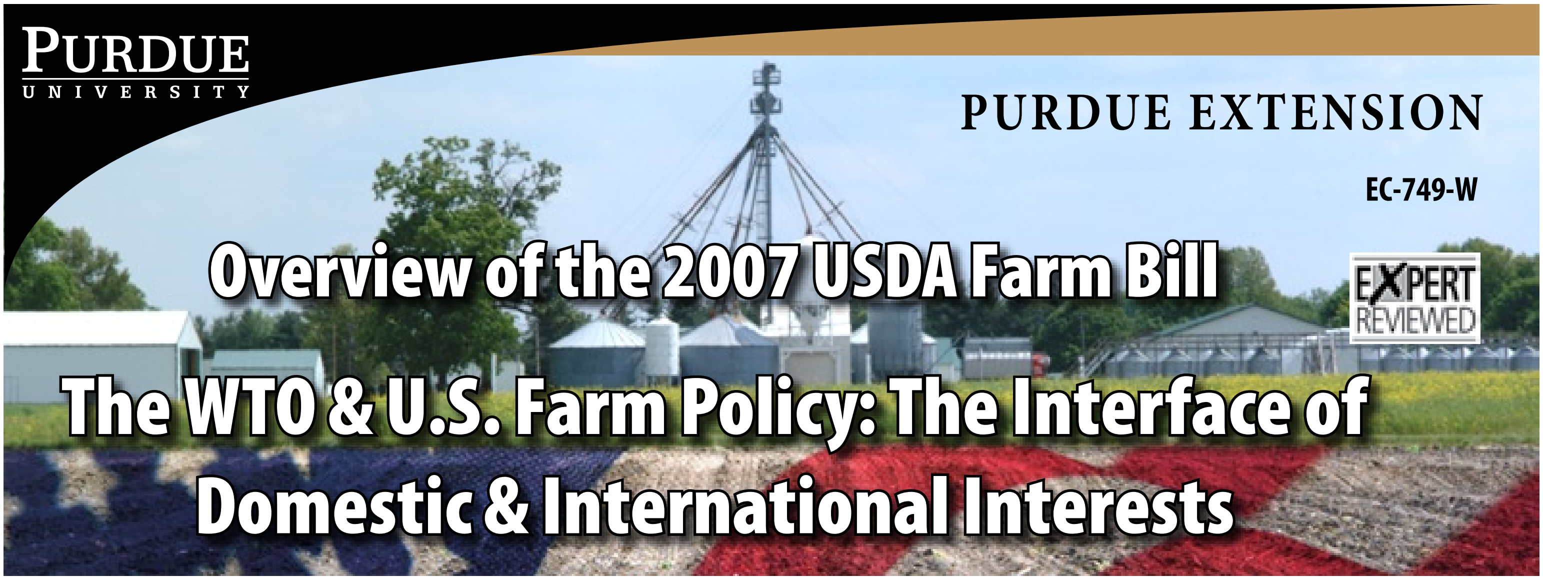

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Overview of the 2007 USDA Farm Bill

The WTO & U.S. Farm Policy: The Interface of Domestic & International Interests

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Introduction

The future of U.S. farm policy is being shaped by both domestic and international debates regarding domestic farm programs. Movement toward a new Farm Bill in the U.S. is progressing, while World Trade Organization (WTO) negotiations on agriculture are mostly stalled. Getting the WTO negotiations moving forward has much to do with a new direction for U.S. farm policy because the level of U.S. domestic support remains a thorny issue in the negotiations. At the same time, the U.S. is seeking greater access to foreign markets, and its domestic farm programs represent an important bargaining chip at the negotiating table.

There are significant dissimilarities in farm support across industrialized countries, and the tensions these create for equitable agreement on agricultural reforms are important considerations for the next U.S. Farm Bill. Internally, the distributional impact across agricultural producers remains a key consideration for policy formation, bringing interest group politics front and center. This publication focuses on U.S. farm policy formation in the broader international context, highlighting the conflicts that arise among competing interests both in the domestic and international policy arenas.

WTO Background

The Uruguay Round Agreement on Agriculture (URAA) was signed in 1994, with initial implementation beginning in 1995. Following many years of complete or partial exemption, the URAA was noted for bringing agricultural support and protection under discipline of international trading rules. The United States played a leading role in getting agricultural tariffs and subsidies onto the WTO negotiating table. This continued a progression of favorable moves toward liberalized agriculture, with actions taken in farm legislation in the 1980s and 1990s orienting U.S. farmers more toward markets and broadening the scope of agricultural legislation beyond commodity production and prices to conservation issues (Alston and Sumner, 2007).

