

# Implications *of the shift* in United States *farm policy*

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This article sets out to describe the main features of the new farm legislation in the United States, assess the extent to which it conforms to World Trade Organization (WTO) rules, and provide a preliminary assessment of its impact on Latin America. The article first looks at the new United States Farm Security and Rural Investment Act of 2002, identifying the different mechanisms used to support the country's farm producers. It then analyses that Act, referred to hereinafter as the 2002 Farm Act, in the light of the rules established and the commitments made in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). This is followed by an analysis of the possible impact of the new law on Latin American agriculture. Lastly, reference is made to recent developments in multilateral trade negotiations and the way they relate to the 2002 Farm Act.

# I

## Introduction

The Fifth Ministerial Conference of the World Trade Organization (WTO), held in Cancun, Mexico, from 10 to 14 September 2003 as part of the current Doha Round of Multilateral Trade Negotiations, brought to light the intentions of the United States Farm Security and Rural Investment Act of 2002 and showed that the United States was seeking to legitimize its arsenal of subsidies in the current round. At Cancun, the multilateral trade negotiations collapsed when agreement could not be reached on agriculture, owing to the defence of protectionist structures by the developed countries. The 2002 Farm Act represented a U-turn, with the United States moving from the liberalization camp to the protectionist camp.

The main characteristic of the subsidy regime enshrined in the 2002 Farm Act is its countercyclical nature, resulting in overproduction of commodities. This drives down prices and leads to surpluses of these products on the world market. The consequences of implementing the Act, however, go beyond the continuation of farm support programmes. By updating programme payment acreages and yields, the new rules have changed the nature of direct government payments, making them "recoupled" rather than "decoupled".<sup>1</sup> This marks a backward step in relation to the modest progress made in the Uruguay Round.

United States commodity spending is expected to be between US\$ 15 billion and US\$ 20 billion a year for crops alone, representing an increase of between

70% and 80% over the provisions of the Federal Agriculture Improvement and Reform Act of 1996 (henceforth termed the 1996 Farm Act) in its last year of operation. The total budget of the 2002 Farm Act has been put at US\$ 180 billion over the full implementation period (six years). As a result, the United States is likely to exceed the annual limit of US\$ 19.1 billion bound at WTO for the Aggregate Measurement of Support (AMS).

While they differ in other respects, United States farm policy and the Common Agricultural Policy (CAP) of the European Union both seek to create protection systems capable of promoting and subsidizing their producers in sophisticated and higher value-added sectors.<sup>2</sup> This being so, subsidy increases by one of these two global players, and countermeasures by the other, are extremely harmful to Latin American countries that produce agricultural goods. Clearly, developing countries are not operating on a level playing field.

The issue is one of vital importance, since among the few measures available to developing countries to counteract protectionist measures by the great powers is their ability to bring in rules favourable to themselves in the trade negotiations being conducted within the framework of WTO. This being so, the 2002 Farm Act can be seen as a strategic device to alter the commitments accepted hitherto and change the ground rules of the current negotiations.

<sup>1</sup> Payments are classified as coupled or decoupled depending on the effects that the subsidies concerned may have on production. If payments are linked to the volume of production, they are considered to be "coupled" because there is a direct relationship between the sums disbursed and production levels. If payments do not affect the volume of production, on the other hand, they are considered to be "decoupled".

<sup>2</sup> The value of farm gate output in the agricultural sectors of the United States and the European Union is almost identical, at about US\$ 190 billion a year (OECD, 2001). The main indicator used by the Organisation for Economic Co-operation and Development (OECD) to measure internal support, the Total Support Indicator (TSI), shows that in 2000 the United States spent US\$ 92.3 billion supporting agriculture, while the European Union spent US\$ 10.5 billion. In per capita terms, United States farmers receive approximately US\$ 338 a year, while those of the European Union receive US\$ 276 (European Union, 2002).

## II

# The United States Farm Security and Rural Investment Act (Public Law 107-171)

This law, termed the 2002 Farm Act in the present article, regulates the payments that the United States Government will make to support its farm producers in the period 2002-2007, laying down the amounts and access conditions for the different programmes. The first three titles of the Act (I. Commodity programmes, II. Conservation, and III. Trade) are the core of the support programmes for United States farmers that will have the greatest impact on agriculture in Latin America: programmes of direct payments, countercyclical payments, Marketing Assistance Loans and LDPS (loan deficiency payments)<sup>3</sup> in lieu of such loans, conservation programmes and export support programmes.

### 1. Commodity programmes

The 2002 Farm Act treats the following as commodities: wheat, maize, sorghum, oats, barley, upland cotton, rice and soybeans and other oilseeds.<sup>4</sup> Income subsidies for commodity producers are provided mainly through the Direct Payment Program, the Counter-cyclical Payment Program and various marketing programmes.

