8 May 2006: ICLQ – Revised draft 9

Reforming the WTO Legal Order for Agricultural Trade: Issues for European Rural Policy in the Doha Round

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I. INTRODUCTION

Farm policy in the Community has undergone radical change over the past six years. This change began with the Agenda 2000 reforms to the Common Agricultural Policy, agreed in Berlin on 24-25 March 1999, which saw a significant shift in financial support away from agricultural products and towards producers. These reforms were greatly extended by the Mid-term Review, agreed in Luxembourg on 26 June 2003, which went far beyond any original remit.[1]. Farm subsidy payments were substantially 'decoupled' from production and switched decisively towards providing income support. In particular, the majority of direct payments to farmers were reconfigured under the umbrella of the 'single farm payment' ('SFP'), implemented in principle as from 1 January 2005. The extent of the shift is emphasised by express legislative characterisation of the SFP as 'income support'.[2] Consequently, of the objectives of the Common Agricultural Policy enumerated in Article 33 EC, that now accorded primacy is the ensuring of 'a fair standard of living for the agricultural community'. It may also be suggested that 'Mid-term Review' is something of a misnomer, in that the measures that it introduced proved more wide-ranging than the measures introduced by Agenda 2000 itself. The reform process remains ongoing. While the Mid-term

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[1] It was envisaged that the main effect of the Mid-term Review would be upon the milk quota system (on the basis that a decision would be taken to end milk quotas by 2006). Yet, in the event, the milk quota system was one of the few areas of the Common Agricultural Policy that remained relatively undisturbed (milk quotas surviving until at least 31 March 2015): Council Regulation 1788/2003, OJ 2003 L 270/123, Art.1.

[2] Council Regulation 1782/2003, OJ 2003 L 270/1 ('2003 Horizontal Regulation'), Art.1.

Review saw the recasting of direct payments to farmers under the First Pillar of the Common Agricultural Policy (market management), proposals have already been agreed for the further reform of the legislation governing the Second Pillar (rural development).[3]

Such radical change has been inextricably linked with negotiations in the World Trade Organization ('WTO'). The relevant WTO disciplines which emerged from the Uruguay Round, and which are encapsulated in the 1994 Uruguay Round Agreement on Agriculture ('URAA'), have played a pivotal role in shaping the approach subsequently taken by the Community. The relevant disciplines may be grouped under three heads: market access, domestic support and export subsidies. For the purposes of the present article, the provisions on domestic support are of key importance. These were predicated upon the adoption of the 'Aggregate Measurement of Support' ('AMS') as a basis both for calculating the level of subsidy received by farmers in contracting Members and for measuring the reduction commitments to be undertaken. AMS was defined by Article 1(a) to mean 'the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic agricultural product or non–product-specific support provided in favour of agricultural producers in general'. This was amplified by detailed rules in Annex 3, which provided for the calculation of AMS on a product-specific basis, using 1986-1988 as the base period. The URAA committed Members, in the case of developed countries, to a reduction of 20 per cent in the aggregate base AMS over six years. So-called 'green box' subsidies were exempt from the calculation of AMS and the reduction commitments;[4] and there was a *de minimis* exclusion for product-specific domestic support which did not exceed 5 per cent of the value of production of that product in a given year or, for non-product-specific support, which did not exceed 5 per cent of the value of total

[3] European Commission, *Proposal for a Council Regulation on Support for Rural Development by the European Agricultural Fund for Rural Development (EAFRD)*, COM(2004)490. On 20 June 2005 political agreement was reached on the proposed regulation: IP/05/766, *Tomorrow's Rural Development Policy: Broader, Simpler, Responding Better to Citizens' Concerns*, Brussels, 21 June 2005.

[4] These are defined in Annex 2 to the URAA.

agricultural production in a given year.[5] Exemption from reduction commitments was also conferred on direct payments made under certain production-limiting programmes, the so-called 'blue box'.[6] It may be noted that the availability of 'green box' exemption has proved a particularly important factor, both in terms of domestic policy development within the Community and elsewhere, and in terms of its significance as a focal point for dispute in the Doha Round. Those subsidies which did not fall within the 'green box' or 'blue box', and which were not *de minimis*, remained within the so-called 'amber box', subject to AMS reduction commitments. The URAA also required Members, in the case of developed countries, to reduce export subsidies by 21 per cent by volume and 36 per cent by value from a 1986-1990 base.

At the commencement of the Agenda 2000 reforms, one of the objectives of the European Commission was to 'help prepare the Union for the next WTO Round'.[7] Initially, however, internal pressures were considered in themselves sufficient to justify change. For example, it was stated in *The Future for European Agriculture*, issued in March 1998, that '[t]he challenges facing the CAP are first and foremost internal in nature'.[8] Nonetheless, by the time of the Mid-term Review it is arguable that WTO considerations had come to reshape the very structure of the Common Agricultural Policy reform and the direct payments regime that it produced. Above all, the provisions which implement the SFP would seem calculated to track the criteria for 'green box' support. In consequence, when the Mid-Term Review was finally agreed, Commissioner Fischler felt able to assert that '[t]his will put us on the offensive in the WTO negotiations in Cancun'.[9] Likewise, shortly after taking office, Commissioner Fischer Boel reiterated that '[t]he agricultural reform of 2003 made a decisive contribution to improving the position of the EU in matters concerning agricultural trade';

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[5] URAA, Art.6.4.
[6] Ibid., Art.6.5.
[7] European Commission, *Agenda 2000: For a Stronger and Wider Union, Bulletin of the European Union, Supplement 5/97*, COM(97)2000, Part I, III.3.
[8] European Commission, (1998), 1 (http://europa.eu.int/en/comm/dg06/ag2000/agprop/mot_en.htm, visited on 3 June 1998).
[9] Speech/03/326, *"The New, Reformed Agricultural Policy"*, Luxembourg, 26 June 2003.

and, more graphically, she could conclude that 'the days are long since past when European agriculture was the ugly duckling that some people still think it is'.[10]

This article will focus on three aspects of the developing relationship between European rural policy reform and the legal order for international trade in agricultural produce. These are: first, the imperatives that have driven change to the Common Agricultural Policy and their linkage with the WTO negotiations; secondly, the key elements of the Agenda 2000 reforms and, most importantly, the Mid-term Review; and thirdly, the compatibility of the Common Agricultural Policy as now constituted with WTO commitments, including consideration of the decisions of the Panel and Appellate Body in *United States - Subsidies on Upland Cotton*.[11]

II. PRESSURES FOR REFORM AND THE WTO

At the commencement of Agenda 2000, internal pressures were in themselves felt sufficient to justify change. Three factors, in particular, were highlighted. These were the need to improve competitiveness, the need to make the Common Agricultural Policy more acceptable to the citizen in the street and to the consumer, and the need to decentralise without giving rise to distortion of competition or renationalisation of the Common Agricultural Policy.[12] The Mid-term Review identified similar internal challenges, emphasising the need to secure 'a fair standard of living and income stability for the agricultural community'. Such support would be justified 'through the provision of services that the public expects farmers to provide'.[13] In this may be detected a new 'bargain' between farmers and society. The necessity for support was not questioned, but the nature of the support would be recast so as to meet the demands of the taxpayers who provided it. In the words of Commissioner

[10] Speech/05/25, *Agriculture and Rural Development in the EU25 - Looking Forward*, Berlin, 20 January 2005.
[11] (2004) WT/DS267/R; and (2005) WT/DS267/AB/R.
[12] See, e.g., European Commission, *The Future for European Agriculture* (1998) (http://europa.eu.int/en/comm/dg06/ag2000/agprop/mot_en.htm, visited on 3 June 1998).
[13] European Commission, *Mid-term Review of the Common Agricultural Policy*, COM(2002)394, 2.

