543

5) Now paragraph 11 of the Revised Draft states: "*For those Members that, under these modalities are subject to reduction commitments in their Base OTDS, such commitments shall apply as a minimum overall commitment. Throughout the implementation period and thereafter, each Member shall ensure that the sum of the applied levels of trade-distorting support under each OTDS component does not exceed the Annual and Final Bound OTDS levels specified in Part IV of its Schedule*." As the €37.543 billion corresponding to the sum of individual cuts in each of the 4 OTDS components exceeds largely €27.576 billion (75% cut in the allowed OTDS of the base period) and even more €16.546 billion (OTDS cut by 85%), this implies that additional cuts would be necessary.

And paragraph 30 states that, in that event, the additional cuts should be made on *de minimis*: "*Furthermore, where, in any year of the implementation period, a lower level of de minimis support than that resulting from application of that minimum percentage reduction would still be required to ensure that the Annual or Final Bound OTDS commitment for that year is not* *exceeded, a Member shall undertake such an additional reduction in what would otherwise be its de minimis entitlement*."

Which means that the excess €9.967 billion (37.543 – 27.576) in case of a minimal cut of 75% in the allowed OTDS would reduce the sum of the allowed PSdm and NPSdm to €1.163 billion, i.e. to 0.52% of VOP, each of them being capped at 0.26% of the VOP of the base period.

However, in case of an OTDS cut by 85%, the elimination of PSdm and NPSdm would not be enough to make up the excess of the sum of cuts in the 4 OTDS components over the cut in the allowed OTDS: €20.997 (37.543 – 16.546) exceeds the sum of PSdm and NPSdm by €9.867. Even the elimination of the allowed BB (6.266) would not suffice so that this would imply an additional cut in the applied total AMS, the applied OTDS itself having disappeared.

II – The EU official OTDS in 2003-04 and estimates for 2007 to 2009

1) The last EU notified AMS for 2003-04 has dropped to €30.880 billion, of which €27.620 billion in fake market price support (MPS) implying no subsidy and €3.260 billion in actual subsidies which therefore accounted for only 10.56% of total amber box.

The notified PSdm was of €901 million and the notified NPSdm of €1.052 billion. The notified blue box was of €24.782. Therefore the applied OTDS was of €57.615 billion.

2) Estimate of the EU OTDS in 2007-2009

Since the CAP reform which began in 2003 the EU has progressively transferred most of its blue box and part of its amber box domestic subsidies (market interventions) to the allegedly green box fully decoupled income support of the SFS (single payment scheme) for the EU-15 and SAPS (single area payment scheme) for the EU-12. Let us remember that the EU was enlarged from 15 to 25 Member States the 1st January 2004 and to 27 the 1st January 2007.

The tendency for the EU is not only to go on transferring the residual market interventions on the domestic market (amber box subsidies) and for exports (refunds) to the blue box and the blue box to the green box but also to its Member States national budgets which are much less transparent because it is difficult to know which subsidies are in the amber box, even if, on principle, they should not distort competition between Member States. But the definition of State aides on agriculture is rather loose: "*By state aids on agriculture it should be understood all State aids, including aid measures financed by parafiscal taxes, granted in connection with activities related to the production, processing and marketing of agricultural products*". In fact, from January to September 2007, 49% (€2.080 over € 4.267 billion) of State aids appropriated for agriculture (not necessarily spent in 2007) billion were amber box subsidies (insurance subsidies, investments in farms and processing industries, promoting quality products). More details on State aids to agriculture can be found pages 31-32 of a preceding paper[1].

[1] Solidarité, *Review of the EU agricultural distorting supports to rebuild fair and sustainable agricultural trade rules after the Doha Round hibernation*, 29 December 2006, http://solidarite.asso.fr/home/textes2006.htm

Table 1 – Evolution of the EU agricultural budget from 2002 to 2009

€ billion	2002	2003	2004	2005	2006	2007	2008 e	2009 e
SPS+SAPS: decoupled (green box)	-	-	-	1.449	16.263	30.368	30.494	32.525
BB: not fully decoupled income support	28.801	29.692	29.825	33.701	17.694	6.679	6.338	6.552
Domestic amber: market intervention	6.632	6.360	5.089	5.349	5.436	4.165	2.727	2.689
Export refunds	3.432	3.730	3.384	3.052	2.494	1.443	1.105	0.336
Rural development (green)	4.349	4.680	6.462	6.827	7.719	10.869	11.379	10.923
Total EU common agricultural budget	43.214	44.462	44.760	50.378	49.606	53.694	52.458	53.846
State aids/agriculture	14.494	14.082	14.107	16.000	16.289			
Total EU agricultural subsidies	57.708	58.544	58.867	66.378	65.895			

