

## The WTO Picture after the Cotton Ruling

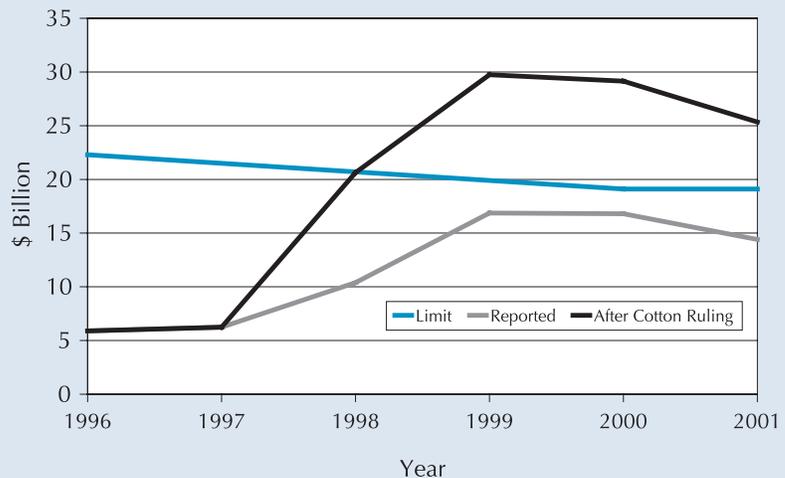
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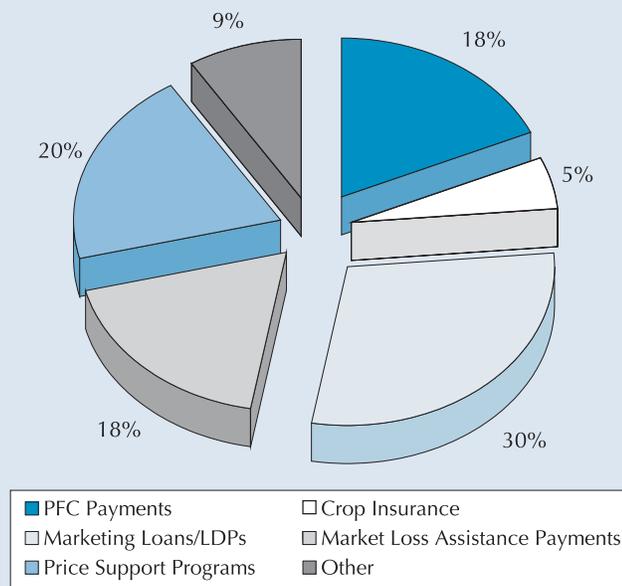
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In early March, the World Trade Organization (WTO) released its report on the U.S. appeal in the cotton dispute with Brazil. The appellate ruling upheld much of the original ruling, including the finding that production flexibility contract (PFC) payments and direct payments are not Green Box measures. This means that these payments are to be counted against the agricultural support limit the United States agreed to under the current WTO Agreement on Agriculture. The rulings also state that the payments from the Step 2 program, marketing loan program, crop insurance, production flexibility contracts, market loss assistance, and other listed programs grant support specific to cotton and that they caused significant price suppression in the world cotton market.

The rulings are a major blow to U.S. agriculture because they call into question whether the United States has met its obligation to limit domestic farm subsidies. The blue line in Figure 1 shows the agricultural support limit the United States agreed to under the current WTO Agreement on Agriculture. The United States has reported agricultural support to the WTO through the 2001 marketing year. The gray line shows the reported agricultural support before the cotton ruling. By these original reports, the United States has complied with the WTO agricultural support limits. The United States reported PFC and direct payments as exempt payments. However, the cotton rulings indicate that the PFC and direct payments are not exempt. This drastically changes the U.S. agricultural support picture. Figure 1 shows how U.S. reported agricultural support would look if the PFC and direct payments are counted as non-



**FIGURE 1. WTO LIMITS AND REPORTED SUPPORT BEFORE AND AFTER THE COTTON RULING**



**FIGURE 2. A BREAKDOWN OF U.S. AGRICULTURAL SUPPORT FOR THE 1999 MARKETING YEAR**

uct-specific support. Reporting these payments in this way follows the U.S. reporting of market loss assistance payments. If this precedent is followed, U.S. agricultural support was at the limit in 1998 and exceeded the limits from 1999 to 2001.