Fischler, '[o]ur proposal DOES NOT mean abandoning the CAP as some claim or fear. We are firmly committed to support also agriculture in the future'. Rather, '[w]hat it DOES mean is that we want to support our farmers differently': the 'political reality' was that continued acceptance by the European taxpayer of the need for a Common Agricultural Policy depended on subsidies producing value for money for the taxpayer.[14]

That said, from the commencement of the reform process two external factors were clearly acknowledged: the prospect of Eastward enlargement; and the (then) forthcoming WTO negotiations.[15] In the case of the WTO negotiations there were, besides, specific time constraints, because agriculture enjoyed its own 'stand-alone' schedule, not dependent upon the launch of a full 'Round'. By virtue of Article 20 of the URAA, WTO Members committed themselves to initiate 'negotiations for continuing the process' one year before the end of the 1995-2000 implementation period for the reforms agreed in the URAA. Indeed, the imperative of ensuring the correct timing of Common Agricultural Policy reform emerges as a recurrent theme in Community discourse. This may, in part at least, be attributed to the general perception that the Community had been ill prepared for the Uruguay Round, when the United States arguably stole a march with its initial proposal of the 'zero-option' (i.e. removing all trade distorting agricultural subsidies over a ten year period). Indeed, many commentators have considered the stance of the Community in the Uruguay Round to be primarily reactive in nature.[16] By contrast, the Agenda 2000 reforms were understood from the outset to stake out the position that would be defended in what would become the Doha Round. In 1999 Commissioner Fischler stated that 'we need from the very beginning to adopt a clear and realistic position with which to enter the negotiations. This we hope to achieve

[14] Speech/02/424, *The Future of Farming and the European Agricultural Policy - Facing the Challenges, Seizing the Opportunities*, Paris, 25 September 2002.
[15] See, e.g., European Commission, *The Future for European Agriculture* (1998) (http://europa.eu.int/en/comm/dg06/ag2000/agprop/mot_en.htm, visited on 3 June 1998); and, generally, e.g., M Cardwell, 'The European Model of Agriculture and World Trade: Reconfiguring Domestic Support', in J Bell, A Dashwood, J Spencer and A Ward (eds), *Cambridge Yearbook of European Legal Studies, Volume 5, 2002-2003* (Oxford: Hart Publishing, 2004), 77-103; and A Greer, *Agricultural Policy in Europe* (Manchester: Manchester University Press, 2005), 113-115.
[16] See, e.g., KA Ingersent, AJ Rayner and RC Hine, 'The EC Perspective', in KA Ingersent, AJ Rayner and RC Hine (eds), *Agriculture in the Uruguay Round* (London: Macmillan Press, 1994), 55-87; and WD Coleman and S Tangermann, 'The 1992 CAP Reform, the Uruguay Round and the Commission: Conceptualizing Linked Policy Games', (1999) 37 *Journal of Common Market Studies* 385.

through Agenda 2000, so that we do not have to negotiate with our back against the wall again as we did in the Uruguay Round'.[17] Accordingly, when agreement on the reform package was reached two months later at the Berlin Summit of 24-25 March 1999, the European Council expressly affirmed that 'the decisions adopted...will constitute essential elements in defining the Commission's negotiating mandate for the future multilateral trade negotiations at the WTO'.[18] Similar sentiments were voiced again four years later, after agreement was reached on the Mid-term Review. Emphasis was laid on the fact that the Community had radically reformed its subsidy regime, and other WTO Members were urged to follow suit. In the words of Commissioner Fischler prior to the Cancun Ministerial Conference, '[t]hese actions clearly demonstrate a path of reform that is fully compatible with what all WTO parties committed to, the US and EU included: to move away from the trade distortions. We have certainly moved; it's time for others to do likewise'.[19]

While the pressure to meet WTO requirements would appear to have been consistent, its translation into specific legislative measures within the Community legal order would appear to have been more incremental. This was expressly recognised at the time of the Mid-term Review, where the Common Agricultural Policy was described as 'an evolving policy'.[20] In consequence, as shall be seen, a significantly different impact on world trade has been claimed by the Community for, on the one hand, the reforms agreed at the Berlin Summit and, on the other, their subsequent Mid-term Review.

Before considering these reform packages in greater depth, two preliminary points should be noted. First, although the specific legislative measures would appear to have been evolutionary, the Community institutions have throughout maintained that the overarching, and stable, objective has been to give 'concrete form' to a European Model of Agriculture.[21] The multifunctional model of European agriculture embraces both food and non-food outputs,

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[17] Speech//99/14, *The WTO and Agriculture in East and West*, Berlin, 23 January 1999.
[18] European Commission, *Bulletin of the European Union, 3-1999*, at I-Special Berlin European Council, 23.
[19] Speech/03/373, *CAP Reform: What Relevance for Cancun?*, Washington, DC, 28 July 2003.
[20] European Commission, *Mid-term Review of the Common Agricultural Policy*, COM(2002)394, 5.
[21] Ibid.; and see, generally, e.g., M Cardwell, *The European Model of Agriculture* (Oxford: Oxford University Press, 2004), passim.

the latter including the protection of the environment, food safety, animal welfare and cultural heritage (these non-food outputs being often characterised as 'public goods', 'externalities' or even 'spillovers'). The legitimacy of the multifunctional model has for some time been questioned. Not least, it has been suggested that many of the public goods delivered by agricultural production could be achieved more efficiently if divorced from such production.[22] This debate has been continued in the Doha Round, where non-food outputs have been associated with 'non-trade concerns' and the focus of the debate has been on the extent to which it is legitimate to provide for their support. In the words of the OECD, '[u]nderlying the debate on multifunctionality are some of the same considerations as the discussion of "non-trade" concerns that has evolved in the context of multilateral trade negotiations'.[23] These issues will be addressed more fully below.