Sources: e: appropriations for 2008 and 2009 (http://eur-lex.europa.eu/budget/data/AP2009_VOL4/EN/nmc-titleN123A5/nmc-chapterN50452281343-265/articles/index.html#N50452385150-509); http://ec.europa.eu/agriculture/fin/finrep06/annexes.pdf; http://ec.europa.eu/comm/competition/state_aid/studies_reports/stat_tables.html

In fact the tendency is to renationalize the CAP, which has just been confirmed by the new regulation proposed by the EU Commission the 7 July 2008 for a broad enlargement of State aids[2]. For agriculture this regulation does not cover the primary production of agricultural products except for training aid, aid in the form of risk capital, aid for research and development, environmental aid – which includes aids to "sustainable" biofuels! –, aid to processing and marketing at a stage beyond the first delivery of products by farmers. The aid per project can go up to €7.5 million for risk capital for investment, for environmental protection and up to €2 million for training and research.

Even if the above table shows the shrinking share of the subsidies component of the applied AMS, it is difficult to estimate its (fake) market price support (MPS) component which is also shrinking because the intervention prices are progressively disappearing for most products, the next ones to disappear being those for fruits and vegetables (their MPS accounted for €8.102 billion in 2003-04). Which means that the EU applied AMS will continue to shrink, as will its BB.

However the EU has largely cheated in its notifications of domestic subsidies, and this change a lot its allowed and applied OTDS.

III – Incorporating the EU and Chair's cheatings on the AoA and the Draft internal contradictions

1) We have first to put right the actual allowed PSdm of the base period which is not 5% of the whole VOP but only 5% of the production value of products without PS AMS. Here, beyond the products notified with PS AMSs we have to take into account the animal products that the EU should have notified with PS AMSs. The reasons for this and the inconsistency of the Revised Draft on PSdm are explained in details in a 13 July paper so that it is not necessary to duplicate them here[3].

[2] http://ec.europa.eu/comm/competition/state_aid/reform/gber_final_en.pdf

[3] Jacques Berthelot, *The US allowed OTDS of the base period cannot be cut by more than 52.7%*, Solidarité, 13 July 2008.

The EU average *notified* product-specific (PS) AMSs have been of €48.242 billion in the base period 1995-2000 but the *actual* PS AMSs have been of €61.901 billion, once taken into account the non notified PS AMSs on animal products, oilseed meals, pulses, butterfat, casein and storage.

The issue is complicated by the fact that the EU has not notified the production value of products notified with a PS AMS from 1995-96 to 1999-00 but only for 2000-01. In fact the main reason why the Revised draft – as all the previous agricultural drafts issued since the Framework Agreement of 31 July 2004, including Canada's simulations of May 2006 – have changed the rule on PS *de minimis*, at least for the reduction commitments during the Doha Round implementation period, is that several Members, including the EU and Japan, have not been able or willing to notify the production value of each product with a calculated AMS.

However we have been able to reconstitute the production value of all products notified with a PS AMS, which has been on average of €122.922 billion in the base period so that the production value of products without PS AMSs has been of €99.655 billion and the allowed PSdm of €4.983 billion.

Adding the production value of animal products, oilseeds and pulses getting PS AMSs to that of the products already notified with a PS AMS increase the production value of products with AMSs to €201.323 billion on average in the 1995-00 period so that the average production value of products without a PS AMS shrinks to €21.253 billion and the allowed PSdm to €1.063.

However the actual EU blue box (BB) has been of only €11.145 billion on average in the base period instead of €20.888 billion because €9.743 billion in BB payments to cereals, oilseeds and pulses (COPs) have been transferred to the PS AMSs of animal products having consumed the COPs.

Therefore the allowed OTDS for 1995-00 becomes: 67.159 (FBTA) + 11.129 (NPSdm) + 1.063 (PSdm) + 11.145 (BB) = €90.496 (instead of 110.305 in Canada's simulations)

Finally, cutting the allowed OTDS between 75% and 85% would bring it between €13.574 billion and €22.624 billion at the end of the implementation period.

