

RETHINKING AGRICULTURAL DOMESTIC SUPPORT UNDER THE WORLD TRADE ORGANIZATION

Chad E. Hart and John C. Beghin

Reforms in agricultural trade essentially began with the Uruguay Round and lag behind reforms in manufacturing sectors, which have gone through eight GATT (General Agreement on Tariffs and Trade) rounds of reductions. Under the previous GATT rounds, agriculture had remained on the sidelines. The Uruguay Round negotiations established the “three pillars” of agricultural support: market access, export subsidies, and domestic support. The market access provisions required, among other things, tariffication; that is, all nontariff trade barriers had to be replaced by tariffs, and bounds were set on those tariffs. The export subsidy provisions established maximum ceilings on the trade quantity and budgetary expenditures for export subsidies and implemented reductions in those ceilings over time. The domestic support provisions outlined various types of support, classified them by their apparent trade effects, and limited those programs deemed the most trade distorting. In this chapter, we concentrate our efforts on third-pillar issues.

The WTO negotiations under the Doha Round are slowly progressing toward an eventual new agreement on agriculture. A new framework for the agriculture agreement was approved by the WTO membership at the end of July 2004 (WTO 2004a). The pace of the agricultural negotiations has offered an opportunity to do some fundamental rethinking of the current definition of domestic support. The agreed-upon July framework outlines reforms in all three agriculture pillars. The changes in the guidelines for domestic support could have effects on many countries and

many types of support. Many of the details on the specific regulations of the framework agreement are yet to be determined, however. There is potential for dramatic reforms in agriculture under the framework, but the decisions made in filling it out will determine if that potential is realized.

Governments provide domestic support to agriculture in myriad ways: direct payments, research grants, loan programs, storage programs, and so forth. Under the current Uruguay Round Agreement on Agriculture (URAA), domestic support programs are divided into three “boxes” that indicate the trade effects of the programs. Green Box programs are programs that are considered minimally trade distorting. The URAA sets out specific guidelines for the structure of such programs but does not set any limits on program expenditures by member countries. Blue Box programs are those that are considered more trade distorting, but the programs have production limits embedded in them. These programs also are not limited currently. All other programs are Amber Box programs. Amber Box programs are considered the most trade distorting and are limited under the URAA. Within the Amber Box, programs are classified as either product- or non-product-specific. These classifications also affect the so-called *de minimis* rules by which certain Amber Box programs may be exempt from domestic support calculations.

WTO member states have had a decade to examine their domestic support guidelines and restructure their agricultural support to fit under these guidelines. For example, the 1996 and 2002 farm bills in the United States and the Agenda 2000 and 2003 Common Agricultural Policy (CAP) reforms in the European Union were all designed after the acceptance of the URAA. But has this restructuring led to more open agricultural markets, or has support just shifted to programs that were deemed minimally trade distorting even when they actually have significant trade effects? With negotiations for a new agriculture agreement under way, we use this opportune time to examine the rules governing domestic support, explore how well those rules have performed, and outline possible changes that would lead to more substantial trade reform.

The Rules as They Now Stand

The URAA is quite specific about the programs that can be classified as Green or Blue Box. Blue Box policies are production-limiting policies that base payments on fixed yields and acreage. Payments must be limited to 85 percent of a base level of production.¹ The old target price deficiency payment program that existed before 1996 in the United States was a Blue Box program, as are the compensatory payments in the European Union and the rice farming income stabilization program in Japan. Green Box policies are policies that are seen to have minimal trade impacts. Payments from

Green Box policies cannot be linked to current production or prices. The URAA lists several types of Green Box policies and the guidelines that they must follow:

- General services, public stockholding for food security purposes, domestic food aid, direct payments to producers, decoupled income support
- Government financial participation in income insurance and income safety net programs
- Payments for relief from natural disasters, adjustment assistance provided through producer or resource retirement programs, adjustment assistance provided through investment aids
- Payments under environmental programs
- Payments under regional assistance programs

Each of these program types has guidelines that define the eligibility of the program for the Green Box. Any direct payments to producers provided by a government program cannot involve transfers from consumers (only from taxpayers). Thus Green Box programs cannot support domestic prices. The guidelines for decoupled income support are as follows: eligibility for the program must be based on clearly defined criteria over a fixed base period; payment amounts cannot be related to production, prices, or input usage after the base period; and no production can be required to receive payments.

For government-provided income insurance or safety net programs to be eligible for the Green Box, income and income loss can only be from agricultural sources; the loss must exceed 30 percent of average gross income (or an equivalent amount of net income) where average income is determined by a three-year average income (from the previous three years) or a five-year “olympic” average income (removing the high and low years before averaging). If payments are provided by this program and a natural disaster relief program, the total amount of payments cannot exceed 100 percent of the producer’s total loss.

The requirements for natural disaster relief follow a similar logic: eligibility is determined by a formal disaster announcement from the government with at least a 30 percent production loss based on average production (the previous three-year average or the five-year olympic average); payments may only be made on losses attributable to the disaster; payments cannot be for more than the amount of loss and requirements on future production; and if payments are provided by this program and a government-provided income insurance or safety net program, the total amount of payments cannot exceed 100 percent of the producer’s total loss.

Producer retirement programs qualify for exemption if eligibility for the program is clearly defined on criteria to transition the producer out of agricultural production and if the payments are conditional on complete retirement from agricultural

production. Resource retirement programs qualify under the following stipulations: payments are conditional on the resource staying out of agricultural production for at least three years; requirements cannot be placed on alternative use of the resource or other resources employed in agricultural production; and payments cannot be related to any remaining agricultural production in which the producer is involved.