The ongoing implementation of a multifunctional European Model of Agriculture was also re-affirmed at the time of the Mid-term Review. Even as the Common Agricultural Policy was described as 'an evolving policy', it was stated that the objectives 'essentially remain today the same as those established in Berlin and enhanced in the European Summit of Göteborg'.[24] Further, it would seem that the Community sees world trade advantages in holding firm to the banner of the European Model of Agriculture. It provides a single rallying point for defence of a disparate range of initiatives; and, in terms of the language of negotiation, on occasion has permitted some rhetoric. For example, Commissioner Fischler could speak in 1999 of putting 'the European model of agriculture to the WTO acid test',[25] and in 2000 of a determination not 'to sacrifice the European Model of Agriculture on the altar of [trade] liberalisation'.[26]

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[22] See, e.g., ABARE, *Multifunctionality: a Pretext for Protection?* (1999) ABARE Current Issues No.3. See also, for more equivocal treatments, e.g.: M Bohman, *et al.*, *The Use and Abuse of Multifunctionality* (Washington, DC:Economic Research Service/USDA, 1999); and Organisation for Economic Co-operation and Development ('OECD'), *Multifunctionality: Towards an Analytical Framework* (Paris: OECD, 2001), passim.

[23] OECD, *Multifunctionality: Towards an Analytical Framework* (Paris: OECD, 2001), 10.

[24] European Commission, *Mid-term Review of the Common Agricultural Policy*, COM(2002)394, 2.

[25] Speech/99/117, *The European Model of Agriculture - Facing the WTO Acid Test*, Verona, 24 September 1999.

[26] IP/00/295, *WTO Farm Negotiations: "EU Constructive but Firm", Franz Fischler Says*, Brussels, 24 March 2000.

Secondly, whether drawing up its legislation to implement the measures agreed at the Berlin Summit or the Mid-term Review, the Community has enjoyed a considerable advantage in comparison with the Uruguay Round. The URAA already being in force, the Community has been able to draft the necessary legislation against the background of a pre-existing legal framework for international agricultural trade, tailoring provisions to meet specific criteria in the WTO legal order that confer exemption from domestic support reduction commitments. Nevertheless, the extent to which the reform process has delivered a fully defensible position in the Doha Round is open to question.

III. THE KEY ELEMENTS OF COMMON AGRICULTURAL POLICY REFORM

A. Introduction

The Agenda 2000 reforms and their Mid-term Review saw major advances in the transfer of support from product to producer. This process arguably commenced with the 1992 MacSharry reforms.[27] Thus, when launching Agenda 2000, the Commission expressly proposed 'deepening and extending the 1992 reform through further shifts from price support to direct payments'.[28] The basic rationale was that earlier enunciated in the 1991 Reflections Paper, *The Development and Future of the CAP*: where support is proportionate to the quantity produced, there is a permanent incentive to greater production and further intensification.[29]

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[27] On the 1992 MacSharry reforms, generally, see, e.g., N Neville and F Mordaunt, *A Guide to the Reformed Common Agricultural Policy* (London: Estates Gazette, 1993), passim; A Swinbank, 'The New CAP', in C Ritson and DR Harvey (eds.), *The Common Agricultural Policy* (2nd ed., Wallingford: CAB International, 1997), 95; and R Ackrill, *The Common Agricultural Policy* (Sheffield: Sheffield Academic Press, 2000), 92-107.

[28] European Commission, *Agenda 2000: For a Stronger and Wider Union, Bulletin of the European Union, Supplement 5/97*, COM(97)2000, Part One, III.4.

[29] COM(91)100, 8.

B. The 1992 MacSharry Reforms

The application of the shift in support from product to producer under the 1992 MacSharry reforms may be illustrated by the cereals sector.[30] Support prices were reduced; and, in particular, the intervention price was cut from 117 Ecu per tonne in the 1993-1994 marketing year to 100 Ecu per tonne as from the 1995-1996 marketing year.[31] However, in return, farmers received compensatory payments on an area basis. These were, as a general rule, calculated by multiplying a basic amount per tonne by the average cereals yield determined for the region concerned. To meet reductions in support prices, the basic amount rose from 25 Ecu in the 1993-1994 marketing year to 45 Ecu per tonne as from the 1995-1996 marketing year.[32] Significantly, there continued to be very considerable differentiation between the levels of compensatory payments for cereals, oilseeds and proteins. Thus, even within the cereals sector itself, specific regimes were retained for durum wheat and, should Member States so decide, maize. It may also be noted that, whether the crops were cereals, oilseeds or proteins, production was curbed by a set-aside requirement (initially fixed at 15 per cent); and, with like objective, in the livestock sector individual quotas were imposed on sheep annual premiums and suckler cow premiums. The effect in world trade terms was apprehended to be compliance with the 'blue box' criteria, so securing exemption from domestic support reduction commitments. As indicated, under Article 6(5)(a) of the URAA, direct payments under production-limiting programmes are exempt if: '(i) such payments are based on fixed area and yields; or (ii) such payments are made on 85 per cent or less of the base level of production; or (iii) livestock payments are made on a fixed number of head'.

There is ample evidence that the 1992 MacSharry reforms did succeed in curbing production. For example, between 1991 and 1997 market support in respect of export refunds

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[30] On the cereals sector, generally, see, e.g., JA Usher, *EC Agricultural Law* (2nd Ed., Oxford: Oxford University Press, 2001), 80-89.
[31] Council Regulation 1766/92, OJ 1992 L 181/21, Art.3(3).
[32] Council Regulation 1765/92, OJ 1992 L 181/12, Art.4.

fell from over 10 billion Ecu to 5.8 billion Ecu.[33] The improvement in market balances and decrease in public stocks was a source of considerable satisfaction to the Commission at the commencement of the Agenda 2000 reforms.[34] However, it had been bought at the cost of very heavy expenditure on direct payments to producers. Thus, budgetary appropriations for arable area payments in 1998 were alone projected to reach 16,243 million Ecu, out of a total European Union budget of 82,019 million Ecu.[35]

C. The Agenda 2000 Reforms: the Berlin Summit

The Agenda 2000 reforms as agreed at the Berlin Summit without doubt took the 1992 MacSharry reforms a step further. That said, they were essentially incremental rather than constituting a sea-change in policy development. Not least, the amended direct payments regime was intended to remain within the 'blue box', a fact reflected by the vigorous defence of the 'blue box' in Community submissions to the WTO. For example, in *European Communities Proposal: the Blue Box and Other Support Measures to Agriculture* reference was made to OECD research which had found that area payments had proved relatively more income efficient and less trade-distorting than market price support (or payments based on output or payments based on variable input use); and that, accordingly, 'considering the considerable reduction in trade impact brought about by this type of policy support and its success in meeting domestic concerns in the process of agricultural reform, the EC wishes to stress that the concept of the blue box, like that of the green box, must be maintained'.[36] The subsequent *EC Comprehensive Negotiating Proposal* was likewise unequivocal, asserting that

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[33] European Commission, *The Agricultural Situation in the European Union: 1998 Report* (Brussels: Luxembourg, European Commission, 1999), 148-149.
[34] European Commission, *Agenda 2000: For a Stronger and Wider Union, Bulletin of the European Union, Supplement 5/97*, COM(97)2000, Part One, III.1.
[35] European Commission, *The Agricultural Situation in the European Union: 1998 Report* (Brussels: Luxembourg, European Commission, 1999), 146 and 150.
[36] WTO, G/AG/NG/W/17, 28 June 2000. For the research referred to in the submission, see OECD, *A Matrix Approach to Evaluating Policy: Preliminary Findings from PEM Pilot Studies of Crop Policy in the EU, the US, Canada and Mexico*, COM/AGR/CA/TD/TC(99)117 (Paris: OECD, 2000).