#### a) *The Direct Payment Program*

Under this new programme, farmers receive direct subsidies from the Government. The Direct Payment Program replaces the Production Flexibility Contracts (PFC) programme, better known as AMTA (Agricultural Market Transition Act) payments, which existed under the 1996 Farm Act. AMTA payments were available for growers of wheat, maize, barley, sorghum, oats, cotton and rice. The 2002 Farm Act includes direct payments for these commodities, and also covers peanuts, soybeans and other oilseeds.

To receive assistance for crops covered by the Direct Payment Program, producers sign annual agreements for the period 2002-2007. How much they receive is calculated from a formula that includes: a payment rate (subsidy) per unit that is granted for each crop, 85% of the acreage registered by the producer, and a pre-set yield per crop for each farm. Thus, direct payment = (commodity payment rate) x (acreage x 0.85) x (pre-set yield).

When enrolling in these programmes, farmers have to choose between two methods for determining growing acreage. The new feature of this system is that before the 2002 Farm Act was passed, producers received direct payments calculated on the basis of the acreage planted as of the mid-1990s and the yields obtained in the 1980s. The 2002 Farm Act allows updating to 1998-2001 acreages for the calculation of direct payments. This adjustment is obviously going to increase budgetary costs substantially.

Aside from certain limitations on the planting of fruit and vegetables, producers are free to choose what crops they grow. For their part, they have to maintain the land given over to "farming" (growing, harvesting, grazing, prevention of soil erosion, etc.) and comply with rules relating to conservation of soil and the environment.

One important difference between the 2002 Farm Act and the 1996 Farm Act is that the latter placed

TABLE I

**United States: Direct payment rate**

Commodity	Unit	Payment rate (dollars)
Wheat	Bushel	0.52
Maize	Bushel	0.28
Sorghum	Bushel	0.35
Barley	Bushel	0.24
Oats	Bushel	0.024
Upland cotton	Pound	0.0667
Rice	Hundredweight	2.35
Soybeans	Bushel	0.44
Other oilseeds	Pound	0.008
Peanuts	Ton	36.00

*Source:* United States Department of Agriculture.

<sup>3</sup> See section II, paragraph 1.d), for more details about LDPS.

<sup>4</sup> The term "other oilseeds" includes sunflower, canola, mustard or any other kind of seeds as determined by the United States Secretary of Agriculture.

annual limits on direct payment amounts, while the new law does not. Direct payments fell from US\$ 5.57 billion in 1996 to US\$ 4 billion in 2002. Some 85% of these annual amounts were split among wheat (26%), maize (46%) and cotton (12%). The 2002 Farm Act, on the other hand, sets specific amounts per unit of output. Consequently, there is no longer any ceiling on total annual assistance; rather, the amount depends on how much is produced.<sup>5</sup> These direct payments give growers of particular crops 10% to 20% additional income, on average, over and above market prices.

Another essential difference between the two laws is that under the 1996 Farm Act, AMTA payments were set only for output in the base years, and calculation rates were fixed for each crop. The 2002 Farm Act allows the base acreage qualifying for the programme to be updated using a four-year average (1998 to 2001) for the planted acreage. By contrast with AMTA payments, in short, the new subsidies provided by the Direct Payment Program do not decrease over time, are higher than the previous payments, and are tied to acreage.

b) *Counter-cyclical (or Counter-seasonal) Payments Program*

This new programme was designed to give farmers a better income safety net, the idea being to replace the emergency payments authorized by Congress from 1998 to 2001, which totalled from US\$ 2.9 billion to US\$ 5.5 billion a year. Countercyclical payments are made whenever the actual price of products is lower than a target price pre-established by the Government.

The actual price is calculated using the following formula:

$$\text{Actual price} = (1) + (2)$$

where:

(1) is the higher of *a* or *b*:

*a* is the average price over the last 12 months;

*b* is the average commodity national loan rate for Marketing Assistance Loans, and

(2) is the direct payment rate (table 1).

The target price is the price per bushel or pound at which the Government lends money to producers participating in support programmes. Farmers can take out a loan for all (or some) of their latest crop at any time from harvesting until the following March or May, depending on the crop.

<sup>5</sup> See United States Department of Agriculture, [www.usda.gov](http://www.usda.gov).

For most of the products included in the assistance programme, the 1996 Farm Act stipulated that loan rates had to be equivalent to at least 85% of the average price for the previous five years, with maximum prices for some products (Basco, 2002). The 2002 Farm Act sets lending rates for 2002-2003 and 2004-2007, those for the latter period being slightly lower. For the commodities included (other than soybeans), the new rates are higher than the maximums authorized in the previous legislation. The most significant change in this policy instrument is the creation of fixed lending rates instead of variable rates based on the price averages of previous years.

