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**COTTON UPDATE – 15<sup>th</sup> October 2007**

**US WTO Agricultural Subsidy Notification**

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**The Context**

On 4 October 2007 the US finally folded under negotiating pressure, not least of which has been applied by the C4, and notified its long outstanding domestic agricultural subsidies for the years 2002 to 2005.

The concern is that while the actual notifications indicate that the US is within their Agreement on Agriculture commitments, there remain serious conceptual caveats as to how the US should be declaring its programmes. Should these caveats have been respected then the US would not have been within their undertaken commitment levels. In short in our opinion there are definite flaws in the declaration methodology adopted by the US.

**The US Numbers**

The notification position indicates that the US is fully compliant with its WTO obligations for agricultural support. This contention should come as no surprise, as it would be unthinkable that the US would admit to providing prohibited support in an official WTO notification. The notified subsidies are summarized into the following value table:

| <b>US Subsidy Element<br/>(US\$ Billion)</b> | <b>2002</b> | <b>2003</b> | <b>2004</b> | <b>2005</b> |
|----------------------------------------------|-------------|-------------|-------------|-------------|
| Amber Box – (Ceiling applicable)             | \$9.6       | \$6.9       | \$11.6      | \$12.9      |
| Amber Box WTO ceiling                        | \$19.1      | \$19.1      | \$19.1      | \$19.1      |
| Blue Box – (No WTO Limit)                    | 0           | 0           | 0           | 0           |
| Green box – (No WTO Limit )                  | \$58.3      | \$64.1      | \$67.4      | \$71.8      |

The US (special envoy Glauber) gave some explanation as to their logic behind the notifications in a press conference.

Regarding the green box the concerning element is as regards 'decoupled income support' which the US plays down as having 'remained constant over that period' at around \$5.2 - \$5.3 billion. These payments represent the US direct payments which we will need to further examine.

As regards the treatment of de minimis AMS payments the US confirms that this is seen as representing non product-specific amber box support items. Concerning is that crop insurance subsidies and the countercyclical payment program are notified under this non-product-specific amber category. The problem with this treatment is that these payments can be ascribed to specific products, where in the notification they are not. The impact is that under the notification these payments do not count toward the amber box constraint, and if they were included as product specific AMS payments they would count towards the AMS constraint. The US confirms that under the Modalities text, in future the US would avoid this grey area as under the proposed modality provisions countercyclical payments would be notified under the so-called 'new blue box'. In our view the current notification of countercyclical payments as non-product-specific amber box is incorrect, as will be further explained hereafter.

### **Is the US Notification Contestable on Direct Payments?**

The cotton dispute confirmed that just because a subsidy is found to be 'income support' as opposed to price support under the ASCM this does not make the measure green box compliant under the Agreement on Agriculture. On the contrary, the presence of any coupling (whether on a price or income support measure) unambiguously makes the subsidy amber box under reading the Agreement on Agriculture. The US has ignored this dynamic and artfully massaged the panel's findings in making their current notifications of direct payments as green box compliant under the Agreement on Agriculture. The US has used the excuse that the panel did not specifically reclassify US direct payments as 'amber box,' nor did the panel recommend that the United States should notify such future payments as amber box. The reality is that this follows naturally under a simple textual reading of the Agreement on Agriculture and it was unnecessary for the panel to have to say anything to this effect. It would

simply have been to 'state the obvious' which we know the WTO dispute settlement organs avoid as a rule in deference to exercising judicial economy.

This distinction is subtle but a critical one because of the enormity of the direct DP payments. During the period 2000 to 2005, PFC and DP payments averaged over \$5 billion per year and accounted for 32% of total U.S. agricultural program outlays. Shifting the direct payments amount to the amber box could have important implications for future dispute settlement cases, as well as for the United States' ability to meet its WTO amber box commitments. Both these items are currently at issue.

### Is the US Notification Contestable on Counter Cyclical Payments?

The US had provided WTO members with the following data in a September 2007 meeting:

| US AMBER AND "BLUE" BOX SUPPORT FOR COTTON, 1995-06<br>(million dollars) |                  |                     |       |
|--------------------------------------------------------------------------|------------------|---------------------|-------|
| Crop Year                                                                | AMS <sup>1</sup> | "Blue" <sup>2</sup> | Total |
| 1995                                                                     | 32               | 901                 | 933   |
| 1996                                                                     | 3                | ---                 | 3     |
| 1997                                                                     | 465              | ---                 | 465   |
| 1998                                                                     | 935              | 316                 | 1,251 |
| 1999                                                                     | 2,353            | 613                 | 2,966 |
| 2000                                                                     | 1,050            | 513                 | 1,563 |
| 2001                                                                     | 2,810            | 524                 | 3,334 |
| 2002 (e)                                                                 | 1,211            | 1,312               | 2,523 |
| 2003 (e)                                                                 | 647              | 392                 | 1,039 |
| 2004(e)                                                                  | 2,566            | 1,375               | 3,941 |
| 2005(e)                                                                  | 1,795            | 1,301               | 3,096 |
| 2006(f)                                                                  | 830              | 1,374               | 2,204 |