'[t]he EC are prepared to negotiate further reductions in support provided that, in particular, the concept of the "blue" and "green" boxes will continue'.[37]

The reforms agreed at the Berlin Summit nevertheless encompassed material amendments to the direct payments regime.[38] Support prices were further driven down, with direct payments being correspondingly increased. Thus, in the cereals sector, the intervention price was reduced by 15 per cent in two annual steps (from 119.19 Euros to 101.31 Euros per tonne), the first step being implemented in the 2000-2001 marketing year.[39] In calculating the direct payment, the basic amount per tonne was raised from 54 Euros to 63 Euros per tonne over the same period, again in two annual steps.[40] As a result, the template established under the 1992 MacSharry reforms was preserved; but increased market competitiveness in terms of price was again bought at the cost of higher direct payments. Even by 2000, these accounted for 25,592.2 million Euros.[41] Indeed, whereas 91 per cent of the agricultural budget had been spent on market support in 1991, it was envisaged that 68 per cent would be spent on direct payments by 2006.[42] However, it may be remarked that the reduction in intervention price was neither as great nor as swift as had originally been proposed at the commencement of Agenda 2000. Indeed, Commissioner Fischler openly accepted that the measures agreed at the Berlin Summit were a compromise.[43]

Importantly, there was also a substantial simplification of the direct payments regime, in line with the stated objectives of the Agenda 2000 reforms.[44] Again taking arable crops as an example, the rates of payment in respect of cereals, linseed, oilseeds and land set aside

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[37] WTO, G/AG/NG/W/90, 14 December 2000.

[38] See, generally, e.g., D Galloway 'Agenda 2000 - Packaging the Deal' (1999) 37 *Journal of Common Market Studies* 9; R Ackrill, *The Common Agricultural Policy*, 115-127; and JA McMahon, 'The Common Agricultural Policy: From Quantity to Quality' (2002) 53 *Northern Ireland Legal Quarterly* 9.

[39] Council Regulation 1766/92, OJ 1992 L 181/21, Art.3(1), as amended by Council Regulation 1253/1999, OJ 1999 L 160/18.

[40] Council Regulation 1251/1999, OJ 1999 L 180/1, Art.4(3).

[41] European Commission, *The Agricultural Situation in the European Union: 1998 Report* (Brussels: Luxembourg, European Commission, 2002), 130.

[42] Commissioner Fischler, Speech/01/477, *Agricultural Policy for the Future: Changing Concerns, Changing Objectives*, Salzburg, 19 October 2001.

[43] Speech/99/101, *The Agenda 2000 Agreement: "Der Himmel in Berlin" or "Sleepless in Seattle"?*, Brussels, 29 June 1999.

[44] European Commission, *The Future for European Agriculture* (1998) (http://europa.eu.int/en/comm/dg06/ag2000/agprop/mot_en.htm, visited on 3 June 1998).

were all to converge to 63 Euros per tonne by the 2002-2003 marketing year. Proteins would remain an exception, receiving 72.5 Euros per tonne as from the 2000-2001 marketing year.[45]

D. The Agenda 2000 Reforms: Mid-term Review

By contrast, the Mid-term Review constituted a substantial reconfiguration of the direct payments regime.[46] As seen, most domestic support schemes were rolled into the SFP; and in the overall structure of the new regime may be detected the influence of WTO considerations. More specifically, there was clear intent to secure 'green box' exemption from domestic support reduction commitments by meeting the criteria for decoupled income support set out in Paragraph 6 of Annex 2 to the URAA. Central to this claim has been the assertion that the SFP is production neutral, in that a farmer does not receive payment differentiated according to the crop or other agricultural product produced. Moreover, it is claimed that the 'decoupled' support permits more effective response to market signals. That said, before considering the more detailed aspects of the Mid-term Review, it must be recognised that on a theoretical level the precise meaning of 'decoupling' remains elusive, notwithstanding its importance to the URAA. In the words of the OECD, '[e]ven if the general meaning of the term "decoupling" seems clear and already well accepted, there are several difficulties in arriving at an operational definition'.[47] Not least, a distinction has been drawn between 'fully decoupled' support and 'effectively fully decoupled' support. The latter requires that 'production (or trade) not differ from the level that would have occurred in the absence of the measure', whereas the former requires also that 'the quantity adjustment due to any outside shock should not be in any way altered either'.[48] In the view of the OECD, the definition of

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[45] Council Regulation 1251/1999, OJ 1999 L 180/1, Art.4(3).
[46] See, generally, e.g., J Moody and W Neville, *Mid Term Review: a Practical Guide* (Bristol: Burges Salmon, 2004), 32-165.
[47] OECD, *Decoupling: a Conceptual Overview* (Paris: OECD, 2001), 8. See also, e.g., MR Grossman, 'Multifunctionality and Non-trade Concerns', in M Cardwell, MR Grossman and CP Rodgers (eds.), *Agriculture and International Trade: Law, Policy and the WTO* (Wallingford: CAB International, 2003), 85.
[48] OECD, *Decoupling: a Conceptual Overview* (Paris: OECD, 2001), 5.

decoupling implicit in the URAA is in line with the definition of an effectively decoupled package: in other words, a package whose introduction does not increase the level of production. Accordingly, while farmers may decide to alter their cropping patterns, this would occur 'in a way that does not result in larger production' (although the response of supply to an external shock could be different).[49]

Six aspects of the SFP will be highlighted here, all of which have significant WTO implications. First, although broad in scope, the SFP is not exhaustive. It has extended *ab initio* to all products included in the arable crops regime, grain legumes, seeds, beef and sheep.[50] Moreover, Member States may opt to implement the SFP on a regional as opposed to an individual basis;[51] and in these circumstances it may also include *ab initio* the dairy premium and additional payments.[52] Further, following reform of the sugar sector, as from 1 January 2006 compensation payments for price cuts in that sector form a yet further element of the SFP.[53] It is significant, however, that over and above the SFP there remain targeted aid schemes, such as the specific quality premium for durum wheat and the protein crop premium.[54] There would seem to be no question that these targeted aid schemes are coupled to a particular form of production.

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[49] Ibid., 9. Express reliance was placed on definitions of decoupling developed in SA Cahill, 'Calculating the Rate of Decoupling for Crops under CAP/Oilseeds Reform' (1997) 48 *Journal of Agricultural Economics* 349.

[50] For the support schemes comprised within the SFP, see the 2003 Horizontal Regulation, OJ 2003 L 270/1, Annex I.