Environmental program payments qualify for the Green Box exemption if eligibility requirements are clearly defined and dependent on specific conditions, possibly involving production inputs or practices, and if the payment is limited to the extra cost or income loss the producer faces to be in compliance. Programs that fit these general types but fail to meet the exemption conditions (such as programs where payments exceed the cost of compliance) and all other domestic support programs would fall into the Amber Box and would possibly be limited under the URAA.

The Aggregate Measure of Support

The aggregate measure of support (AMS) is a measure, expressed in monetary terms, of the annual level of domestic support—other than Green Box support—provided to producers of agricultural products. The AMS limit is based on the member state's agricultural support over a base period, usually 1986–88. The countries that signed the URAA agreed to limit Amber Box spending to a level at or below their AMS for their base period. Implementation of the reforms began in 1995. Developed countries were given 6 years to meet the commitments, while developing countries had 10 years. Developed countries were to reduce their AMS by 20 percent, and developing countries by 13 percent, during the implementation period (WTO 2000).

Amber Box policies can be exempted from the AMS counted against a country's limit if the policy is termed *de minimis*. Within the Amber Box, support is divided into product-specific and non-product-specific groups. The non-product-specific support (the definition of which is still contentious) is not specifically tied to a certain product, and the AMS is assigned to all agricultural production. Once the AMS is classified, the values are compared against minimum values, called *de minimis* values. The *de minimis* rule states that, for developed (developing) countries, AMS values below 5 (10) percent of the product's value of production for product-specific support and AMS values below 5 (10) percent of the country's overall value of agricultural production for non-product-specific support are exempted from the URAA's domestic support limits. When countries design their policies accordingly, and most would, they effectively treat these two constraints additively to 10 (20) percent. The United States arguably used such an approach with market loss assistance payments in 1999–2001, stating that the payments were non-product-specific and qualified as nonspecific *de minimis*. Also, several commodity associations in the United States have reported to their members that the base for U.S. domestic

support under the new framework would be roughly \$49 billion (American Farm Bureau 2004; National Cotton Council of America 2004; American Soybean Association 2004). To have a domestic support base this large, the United States must treat the product- and non-product-specific *de minimis* as separate rules, obtaining \$19 billion from the existing limit on AMS and \$10 billion each from product-specific *de minimis*, non-product-specific *de minimis*, and the Blue Box.

Thirty-four WTO member states had base-period AMS values exceeding their *de minimis* levels (WTO 2004b). Thus, only these 34 members (out of the entire membership of the WTO) faced the prospect of cutting domestic support programs. There have been five reported cases (Argentina in 1995, Hungary in 1998, and Iceland in 1998, 1999, and 2000) where countries have exceeded their commitment levels; however, these countries had not exceeded the levels if inflation is factored in. An aspect of more concern relates to attempts to water down the AMS ceilings by either crediting negative and positive commodity supports or “carrying over” unused AMS limits from year to year to meet the AMS ceiling on average (Shetkari Sanghatana 2001). For example, India proposed that negative AMS values from product-specific support be allowed to offset positive non-product-specific support (WTO 2001). Nevertheless, these attempts have been limited and unsuccessful and are clearly not allowed by Article 6 of the URAA (WTO 1995). The consensus view is that a new agreement on agriculture should not allow such dilution of the original intent of the URAA.

The use of WTO-limited domestic support programs varies by member states. Over the reporting periods, New Zealand has not used any of its domestic support limits. Canada has restructured programs so that its AMS has fallen to 15 percent, on average, of the country’s allowable amount. The average AMS level for Australia is 27 percent of the limit. The United States utilized 54 percent of its limit. The average AMS levels for Japan, the European Union, and the Republic of Korea were 45, 67, and 90 percent of their respective limits. As these numbers show, the participating countries have reduced their spending on programs that are classified as trade distorting, and these reductions have met or exceeded the requirements of the URAA.

AMS calculations are meant to estimate the amount of support provided to the commodity as close as possible to the point of the commodity’s first sale. AMS can be calculated in two ways. For most types of support, the direct measure of the budgetary outlays and forgone revenue to the government for the program is used as the AMS figure. National and subnational support is to be included in the figure, while any fees or levies paid by producers are to be deducted. For market price support (MPS) programs, the AMS for particular products is based on the price gap between a fixed external reference price and the applied administered price from the program and the quantity of production eligible under the program. Hence, the MPS component of the AMS is not based on actual expenditures or current price gap information.

This is a fundamental difference between the AMS and the market price support component of the producer support estimate (PSE) prepared by the Organisation for Economic Co-operation and Development (OECD). The OECD relies on actual market data to compute a price gap leading to the MPS component of the PSE.

The fixed external reference prices were set based on prices during the base period. They represent the average free-on-board price for the commodity in a net-exporting country and the average cost, insurance, and freight price for the commodity in a net-importing country. Adjustments to the fixed external reference prices are allowed for differences in commodity quality.

Total AMS is the sum of all AMS figures (both product-specific and non-product-specific). Current total AMS is the sum of all AMS figures after accounting for exemptions for Blue Box programs and the de minimis rules. To examine the issues outlined in the introduction, we have chosen four member states to highlight: the United States, the European Union, Japan, and Brazil. Tables 8.1 to 8.4 show the domestic support for agriculture that these member states have reported to the WTO as of the end of 2004. For Green Box support, we report the total amount of support, decoupled income support, marketing support, and transportation and infrastructure support. Total Blue Box support is also listed, along with figures for the Amber Box, or AMS limits, total AMS, and current total AMS (the support actually counted against the limits after de minimis exemption).