Countercyclical payments are arrived at by comparing the highest actual price (calculated by one of the two methods described) with the target price set by the Government. Once this comparison has been made to determine whether or not a payment is due to producers, countercyclical payment amounts are calculated in much the same way as direct payments. The variables used are 85% of the growing acreage registered by the producer, the yield per commodity of each agricultural establishment or farm, and a countercyclical payment rate. The acreage is calculated using the same two methods as for direct payments; in turn, the yield per crop can be updated in three different ways, including re-rating of yields qualifying for inclusion up to 93.5% of 1998-2001 yields. The resulting formula is:

$$\text{Countercyclical payment} = (\text{countercyclical payment rate}) \times (\text{growing acreage} \times 0.85) \times (\text{pre-established yield})$$

where the countercyclical payment rate = (target price) - (payment rate) - (the higher of *a*, the average price over the last 12 months, or *b*, the loan rate).

TABLE 2

**United States: Target prices  
(Dollars)**

Commodity	Unit	2002-2003	2004-2007
Wheat	Bushel	3.86	3.92
Maize	Bushel	2.60	2.63
Sorghum	Bushel	2.54	2.57
Barley	Bushel	3.21	2.24
Oats	Bushel	1.40	1.44
Upland cotton	Pound	0.724	0.724
Rice	Hundredweight	10.50	10.50
Soybeans	Bushel	5.80	5.80
Other oilseeds	Pound	0.098	0.101
Peanuts	Ton	495.00	495.00

Source: United States Department of Agriculture.

Target prices are true support prices in that they guarantee producers a minimum income irrespective of fluctuations in market prices. This new policy almost completely insulates United States producers from market signals and represents a step back in United States farm policy from the liberalization process begun by the Government. Given the rise in yields over recent years, particularly for certain products, these payments will increase disproportionately.

c) *Marketing assistance loans and payments in lieu*

The United States Government offers a range of non-recourse loans to farm producers, repayable after nine months. The 2002 Farm Act gives continuity to these programmes, widens the range of commodities covered and does away with the requirement for an annual direct payment agreement to have been signed as a precondition for receiving the loan. Loans granted to commodity producers can be repaid in three ways: i) by paying off the loan at a set rate plus the interest established by the Commodity Credit Corporation (CCC); ii) by transferring the crops grown to the Government, or iii) by paying off the loan at an alternative rate.

Marketing assistance loans enable producers to pay off non-recourse commodity loans at a rate lower than the original one, provided that world prices for the commodity concerned are lower than the initial payment rate plus interest; the idea behind this is for the Government to avoid an excessive build-up of stocks.

When world prices for the commodity in question are lower than the initial payment rate plus interest for the non-recourse loans granted, farm producers have an alternative: the Secretary of Agriculture is entitled to make discretionary payments directly to farmers who undertake not to apply for non-recourse commodity loans. Known as loan deficiency payments or LDPS, these are calculated by multiplying the payment rate of the marketing loan by the amount of the commodity qualifying for lending. In this way, the farmer does not take on the risk of a marketing loan. LDPS are countercyclical by their very nature, since more is paid out in price subsidies when prices are low and less when they are high.

Marketing assistance loans and LDPS are designed to keep potential credit arrears to a minimum and prevent the Government from having to build up commodity stocks. The 2002 Farm Act adds peanuts, wool, mohair, honey, chickpeas, lentils and peas to the products eligible for this type of loan (which are wheat, maize, sorghum, cotton, rice, barley, soybeans and other oilseeds).

d) *Support programmes by sector and product*

This section will describe different forms of assistance for producers of dairy products, peanuts, sugar, wool, angora, honey, chickpeas, lentils, apples, fruit and vegetables.

i) *Dairy products.* The 2002 Farm Act extends application of the government procurement programme and export incentive programme for dairy products, dismantles the North-East Dairy Compact programme (giving special treatment to the New England region) and sets up a new programme of payments for commodity marketing losses, known as dairy market loss payments, to replace the emergency payments authorized by Congress (market loss assistance) and made to dairy producers in 1999, 2000 and 2001.

The government procurement programme authorizes the Commodity Credit Corporation (CCC) to purchase butter, powdered skimmed milk and cheese at a pre-set minimum price. The prices set by the 1996 Farm Act were to decrease from 1996 until 1999, when they were to be done away with. The promise to abolish these price supports was not kept and the pre-set prices were extended until 31 May 2002. The 2002 Farm Act maintains these prices at their 1999 level and does not provide for any reduction until 2007.

Under the Dairy Market Loss Payment programme already alluded to, producers receive direct monthly payments whenever the monthly price of milk generally, skimmed milk, low-fat milk, etc. (Class 1 products according to federal marketing orders)<sup>6</sup> falls below US\$ 16.94 per hundredweight. Payments are limited to 2.4 million pounds of milk per organization per year, and the number of producers benefiting from these operations does not affect the scope of this limitation.

The Dairy Export Incentive Program (one of the export support programmes analysed further on) subsidizes exports of United States dairy products by means of bidding-based payments to companies selling dairy products for export. It specifically provides that the Secretary of Agriculture must authorize enough subsidies to achieve the maximum dairy export volumes permitted under the GATT Uruguay Round commitments. This programme is used for market

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<sup>6</sup> Federal marketing orders for dairy products were designed to help establish and maintain clear, orderly marketing conditions. These provisions establish a pricing system whereby prices are classified and set according to the products milk is used for. Class 1 is the first step in an 11-category classification.

development purposes and was extended until 2007 by the 2002 Farm Act.