[51] Under the general rule, farmers receive the SFP on an individual basis by reference to their historic entitlement over a 2000-2002 reference period: ibid., Arts.37-38. However, by way of derogation, Member States may allocate flat-rate entitlements per hectare to farmers within a region: ibid., Arts.58-63. In the case of England, the decision has been to phase in payments on a regional basis over the period 2005-2012: Common Agricultural Policy Single Payment and Support Schemes Regulations 2005, S.I.2005 No.219, Sch.1 (the regional element rising from 10 per cent in 2005 to 100 per cent in 2012 and the historic element falling correspondingly).

[52] 2003 Horizontal Regulation, OJ 2003 L 270/1, Art.62. The dairy premium and additional payments were introduced as from 2004 to compensate dairy farmers for the reduction of market support in the milk sector: ibid., Arts.95-97. Their incorporation into the SFP arguably prejudices dairy farmers, in that compensation directed to one sector of the agricultural industry (the milk sector) becomes spread among all farmers entitled to the SFP. That said, any potential claim that this breaches the Community legal order would seem ill-founded given the express authorisation of the incorporation of dairy premiums into the SFP by Council Regulation 1189/2005, OJ 2005 L 24/15.

[53] See, e.g., IP/05/776, *Sugar Reform will Offer EU Producers Long-term Competitive Future*, Brussels, 22 June 2005. For the implementing legislation, see the 2003 Horizontal Regulation, OJ L 270/1, as amended by Council Regulation 319/2006, OJ L 58/32

[54] 2003 Horizontal Regulation, OJ 2003 L 270/1, Arts.72-78.

Secondly, while as a general rule the SFP is applicable as from 1 January 2005, Member States enjoy the ability to delay implementation until either 1 January 2006 or 1 January 2007.[55] In consequence, substantial coupled support may be retained for up to two years and Greece, Finland, France, the Netherlands and Spain have taken advantage of this derogation.[56]

Thirdly, once the SFP is fully implemented, Member States will still enjoy the ability to provide for partial as opposed to full decoupling. For example, in the arable sector it is possible to retain up to 25 per cent of arable crop area payments linked to production or, alternatively, up to 40 per cent of durum wheat supplement payments. In the case of sheep and goat payments, up to 50 per cent may remain coupled.[57] The extent to which this derogation has been exercised has been variable. For example, in England there has been no partial decoupling in 2005, while in Scotland up to 29.8 million Euros could be linked to beef calf production and in Italy up to 142,491,000 Euros could be linked to arable crop production.[58]

As a result of these targeted aid schemes and derogations, the Community has openly accepted that, at least initially, there remains a proportion of domestic support that does not fall within the 'green box'. This is reflected in the continuing defence of the 'blue box' even after the Mid-term Review had been agreed.[59] However, the Community has also contended that by 2005 some 90 per cent of the direct payments covered by the Mid-term Review have already been decoupled from production.[60] And this has proved the basis of the proposal in the Doha Round negotiations to cut trade-distorting subsidies by 70 per cent.[61]

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[55] Ibid., Art.71.
[56] See, e.g., *Agra Europe Weekly*, No.2142, 4 February 2005, EP/9-10.
[57] 2003 Horizontal Regulation, OJ 2003 L 270/1, Arts.66-67.
[58] Ibid., Annex VIII, as amended by Commission Regulation 118/2005, OJ 2005 L 24/15. For the Scottish Beef Calf Scheme, see the Common Agricultural Policy Single Farm Payment and Support Schemes (Scotland) Regulations 2005, S.I.2005 No.143, Regs.16-25.
[59] See, e.g., European Commission, *EU Agriculture and the WTO: Doha Development Agenda, Cancun - September 2003: INFO* (Brussels: European Commission, 2003), 5.
[60] Commissioner Fischer Boel, Speech/05/773, *WTO – Hong Kong Ministerial: Time to Get Serious*, Brussels, 8 December 2005.
[61] See, e.g., MEMO/05/400, *Doha Round: EU Offer in Agricultural Negotiations*, Brussels, 28 October 2005; and see also Hong Kong Ministerial Declaration, WTO, WT/MIN(05)/DEC, 22 December 2005, Annex A, para 8.

Fourthly, close attention must be paid to the SFP provisions governing land use, in the light of the Panel and Appellate Body decisions in *United States - Subsidies on Upland Cotton*.[62] As a general rule, SFP payment entitlements can only be unlocked by 'matching' them against eligible land owned or occupied by the producer. In other words, a producer must be able to show that he owns or occupies a hectare of eligible land for each SFP payment entitlement in respect of which a claim is made.[63] However, it is expressly provided that land under, *inter alia*, fruit, vegetables and potatoes may not sustain a claim for the SFP (except, in the case of potatoes, where intended for the manufacture of potato starch).[64] The rationale behind the measure was that fruit, vegetables and potatoes had in the past been largely unsupported; and, in the absence of such an exclusion, there was a danger that farmers entitled to the SFP would move into these sectors bolstered by the competitive advantage that it conferred. The net result, nonetheless, is that the SFP may on this account fall short of full production neutrality, channelling support into those agricultural sectors that have previously enjoyed support. On the other hand, where a Member State opts to allocate the SFP on a regional basis, land under, *inter alia*, fruit, vegetables and potatoes may unlock payment entitlements.[65]

Fifthly, the Mid-term Review saw the retention of set aside as a supply-side management tool in the arable sector, notwithstanding some nervousness as to the extent to which land retirement measures of this kind are 'green box' compatible. The set-side model used in previous Community legislation had been 'rotational', whereby the land set aside from production by each producer was changed annually; and, under the reforms agreed at the Berlin Summit, a compulsory set-aside rate was fixed at 10 per cent from the 2000-2001

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[62] (2004) WT/DS267/R; and (2005) WT/DS267/AB/R. This is considered further below.

[63] 2003 Horizontal Regulation, OJ 2003 L 270/1, Art.44(1): '[a]ny payment entitlement accompanied by an eligible hectare shall give rise to the payment of the amount fixed by the payment entitlement'.

[64] Ibid., Art.51, as amended by Council Regulation 864/2004, OL2004 L 161/48. More precisely, in the case of fruit and vegetables, farmers may not unlock payment entitlements with (i) land used for the production of products referred to in Art.1(2) of Council Regulation 2200/96, OJ 1996 L 297/1 (on the common organisation of the market in fruits and vegetables); or (ii) land used for the production of products referred to in Art.1(2) of Council Regulation 2201/96, OJ 1996 L 297/29 (on the common organisation of the market in processed fruit and vegetable products). For allocation on a regional basis, see n.51.