In the United States, Green Box support represents most of the support to agriculture, as illustrated in table 8.1. Roughly 60 percent of this support is in domestic food aid. Decoupled income support is roughly 10 percent of all Green Box

TABLE 8.1 Reported Domestic Support from the United States, 1995–2001 (US\$ billions)

Category	1995	1996	1997	1998	1999	2000	2001
Green							
Total	46.0	51.8	51.2	49.8	49.7	50.1	50.7
Decoupled income support	0.0	5.2	6.3	5.7	5.5	5.1	4.1
Marketing ^a	0.7	0.7	0.8	0.8	0.8	0.8	1.0
Blue	7.0	0.0	0.0	0.0	0.0	0.0	0.0
Amber							
Limit	23.1	22.3	21.5	20.7	19.9	19.1	19.1
Total	7.9	7.0	7.0	15.1	24.3	24.1	21.5
Current total	6.2	5.9	6.2	10.4	16.9	16.8	14.4

Source: See data sources for tables at end of chapter.

a. Transportation and infrastructure support is included in marketing category; data could not be separated.

support in the United States. Subsidies that are directly targeted at marketing, transportation, and infrastructure are about 2 percent of Green Box support. The United States eliminated its Blue Box support with the 1996 farm bill. In the late 1990s the United States expanded its Amber Box support, as some existing and some new programs provided support to counter the low prices experienced during the time. The latest U.S. farm legislation maintains most of the existing programs, including decoupled income support payments, and incorporates a new Amber Box program that provides support in low-price scenarios. The United States has used the *de minimis* rules very effectively to meet its limits and would be seriously constrained by a phaseout of the exemptions.

The European Union has reported significant support in all three boxes. However, the reports show a trend toward an increase in Green Box support and a decrease in Amber Box support. Decoupled income support and subsidies tied to marketing, transportation, and infrastructure account for less than 20 percent of all Green Box support. The Blue Box support consists of compensatory payments for grains, oilseeds, and livestock—programs that have production limits embedded in them. Recent changes in the European Union's CAP are structured to transfer much of the EU's Blue and Amber Box support to the Green Box and are not fully reflected in the recent history shown in table 8.2. The incorporation of many of the EU commodity-specific compensatory payments into a single farm payment that is tied to a payment entitlement will transfer a great deal of EU agricultural support to the Green Box as decoupled income support payments.

TABLE 8.2 Reported Domestic Support from the European Union, 1995–2000 (1 billions)

Category	1995	1996	1997	1998	1999	2000
Green						
Total	18.8	22.1	18.2	19.2	19.9	21.8
Decoupled income support	0.2	0.2	0.2	0.1	1.0	0.5
Marketing	0.5	0.6	0.8	1.1	1.1	1.0
Transportation, infrastructure	0.8	1.3	0.6	0.6	2.4	1.0
Blue	20.8	21.5	20.4	20.5	19.8	22.2
Amber						
Limit	78.7	76.4	74.1	71.8	69.5	67.2
Total	52.4	51.5	50.5	46.8	47.9	43.9
Current total	50.0	51.0	50.2	46.7	47.9	43.6

Source: See data sources for tables at end of chapter.

TABLE 8.3 Reported Domestic Support from Japan, 1995–2000 (¥ billions)

Category	1995	1996	1997	1998	1999	2000
Green						
Total	3,169	2,818	2,652	3,002	2,686	2,595
Decoupled income support	0	0	0	0	0	0
Marketing	21	17	17	20	20	20
Transportation, infrastructure	1,908	1,681	1,488	1,801	1,552	1,621
Blue	0	0	0	50	93	93
Amber						
Limit	4,801	4,635	4,469	4,304	4,138	3,973
Total	3,625	3,434	3,282	922	851	719
Current total	3,508	3,330	3,171	767	748	709

Source: See data sources for tables at end of chapter.

Japan also utilizes support in all three boxes (table 8.3). More than half of its Green Box support is targeted at agricultural transportation and infrastructure. A shift in the Japanese rice program moved some agricultural support from the Amber Box to the Blue Box. The shift resulted in a significant decrease in AMS figures: current total AMS fell by more than 75 percent. The shift also moved Japanese AMS levels well below the targeted limits.

TABLE 8.4 Reported Domestic Support from Brazil, 1995–98 (US\$ millions)

Category	1995	1996	1997	1998
Green				
Total	4,883	2,600	3,458	2,420
Decoupled income support	0	0	0	0
Marketing	56	26	21	34
Transportation, infrastructure	597	436	716	617
Blue	0	0	0	0
Amber				
Limit	1,039	1,025	1,011	997
Total	432	376	310	578
Current total	0	0	0	83

Source: See data sources for tables at end of chapter.

Brazil, like the United States, has provided most of its agricultural support through the Green Box (table 8.4). While the total amount of Green Box support has varied considerably over the reported years, support targeted at marketing, transportation, and infrastructure has held between \$450 million and \$750 million. The first year that Brazil reported any support that counted against the AMS limits was in 1998—before that all Amber Box support was below the *de minimis* levels.

