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# The WTO and US Agricultural Policy: Intersections and Consequences

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## Introduction

Except during the Korean War and in 1959, US agriculture has recorded a positive trade balance on a fiscal year basis since the second year of World War II. Largely as a result of agricultural productivity growth during the 20th century, US agricultural production consistently exceeds the domestic demand for food, feed, and fiber, resulting in an increasing reliance by US agriculture on foreign markets for sales of US products. The US policy approach looks toward multilateral reform of agricultural policy under the auspices of the World Trade Organization (WTO) as a prime opportunity to achieve gains in market share.

On the other hand, US agriculture also has been the beneficiary of federal farm spending over approximately the same period, intended to support prices and/or income of American farmers, with the stated objective of maintaining a healthy rural economy. Periodically, Congress re-examines legislation that authorizes such programs, commonly known as farm bills. The current farm bill is due to expire in 2007.

Several key features of the US farm programs are regarded by trade analysts as highly distorting of trade and production due to their direct linkage to movements in commodity price and the volume of production or exports. The agricultural reform efforts in the Uruguay Round focused on reducing these types of policies. Both that round and the current negotiations to reform agricultural trade rules under the WTO have been focused on three main areas: (a) improving export competition by ending subsidization of exports, (b) improving market access by reducing tariff rates and eliminating non-tariff barriers, and (c) reducing use of the most trade-distorting forms of domestic support.[1]

Consequently, US support for trade reform within the WTO, if successful, implies changes in US farm programs—a process that should come to a head in the next few years.

## Background

In 1994, 125 countries signed the Final Act of the Uruguay Round in Marrakech, Morocco establishing the WTO and subsuming the General Agreement on Tariffs and Trade (GATT). The various agreements were built on GATT rules, most notably creating a legally binding dispute settlement mechanism and including agricultural trade, trade in services, and trade-related intellectual property rights issues as areas subject to multilateral reforms for the first time.

As of October 2004, there were 148 signatories to the WTO, with 25 more countries in negotiations to accede to the organization. Member countries are currently engaged in a new round of multilateral negotiations formally known as the Doha Development Agenda (DDA), with the stated objective of strengthening existing rules and continuing to reform trade policy and improve market access across the entire spectrum of trade in goods and services.

A so-called framework agreement, reached in July 2004, set consensus boundaries on how negotiations in all key areas will be undertaken, but much work and bargaining will be necessary before a final agreement can be reached. Disputes with respect to issues in agricultural trade have impeded overall progress in the round. In particular, a significant rift has opened up between developed and developing countries as to how much reform they are

1. *Member countries are committed to cap and reduce the most trade-distorting domestic farm support programs under the Uruguay Round. These are known as amber box programs.*

willing to undertake in the three key areas of export competition, market access, and domestic support. Developing countries, under the loose coordination of the G-20 group led by Brazil, India, Argentina, and South Africa, have increasingly asserted themselves in negotiations, a role they first adopted at the failed Ministerial meetings in Cancun, Mexico in September 2003. They are seeking to force developed countries to firmly commit to significant reforms before they will agree to even consider their own reforms.

## US Role in WTO Trade Negotiations

The United States was one of 23 original contracting parties to the GATT, which went into force in 1948. Eight rounds of negotiations intended to liberalize trade were initiated under the auspices of the GATT; the last round, known as the Uruguay Round (URAA) after its launch in 1986 in Punta del Este, Uruguay, culminated in the establishment of the WTO. Two of the rounds were named after officials of the US government—Douglas Dillon, Undersecretary of State in the Eisenhower Administration (and later Secretary of Treasury between 1961 and 1965), and President John F. Kennedy—indicating the prominent role taken by the United States in pushing the liberalization process over the years.

Initially, most GATT members, including the US government, insisted on keeping their agricultural sectors out of the jurisdiction of the GATT. These exemptions or exceptions were embodied in Article XVI of the original GATT agreement (amended in 1955), exempting primary products (including agriculture) from prohibitions against use of export subsidies, and Article XI, which excepted agriculture from restrictions against use of export or import restrictions under certain conditions.