[65] 2003 Horizontal Regulation, OJ 2003 L 270/1, Art.60, as amended by Council Regulation 864/2004, OJ 2004 L 161/48.

marketing year through to 2006-2007 marketing year:[66] On issue of the *Mid-term Review of the Common Agricultural Policy* it was proposed that the set-aside concept be extended and, further, that compulsory long-term set-aside be introduced on arable land for 10 years.[67] In the event, however, the rotational model has been retained, in a complex settlement under which set-aside entitlements are allocated and managed as a separate branch of the SFP scheme. Each producer has been allocated set-aside entitlements calculated in principle by reference to the average number of acres compulsorily set aside over 2000-2002. However, the United Kingdom has opted to apply a regionalised method for calculating the set-aside rate, as allowed for in the Community legislation.[68] In consequence, it has been fixed at 8 per cent for lowland England, 1.3 per cent for severely disadvantaged areas and 0 per cent for moorland.[69] Land which is set aside cannot as a rule be used for agricultural purposes or for the production of a commercial crop, but must be maintained in good agricultural and environmental condition.[70] Payment of set-aside entitlements is unlocked where a producer can match set-aside entitlements against eligible land, as under the SFP scheme generally.

Sixthly, the multifunctional role of agriculture has been recognised by the imposition of cross-compliance conditions upon receipt of both the SFP and other direct payments. Farmers are obliged to observe a range of Community statutory management requirements in the areas of: public, animal and plant health; the environment; and animal welfare.[71] They must also maintain all agricultural land in 'good agricultural and environmental condition', minimum requirements for which are to be defined at national or regional level by the

[66] Council Regulation 1251/1999, Art.6, OJ 1999 L 160/1.
[67] European Commission, COM(2002)394, 21.
[68] 2003 Horizontal Regulation, OJ 2003 L 270/1, Art.63(2).
[69] The calculations are labyrinthine. The set-aside rate is less than the original 10 per cent applied from 2000 because the new scheme covers a larger area of each holding: instead of just applying to arable land the set aside scheme now applies to land used for all purposes other than permanent pasture (it could include, for instance fodder crops and temporary grass). The percentage of the total eligible area of a holding to which the set-aside rate applies is, therefore, greater. The intention is to arrive at a similar area of arable land set aside in any one year, defined on a regional basis, by scaling down the total set-aside requirement proportionately.
[70] 2003 Horizontal Regulation, OJ 2003 L 270/1, Art.56(1).
[71] Ibid., Art.4 and Annex III. These statutory management requirements are to be introduced in three tranches over the period 1 January 2005 to 1 January 2007.

Member States on the basis of a Community framework.[72] This aspect of the reform measures would appear to be targeted towards improving the public acceptability of the Common Agricultural Policy. Moreover, Commissioner Fischler could state that, '[b]y making direct payments subject to cross-compliance, the end product is fully traceable from stable to table'.[73] That said, the statutory management requirements set out in Annex III to the 2003 Horizontal Regulation are requirements that farmers should in principle already be observing under Community law. This point was recently highlighted, for example, by the Royal Society for the Protection of Birds in evidence to the House of Common Environment, Food and Rural Affairs Committee. Their view was that the cross-compliance conditions should be regarded as unnecessary 'green-tinging' of direct payments.[74] For the same reason, a sharp distinction can be drawn between the SFP and payments for agri-environmental and animal welfare commitments under Council Regulation 1257/1999 ('Rural Development Regulation'). The latter must specifically 'involve more than the application of usual good farming practice including good animal husbandry practice';[75] and it is noteworthy that payments under environmental programmes have long been notified to the WTO under Annex 2 to the URAA.[76]

It is therefore questionable whether the cross-compliance conditions attached to the SFP and other direct payments deliver additional benefits in return for public expenditure.[77] On the other hand, it would seem incontrovertible that cross-compliance does offer new

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[72] Ibid., Art.5 and Annex IV. For the implementing legislation in England, see the Common Agricultural Policy Single Payment and Support Schemes Appeals)(England) Regulations 2004, S.I.2004 No.2689; the Common Agricultural Policy Single Payment and Support Schemes (Cross Compliance)(England) Regulations 2004, S.I.2004 No.3196; the Common Agricultural Policy Single Payment and Support Schemes (Set Aside)(England) Regulations 2004, S.I.2004 No.3385; the Common Agricultural Policy Single Payment and Support Schemes (Integrated Administration and Control System) Regulations 2005, S.I.2005 No.218; and the Common Agricultural Policy Single Payment and Support Schemes Regulations 2005, S.I.2005 No.219.

[73] Speech/04/08, *Trade, Reform and the Future of Europe*, Krems, Austria, 9 January 2004.

[74] House of Commons Environment, Food and Rural Affairs Committee, *The Mid-term Review of the Common Agricultural Policy*, Third Report of Session 2002-03, HC 151, para 76. See also Moody and W Neville, *Mid Term Review: a Practical Guide* (Bristol: Burges Salmon, 2004), 32.

[75] OJ 1999 L 160/80, Art.23(2), as amended by Council Regulation 1783/2003, OJ 2003 L 270/70 (which introduced payments for animal welfare commitments).

[76] See, e.g., WTO, G/AG/NG/S/2, *Green Box Measures: Background Paper by the Secretariat*, 19 April 2000, Annex 2, Table S.

[77] See, e.g., House of Commons Environment, Food and Rural Affairs Committee, *The Mid-term Review of the Common Agricultural Policy*, Third Report of Session 2002-03, HC 151, para 52.

means of enforcing pre-existing multifunctional obligations in the Community legal order. In particular, in the case of the statutory management requirements set out in Annex III, the 2003 Horizontal Regulation provides for reduction or exclusion from payments in the event of non-compliance and, in so doing, provides a sanction over and above any sanctions in the various Directives and Regulations which form the basis of those cross-compliance requirements.[78] Where non-compliance is intentional, the percentage of reduction is not in principle to be less than 20 per cent; and, as the most draconian sanction, it is possible to exclude a farmer from one or several aid schemes for one or more years. Moreover, the 2003 Horizontal Regulation imposes the same sanctions for breach of its requirement to maintain all agricultural land in good agricultural and environmental condition.

Finally, it may be emphasised that, apart from cross-compliance, non-trade concerns were expressly addressed at the time of the Mid-term Review by amendment to the Rural Development Regulation. As indicated, payments are now available for animal welfare as well as agri-environment commitments, provided that those commitments extend beyond usual good farming practice, including good animal husbandry practice. Further, new chapters have been added on 'meeting standards' and on food quality.[79] The former provides support to help farmers to adapt to demanding standards based on Community legislation in the fields of:: the environment; public, animal and plant health; animal welfare; and occupational safety. The latter comprises support for both production methods designed to improve the quality of agricultural products and the promotion of those products, with a view to, *inter alia*, achieving added value.

IV. COMPATIBILITY WITH WTO COMMITMENTS

A. General

[78] OJ 2003 L 270/1, Arts.6-7.
[79] OJ 1999 L 160/80, Arts.21a-d and 24a-d, as amended by Council Regulation 1783/2003, OJ 2003 L 270/70.