The URAA's impact on world agricultural markets and reducing barriers to trade has not been large. The lack of impact of the URAA has been well noted in research literature and among member countries participating in the current Doha Development Agenda (DDA) round of negotiations. A primary hindrance to achieving liberalization in agricultural markets was the choice of the mid to late 1980s as a base period from which to cap and begin reducing agricultural tariffs and subsidies. That period featured very high protection and support for many agricultural trading nations. Its choice as a reference period meant that many countries at the time of URAA implementation were merely reducing the legal maximum on support and tariffs because their policies as applied were already well below the limiting amounts.

With minimal impact on markets, the primary success of the URAA was to establish a framework for liberalizing agricultural trade and a more effective means of bringing and settling disputes before an international body. As set out in the URAA, agricultural negotiations under the WTO now take place across three pillars of support: tariffs, domestic support, and export subsidies. Each of these represents some part of the agricultural policy framework of most developed nations and is subject to negotiated reform, with many of the compromises requiring cross-pillar bargaining. The pillar on domestic support, representing internal farm subsidies and other forms of producer support, remains a contentious area of WTO negotiations. Much of the difficulty with domestic support policies in the agricultural negotiations arises from the difficulty of ascribing the level of protection each provides (Box 1, WTO Classifications for Domestic Support).

The current WTO round has been beset by difficulties in reaching agreement on agricultural reforms, particularly in the areas of tariff reduction and domestic agricultural subsidies. Much of the tension between tariff and subsidy reduction in the agricultural negotiations is caused by differing policy patterns in industrial countries. This is best epitomized by the U.S. reliance on farm subsidies and the European Union's reliance on border interventions and the counter positions these countries take on where aggressive reform is most needed.

Beyond the industrial countries, developing nations have invested in analysis and alliances to become a significant presence in the negotiations. They have particularly targeted producer subsidies in all forms, complaining that the very magnitude of transfers into industrial country farm sectors presents a source of harm to their interests, regardless of how those transfers are executed.

Box 1—WTO Classifications for Domestic Support

To deal with domestic agricultural policies, the URAA enacted a classification system with three boxes of support: amber box, blue box, and green box.

- Amber box policies are those that influence current farm decisions on production, such as loan deficiency payments with their minimum price loan rates, and that have the most trade-distorting impact.
- Blue box policies are a special class of payments in which producer incentives and thus trade are distorted in a manner similar to amber box policies, but support payments are coupled to a production limiting mechanism, which leaves the overall output effect of the policy unchanged. The European Union's system of support payments, which require land set-asides, are the most prominent blue box policy.
- Green box policies are those that are deemed minimally distorting to production incentives and markets, as exemplified by payments for conservation easements or transition payments that are delivered at a set amount regardless of producer decisions.

Both the amber and blue boxes are subject to negotiated limits on total transfers, while the green box is exempt.

U.S. Policy in the URAA Era

The URAA Era of the WTO has seen passage of two omnibus farm bills in the U.S. The first of these was the 1996 Farm Bill, which featured a significant movement away from price and production linkages in farm payments, designed as a means of transitioning the U.S. away from agricultural support and towards greater market integration. The period of high prices in which the 1996 Farm Bill was passed was followed by low prices and depressed farm returns, leading to ad hoc emergency legislation to boost agricultural returns.

These emergency payments led to some of the highest outlays for farm payments in U.S. history and were formalized in the 2002 Farm Bill as counter-cyclical payments to be triggered by low prices. This redirection of policy from the 1996 Farm Bill's strong decoupling has been viewed as a significant backslide from the U.S.'s earlier position of leadership and has made them a significant target for opposition at the negotiating table and for complaints of noncompliance and serious prejudice under the WTO system.

Aside from passage of two farm bills, the most noted occurrence at the interface of the WTO agricultural agreement and U.S. farm policy has been the cotton complaint brought by Brazil against the United States. Significant points about U.S. farm policy in cotton and other commodities have emerged as this case moved forward through complaint and appellate bodies of the WTO.