The United States did propose to include tariffs on agricultural products among reductions to be negotiated in the Dillon and Kennedy Rounds in the 1960s, but those proposals were blocked by members of the European Union (then known as the European Economic Community [EEC]), which had formed in 1957. Early in its history, the EEC was focused on developing a Common Agricultural Policy (CAP), which was intended to help European farmers produce enough food to feed all of Europe without having to rely on imports. The major policies adopted to reach this goal were high support prices, export subsidies, and correspondingly high tariffs or variable levies to prevent imported commodities from competing with domestic production. These policies, regarded as highly trade-distorting by most analysts, were in place through the 1990s, but the support price component of the CAP for most commodities is being phased out in favor of direct payments, which are increasingly decoupled from production decisions. These changes are being made to achieve greater predictability in budget costs as well from a desire to position the CAP for further WTO reforms.

In both the Uruguay Round and the Doha Round, the US government submitted initial proposals in the agricultural negotiations that were among the most far-reaching offered. Both proposals were supported by the majority of US agricultural groups as well as many members of Congress from farm states.[2] Under the trade promotion authority provided to the President in the Trade Act of 2002, Congress limits itself to an up-or-down decision on legislation implementing trade agreements without being able to offer amendments; Congress does not vote on the trade agreements themselves.

## Agricultural Trade Negotiations in the Doha Round

Article XX of the URAA specifically committed countries to resume agricultural negotiations one year before the end of the implementation period, in January 2000. A number of countries, including the United States, submitted proposals during the summer of 2000 intended to establish the scope of the reform that would be undertaken. A WTO Ministerial meeting held in Doha, Qatar in November 2001 affirmed countries' commitments to the overall process and established vaguely-worded objectives for agricultural reform and a timeline for completion by January 2005.

Utilizing concepts contained in the various proposals submitted by member countries in 2000 and resubmitted with minor changes in 2002, the chair of the agricultural negotiations, Stuart Harbinson, released a document for consideration in March 2003. This draft text, outlining proposed modalities or methods for proceeding to reform export competition, market access, and domestic support, was intended to forge a compromise between the more far-reaching types of reforms proposed by the United States, Aus-

2. *Groups such as the National Farmers Union and American Corn Growers did express disappointment with the US proposals to reform agriculture under the WTO in the Doha Round.*

**Table 1.** Key features of initial US and EU agricultural proposals in the Doha Round.

| | US proposal | EU proposal |
|---|---|---|
| **Export competition** | •Eliminate export subsidies over a fixed period<br>•End single-desk trading by State trading entities<br>•Prohibit use of export taxes by state trading entities | •Reduce export subsidies by 45% on outlays<br>•Discipline use of export credits and food aid<br>•Discipline unfair practices |
| **Market access** | •Harmonize tariff levels among countries, with no tariff greater than 25%<br>•Reduce tariffs from applied rates<br>•Increase TRQs for sensitive products<br>•End use of special safeguard | •Reduce tariffs an average of 36%, with 15% minimum<br>•Provide duty-free, quota-free access to agricultural products from LDCs<br>•Discipline TRQs<br>•Keep special safeguard |
| **Domestic support** | •Combine amber and blue box supports,[a] limit to 5% of total value | •Reduce amber box AMS (aggregate measure of support) by 55% of agricultural products<br>•Eliminate use of amber box de minimis by developed countries |

Note: Summarized from proposals submitted to WTO during fall of 2002.
[a]Blue box programs are deemed to be trade-distorting but mitigated by use of offsetting production-limiting mechanisms. Spending on blue box programs is not capped under the Uruguay Round.

tralia, and others, and the more modest reforms proposed by the EU and separately by Japan (Table 1). The Harbinson text was widely rejected.