In line with the development of Community policy, the defence of domestic support in the context of the WTO has evolved from emphasis on non-trade concerns, under the broader umbrella of the multifunctional European Model of Agriculture, to a newer emphasis on decoupled income support. At the inception of the Doha Round the importance attached by the Community to non-trade concerns was seen as a defining feature. Commissioner Fischler stated in 1999, for example, that 'the negotiations would have to go beyond purely market-related issues and cover areas of social concern such as environmental protection, animal welfare, quality and food safety. We must realise that suspicion of the WTO is already running high. If people's impression that the WTO puts trade before health issues is confirmed, it will not become stronger in future, but weaker'.[80]

The Community was not alone in advocating the incorporation of non-trade concerns into the URAA, as evidenced by the formation of a loose grouping under the title 'The Friends of Multifunctionality' (of which the Community was a leading member). The profile of this grouping was heightened by, for example, a Conference on Non-trade Concerns at Ullenswang, Norway, in July 2000.[81] Nonetheless, reaching a consensus on the identity of the non-trade concerns to be promoted in the framework of the agriculture negotiations continues to prove difficult, as does agreeing the relative priority to be accorded to each of them. Within the 'Friends of Multifunctionality' itself, different weight is accorded to different non-trade concerns. In the case of several major food importers, such as Japan, food security is seen as a key issue.[82] Yet, for others, such as Norway, rural employment, agricultural landscapes and biodiversity have been granted higher status.[83] The position is exacerbated by the fact that, although Article 20 of the URAA expressly provided that non-trade concerns should be taken into account in the re-negotiations, it gave no indication of the nature of the concerns which this might encapsulate, other than in the Preamble specifically to mention food security and the need to protect the environment.

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[80] Speech/99/71, *WTO Press Conference Speaking Note*, Speech/99/177, Brussels, 23 November 1999.
[81] WTO, *Note on Non-trade Concerns*, G/AG/NG/W/36, 22 September 2000.
[82] WTO, *Negotiating Proposal by Japan*, G/AG/NG/W/91, 21 December 2000.
[83] WTO, *WTO Agriculture Negotiations: Proposal by Norway*, G/AG/NG/W/101, 16 January 2001

Perhaps unsurprisingly, the initial negotiating position of the Community depended heavily on acceptance of the multifunctional nature of the European Model of Agriculture, and with it the importance of accommodating non-trade concerns such as animal welfare, the protection of the environment and food safety. For example, the *EC Comprehensive Negotiating Proposal* identified four categories of measure targeted at 'important societal goals' and for which 'green box' exemption should be applied: measures for the protection of the environment; measures targeted at the sustained vitality of rural areas and poverty alleviation; food security for developing countries; and animal welfare measures.[84] Many other WTO Members have also addressed non-trade concerns in their negotiating proposals, more especially in the Second Phase, which commenced in March 2001. Ten issues were recommended for consideration in this Phase, of which three could be described as non-trade concerns, *viz*. food security, food safety and rural development.[85] Subsequent submissions confirmed this trend.[86] However, they did not squarely address the fundamental problem of defining the parameters of the concept. As a consequence, although the 2001 Doha Declaration included an unequivocal statement that '[w]e take note of the non-trade concerns reflected in the negotiating proposals submitted by Members and confirm that non-trade concerns will be taken into account in the negotiations as provided for in the Agreement on Agriculture', no attempt was made to give this substance.[87] The Community heralded the inclusion of this statement in the Doha Declaration as recognition of its own negotiating stance.[88] Yet, in reality, it could be argued that it merely reiterated the requirements already stipulated by the URAA. Similarly, the *Framework for Establishing Modalities in Agriculture* agreed in Geneva in the summer of 2004 ('2004 Framework Document'), and on

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[84] WTO, *EC Comprehensive Negotiating Proposal*, G/AG/NG/W/90, 14 December 2000, para 13. See also, e.g., R Aggarwal, 'Dynamics of Agriculture Negotiations in the World Trade Organization', (2005) 39 *Journal of World Trade* 741.

[85] WTO, *Agriculture: Negotiations 2000 March 2001: Work Programme for the Second Phase, 27 March 2001* (http://www.wto.org/english/tratop_e/agneg7_e.htm, visited on 2 April 2001).

[86] A good illustration is provided by the submission by the Community on food safety issues: WTO, *Food Safety: Note by the European Communities*, D(2001)(DIVERS/500186 ur), 20 July 2001.

[87] WTO, *Ministerial Declaration* WT/MIN(01)/DEC/W/1/, 14 November 2001, para 13.

[88] IP/01/1584, *"New WTO Round Slap in the Face for Isolationism", Says EU Farm Commissioner Fischler*, Doha, 14 November 2001.

which the ongoing negotiations are now based, contains a statement of principle that '[n]on-trade concerns, as referred to in Paragraph 13 of the Doha Declaration, will be taken into account', but again takes us no further forward in identifying the nature or scope of the concerns to be included.[89]

As indicated, certain key WTO Members have displayed a considerable measure of scepticism towards the very concept of multifunctionality. Significantly, however, the United States has adopted a relatively neutral approach, as in the 2001 policy document, *Food and Agricultural Policy: Taking Stock for the New Century*.[90] More specifically in the context of the WTO, the United States has affirmed that it is 'committed to and supports policies that address non-trade concerns, including food security, resource conservation, rural development, and environmental protection'.[91] Its negotiating position has also been characterised, nevertheless, by a determination that meeting these objectives must not be allowed to create new economic distortions. In particular, a consequence to be avoided is the passing of the cost of state funding for such activities onto other countries by closing markets, or introducing unfair competition, or both. It could be argued on the one hand, therefore, that the need to address non-trade concerns without 'spillover' and trade distortion has become a recurrent feature of United States policy in agriculture (if not elsewhere).[92] On the other hand, it must also be noted that, even by the time that the *U.S. Proposal for Global Agricultural Trade Reform* was submitted to the WTO in 2002, there was distinctly less emphasis on both non-trade concerns and multifunctionality more generally.[93]

While non-trade concerns constituted a defining feature of the negotiating position adopted by the Community at the commencement of the Doha Round, the Mid-term Review triggered a switch in focus to the SFP and, in particular, to claims that it met the 'green box'

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[89] WTO, *Doha Work Programme: Decision Adopted by the General Council on 1 August 2004*, WT/L/579, 2 August 2004, Annex A, para 2.
[90] United States Department of Agriculture ('USDA'), (Washington, DC: USDA, 2001).
[91] WTO *Proposal for Comprehensive Long-term Agricultural Trade Reform: Submission from the United States*, G/AG/NG/W/15, 23 June 2000.
[92] See, e.g., Bohman, M. *et al.*, *The Use and Abuse of Multifunctionality* (Washington, DC: Economic Research Service/USDA, 1999).
[93] USDA, *U.S. Proposal for Global Agricultural Trade Reform* (http://www.fas.usda.gov/itp/wto/actual.htm, visited on 3 October 2002).