The July Framework, Recent Policy Changes, and WTO Rulings

The July 2004 framework for agricultural domestic support is targeted at achieving substantial reductions in trade-distorting domestic support. Harmonization of permitted support levels is approached by requiring larger cuts in higher bound levels of permitted support. The framework proposes new limits be put in place on *de minimis* support, Blue Box support, and product-specific AMS. Total support, as measured by the sum of permitted AMS, *de minimis*, and Blue Box support, is also to be limited. This limit on total support is to be reduced during the implementation period. All member states would face a 20 percent reduction in the total support limit in the first year of implementation. Additional reductions in the total support limit are to be based on a tiered formula that is yet to be determined. However, the formula will result in larger reductions for member states that have higher levels of permitted support.

Permitted total AMS and *de minimis* levels will also be lowered throughout implementation. Product-specific AMS and Blue Box support are only capped. Article 9 of the framework states, however, that the required reductions in total support and total AMS will force reductions in product-specific support as well. The Blue Box is redefined to include direct payment schemes that either limit production or do not require production at all. A member state's limit for Blue Box support will be based on 5 percent of its average total value of agricultural production over a historical period or the amount of existing Blue Box payments over a historical period, whichever is higher. Green Box guidelines are to be reviewed to ensure that all Green Box programs are only minimally trade or production distorting. Monitoring of compliance with the new agreement, through "timely and complete notifications with respect to the commitments in market access, domestic support and export competition," is to be enhanced (WTO 2004a, A-7).

Both the United States and the European Union have significantly altered their agricultural support in the last few years. These changes have moved a great deal of their agricultural support to direct payments to agricultural entities. The direct and countercyclical payments in the United States and the Single Farm Payments in the European Union all fit the description of direct payments. Given the current

structure of the Green Box and the new definition of the Blue Box, the U.S. direct payments and the EU Single Farm Payments would be filed in the Green Box, and the U.S. countercyclical payments would go in the Blue Box. These moves would seem to give the United States and the European Union a great deal of flexibility in dealing with the proposed reductions.

However, the WTO panel ruling on the Brazil-U.S. cotton dispute has questioned whether the U.S. direct payments belong in the Green Box. The panel concluded that the U.S. direct payments “do not fully conform” to the guidelines for Green Box direct payments. The major reason for this conclusion is the restriction on the production of fruits and vegetables on the payment base acreage (WTO 2004b). By the same argument, the EU Single Farm Payments would not conform to the Green Box requirements. It would be relatively easy to fix both issues.

Article 9 of the framework explicitly states that the reductions in total AMS permitted levels “will result in reductions of some product-specific support” (WTO 2004a, A-2). But given the loopholes with MPS, discussed in the next section of this chapter, and the flexibility of member states to channel support through other mechanisms, true reductions may not be achieved or the results may not be as dramatic as hoped. For example, the United States could utilize the MPS loopholes and make cosmetic changes to the dairy and sugar programs to fulfill a target in product-specific support reductions without truly affecting actual support. Another example would be if the United States moved to lower loan rates in the marketing loan program (reducing product-specific AMS) and augmented the countercyclical program to make up the support difference (by changing the target price). Aggregate support would remain the same, but support would shift from the Amber Box to the Blue Box. The ability of reductions in total permitted AMS levels to force reductions in product-specific support will also hinge on the product-specific AMS limits. These limits have yet to be determined, although the framework does state that the limits will be based on “respective average levels” (WTO 2004a, A-2). To guarantee product-specific support reductions, the final level of total permitted AMS must be less than the sum of the product-specific AMS limits.

Should AMS Be Redefined?

AMS is calculated in two ways. For support financed from the budget, the actual government expenditures on the program are used. However, for MPS programs, the AMS calculations depend on fixed external reference prices that are derived from import and export prices during the 1986–88 base period. The calculations also depend on the administered or policy prices set by the member state during the given marketing year. AMS is computed as the product of the difference

between the administered price and the external reference price and the amount of eligible production, less any fees or levies associated with the program.

Having the calculations based on fixed prices simplifies them, as the only random parts of the AMS calculation are then the eligible production and program fees. But does this definition of AMS truly capture the amount of support from these programs? The use of the administered price does not necessarily reflect the market situation in the member state for the given year, just as the external reference price does not reflect the world market situation. If domestic market prices are lower than the administered price or the actual world price is above the external reference price, or both, then the amount of support, as computed under current AMS guidelines, is overestimated. If these price relationships are reversed (the domestic market price exceeds the administered price or the actual world price is below the reference price), then the amount of support is underestimated.

Many of the agricultural programs in the four member states we consider here are considered market price support programs. In the United States, the dairy, sugar, and pre-2002 farm bill peanut programs fell into this category. The European Union has market price support programs for beef, butter, corn, rice, sugar, wheat, and several other commodities. Japan supports barley, beef, milk, pork, potatoes, sugar, and wheat. Brazil has price support programs for corn, cotton, edible beans, rice, sisal, soybeans, and wheat.

Table 8.5 shows the proportion of reported AMS that comes from MPS programs for these four member states. The table shows that the United States, European Union, and Japan have all relied on price support programs for a majority of their reported agricultural support. The U.S. proportion has sizably dropped over the period, as other support programs have grown. The EU proportion has remained steady over the period. The Japanese proportion has fallen, mainly because of the shift in support for rice. Almost all of Brazil's support comes from other types of programs.