During 2004, WTO member countries renewed their efforts to move agricultural trade negotiations forward and ultimately agreed in July 2004 on a framework document containing several commitments. They are summarized as follows:

- In export competition, eliminate export subsidies over an unspecified period and impose disciplines on use of export credits, food aid, and state trade enterprises.
- In domestic support, reduce spending on "amber box" programs on a tiered basis, so that member countries with the highest level of support deemed as significantly trade-distorting would reduce spending in this category the most.
- In domestic support, cap support under the "blue box" category of spending (programs deemed to be partially decoupled) to 5% of total agricultural receipts while providing for the possibility that the blue box definition would be expanded to include US counter-cyclical payments.
- In market access, reduce bound tariffs on a tiered basis, so that countries with the highest tariffs would have to cut them the most. However, countries would be given flexibility to protect their most sensitive products.

This framework document is extremely sparse on specific numbers representing concrete commitments as to the pace and extent of reform. However, if the final agreement includes significant reform of trade-distorting domestic support programs, the United States would be agreeing to modify and/or reduce its spending on price/income support programs that are currently reported to the WTO as amber box programs in order to meet its obligations. These programs include the marketing assistance loan program for crops such as wheat, feed grains, rice, cotton, and oilseeds, dairy price supports, and the sugar program. If the Doha Round is completed in the next few years, changes to these programs are likely to be incorporated in the 2007 farm bill.

However, such a deal is not a foregone conclusion, as member countries have taken very strong positions about how much they are willing to concede in this round, especially in the agricultural talks. In a November 2004 conference in Athens, GA, American Farm Bureau Federation President Bob Stallman, leader of the country's largest farm group, said, "If the world wants us to decrease our domestic supports, we must be met in-kind with increased market access for all farm goods. Tariffs and other barriers to trade must also be targets in the crosshairs."

It is not clear that a final deal on agriculture that would fulfill terms such as those enunciated by Mr. Stallman can be struck based on the July 2004 framework agreement. Although the main user of export subsidies, the EU, has conceded its willingness to eliminate them over an unspecified period, developing countries in particular have balked at making significant concessions on market access. Although US farm groups do not hold veto authority over trade deals negotiated by the US government, they have direct access to the lead US negotiators as members of Congressionally-authorized advisory committees. They have also demonstrated considerable influence in the past in convincing members of Congress to vote for trade agreements they favor. Because the most recent legislation which granted the

President the authority to negotiate such agreements passed by only one vote in the House of Representatives in 2002, even modest shifts in sentiment on trade issues can have a significant impact, whether it occurs among agricultural interest groups or other groups with political influence.

## WTO Dispute Resolution

Out of the new or strengthened components of the WTO as compared to the GATT, the US government was particularly pleased with the provisions of Annex 2 of the Final Act, which established a new legally binding dispute settlement understanding procedure. Previous US efforts to pursue complaints under the GATT were frustrated by the ability of either party to reject the findings of the dispute settlement panel and prevent them from taking effect. For example, in agriculture, successful cases under the GATT against the EU banana trade regime and the EU ban on hormone-treated beef were rendered moot by the lack of an effective enforcement mechanism.

Within a few years after the WTO agreements took effect, the US and other member countries filed new cases against these two EU policies and won the support of dispute settlement panels. However, it took four years for the EU to come up with a new banana regime that satisfied the other parties, and after more than seven years, the EU has yet to take action in the beef hormone case that satisfies the US and Canada, which was the other complaining party. Unlike with cases filed under the GATT, winning parties under the WTO process are permitted to retaliate against parties that fail to come into compliance with panel findings through imposition of additional tariffs on selected export products sourced from that country.

Through October 2004, there have been 317 separate cases pursued under the WTO dispute settlement procedure, although not all have been followed through to establish panels. During that period, the United States filed 69 complaints under the dispute settlement process, 21 of them dealing with trade in food or agricultural products. The United States has also been the respondent in 80 other cases, 11 of these cases addressing trade in food or agricultural products. From the viewpoint of US agricultural policy, the case filed by the government of Brazil against the US cotton support programs in September 2002 was the first to call US commodity programs directly into question.

