COTTON UPDATE – 3 October 2011

US and EU agriculture subsidies: major reforms or budget adjustments?

Introduction

Whereas Geneva is supposed to be gearing up for the December Ministerial, the climate is pessimistic overall and there are no grounds for high expectations. Even if there is still a bit of hope in terms of tangible outcomes for LDCs, these outcomes will probably relate to subjects that are either not very sensitive or not directly on the Doha agenda such as the simplification of WTO accession rules for LDCs. Despite the slim chances of seeing even a single "step forward" at the Ministerial, it is necessary to keep putting the work back on the weaving loom and cotton back on the WTO agenda. The US has clearly stated that it was expecting China to move on cotton, but as China itself has indicated, such a change will not be forthcoming, even for LDCs alone.

On the other hand, as far as national legislations are concerned, in conjunction with the agricultural reforms underway in the US and the EU, discussions are continuing and reforms are taking shape. That having been said, if the formulation of agricultural policy in these countries was being driven by a desire for compliance with WTO rules, word would have got around.

United States: cutting direct payments

Following the current debate in the US is no picnic: every day brings its share of proposals by the Administration, the House, the Senate or the farm lobby itself. In the very near future, the debate on the Farm Bill is closely intertwined with – and even overtaken by – the debate on budget restrictions.

Cutting direct payments is a logical move for the US. According to Professor Thompson, the Farm Bill budget fell from USD 39 billion in 2005 to 23 billion in 2011, implying that any further cuts will start from an already historic low level. The point should be made that nearly 70 per cent of the Farm Bill budget goes for nutrition programs (to ensure support for the Farm Bill, it cannot benefit farmers or farming areas alone). In the final analysis, the agriculture support programs are grouped around five components: (i) product-specific insurance, which has skyrocketed in recent years (some USD 8.4 billion) and (ii) risk coverage for natural disasters (USD 19 billion), two programs that are very popular and will be tough to cut; (iii) counter-cyclical payments and (iv) marketing loans which, although they come under WTO's orange box, are extremely low at present owing to high agricultural prices, so there are not many cuts that will yield immediate benefits; and (v) direct payments (some USD 5 billion) paid out in a context where farmers' incomes are already comfortable owing to high prices for agricultural products. Accordingly, cutting direct payments is a logical step, even though it is regrettable from the strict perspective of compliance with WTO rules.

Producers' organizations, which are mindful that cuts are inevitable, have two options: either meekly accept across-the-board cuts (a given percentage per sector/program) or reach out with constructive suggestions. The National Cotton Council (NCC) seems to have opted rather subtly for the second option. It is proposing[1] to group together all cotton price support programs under an umbrella program based on guaranteed income for farmers by product (STAX: Stacked Income Protection Plan). This safety net will probably be rounded out by a new type of marketing loan designed to both ensure compliance with WTO rules and satisfy Brazil. This new program's impact on WTO commitments will depend on how these concepts are put into practice. For the time being, crop insurance programs are notified in the orange box category. If the NCC proposal is geared to farmers' income, this could change. One requirement is that risk coverage may not exceed 70 per cent of a farmer's income. However, the fact that coverage is still product-specific tends to indicate that these measures may not qualify for the green box category.

European Union: neither more nor less for cotton, against a backdrop of recoupling

For some years, the Common Agricultural Policy (CAP) has been moving by and large towards an overall reduction in coupled payments, thereby ensuring better compliance with WTO rules. The European Union has reached an average of 90% decoupled payments. Here, cotton, with its decoupling capped at 65%, was a bit of an exception, not to say a