TABLE 8.5 Market Price Support as a Percentage of Reported AMS, 1995–2001

Country/Region	1995	1996	1997	1998	1999	2000	2001	Average
United States	100	100	93	56	35	35	40	66
European Union	64	68	69	73	71	70	—	69
Japan	93	94	94	84	83	71	—	87
Brazil	0	0	0	1	—	—	—	0

Source: See data sources for tables at end of chapter.

Note: — = not available.

TABLE 8.6 U.S. Sugar Program AMS Calculations with External Reference Prices, 1995–2001

Year	Administered price (US\$/metric ton)	External reference price (million metric tons)	Eligible production (million metric tons)	AMS (US\$ millions)
1995	396.8	230.8	6.7	1,107.8
1996	374.8	230.8	6.5	937.2
1997	374.8	230.8	7.3	1,045.4
1998	374.8	230.8	7.6	1,093.2
1999	374.8	230.8	8.2	1,180.2
2000	374.8	230.8	7.9	1,132.8
2001	374.8	230.8	7.2	1,031.8

Source: See data sources for tables at end of chapter.

As an example, consider the U.S. sugar program. It is a price support program in which the support originates in the form of commodity-backed loans. The administered price is the loan rate for the program less a forfeiture penalty. The external reference price is the 1986–88 average Caribbean price for sugar plus transportation costs to the United States. No fees or levies are associated with the program. Table 8.6 displays the reported AMS figures for the U.S. sugar program from 1995 to 2001. The administered price changes only with a change in the loan rate for the program, as happened with the passage of the 1996 farm bill. The external reference price is a constant (the 1986–88 average Caribbean price of \$202.16 per metric ton plus \$28.66 per metric ton transportation charge). Thus, the AMS for the program varies only with the eligible production. The average level of AMS was \$1.075 billion and the range between high and low years was roughly \$250 million.

To show the effects of moving to different prices in the AMS calculation, we have calculated the AMS for the U.S. sugar program using the actual Caribbean sugar prices for the given years. These prices and the resulting AMS figures are given in table 8.7. On average, the change has a minor effect, as the average AMS would have been \$1.034 billion annually over the period. Thus, on average, the amount of calculated support from the program fell when actual world prices were used. But the variability of the AMS figures dramatically increased with the inclusion of actual world prices. The range between high and low years increased to nearly \$900 million.

A similar exercise for the EU sugar program shows parallel results. On average, annual AMS levels for the program would fall modestly over the reported period if actual world prices were used in the calculation, but the variability of the AMS

TABLE 8.7 U.S. Sugar Program AMS Calculations with Actual World Prices, 1995–2001 (US\$ per metric ton except where indicated)

Year	Administered price	Freight on board Caribbean price	Transportation adjustment	Eligible production (million metric tons)	AMS (US\$ millions)
1995	396.8	273.0	28.6	6.7	635.1
1996	374.8	257.0	28.6	6.5	580.2
1997	374.8	238.0	28.6	7.3	785.2
1998	374.8	155.0	28.6	7.6	1,451.4
1999	374.8	166.0	28.6	8.2	1,476.7
2000	374.8	216.0	28.6	7.9	1,024.0
2001	374.8	167.0	28.6	7.2	1,283.8

Source: See data sources for tables at end of chapter.

levels would increase. Reported AMS for the EU sugar program ranged from €5.72 billion in 1999 to €5.8 billion in 2000. Calculated AMS with actual world prices ranged from €4.5 to €6.5 billion.

If actual domestic prices were used in the AMS calculation, then additional shifts would be expected. In table 8.8, we have calculated AMS for the U.S. sugar program using the actual Caribbean sugar prices and estimates for the U.S. domestic prices for the given years. The estimated domestic prices are based on

TABLE 8.8 U.S. Sugar Program AMS Calculations with Actual Domestic and World Prices, 1995–2001 (US\$ per metric ton except where indicated)

Year	Market price	Freight on board caribbean price	Transportation adjustment	Eligible production (million metric tons)	AMS (US\$ millions)
1995	501.6	273.0	28.7	6.7	1,333.7
1996	496.0	257.0	28.7	6.5	1,369.1
1997	485.0	238.0	28.7	7.3	1,584.9
1998	486.9	155.0	28.7	7.6	2,301.8
1999	486.4	166.0	28.7	8.2	2,392.0
2000	405.6	216.0	28.7	7.9	1,266.2
2001	464.4	167.0	28.7	7.2	1,926.7

Source: See data sources for tables at end of chapter.

U.S. raw sugar prices that are reported with duty fees paid in New York on a fiscal year basis. This change has a major impact on AMS figures. The average annual AMS level over the reported period would have been \$1.74 billion, a jump of nearly \$700 million in estimated support. In some of the years, the estimated AMS levels in table 8.8 are double the actual reported values from table 8.6.

Whether such changes to the definition of AMS would increase or decrease a WTO member's chances of violating WTO commitments depends on the relative relationships among the administered program price, the domestic market price, the external reference price, and the actual world price. As the U.S. sugar example shows, any new definition of AMS may lead to decreased chances of violations in some years but increased chances in others. The current definition has the relative benefit to member states of being fairly stable (only varying with production and policy changes), while new definitions of AMS would likely be more variable, at least based on this example. However, if domestic and world prices move together (as they would with more open trade), then the variability of the AMS calculations using actual prices would be lower than was previously demonstrated. An increase in AMS variability would also contribute to a higher chance of violations, especially given the lower levels of AMS commitments put forth under the July Framework. Also, the change from the administered price to an actual domestic market price changes the meaning of the support estimate. One argument for staying with the administered price is that it represents the price supported by the domestic support program in question. By moving to an actual domestic price, the support estimate is picking up the effects of other policies (such as tariffs) and market events not embodied in the domestic support program. With an eye toward the goal of the negotiations, the potential variability from these changes to AMS calculations could bring more policy discipline and decrease the reliance on anti-cyclical support. But the panel ruling on the Brazil-U.S. cotton dispute also gives some insight on the framing of the URAA. In the ruling, the panel discussed MPS calculations for AMS. They stated that "a prime consideration of the drafters was to ensure that Members had some means of ensuring compliance with their commitments despite factors beyond their control" (WTO 2004b, 134). Thus, the framers of the URAA chose to provide member states a greater degree of control over their MPS measurement at the expense of an updated representation of the effective support from the programs.