2) Rectifying the EU huge under-notifications in its NPS AMS

The average NPS AMS of €528 notified in the base period have been hugely under-notified given that we should add the €5.638 billion on investments subsidies (improperly notified in the green box), €1.2 billion of irrigation subsidies (no notification at all), €2 billion in tax rebates on agricultural fuel (no notification at all), €500 M on agricultural insurances (only notified for €101 million) and €200 M on agricultural loans (only notified for €420 million), which will raise the NPS AMS to around €10 billion on average. All the detailed justifications are given in the paper mentioned in footnote 1.

The more so as we do not take into account, as we should, at least 40% of the €15.616 billion in State aids to agriculture, which would raise the average NPS AMS to more than €16 billion, then exceeding largely the allowed NPSdm of €11.129 billion.

Nevertheless the applied NPSdm has been exceeded in 1995-96 so that the €11.279 billion of NPS AMS for that year (exceeding the allowed NPSdm of €10.370 billion) has been transferred to the total AMS which has jumped to €73.535 billion for that year, increasing the average applied total AMS of the 1995-00 period from €61.901 billion to €63.628 billion.

However this is for the base period and let us turn to the present and future situations.

3) The SPS and SAPS are not in the green box or the blue box but in the amber box

Of a much greater concern is the fact that the EU considers that its SPS (single payment scheme) and SAPS (single area payment scheme) are in the green box, even though they have not yet been notified because of the EU recurrent overdue notifications (the last one being for the 2003-04 marketing year). Let us remind the main reasons why they cannot be in the green box nor in the blue box and are therefore in the amber box. We will concentrate on the SPS because the SAPS is a transitory status for the EU-12 which will join the SPS status in 2013.

a) The SPS is not in the green box because it does not abide by 3 of the 5 conditions imposed by the AoA Annex 2 paragraph 6 for the decoupled income support:

i) It is based on the amount of direct payments received from 2000 to 2002, a criterion not allowed by the condition a) of paragraph 6.

ii) Above all it contradicts the condition b): EU farmers cannot produce what they want since many productions are either forbidden (fruits and vegetables; milk and sugar beet if farmers have no production quota) or capped (rice, cotton, tobacco, olive oil and wine, and not beyond the milk or sugar beet quotas). Now, the only interdiction to grow fruits and vegetables has been enough to condemn the US direct payments to cotton as coupled (Appellate Body of 3 March 2005).

iii) It contradicts the condition d): EU farmers must show each year that they have eligible hectares to receive the SFP so that it is still coupled to the hectarage.

iv) Another reason why the SPS cannot be put in the green box is that, as long as the largest share of the EU COPs will continue to be fed to EU animals, the corresponding share of the SPS derived from the former blue direct payments to COPs will continue to be input subsidies which are in the amber box for the developed countries.

v) Besides, since the SPS cannot be attributed to a particular product, it can be attributed to all of them of which it is reducing the export price below the EU average production cost. All EU agricultural exports can therefore be sued on dumping to the extent their producers are getting the SFP, which concerns nearly all EU farmers.

b) But the SPS cannot be either in the blue box, in the old BB as in the new BB.
i) It cannot be in the old BB for the following reasons:
1- France and Spain have chosen to keep BB for 25% of their production of COPs, 60% of which are fed to animals and hence are input subsidies of the amber box.

2- AoA Article 13.2(b)&(c) states that blue box payments are exempted from challenge at the

WTO "*provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year*". But the CAP reform of 1999 has largely increased the BB payment per ton of COP and even more the BB payments for bovine meat. And the on-going CAP reform since 2003 has created new BB payments for cotton, olive oil, tobacco, hemps, milk, sugarbeet and soon for fruits and vegetables and wine.

3- BB payments were exempted from inclusion in the AMS on the condition to be "*Direct payments under production-limiting programmes*". Which is confirmed by OECD, "*A policy is considered as being effectively decoupled if it does not lead to an increase in production or trade in the country examined compared to a situation in which the policy was not in place*"[4]. Precisely EU-15 cereals production has risen from 181 million tonnes (Mt) in 1992 to 215 Mt in 2002, a significant 11.9% increase, since the average yield has increased by 1 tonne (from 4.72 t/ha to 5.67 t/ha).