*ii) Peanuts.* The peanut price support programme is abolished and replaced by a system of direct payments, countercyclical payments and marketing loans much like the programmes for other commodities. The internal peanut marketing quota applied under the 1996 Farm Act is abolished and quota holders are compensated through a quota repurchase system. Under this new system, peanut growers have the same rights of access to government support programmes.

*iii) Sugar.* Before 1996, the sugar programme had to be administered on a no net cost basis. This no net cost condition meant that the CCC was debarred from building up stocks of sugar acquired under commodity assistance programmes. This requirement was met by adjusting import quotas or setting internal marketing allotments. The 1996 Farm Act did not include the no net cost condition and authority to set marketing allotments was not renewed. The 2002 Farm Act restored the mechanism, to prevent stocks built up under non-recourse loan programmes being diverted to the Government; it authorizes the non-recourse loan programme until 2007 (18 cents per pound of unrefined cane sugar and 22.9 cents per pound of refined beet sugar), and abolishes sugar marketing payments, along with the penalties for crop diversion.

Similarly, the 2002 Farm Act reintroduces a supply control system that was abolished by the 1996 Farm Act: the Secretary of Agriculture is authorized to set market quotas in order to balance out supply and demand, prevent products being diverted into government stocks and comply with sugar import commitments. The new law also creates a loan programme to facilitate sugar storage, which provides cane and beet sugar processors with financing to build or improve storage facilities.

The payment in kind (PIK) programme continues. This programme gives beet sugar producers the option of swapping part of their crop for sugar held in CCC stocks.

The sugar import quota is maintained, restricting imports of this product to support the domestic price. The quota is 1.23 million tons of raw cane sugar and 24,250 tons of refined sugar.

*iv) Wool, angora, honey, chickpeas and lentils.* These commodities, which were not supported by the 1996 Farm Act (except by ad hoc payments) have a guaranteed level of support under the 2002 Farm Act

through Marketing Assistance Loans and LDPS. The number of products supported directly by the Government has thus increased, and the possibility of new products being included in the near future has been established.

*v) Apples, fruit and vegetables.* The 2002 Farm Act includes US\$ 100 million of subsidies for apple producers, supposedly to compensate for low prices in 2000, and over US\$ 200 million in additional funding to purchase and distribute fruit and vegetables under various programmes.

e) *Maximum limits on commodity programme payments*

For direct payments, the limit has been kept at US\$ 40,000 per person. For counter-cyclical payments, the limit is US\$ 65,000. Marketing loan payments have a maximum of US\$ 75,000. Producers whose gross revenues average more than US\$ 2.5 million over three years will be entitled to payments only if 75% of these revenues are from agriculture.

The 2002 Farm Act keeps the three-entity rule, whereby an individual farmer who owns three farms or agricultural establishments can receive a full direct annual payment for the first farm and half-payment for each of the others. In other words, the farmer may receive up to twice the total annual payment in the form of contract and marketing loan profit payments for three separate farms (one full payment for the first operation and up to half for each of the other two).

Although the 2002 Farm Act contains measures to limit subsidies under specific programmes to a total of US\$ 360,000 per agricultural establishment or farm, a range of exceptions in the Act may have the effect of nullifying this limit. By means of crop loan certificates, for example, farmers who have taken out non-recourse loans for the largest amounts and have had to hand over their crops as payment can purchase these certificates from the CCC at a rate lower than the original rate plus interest on the loan they took out, and then swap them for the crops delivered as surety. In this way, big producers recover their crops and pay off their loans at a lower rate. With provisions like this, the many payments provided for by the 2002 Farm Act are going to benefit large producers rather than the small farmers at whom this law is supposedly aimed.

f) *The cost of commodity subsidies*

Early estimates put the cost of direct subsidies and countercyclical payments at between US\$ 11 billion

and US\$ 12 billion a year. Payments made under the loan programme in 1999-2001 have totalled between US\$ 6 billion and US\$ 8 billion, and if prices were to hold steady then spending would be similar in the coming years. Payments are expected to increase, however, because the 2002 Farm Act will hasten the fall in the prices of the affected products.

Thus, it is estimated that annual commodity spending will reach between US\$ 15 billion and US\$ 20 billion a year for crops alone. This represents a rise of 70% (other preliminary estimates put it as high as 80%) over the stipulations of the 1996 Farm Act in its last year of operation (European Union, 2002).

## **2. Conservation programmes**

Land and natural resource conservation programmes have existed since the 1930s and are of great importance in United States agricultural policy. As well as promoting environmental values, payments linked to the conservation of natural resources can act as measures of support for agricultural production.