Another question related to AMS is the "double coverage" of such programs under the URAA. MPS programs essentially fall under two of the three pillars, market access and domestic support. Does it make sense to cover these programs twice? It does not in terms of the accounting of agricultural support, but in political economy terms, this was not an innocuous oversight. Indeed, it would be relatively simple to remove MPS programs from both the base and annual AMS

calculations and allow the market access commitments to govern their behavior. This change would make clear how the programs are treated.

The removal of the MPS programs from both reported and base AMS would also remove the possibility of another policy change like the one in Japanese rice policy. The Japanese government abolished its official price for rice. This move dramatically reduced Japan's reported AMS (shown in table 8.3) without any reduction in permitted support. But the level of protection for rice was maintained. Events such as this highlight the loopholes in the MPS approach. It is likely that new approaches will bring new loopholes or new policies circumventing the new rules, especially as long as market access limits allow high protection paid by consumers. The Japanese rice example also shows the importance of the administered price in MPS and the possible moves a member state can make to remove an MPS program from its notifications. One tactic WTO negotiators could use to tighten controls on MPS programs would be to define more clearly what constitutes an administered price and how an MPS program must be changed before it can be removed from notifications.

Another example of double coverage is U.S. dairy policy before the 2002 farm bill. This program consisted of border protection measures and a domestic support price. Thus, the policies were covered by both the market access and domestic support pillars. But as Sumner (2003, 104) points out, the domestic support price "provides almost no support in addition to that provided by the dairy trade barriers." Under the current structure of domestic support reporting, though, the United States reports \$4.5 billion in dairy AMS for domestic support. U.S. sugar policy could also be amended in a way that would make the sugar MPS (\$1.1 billion) vanish without significant changes in the actual support received by U.S. sugar growers.

However, the current double coverage does have the trade benefit of allowing either the market access or domestic support commitments to be binding. Thus, while an MPS program may be acceptable under the market access commitments, its domestic support commitments may not be met (or vice versa) and support reductions would be warranted. In different states of the world, different pillars may become binding. Also, many governments use trade restrictions to decrease the expected treasury cost of their farm support. A fundamental issue is whether the domestic program would indeed become fiscally unsustainable with open borders. The answer is a qualified yes. It is clear that the foreseeable reduction in border protection is driving many of the EU's CAP reforms, the recent reform of the U.S. peanut program, and other reforms. Yet there are a few powerful counterexamples such as U.S. and EU cotton subsidies, which appear sustainable despite open borders. A government's largesse is also conditioned on fiscal surpluses or deficits. The budgetary situation has been deteriorating for the largest providers of farm support in OECD countries.

Is the Domestic Support Pillar Worth the Trouble?

With market price support programs covered by market access commitments, and most member states moving to Green Box support for most agricultural support, does it make sense to continue to discipline domestic support in the WTO? Only 20 percent of the WTO membership currently has explicit domestic support commitments. Many of the domestic support programs can be or are covered by the other pillars. Works such as that by Hoekman, Ng, and Olarreaga (2004) have shown that tariff reductions generate much larger welfare gains than similarly sized reductions in agricultural subsidies. However, Hoekman, Ng, and Olarreaga still conclude that it is important to focus on both tariffs and subsidies.

With some caveats on dirty tariffication and tariff rate quota administration, the two trade pillars have fairly clear measures of their effectiveness, whereas the domestic support pillar is much less transparent. The rules of the domestic support pillar are structured to separate those programs that have minimal or no trade effects from those that are trade distorting. But a program's ability to distort trade is in the eye of the beholder. Earlier in this chapter, we outlined the list of program descriptors that define minimal- to non-trade-distorting programs (the Green Box guidelines). Recent disputes within the WTO (such as the U.S.-Brazil cotton dispute) have questioned the trade impacts of some of these Green Box programs, however. The goal of the domestic support commitments is to allow member states to direct support to the agricultural sector while limiting the trade effects from such support. The ability of the commitments to do this is strictly dependent on the precision of the domestic support guidelines in categorizing programs in their trade impacts. Judging from recent trade disputes, precision is somewhat lacking.

This lack of precision was recognized in the URAA, as Blue and Amber Box programs were not completely restricted. If only non-trade-distorting programs had been allowed, the ability of member states to reach consensus on the guidelines for such programs would have been severely tested. The Uruguay Round lasted eight years and the current agricultural negotiations are already in their sixth year. If the negotiations included strict guidelines on non-trade-distorting domestic support, we can imagine that the negotiations might take considerably longer and be even more contentious. One potential way to avoid this situation is to provide a temporarily generous definition of the Green Box, which would allow buyout or phaseout of Amber and Blue Box forms of support. Then a progressive phasedown of the Green Box would discipline remaining farm support over time. It took eight GATT rounds to get rid of industrial protection. It is foolish to hope that vested agricultural interests in some of the high- and middle-income countries would give up huge and concentrated rents without virulent and long fights. Part of the solution is also demographic in the European Union and North America,

where farming populations and farm political representation are aging rapidly and not being replaced.² This withering process is happening in a new political economy context for farm subsidies. The general public now perceives OECD subsidies as exacerbating development and environment problems thanks to greater transparency induced by nongovernmental organizations such as Oxfam and the Environment Working Group.