<sup>1</sup>Includes marketing loan gains, loan deficiency payments, interest subsidies and Step 2 payments.  
<sup>2</sup>Includes deficiency payments (1995), market loss assistance payments (1998-01) and counter-cyclical payments (2002-06).

Note that the US is clearly showing 'Blue' read as 'Countercyclical Payments' specifically applicable to cotton in the above table. It is thus somewhat perplexing that in the latest US notifications, they take the view that countercyclical payments are actually amber box! These payments do in fact belong in the amber box because the measure provides payments when prices of program commodities (like cotton) fall below a target price i.e. they are price contingent.

The reason for taking the non-product specific line on countercyclical payments on the current notifications is actually a brilliant ruse. While it looks as if the notification is 'solid' as the countercyclical payment is called 'amber' by listing it as AMS; we find that it is immediately re-excluded from the amber box. This ruse relates to the reason for making it 'non product specific'. By doing this it falls below the de minimis limit for non product specific support, and under the Agreement on Agriculture provisions of Article 6.4, de minimis amounts are excluded from the AMS calculation. If the US had declared the countercyclical payments as product specific support then they would have breached the de minimis amounts and be counted towards the AMS ceiling. This counting towards the AMS ceiling would then result in a breach of that AMS ceiling. In our opinion this is exactly what the correct treatment of the countercyclical payments would have been for this notification. Based on the fact that the US has actually provided product specific data to the C4 on a cotton specific basis, confirms that they are well aware of this, but have acted contrary to what is technically correct.

### **Is the US Notification Contestable on Crop Insurance Payments?**

Crop insurance is subsidized by virtue of the fact that a subsidy is reflected in the net value of the indemnities paid to producers for losses less the amount of the producer-paid premium. Indemnities are paid whenever actual yield or revenue falls below the guarantee level.

Again this description falls squarely within the definition of the Agreement on Agriculture amber box definitional scope. The US agrees and notifies this as under their AMS commitments. However once again they do this as non-product specific AMS support meaning that it is actually excluded from counting towards the AMS binding of \$19.1 Billion under the de minimis exemption rule. As with countercyclical payments, it is contended that these crop insurance payments are readily ascribed to specific commodities (notably used for cotton). This product specific allocation would mean that these insurance payments would not escape the total AMS limit as they would not qualify as de minimis spending for most crops. This would definitely be the case for cotton. In our view crop insurance payments have been misallocated in terms of the latest US notifications.

## US Notification Tables 2002 to 2005 Revised

Taking the US notification table listed earlier and adjusting this for the possible notification anomalies identified, the following becomes evident:

| US Subsidy Element<br>(US\$ Billion) | 2002      | 2003       | 2004      | 2005      |
|--------------------------------------|-----------|------------|-----------|-----------|
| Amber Box (As per US figures)        | \$9.6     | \$6.9      | \$11.6    | \$12.9    |
| Add Direct Payments                  | \$5.3     | \$5.27     | \$5.26    | \$5.22    |
| Add Countercyclical Payments         | \$1.8     | \$0.54     | \$4.23    | \$4.75    |
| Add Crop Insurance                   | \$2.89    | \$1.86     | \$1.12    | \$0.76    |
| Total Revised Amber Box              | \$19.59   | \$14.57    | \$22.21   | \$23.63   |
| Amber Box WTO ceiling limit          | \$19.1    | \$19.1     | \$19.1    | \$19.1    |
| US Compliant with Obligations?       | <b>No</b> | <b>Yes</b> | <b>No</b> | <b>No</b> |

The table indicates that the US is most likely not in compliance with its Agreement on Agriculture obligations, contrary to what one would infer from the US notifications for 2002 – 2005 made on 4 October 2007.

### Closing Observation

The US notifications of their domestic support payments for the period 2002-2005 must be welcomed as these have been long outstanding and their absence has certainly been a difficulty in performing the background analysis that has been necessary to effectively conduct the Doha agriculture negotiations. There is however cause for concern that the said notifications are flawed as regards the allocation methodology applied by the US. This flaw can be addressed either through the negotiations or via dispute settlement, both of which are currently active processes in the WTO.

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