The 1996 Farm Act provided for a number of conservation programmes, among them the Conservation Reserve Program (CRP), the Wetlands Reserve Program (WRP) and the Environmental Quality Incentives Program (EQIP). In its conservation title, the 2002 Farm Act maintains existing programmes and creates a new one, the Conservation Security Program (CSP), which offers producers incentives to adopt or maintain a range of structural management practices targeted on one or more resources of interest, such as soil, water and wildlife. This title provides for an 80% increase in the funding hitherto assigned to environmental and conservation programmes, bringing the combined total to US\$ 17.1 billion.

The Conservation Reserve Program (CRP) entails annual payments by the Government and a cost sharing system. Owners of farmland sign 10 to 15-year contracts in which they agree to retire cropland and establish long-term land cover (such as trees or grass) in exchange for annual payments. When this programme began its main objective was to reduce erosion, but the 1990 Farm Act extended its environmental objectives to water quality and wildlife. Annual disbursements during the 1990s averaged US\$ 1.5 billion. The land included varied from 30 to 36 million acres and there was a ceiling of 36.4 million acres, representing about an eighth of all land suitable for commodity growing. The 2002 Farm Act increased the maximum coverage of this programme to 39.2 million acres and changed the qualifying criteria.

The Wetlands Reserve Program (WRP) is based on a system of State purchases and of cost sharing and payment facilities as incentives to bring producers into the programme. The 1996 Farm Act authorized the payment of US\$ 1.3 billion over a seven-year period to help farmers and ranchers carry out environmental improvements and conservation work on their properties; the maximum land area covered by the programme was 1.075 million acres. The 2002 Farm Act increases this to 2.275 million acres, with a maximum annual enrolment of 250,000 acres.

The Environmental Quality Incentives Program (EQIP) offers technical assistance, cost sharing and financial incentives to help farmers and ranchers adopt and implement environmental improvements and conservation measures in their establishments. The 1996 Farm Act authorized up to US\$ 1.3 billion for the seven years of the implementation period. The 2002 Farm Act significantly increases the funding for this programme, as it provides for a gradual increase from US\$ 400 million to US\$ 1.3 billion for the period 2002-2007.

## **3. Export support programmes**

Products from Latin American countries often have to compete with United States goods in both domestic and export markets. The support programmes run by the United States for its own exports facilitate the country's export operations abroad by means of special incentives and credit facilities for potential buyers and infrastructure abroad for storing United States farm produce. The United States Government operates a number of export assistance programmes: the Export Enhancement Program, the Dairy Export Incentive Program, the Market Access Program, the Foreign Market Development Cooperator Program and the Emerging Markets Program. Meanwhile, the United States Department of Agriculture runs four export credit guarantee programmes: i) the CCC-run short-term Export Credit Guarantee Program (GSM-102), which is the largest export promotion programme in the United States; ii) the intermediate-term Export Credit Guarantee Program (GSM-103); iii) the Supplier Credit Guarantee Program, and iv) the Credit Guarantee Programme for infrastructure. The provisions of the 2002 Farm Act affect the different United States export assistance programmes as follows:

- The 1996 Farm Act allocated an annual minimum of US\$ 5.5 billion to the GSM-102 and GSM-103

programmes and specified the minimum proportion of credit guarantees that had to be used for high-value processed products: 25% in 1996 and 1997, 30% in 1998 and 1999, and 35% thereafter. The 2002 Farm Act keeps these provisions, so that no less than 35% of guarantees have to be used for products of this type.

- The term of short-term credits granted under the Supplier Credit Guarantee Program is extended by the 2002 Farm Act from 180 to 360 days, with a view to encouraging United States exporters to expand, maintain and develop markets for their country's export products in areas where commercial financing may not be available without a CCC payment guarantee.
- The 2002 Farm Act provides for US\$ 1 billion to go to direct credit or credit guarantee programmes for exports to emerging markets, the aim being to provide facilities and services or supply United States products to improve transport, handling, marketing, processing, storage or distribution conditions for United States farm products in the markets identified.
- The United States supplies food aid through the Food for Progress programme (Public Law 480). The 2002 Farm Act allows the programme to be extended until 2007. It also includes conflict prevention as an objective and raises minimum assistance levels from 1.875 billion to 2.5 billion metric tons a year, among other provisions.
- As well as modifying existing programmes, the 2002 Farm Act establishes new programmes with the aim of eliminating, resolving or mitigating

sanitary and phytosanitary barriers and other technical obstacles to trade:

- The Biotechnology and Agricultural Trade Program deals with non-tariff regulatory barriers to United States commodity exports. It authorizes donations for public-sector and private-sector projects concerned with biotechnology, food safety, diseases or other sanitary and phytosanitary issues.
- The Technical Assistance for Specialty Crops Program helps exporters overcome particular barriers that prevent or jeopardize exports of specialized products from the United States, by means of public- and private-sector projects and technical assistance to deal with delicate strategic issues of market retention, access and expansion. The amount made available for this is US\$ 19 million.