Another approach to defining the degree of trade distortion from agricultural support is through litigation. The U.S.-Brazil cotton dispute is but one example of this approach. The litigation approach would allow for an examination of specific aspects of the programs in question and provide a finer breakdown of the trade impacts. However, the possible costs of such an approach could be prohibitive.

Looking at the approved July Framework, negotiators are exploring extensions of current guidelines on domestic support, with the possible redefinition of what may be considered minimal- to-non-trade-distorting policy. As the possibility of changing domestic support guidelines is discussed, it is important to try to balance the many issues linked with the support. Agricultural research, marketing, transportation, infrastructure, and inspection services are all covered by the Green Box. Programs with links to conservation, agricultural retirement, and disaster assistance efforts are also included. Many of these programs have multiple targets, and some of these targets are nonagricultural in nature. Part of the issue of tightening Green Box rules will be the tradeoff between limiting the possible trade-distorting effects of current Green Box programs and limiting a country's ability to fund multipurpose projects.

Transportation and infrastructure support can illustrate this point. A seemingly farfetched example is the U.S. interstate highway system. The system was envisioned as part of a strategic plan for the defense of the nation. The system now serves more in an economic capacity than in a defense capacity (Weingroff 1996) and has become a nontrivial factor of production, especially for agriculture and food processing. Any infrastructure investment that decreases transaction costs of production and trade will potentially distort trade in agriculture (Anderson and van Wincoop 2004).

There are two main areas of concern in the Green Box: the trade impacts from decoupled income support; and marketing, transportation, and infrastructure subsidies. The current guidelines indicate these programs are minimally trade distorting, but on the basis of the Brazil-U.S. cotton dispute ruling and other comments by WTO member state delegations, those assumptions are being questioned. Proposals, such as those from Pakistan and India, have called for an investigation of Green Box policies in combination with a reshaping of the Green Box guidelines (Ingco and Kandiero 2003). The framework explicitly calls for a review of Green Box criteria. Decoupled income support has become a favored way to support

agriculture in the United States and European Union. The United States shifted to decoupled income support with the 1996 farm bill and continued this type of support through the 2002 farm bill. The European Union, in its latest agricultural policy change, moved to combine many individual commodity payments into decoupled income support, known as the Single Farm Payment.³

The G-20 developing countries have questioned whether this income support is truly decoupled. The payment bases for the U.S. and EU income support programs are set on historical, but recent, production decisions. In the case of the United States, the 2002 farm bill allowed producers to update their payment base to reflect recent shifts in production patterns and to allow the incorporation of a new commodity in the program.

The decoupled income support used by the United States and European Union is being criticized on a number of other grounds as well. Many argue that the sheer size of the payments may affect producer decisions. As an example, for the 2001 marketing year, the decoupled income support received by U.S. rice producers equaled 38 percent of the total value of the U.S. rice crop. Second, the payments may reduce the risk of producing payment crops and the associated income stream, possibly creating incentives to increase output. These wealth and input effects have been examined and found to be small (Hennessy 1998; Young and Westcott 2000). Third, as was the case for the U.S. program, the possibility of updating payment bases may induce links between current production and the payments. Fourth, these programs often require that the land remain in agricultural use and the program may restrict the ways in which the land can be used. For example, producers receiving decoupled income support in the United States cannot shift the payment acreage to the production of certain fruits and vegetables. In a recent study, de Gorter, Ingco, and Ignacio (2004) explore in depth the factors that could link income support payments to production decisions. As was noted earlier in this chapter, a WTO dispute panel found that U.S. direct payments fail to meet Green Box guidelines. Ongoing negotiations should further strengthen and clarify the Green Box guidelines for direct support.

Marketing, transportation, and infrastructure subsidies have also received scrutiny from member states, often for mercantilist reasons. As exemplified by a letter from U.S. Senator Charles Grassley to the U.S. Department of Agriculture and the Office of the United States Trade Representative (Grassley 2003), this concern is targeted mostly at specific developing countries and comes from developed countries. Protectionist interests in developed countries, such as the U.S. sugar lobby, regularly complain about unfair infrastructure subsidies in competing developing countries (Roney 2004). The situation in Brazil is probably at the forefront of this discussion. As indicated in table 8.4, Brazil has spent more than \$500 million annually on marketing, transportation, and infrastructure support. Most of

this support has been targeted at improvements in the Center-West region, where there has been tremendous growth in agricultural production.⁴

In a study of Brazilian and Argentine agricultural development, Schnepf, Dohlman, and Bolling (2001) refer to “the Brazil Cost,” the additional costs and distortions that affect Brazil’s ability to market agricultural commodities effectively. One of the major components of the Brazil Cost is the country’s inefficient infrastructure and transportation system. In their analysis, Schnepf, Dohlman, and Bolling find that Brazil and Argentina have production cost advantages in comparison with the United States, but these advantages are largely eliminated by the difference in internal transportation and marketing costs.