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[1] National Cotton Council 2012 Farm Policy Statement, http://www.cotton.org/news/releases/2011/farmstrat.cfm, http://southeastfarmpress.com/print/government/ncc-advocates-change-course-farm-policy

heresy. Yet the leaked Commission paper[2] on the future CAP, which came out in September, refers to a new trend towards the recoupling, at national level, of certain decoupled subsidies granted at the EU level. The authorization to recouple a certain amount of direct subsidies was already enshrined in previous legislation (Article 63 of the 2003 reform and Article 68 of the 2008 reform), and certain countries are using it for specific production types. The new text, as it stands in the Commission's text, runs to the effect that national envelopes are to be replaced by "a general provision to allow voluntary coupling where certain conditions are met. Member States can grant up to 5% of their national ceiling to sectors or regions where specific types of farming or specific agricultural sectors undergo certain difficulties and are particularly important for economic and/or social reasons. This proportion is increased automatically to 10% of their national ceiling for the new Member States or countries that have provided coupled support to suckler cows".[3] The wording at this stage is vague enough to leave the door open to a wealth of interpretations, enabling Member States to recouple direct support in various sectors, especially in times of crisis. It is worth noting that cotton is a sector where recoupling is already authorized. These subsidies are in the green box category when they leave the EU's pockets. If they are subsequently recoupled, the terms of these operations will have to be monitored closely, and the EU will have to guarantee that the recoupling measures still meet green box requirements. More broadly, with regard to the CAP as a whole, many analysts feel that the EU is passing up an opportunity for sweeping agricultural policy reform. Moreover, as specialists see it, once virtually all of the (considerable) support is classified as authorized, trade-distorting effects cannot be ruled out and the European Union should be prepared to be grilled on its green box.

It is not certain that the direct payments dedicated inter alia to cotton producers will be recoupled and that producers will receive considerably more coupled subsidies than the 272 million euros budgeted in the 2004 reform. On the other hand, whereas cotton subsidies stood out a bit in a landscape of widespread decoupling, the proposed reform tends in the final analysis to trivialize at least partial coupling of subsidies, making it more difficult to criticize the somewhat special past status of cotton subsidies. The Commission is expected to produce an official text by 12 October, and it is clear that it will be further amended by then.

Conclusion

[2] European Commission, "Proposal for a Regulation of the European Parliament and of the Council establishing rules for direct payment schemes for farmers under the Common Agricultural Policy. To continue this analysis, please consult the site www.capreform.eu, and in particular the following article: http://capreform.eu/leaked-legislative-proposals-anticipate-commission-cap-reform-proposals-due-october-12th/,

[3] http://capreform.eu/the-future-for-national-envelopes-and-member-state-flexibility-in-pillar-1/

It cannot be repeated often enough that "objective" conditions (high farm commodity prices, budget pressures) are right for agricultural reform in the US and the EU while limiting the political cost. "The US and the EU are both looking for the right formula to make direct payments in a way that both meets producers' needs and can be justified to taxpayers".[4] There will be unprecedented subsidy cuts in the US, owing to budget pressures. However, these will not really be on the table in the European Union, not only because the EU has already thoroughly reformed its system but also because agriculture is THE subject on which the Member States find it hardest to compromise, preferring to let the status quo prevail. The question of WTO compliance is not a priority, even though certain direct payments have been recoupled and others are product-specific, which could make it rather difficult, to say the least, for them to qualify as green box subsidies.

As has been said, political decision-makers in Europe and the US are not primarily guided by the constraints generated by the WTO. In the end, however, if outside pressure on the fringes can help modify support programs that are up for discussion anyway, the opportunity should be seized. It will be up to the African cotton-producing countries to make their case, namely, that opting for a given type of subsidy may, while helping to resolve a domestic problem, relieve (or redouble) the pressure on their own economies while increasing (or decreasing) compliance with the rules of multilateral trade. In the end, what the African cotton-producing countries are proposing to the other players in the game is to kill three birds with one stone – a win-win-win situation.

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[4] Cf. In particular D. Blandford, T. Josling and J-C. Bureau, Farm Policy in the US and the EU: The status of reform and the choices ahead, *IPC discussion paper*, September 2011, 46 pp.