The new feature of the 2002 Farm Act where export support programmes are concerned is the requirement for the United States Agriculture Secretary and Trade Representative to consult regularly with Senate and House of Representatives committees on negotiations over export credit guarantee programmes for farm produce that are conducted in WTO and the Organisation for Economic Co-operation and Development (OECD). If the United States and other OECD countries have so far been unable to commit themselves to minimum restraints on the use of government-guaranteed export credits and export subsidies, this new consultation mechanism is going to make it considerably harder to achieve, even if the United States makes an ambitious proposal at WTO to dismantle such credits.

### III

## The 2002 Farm Act and WTO provisions

### 1. Agricultural assistance measures and their classification by WTO

The WTO Agreement on Agriculture<sup>7</sup> places internal measures of assistance for the production and marketing of farm produce in three “compartments”: “amber box” measures, “green box” measures and “blue box” measures. These “compartments”, which embody the general rules for subsidy use in agriculture, are of the greatest importance for understanding the nature of the new programmes included in the 2002 Farm Act.

- Amber box measures are those considered trade-distorting. They include, among others, support prices, direct payments that affect output volume (“coupled payments”) and input and capital subsidies. These measures are subject to progressive reductions and periodic review, and are the ones taken into account to calculate the Aggregate Measurement of Support (AMS).
- Green box measures are those that do not involve direct payments to producers, have little or no effect on output and trade, do not increase market prices, and have to be financed out of the public budget. These measures are identified as “decoupled payments” and are exempt from reduction commitments.
- Blue box measures are direct payments made under output limitation programmes based on fixed acreages and yields, apply to 85% or less of the base output level and, in the case of livestock payments, are made for a fixed number of head. These payments are exempt from AMS reduction commitments.
- The *de minimis* clause is an exception to the amber box reductions. It states that small-scale subsidies do not have to be reduced or abolished. Assistance for specific products must not exceed 5% of the total output value of the product in the case of developed countries or 10% in the case of developing ones.

Internal assistance that is not product-specific must not exceed 5% of total agricultural output by value in the case of developed countries or 10% in the case of developing ones.

A key condition for classifying subsidies is whether or not payments to producers are decoupled, i.e., whether or not they are independent of output, domestic and external prices and input use. Insofar as these payments are pre-set and do not vary with output or market conditions, the relationship between support and production is broken. To put it another way, output would be virtually the same with or without these payments. Consequently, such decoupled payments are said to be “minimally distorting”.

Underlying the idea of decoupled payments and their relatively undistorting effects is the fact that freedom to plant and choose among crops year by year reduces the distortions that arise when subsidies are based on a particular crop. If all support to agriculture were decoupled, farmers would respond to marginal price changes in world markets and would thus produce the same as they would have done had there been no market intervention. Where payments are not tied to any of the main variables influencing production decisions, farmers will invest their money in the activities that offer the highest returns. But the most important thing in judging whether so-called decoupled payments are market-distorting or not is to ascertain whether this assistance encourages farmers to plant a larger acreage or produce more with the aim of receiving greater benefits from the government in future.

Depending on whether or not payments qualify as decoupled, subsidies are classified in the different compartments and the regimes they should follow are determined. If payments are coupled to some variable that affects the volume of production and do not comply with “blue box” rules, they belong in the “amber box” and are thus subject to the limits established by the Aggregate Measurement of Support and to reduction commitments. Conversely, coupled payments that do meet the “blue box” provisions classify as exceptions and are exempt from the reduction commitments. Where payments are decoupled, they belong in the

<sup>7</sup> See GATT (1994).

"green box" and are not subject to AMS limitations or reduction commitments.

## 2. Classifying direct payment programmes

Being coupled, direct payments rightly belong in the amber box and should count towards AMS commitments, i.e., towards the annual farm support spending limit to which the United States has committed itself at WTO.

In 1996, LDPS were replaced by the decoupled payments established by the AMTA. This seemed to be the beginning of a commitment by the United States to move away from the highly coupled nature of the traditional farm income support programmes created since the 1930s. When AMTA payments were introduced in 1996, they seemed to be quite closely attuned to the requirements for decoupled payments. They were applied on the basis of fixed acreages and yields corresponding to pre-1996 averages, they did not vary with changes in output, prices or input use, and farmers were not required to have grown any crop previously to receive them. The United States reported them to WTO as decoupled payments.

Until 2001, payments classified as decoupled met clearly defined criteria based on pre-1996 acreages and yields. The 2002 Farm Act, however, offers farmers the option of updating these acreages and yields to 1998-2001 averages. Consequently, farmers who planted more and/or cultivated their land more intensively from 1996 onward, in the expectation that their lobbyists would be able to persuade Congress to update the future payment basis and thus increase the amount of their payments at a later date, succeeded in achieving a permanent increase in their incomes from decoupled payments.

## 3. Classifying countercyclical payment programmes

According to the provisions of the WTO Agreement on Agriculture, subsidies tied to product prices should be in the amber box, and should count towards the upper limits agreed at WTO. The sponsors of the 2002 Farm Act maintain, however, that countercyclical subsidies should not be set against the agreed maximum, but against the *de minimis* subsidies permitted. They also maintain that these subsidies are non-specific.