The inclusion of the PFC and direct payments in the reported agricultural support has a double

impact. The U.S. reported support actually increases by more than the amount of the PFC and direct payments, because the other payments that were in the non-product-specific support but were exempted by *de minimis* rules must now be counted. These other payments include the net benefits from the crop insurance program, market loss assistance payments, state credit pro-

grams, and grazing and water subsidies. For 1999, the addition of the \$5.47 billion in PFC payments turns into a \$12.88 billion increase in reported support. Figure 2 shows a breakdown of our revised estimate of 1999 agricultural support. Marketing loan benefits (through loan deficiency payments or marketing loan gains) account for 30 percent of this support. PFC payments, mar-

ket loss assistance payments, and price support programs for dairy, sugar, and peanuts each account for roughly 20 percent of the support. Crop insurance represents 5 percent, while other agricultural programs contribute the remaining 9 percent.

The end results of the cotton dispute are still uncertain. How Congress and the administration will

respond to this ruling, either in modifying the current farm bill or in creating the next farm bill, is unknown. But the cotton ruling, combined with the federal budget pressures we are now seeing in the United States, has the potential to set off substantial changes in U.S. agricultural policy. ♦

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bean farmers received such a policy instead of current farm programs.

We calculated the Figure 3 results assuming that county revenue guarantees are based on a \$2.73 corn price and a \$6.00 soybean price. A payment was made to all farmers in a county if the product of the season-average price and the yield per planted acre fell below 90 percent of the guarantee. Figure 3 shows that this new policy tool would have avoided most of the overcompensation of corn and soybean farmers in 2004. The lower overcompensation that occurred in 2003 results from payments being targeted to those counties with low yields. For corn in 2002, the new policy would have come much closer to hitting the revenue target than either the current farm program or the market-based GRIP.

### **WTO OUTLOOK**

A GRIP-type farm program would be classified as “Amber Box” under the current WTO agriculture agreement and the Doha Round framework because payments are tied to the current price level and the farmers’ choices in planted acres. The pro-

gram could be modified to fit within the “Blue Box” or the “Green Box.” However, the modifications might limit the effectiveness of the program. The Blue Box modifications would allow payments to be triggered by price declines or regional yield disasters, but the payments could not change with national and/or farm shifts in planted areas. Green Box modifications would allow price and/or yield reductions to trigger payments and some updating for regional shifts in crop production; but shifts in farm production would not be accounted for and the program would require larger price and/or yield declines to trigger payments.

### **POLICY IMPLICATIONS**

Matching up policy tools with policy objectives is critical for program cost-efficiency. It is not surprising that our current mix of farm programs does a poor job of matching program support and market revenue shortfalls. These programs are with us for a variety of reasons: program inertia, opportunism concerning budget scoring, and WTO considerations. They are not the result of a deliberate process of choosing program instruments for their efficiency in meeting program objectives.

A more deliberate process would reveal that our commodity programs consist of two programs that protect against low prices, one program that delivers aid even when farm income is at an all-time high, and an ad hoc disaster system that pays out when regional production is low. In addition, we have a crop insurance program that also pays out when low yields or low prices occur and that offers a program, GRIP, that could easily be modified to replace all commodity and crop insurance programs for major field crops.

Rationalizing commodity, disaster, and crop insurance programs by replacing them with a single-payment program based on a modification of GRIP would increase program transparency, eliminate program duplication, reduce administrative costs, and largely eliminate over- and undercompensation of farmers. Perhaps budget pressures will lead congressional leaders and farm groups to take a fresh look at the current structure of farm programs with an eye toward increasing the efficiency of taxpayer support for farm income. ♦