## Brazil Cotton Case

Brazil's case challenged aspects of both the US domestic support system and the export programs. The core of Brazil's case with respect to US domestic support programs consisted of two main arguments. First, the level of support provided to US cotton producers between 1999 and 2002 under the 1996 and 2002 farm bills exceeded the level that guaranteed these programs immunity from challenge as illegal subsidies under previously existing trade rules. Second, if the panel agreed with the claim that US programs should be denied such protection under the so-called Peace Clause (Article XIII) of the URAA, the government of Brazil asserted that the cumulative effect of the programs caused harm to Brazil's cotton producers, which constituted a violation of the Subsidies and Countervailing Measures Agreement of the WTO, which restricts use of subsidies that cause harm to producers in other countries.

Other key arguments of Brazil's case dealt with the US export credit guarantee program and a separate program (the Step 2 program) that provides a subsidy to cover the difference between domestic cotton prices and the world cotton price for either export transactions or sales to domestic millers. Brazil argued that both programs were operated as export subsidies; because the US government failed to report them as export subsidies in the Uruguay Round and has not limited program expenditures consistent with US reduction commitments on export subsidies, these programs should be deemed as prohibited export subsidies by the WTO dispute settlement panel. If the panel agreed with that claim, then it should require that the cotton Step 2 program be terminated by the US government, and the export credit guarantee program should be ended for those commodities not covered under the US export subsidy commitment. The portion of the case addressing export credit guarantees addressed all commodities covered by the program, not just cotton.

In a ruling released publicly in September 2004, the initial dispute panel found in favor of Brazil on most points (Table 2). The United States filed a formal appeal the following month. The Appellate Body's decision is expected in March 2005. The text of the panel's ruling on the Brazil cotton case provides little guidance as to what steps the US government should take to reform domestic support programs, if it decides to comply with the ruling by modifying the programs rather than provide compensation. It is important to note that the panel declined to support Brazil's claim that the programs included in the 2002 farm bill threat-

**Table 2.** Key findings of dispute settlement panel on Brazil cotton case.

| Brazil's claim | Panel's finding |
|---|---|
| Peace Clause violated. | Peace clause violated because domestic support in 1999-2002 exceeded 1994 levels. This determination occurred in part because the panel deemed that fruit and vegetable planting restrictions on PFC and direct payments made them ineligible for green box status. |
| All US domestic support programs caused serious harm to Brazil's cotton producers in 1999-2002. | US price-related programs (marketing loan, countercyclical payments, market loss assistance, Step 2) caused serious harm to Brazil's cotton producers in 1999-2002. |
| Cotton Step 2 program for exporters is an export subsidy. | Cotton Step 2 program is an export subsidy. |
| Cotton Step 2 program for domestic millers is an illegal import substitution subsidy. | Cotton Step 2 program for domestic millers is an illegal import substitution subsidy. |
| Export credit guarantees are export subsidies for all commodities, not just cotton. | Export credit guarantees cannot be used for commodities not scheduled under US export subsidy commitment. |
| US domestic support programs threaten serious harm to Brazil's cotton producers for remainder of 2002 farm bill. | Did not support Brazil's claim, because finding involved effect of price-related programs and cotton Step 2 and export credit programs, and the latter two programs are supposed to be terminated. |

ened to cause serious harm to Brazil's cotton producers in the remaining years of the legislation. The panel noted that their finding of past serious harm hinged on the combined effect of price-related supports and the cotton Step 2 and export credit guarantee programs, and thus they were unwilling to find that the serious harm would persist once the latter two programs are terminated as would be required under the panel's ruling. The government of Brazil has appealed this aspect of the case.

In addition, the panel's ruling would require the US government to eliminate the cotton Step 2 program and modify the export credit program. The panel ruled that export credit guarantees could no longer be used to assist in the export of commodities such as cotton, corn, or soybeans that were not listed by the US government as being subject to reductions under US export subsidy commitments in the Uruguay Round.[3] Under the WTO rules governing prohibited subsidies, these actions would have to be taken by July 1, 2005.