Foremost of these, the characterization of direct payments (the direct descendant of the 1996 Farm Bill production flexibility payments) as minimally distorting, has been called into question due to restrictions on alternative land uses that maintain payment eligibility. Additionally, the identification of counter-cyclical payments (and the predecessor emergency market loss payments) as non-product specific distorting support puts in jeopardy U.S. compliance with its URAA commitments on total distorting support (Sumner, 2005).

The case of U.S. cotton and the finding of serious prejudice against Brazilian cotton producers stand out among WTO complaints because they highlight the exposure the U.S. has to future complaints on other commodities. Sumner (2005) finds that corn, wheat, and rice are all candidates for findings of price depressing effects. Keeney and Beckman (2007) take an in-depth look at U.S. rice support and the WTO negotiations (Box 2, p. 4, Negotiating Difficulties and Exposure to WTO Complaints: The Case of Rice).

Their analysis shows that U.S. rice-producing households tend to rely more heavily on farm income and that their rice revenue is dependent on the U.S. support program. These losses in revenue could be more than recovered if Japanese markets are significantly opened, an unlikely event with the inclusion of sensitive products provisions (which allow a country to exempt a certain amount of products from negotiated reductions) in the tariff negotiations. This puts U.S. policy-makers in the position of leaving significant gains to rice producers on the negotiating table through sensitive product declarations and potentially having to find WTO friendly means to compensate those producers in new farm legislation.

Implications of the WTO for New U.S. Farm Legislation

The rice case in Box 2 (p. 4) exemplifies the difficulty of reaching agreement on domestic commodity policy and reforms to those policies in the international setting. A difficult international position for the U.S. in achieving gains for rice producers means that making a WTO agreement politically feasible at home will require some accommodation in a reformulated domestic policy. One expects that this will foster additional payments addressing other commodity-aligned interests as well. Crops like sugar and peanuts in the U.S. are characteristically similar to rice, with small producer numbers, concentrated wealth, and limited production alternatives.

In short, these factors come together and present the strong possibility that any new U.S. farm legislation will not feature drastic reform. If a new WTO agreement with reduced limits on amber box support is anticipated, it is likely that the 2007 Farm Bill would be written with accommodating those commitments in mind, even if the total amount of support is unchanged through use of the blue and green box. Indeed, the U.S. negotiating position on an expanded blue box is largely focused on inclusion of counter-cyclical payments. Notifying a policy to be part of the blue box is no guarantee against a challenge and an unfavorable ruling, however, as was seen in the Brazilian cotton case. (See Box 1 [p. 2] for an explanation of the URAA classification system.)

Many agricultural interests are forecasting a new U.S. Farm Bill that maintains the primary means of support, with only adjustment of some of the payment parameters. As Sumner (2005) and Alston and Sumner (2007) point out, this would leave the U.S. exposed to WTO challenges and findings of redress in several commodities for which the policies operate in a similar manner to cotton.

Even absent new and more prohibitive WTO disciplines, Sumner (2005) identifies several commodity cases of world prices being depressed stemming from U.S. policies that stimulate production. While it can be argued that the U.S. would be well-served from an efficiency standpoint to get ahead of the game and reform these areas of exposure now by reducing domestic support, that argument can be countered on grounds of political feasibility in cases such as rice, where domestic support provisions represent the key element in offsetting income losses realized due to policies external to the U.S. Moreover, it is unclear whether preemptive reform would again place the U.S. in a leading reformer role within the WTO or whether it would diminish its role by removing significant bargaining chips from the table.

Box 2—Negotiating Difficulties and Exposure to WTO Complaints: The Case of Rice

The case of rice is of special interest in discussion of the WTO and domestic farm policies due to the focus on providing meaningful reforms with positive impacts in developing countries under the DDA. Rice is collectively the most protected crop among the developed countries and represents a staple food source for the majority of the world's poor in developing countries. Strong political interests are tied to rice in many developed countries, and rice trade is characterized by low volumes, making for volatile world prices.

Keeney and Beckman (2007) investigate the international and domestic political motivations surrounding potential rice reform under a DDA WTO agreement focusing on farm household level impacts in the United States. Rice-producing farm households in the United States tend to be wealthier than the average farm household and are significantly more dependent on farm income for household earnings. Household income data for 2001-2004 indicates that farm income's share in the total for the household is around 50% for the poorest rice farm households. Meanwhile, over this same period, the wealthiest non-rice farm households earned on average less than a quarter of their income from the farm business.