The fact that direct payments were granted on fixed yields and on the actual area sown each year within the limit of the ceiling of the base period does not rule out that these payments were coupled, since the increased rate of payment per tonne had been an incentive to increase yields in order to increase production.

4- The AoA Article 6.5 is fundamentally flawed for two reasons: 1) It is based on a theoretical incoherence because any measure limiting production is by essence coupled twice since the restrictive effect on the production level is limiting accordingly a drop in price. It has indeed been shown that a 1% increase in EU's dairy quotas reduces the milk price at the farm gate by 3% and "*Conversely, when supply is fixed by quota, a 1 per cent increase in domestic demand generates a 3 per cent increase in farm milk price*"[5]. 2) The criteria of Article 6.5 cannot limit production. The only way to do it is precisely to impose production quotas and high penalties when they are exceeded, as again it is done for milk quotas. As it is stressed by another OECD study: "*The production effects of a quantitative constraint on a single input such as the base area are accordingly far less direct and automatic than the effects of a quantitative constraint directly affecting output*"[6].

5- The "partial recoupling" authorising the coexistence of BB payments with the new green SPS have had the effect of coupling these BB payments even more since EU farmers are permitted to increase their production as much as they want, thus beyond the ceilings having justified these BB payments. Indeed paragraph 28 of the Preamble of the Council regulation (EC) N° 1782/2003 of 29 September 2003 states: "*In order to leave farmers free to choose what to produce on their land, including products which are still under coupled support, thus increasing market orientation, the single payment should not be conditional on production of any specific product*".

<u>ii) It cannot be either in the new BB</u>: the Appellate Body's ruling of 3 March 2005 in the cotton case – that the US fixed direct payments cannot be put in the green box because farmers are

[4] OECD, *Effects of quantitative constraints on the degree of decoupling of crop support measures*, 15 July 2003.
[5] Consortium INRA - University of Wageningen, *Study on the impact of future options for the Milk Quota system and the common market organisation for milk and milk products*, June 2002.
[6] OECD, *Effects of quantitative constraints on the degree of decoupling of crop support measures*, 15 July 2003.

prevented to grow fruits and vegetables – applies also to the new BB condition of being "*Direct payments that do not require production*. This condition can be interpreted as allowing to produce any type of agricultural product – a full production flexibility – or not to produce any. But EU farmers getting the SPS – practically 100% in the future, once generalized the allocation of the SPS as a EU-wide flat rate per eligible hectare, type of allocation intended by the EU Commission – have to face many more limitations in their production flexibility than their US colleagues: they are prevented not only to grow fruits and vegetables but also to produce milk or sugar (if they do not have production quotas which will be maintained up to 2014-15) and caps have been put on the production of cotton, olive oil, tobacco and wine.

3) The EU-27 future total AMS and OTDS in the implementation period

Therefore the €32.525 billion in SPS+SAPS appropriated for 2009 should be notified in the applied total AMS in the implementation period, and this amount will be a minimum because it will increase up to 2013 when the EU-12 farmers will get their SPS on the same base as their EU-15 colleagues.

The applied total AMS will in fact reach €41.766 billion in the near future, once added the remaining market intervention subsidies of €2.689 billion and even the remaining BB of €6.552 billion appropriated for 2009, more than twice higher than the allowed €20.147 billion at the end of the implementation period. Indeed the revision of the CAP (common agricultural policy) contemplated by the EU Commission at the latest in 2013 is to get rid of the BB. In any case this remaining BB still incorporates feed subsidies in the SPS allocated to France and Spain which have not fully decoupled their subsidies to COPs.

Therefore the applied total AMS of 2014 will be at least of €41.766 billion, twice as much as the allowed €20.147 billion!

And the EU OTDS will be at least of €51.832 – 41.766 (total AMS) + 10.066 (NPSdm) –, exceeding the allowed OTDS, which should be between €13.574 billion and €22.624 billion at the end of the implementation period, by between €29.208 billion and €38.258 billion!

This is a very minimum because: 1) we have not taken into account the State aids which are going to increase; 2) we have kept the same level of NPSdm as in the base period whereas it should increase significantly because it will apply to the EU-27 and not to the EU-15.

A last issue is that the elimination of formal export subsidies would not stop the EU dumping because the large drop in the EU agricultural prices has been compensated by large domestic subsidies of the blue and green boxes which are benefiting as well to the exported products.

As the US emperor the EU king is also naked.