## US Government Response

Except when programs are found to be prohibited export subsidies, the rules under which WTO dispute settlement panels operate do not normally specify how long countries are allowed to take to modify their programs or policies to come into compliance with adverse rulings. Past cases suggest that the more complex the issues involved, the longer the matter will take to resolve, especially if the country or countries filing the case are not satisfied that the programs or policies found to be WTO-incompatible have been properly fixed.

For example, although the EU ban on hormone-treated beef was judged to be improper under WTO rules in 1997, the EU has not yet removed that ban, and there is no authority available under the WTO to force such an action. Instead, the EU has sought to bolster the scientific basis under which the ban was promulgated, believing such an action would allow them to maintain the ban while complying with the WTO ruling. This matter recently entered a new stage, as the EU filed for a WTO dispute settlement panel in November 2004, seeking to force the United States and Canada to drop their sanctions, since the EU asserts their regulations are now science-based and thus in compliance with the 1997 ruling.

Because the Brazil cotton case covers entirely new ground in international trade disputes, and the initial panel's report does not prescribe how compliance should be achieved, it seems conceivable that resolving this dispute could take several years, if we assume that the Appellate Body does not overturn the original ruling. One factor that will govern the length of time to reach resolution depends on how soon the government of Brazil presses the WTO to establish a deadline for action and subsequently asks for permission to impose retaliatory tariffs on US products if the US government does not meet that deadline. A second complicating factor that could extend the

3. *Under the initial panel ruling, only the following products would be eligible for the export credit guarantee programs: wheat, wheat flour, barley, vegetable oil, butter, skim milk powder, cheese, beef, pork, poultry, eggs, live dairy cattle, and rice. However, the use of program for rice is likely to be restricted, because the current level of rice exports using export credit exceeds the level permitted under US export subsidy commitments made in the Uruguay Round.*

length of time is if the government of Brazil is not satisfied with the actions taken by the United States to modify its programs and seeks a second case in order to test the WTO compatibility of the modified programs.

Although the Brazil case was entirely focused on support for US cotton producers (except on the export credit issues), it potentially has much broader implications for US agricultural policy. The panel's finding that US domestic support programs for cotton producers were not entitled to the protection of the Peace Clause was partly based on a determination that direct payments (and Production Flexibility Payments under the 1996 farm bill) should not be classified as decoupled (or "green box") programs because of the restrictions imposed on farmers using program base acres to grow most types of fruits and vegetables. Some WTO member countries could decide to use this finding as a basis for a new dispute settlement case, which asserts that the United States has improperly reported these payments in the green box category and thus has violated the US commitment to maintain annual amber box program spending at $19.1 billion or less. Brazil's success in the cotton case could also lead Brazil or other countries to file additional cases against US domestic support programs, focusing on programs benefiting producers of commodities other than cotton.[4] Such actions are far more likely to occur if agricultural negotiations in the Doha Round over the next several months are perceived to stall or fail.

## Conclusions

In the next several years, the House and Senate Agriculture Committees could face the following matters:

- a possible agreement in the Doha Round of the WTO;
- a possible direction to modify certain domestic programs to come into compliance with the appellate ruling on the Brazil cotton case;
- annual budget deficits projected in excess of $400 billion over the next several years, if one assumes that expiring tax breaks are extended and significant numbers of US troops continue to serve in Afghanistan and Iraq; and
- expiration of the current farm bill in 2007.

The perfect storm of the combination of these legislative responsibilities and likely pressures to reduce the federal budget deficit could lead US agricultural policy in new directions. In the past, federal farm policymaking has been largely evolutionary rather than revolutionary, but in this environment, evolution could speed up dramatically.

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*4. The Peace Clause (Article XIII) has expired, so countries would not have to prove that support for a given commodity had increased since 1994, only that it caused serious harm to producers in other countries.*