The *de minimis* clause, however, allows subsidies not exceeding 5% of the output value of each crop included in the payments to be exempted from the AMS

calculation. For payments that are not product-specific, the exemption is based on the total value of agricultural output. Given the high value of United States agricultural production (some US\$ 190 billion a year), 5% of this (about US\$ 10 billion) is enough to cover any kind of subsidy. Furthermore, the 2002 Farm Act states that countercyclical payments are to be determined by what was grown in the base year, which means that they will reflect the price movements of each crop included. It is clear that these payments are product-specific and cannot be classified as non-specific.

Again, approvals of emergency assistance packages from 1998 to 2001 rose as prices fell. These payments were distributed among farmers on the basis of the same acreages and yields as were used for AMTA payments. After a number of delays in submitting the required notifications, and after lengthy discussions in government, academia and producers' organizations, the United States Government began to notify these additional payments to WTO as part of its AMS, i.e., as being among the internal assistance measures deemed market-distorting and thus subject to the agreed reductions.

## 4. Is the 2002 Farm Act in breach of the Aggregate Measurement of Support commitments?

The question of how different support programmes should be classified is not a minor one, since the answer determines whether the 2002 Farm Act conforms to the limits agreed by the United States in the AMS. The AMS is the annual level of assistance, expressed in monetary terms, that is provided to an agricultural commodity or to the producers of the base commodity, or the level of non-product-specific assistance provided to farmers in general. The AMS applies to all internal measures of support, except those included in the green and blue boxes and in the *de minimis* clause.

The most important thing is to know what is going to happen to the AMS limit of US\$ 19.1 billion a year to which the United States committed itself in the Uruguay Round. The total budget for the 2002 Farm Act has been put at US\$ 180 billion over the implementation period (European Union, 2002). Given the obvious discrepancy between the upper limit bound at WTO and the expenditure anticipated, disbursements seem likely to exceed the limit bound in the AMS. Some statements made by the United States Department of Agriculture also suggest, however, that there will be a heated debate over how each expenditure item should be classified,

to determine whether or not it should be counted in the AMS.

To avoid problems, the 2002 Farm Act authorizes the Agriculture Secretary to make adjustments "insofar as this is feasible" to prevent WTO commitments from being exceeded. One extreme option should excessive disbursement occur is to require farmers to return any portion of the payments they have received that exceeds the limit, but this would raise both operational problems and political ones, given the strength of farmers' objections. Another option is simply to break the agreements and then deal with the complaints of the country or countries affected, which can be done through the dispute settlement system, or to offer compensation or find some other innovative way of reclassifying the subsidies. A third possibility is that the United States is not too worried about the long-term effects,

and that the 2002 Farm Act is in fact a strategic negotiating device created with the intention of altering existing commitments and changing the ground rules of the current WTO negotiations.

As for the question of whether the 2002 Farm Act is in breach of the rules agreed to within WTO, opinions are divided. Hitherto there has been no formal submission to WTO questioning the legality of the new Act, although many delegations, including those of Brazil, Colombia, Paraguay and Uruguay, have expressed concern about its content and some Governments (that of Brazil, for example) have informed the press that they intend to begin consultations within WTO (the first step in challenging a measure under the dispute settlement system). The matter can only be settled in the longer term, however, once the annual results of the AMS calculation are known.

## IV

### The impact of the 2002 Farm Act on Latin American agriculture

The United States Farm Act of 2002 is a complex piece of legislation, and this makes it difficult to evaluate fully the economic and trade impact that it will have. Even so, a preliminary attempt can be made to gauge its possible implications for agriculture in the Latin American countries.

#### 1. The effects of certain support programmes

The United States exports about 25% of its agricultural output, a figure that rises to as much as 40% for some crops, such as wheat. LDPs and countercyclical payments will lower the export prices of United States products in receipt of them, so that they will be subsidized when they reach world markets.

Countercyclical payments and LDPs guarantee United States farmers a certain level of income. Consequently, farmers pay less attention to market signals, something that is particularly harmful at times when prices are depressed. Because of the way these payment mechanisms work, a fall in prices may mean that farmers actually receive higher incomes than they

would have if market prices were higher. This can create a disincentive to rein in overproduction. Because the guaranteed income means an assured return on crops, there is no reason whatsoever why United States farmers should refrain from maximizing their output, or worry about the prospects of fetching a good price for their crop. The most likely outcome is that overproduction will saturate the market and drive prices down, while the incomes of United States farmers will be protected by yet larger LDPs and countercyclical payments.

The central fact is that subsidies result in overproduction, driving down prices and leading to a kind of dumping of commodities on the world market. According to preliminary estimates, international prices might be driven down by some 5% to 8% by the 2002 Farm Act (Gardner, 2002). The kind of unfair competition thus generated by the 2002 Farm Act entails serious threats to farm producers, not only in Latin America but in all countries involved in agriculture.