Moreover, rice households tend to be more specialized in income derived from rice than other producers are in their primary agricultural output. Because much of the value of the U.S. rice crop is derived from policy intervention, and rice land offers relatively few agricultural alternatives, we arrive at a situation with few producers who tend to be large and relatively wealthy with strong dependence on rice farm income and policy support. All of these factors combine to promote successful organization and significant influence in the policy process for these rice farmers.

The domestic politics of rice support are not unique to the United States. The East Asian markets of Japan and Korea are highly protected, with prohibitive border measures ensuring little penetration of foreign grown rice into the domestic markets. The minimal increases in access to East Asian markets between 1995 and 2005 under the URAA have generated export gains for the United States. Keeney and Beckman (2007) analyze further liberalization of agricultural markets, focusing on U.S. rice farm household income changes. (Keeney and Beckman use the GTAP/World Bank scenarios, which mimic the July 2004 framework agreement. These scenarios assume aggressive liberalization for bindings on tariffs and domestic support and are detailed at <https://www.gtap.agecon.purdue.edu/databases/v6/V6_dohascen.asp>.)

In Table 1, we see the separate income impact of different policy reforms. Column one indicates that domestic subsidy reductions reduce household income for rice producers from 1 to 4% (-2.5% on average). In column two, we see that these losses may be more than offset by further opening of the Japanese rice export market, leading to potential income gains ranging from 4 to 23% (+13% on average).

However, the type of aggressive liberalization of Japanese border measures required to achieve these income gains would have drastic impacts in the Japanese farm economy. Insulation of the domestic market in Japan is critical to maintaining the high

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Table 1. Analysis of Reform Scenarios on U.S. Rice Household Incomes

Rice Household	U.S. Unilateral Rice Reforms	Japan Unilateral Rice Reforms	Reforms with "Sensitive Products"
Poorest 10% of Rice Households	-0.80 %	4.22 %	-0.69 %
Average Rice Household	-3.25 %	13.27 %	-1.57 %
Wealthiest 10% of Rice Households	-4.38 %	23.04 %	-2.43 %

Source: Keeney and Beckman (2007).

Box 2 continued

prices that keep rice farming profitable, with domestic consumers paying well above world prices. The cultural importance of rice in Japan and similar issues in other countries have given rise to special "sensitive product" declarations, meaning that a certain percentage of products may be excluded from negotiated tariff reductions and instead subjected to much more modest reform. Allowing for rice as a sensitive product in Japan in column three, we see a complete reversal of the potential income gains for U.S. rice farm households as Japanese market access no longer offsets the lost revenue of domestic subsidies.

While the average 2% income loss for rice farmers in column three is small considering the average wealth of these farm households, the difference in the impact between an agreement with and without sensitive product provisions points clearly to how sensitive this group of farm households is to the international politics of agricultural negotiations. The escalation of losses such that the majority of income foregone is among the wealthiest rice producers serves to motivate the lobbying process. The results indicate that the rice producers have strong incentive to push for aggressive opening of East Asian rice markets, while the East Asian countries view exclusion of rice from major disciplines as crucial to maintaining the structure of their domestic agriculture and food security.

Given the strong international pressure for domestic subsidy reform that the U.S. faces and the likelihood that some form of sensitive product declarations will remain part of the agreement, the challenge lies in selling an injurious agreement to domestic producers that leaves sizable income gains on the negotiating table due to the sensitive product provision. One can anticipate that at a minimum U.S. policy-makers would need to redesign domestic subsidies to provide WTO-friendly green box payments to rice producers at a level that would offset the losses from reforming price-contingent subsidies. In light of the WTO Panel ruling in U.S. cotton, even this kind of domestic offset may not diminish exposure to challenges of U.S. domestic rice policies.

Final Comments

Well past the anticipated 10-year reign of the URAA in controlling international agricultural policy, the balancing act between international and domestic policy and politics still proves difficult. The hyped gains from trade occur across a distribution. The case of rice discussed here mirrors the situation for other commodities. A set of farmers with very similar interests in the domestic policy process stand to lose significantly.

This political reality of farm support means that these commodity interests will continue to be the most well-defined and that they will determine the political feasibility of any changes to agricultural policy. This presents an ominous forecast for serious domestic policy reform being driven by international negotiations on trade and an uncertain outlook for getting the WTO negotiations on agriculture moving forward again.

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