Fuller and others (2000) examine five potential transportation improvements that could be made in Brazil and find that these improvements could lead to significant increases in producer prices for soybeans, in the range of \$0.30 to \$0.60 a bushel. Such changes in producer prices are likely to have major implications for the continued expansion of agriculture in the Brazilian Center-West, for the trading capacity of Brazil, and for the world agricultural trade outlook. Thus, it would be hard to argue that these expenditures will have minimal trade effects. But just as in the example of the U.S. interstate highway system, there will likely be other beneficiaries from the transportation and infrastructure expenditures, as reductions in transaction costs are often nontrivial. These beneficiaries will mostly be from nonagricultural sectors, giving the expenditures a public-good aspect. As a developing member, Brazil could also use Article 6.2, which explicitly allows for infrastructure subsidies and exempts them from domestic support commitment. Article 6.2 is seldom used and it has been extended in the July Framework. In the long run, it will represent some option value for developing members whenever infrastructure subsidies under the Green Box may be capped or cut. Subsidies under Article 6.2 will then become another potential loophole to scrutinize.

Blue Box supports have been significantly affected under the July Framework. The changes include an expansion of the box by adding an additional category of payments, namely direct payments with a fixed payment base and no production requirement. Also, limits have been placed on the amount of support that can come from Blue Box programs, whereas the URAA placed no such limits. The vast majority of WTO member states do not use Blue Box programs. Only seven (the European Union, Iceland, Japan, Norway, the Slovak Republic, Slovenia, and the United States) have reported Blue Box support, and the United States eliminated its Blue Box programs with the passage of the 1996 farm bill. However, the new definition of the Blue Box opens its usage to all member states. The U.S. counter-cyclical program would seem to be a candidate for the new Blue Box. If U.S. direct payments and EU Single Farm Payments fail to meet Green Box guidelines, then those payments may find a home in the Blue Box.

Ways to Improve Domestic Support Guidelines

This discussion has highlighted some of the issues embedded in the current WTO domestic support negotiations. The issues are many because of the myriad agricultural programs used by WTO members throughout the world. But the July Framework for categorizing all of the programs has allowed us to condense this support into manageable points in which further clarifications can be made.

Given the possible effects of decoupled income support and marketing, transportation, and infrastructure support on world trade, these programs may not truly fit the Green Box target of minimally trade-distorting policies. However, these programs are not directly linked to current production or prices and may have other nonagricultural benefits. Therefore, leaving them in the Green Box but tightening the rules for them may make the most sense. The new rules might include expenditure limits patterned after the *de minimis* rules and stricter guidelines on the definition of base periods and production for decoupled income support. Such changes would address the concerns raised about these programs while allowing members to continue to employ them. As we explained previously, there is a political economy tradeoff in disciplining the Green Box too much. An initially generous Green Box definition may facilitate negotiation of a phaseout of the Amber Box policies, which are the most damaging distortions.

The current AMS framework for market price support, while providing a stable estimate of support, cannot adequately reflect actual support levels. Moving to an AMS based on current world and domestic prices would better capture the actual level of support and align market price support programs with other Amber Box programs in which actual expenditures are used in the calculations. An alternative change would be to remove the market price support programs from both the AMS limits and the current AMS calculations. As shown by Japan, the URAA market price support AMS structure has a significant loophole, allowing the possibility that countries can make small changes in official policy (resulting in minimal changes in agricultural trade protection) and provide themselves large cushions from agricultural support reductions. Either of the proposals suggested here would close this loophole. Resistance to closing the loophole is likely to be strong, given the vested interest of some OECD countries in the loophole.

The July Framework has provided the *possibility* for significant agricultural trade reform in domestic support. New limits, such as those for Blue Box support and product-specific AMS, encompass more support programs than before and provide additional rules for programs already covered by existing limits. Unfortunately, the Blue Box cap proposed in the framework is so generous that many programs could be folded into the Blue Box with no effective change in policy.

Actually the MPS loopholes, initial AMS bindings, and Blue Box caps are so generous that no actual change in aggregate support would occur. As the framework stands now, actual cuts in support would have to wait for a third round of agricultural negotiations.

Further steps could be taken to convert the possibility of reform into genuine reductions in agricultural support. Changes such as the ones we have outlined address many of the concerns various member states have expressed during the negotiations while still allowing flexibility in domestic support. Additional changes, such as explicit language on the role of inflation in support limits, scheduled reductions in Blue Box and product-specific AMS limits, a cap on and eventually future cuts in Green Box payments, and rules evaluating the effects of different policies on domestic versus export markets, may also be beneficial to agricultural trade reform. A more radical approach, but an unlikely one because of its political economy, may be to require drastic cuts (75 percent or more) in bound AMS (Jensen and Zobbe 2006). This would bring cuts in actual supports, not just in bindings, and would somewhat compromise the ability of a country to play the color box game, although the Green Box would remain uncapped. As the negotiations continue, these issues will have to be addressed by member states as they strive for a new agreement.

Notes

1. The limit on base-level production is somewhat arbitrary but has become almost irrelevant given the new cap on Blue Box payments at a maximum of 5 percent of production value agreed upon in the July Framework document (WTO 2004a).
2. A similar observation can be made of the agricultural economics profession!
3. See Messerlin (2003) for a discussion of the political economy associated with these changes.
4. This region consists of the states of Goiás, Mato Grosso, and Mato Grosso do Sul, along with the Federal District, which includes Brasília.

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