In fact, these support programmes not only result in inefficient production, but encourage monopoly practices. This is happening, for example, with grain

and cotton producers. Of the more than 2 million farm producers receiving government subsidies in the United States, 10% account for 67% of the US\$ 19 billion paid out each year (Clarín, 2002). According to United States statistics (United States Department of Agriculture, 2002), these big farmers have used government cheques to enlarge their holdings by buying up neighbouring farms and thus increase output. The business is still profitable for them, because any shortfall is made up by the Government.

Another consequence of the 2002 Farm Act is that, by bringing down the price of commodities in the domestic market, it provides the food processing industry with cheap inputs. Beef, poultry, pork and milk producers are a good example: cheaper fodder increases their competitiveness in external markets or discourages imports of these products from more efficient countries. This forces marginal exporters to withdraw from the market, whereupon subsidized exports from the United States may well fill the gap. By artificially lowering commodity prices in the domestic market, the United States makes itself less attractive to potential importers. The insulation of United States producers from international market signals thus comes full circle.

## 2. The impact by sector and country

— The products of greatest interest to the countries in the region, such as sugar, citrus fruits, orange, grapefruit and lemon juice, apples, vegetables in general, peanuts, cotton and tobacco, are very unlikely to be allowed greater access to the United States market. The effects of the 2002 Farm Act

on imports and local output will vary from country to country. In the case of wheat, the United States will increase its competitiveness relative to Argentina and Canada in all the markets of the region. The new law also seems to be taking the battle to Canada in the market for high-quality wheat.

- United States subsidies for maize and sorghum will particularly affect small local growers in the Latin American countries, who are going to suffer from their impact and find it hard to survive. The region's big producers will see their export revenues fall and local consumers will benefit from the lower prices. Soybean subsidies will mainly affect Brazil and Argentina, whose export revenues will drop because of lower prices.
- The new United States regulations will adversely affect dairy production in all the Latin American countries. Continuing and increased subsidies for domestic production and export of dairy products will depress international prices yet further. The region's less competitive producers are going to find it hard to stay in business because the tariff levels required for them to do so might exceed the aggregate commitments accepted at WTO.
- Local poultry producers will be among the worst affected. Cheaper food, and subsidies in general, will increase the competitiveness of United States poultry exports and this will force an adjustment in local output, particularly in countries that retain protection for maize and/or sorghum.
- Exports of United States prepared foods, such as breakfast cereals, will become more competitive, discouraging local production.

# V

## Final considerations

The United States Farm Act of 2002 has a number of objectives, and these operate on two levels at once. On the one hand, it represents an effort to bolster the production capacity of the United States farm sector and respond to pressure from traditional farming lobbies. On the other, it is an attempt to change the ground rules of the multilateral system governing agriculture.

This paper has provided details of the support programmes included in the Act that are likely to have the greatest effect on the economies and markets of the Latin American countries. It has sought to characterize the new programmes established by the Act by analysing WTO rules on internal support measures and the classification of subsidies. In an effort to calculate the impact the new United States farm support measures

may have on Latin American agriculture, it has outlined the long-term effects that might arise for the different sectors and commodities in the Latin American countries.

The 2002 Farm Act raises the number of protection and assistance mechanisms for the United States agricultural sector, and increases the sums provided for by the 1996 Farm Act. It is very likely to insulate United States farmers/agricultural producers from market signals and depress international commodity prices. By updating the acreages and yields used as the basis for determining subsidy amounts, the new law changes the payments made by the Government from "decoupled" to "recoupled" ones. Given the characteristics of the support mechanisms used, the funds that will have to be disbursed under the 2002 Farm Act will probably exceed the Aggregate Measurement of Support bound by the United States at WTO.

Some recent events have borne out the initial fears about the United States position on agricultural support measures and their relationship with the 2002 Farm Act. At the recent WTO Ministerial Conference in Cancun, corresponding to the Doha Round of Multilateral Trade Negotiations, the trade negotiations collapsed because agreement could not be reached on agriculture.

The path taken by the United States in implementing the 2002 Farm Act has revealed a position very different from the official one of support for trade

liberalization. It even seems to be running counter to the recent reforms made by the European Union to its Common Agricultural Policy, the thrust of which was to decouple payments to farmers and reduce blue box measures, although green box ones increased. The alliances which emerged during the agriculture negotiations laid bare the protectionist position of the United States. By contrast with the Uruguay Round, where the main struggle in agriculture was between the United States and the European Union over subsidy cuts, in the current negotiations the United States and the European Union submitted a joint negotiating proposal. This proposal, which was quite far from the original United States proposal, alerted developing countries and obliged them to create a new alliance to counter this position.

The failure of the Cancun Conference raises serious doubts about the prospects for completing the Doha Round in 2005, the date set for ending the negotiations. This could represent both a threat and an opportunity for the Latin American countries; what is absolutely certain is that the 2002 Farm Act is a strategic device to alter the commitments accepted and change the ground rules in the current WTO negotiations. This being so, the greatest concern, apart from the large sums set aside for subsidies, has to be about the efforts to reclassify assistance programmes at WTO in a way that legitimizes the new United States support programmes.

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