criteria for decoupled income support. This change of approach was evident from the inception of the Mid Term Review in 2002.[94] Further, the position adopted at Cancun in 2003 was predicated on the transfer, by reason of the SFP, of most domestic support from the 'blue box' to the 'green box'. Indeed, the Commission estimated in 2003 that 'blue box' payments of over 30 billion Euros per year would fall to under 10 billion Euros per year, with 'green box' payments correspondingly increasing to reach over 20 billion Euros per year.[95] More recently, the decoupling of support payments from production was described by Commissioner Fischer Boel as 'perhaps the cornerstone of our reforms'.[96]

Two principal questions need to be addressed. To what extent does the SFP meet the 'green box' criteria in the WTO legal order for decoupled income support? And to what extent can non-trade concerns be accommodated under the URAA or, indeed, under a re-negotiated agreement? This second question may be examined with regard to both the multifunctional cross-compliance conditions attached to the SFP and other direct payments and with regard to the more targeted farm support provided under the Rural Development Regulation. A related and further question is the vexed issue of quantification, which underlies many of the difficulties confronting both the URAA as currently implemented and any attempt to negotiate a new agreement.

B. The Single Farm Payment as Decoupled Income Support

The rules governing 'green box' exemption from domestic support reduction commitments are currently contained in Annex 2 to the URAA. To qualify for exemption, domestic support must satisfy two criteria. First, it must satisfy the 'fundamental requirement', set out in Paragraph 1 of Annex 2, that a support scheme 'must have no, or at most minimal, trade-

[94] See *Mid-term Review of the Common Agricultural Policy* COM(394)2002, 20, where a key objective of the introduction of reforms was expressly stated to be 'to conserve the WTO-Green Box compatibility of the payments'.
[95] European Commission, *EU Agriculture and the WTO: Doha Development Agenda, Cancun - September 2003: INFO* (Brussels: European Commission, 2003).
[96] Speech/05/280, *Agricultural Reform in a Global Context*, Oslo, 13 May 2005.

distorting effects or effects on production'. Paragraph 1 further provides that the support must be provided through a publicly funded government programme not involving transfers from consumers; and that the support must not have the *effect* of providing price support to producers. Additionally, it must satisfy one of a number of policy-specific conditions set out in the remaining Paragraphs of Annex 2. Before examining these, it should be noted that the fundamental requirement in paragraph 1 itself raises a number of problems. It is unclear whether the criterion that a measure be at most minimally trade-distorting is a free-standing obligation or not. This question was expressly left open by both the Panel and the Appellate Body in *United States – Subsidies on Upland Cotton*.[97] Another problem raised by the fundamental requirement is the issue of quantification: what is meant by 'minimal' trade distortion? The URAA gives no indication of the basis for quantifying the effects of support for the purposes of ascertaining whether its trade-distorting effects are more than 'minimal'. Similarly, the URAA supplies no guidance for determining whether the *effect* of support is in fact to provide price support to producers. This question will be revisited below, as it is common to several of the key 'green box' criteria, as currently framed.

Of the specific conditions to be met in addition to the fundamental requirement set out in Paragraph 1, those governing schemes that provide direct payments to producers are of central importance to the 'green box' compatibility of the SFP. The detailed rules are contained in Paragraphs 5–13 of Annex 2 to the URAA. Paragraph 6 governs decoupled income support and is of greatest relevance in this context. It provides as follows:

> '(a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.
>
> (b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.

[97] (2004) WT/DS267/R, para 7.412; and (2005) WT/DS267/AB/R, para 334.

(c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.

(d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.

(e) No production shall be required in order to receive such payments.'

These detailed rules raise a number of issues.[98] First may be considered the provisions governing base periods. Their underlying rationale is that, because exempt direct payments must be founded on a historical base period, farmers cannot influence the size of the direct payments that they receive through changes in their current behaviour. It follows, in theory at least, that their current production decisions will be determined solely by free market considerations. In *United States – Subsidies on Upland Cotton* one of the key issues was the extent to which it was permissible to update base areas. Under the United States Farm Security and Rural Investment Act of 2002 farmers were permitted for the purposes of the direct payments regime to update base areas from those established earlier for the production flexibility contracts regime formerly applicable under the Federal Agriculture Improvement and Reform Act of 1996. Brazil argued before the Panel that, where one decoupled income support regime was replaced by another with the same structure, design and eligibility criteria, then they should have the same base period. The Community also argued that continued updating of reference periods in respect of the existing decoupled support created an expectation that production of certain crops would reap payment benefits.[99] The Panel did not consider it necessary to decide the issue; but it did observe that the direct payments regime was a 'successor' programme to the production flexibility contracts regime, albeit with differences. Also, it felt there was no evidence, 'only speculation', as to whether

[98] See, e.g., A Swinbank and R Tranter, 'Decoupling EU Farm Support: Does the New Single Payment Scheme Fit within the Green Box?', (2005) 6 *Estey Centre Journal of International Law and Trade Policy* 47; and A Swinbank, 'Developments in the Doha Round and WTO Dispute Settlement: Some Implications for EU Agricultural Policy, (2005) 32 European Review of Agricultural Economics 551.
[99] (2004) WT/DS267/R, paras 7.389 and 7.392.

producers would in the future be able to further update their base areas.[100] The Appellate Body similarly eschewed detailed consideration of this issue.[101]

In the context of the SFP, this raises the question whether it is a 'successor' programme to earlier support regimes. The general rule is that the SFP is based upon support payments claimed by producers during the 2000-2002 reference period, and this clearly involves considerable updating from, for example, the 1989-1991 base period which had earlier applied for arable area payments made to cereals producers.[102] Although the clear intention with the SFP was to exclude the linkage of payments to the type or volume of production in any year *after* the base period chosen, payments *can* be based on the type or volume of production in the base period itself. A link with production therefore remains. Perhaps more importantly, until clear guidance is given by the Panel or Appellate Body on the legitimacy of updating the base areas used in support schemes, WTO Members cannot be sure whether or not it is legitimate to update base areas to take account of more recent production patterns.

Secondly, considerable obscurity is evident in the fundamental 'green box' stipulation for decoupled income support that '[n]o production shall be required in order to receive such payments'.[103] This part of the definition is central to a key policy objective of the URAA 'green box' criteria, namely to breaking the link between support payments and production. As a matter of textual analysis, however, the clause is open to conflicting legal interpretations. Does it mean that a support scheme must prohibit continued production if a producer is to be eligible for payments? Or is it sufficient merely for the support scheme to remove the requirement for continued production as a mandatory pre-requisite for payments? This issue was another that was considered in *United States – Subsidies on Upland Cotton.* The Panel held that the criterion 'does not concern a negative requirement. It only prohibits a positive

[100] Ibid., paras 7.398-7.399 and 7.405.
[101] (2005) WT/DS267/AB/R, paras 343-344.
[102] The general rule does not apply where a Member State opts to implement the SFP scheme on a regional basis.
[103] Annex 2, para 6(e).

requirement, i.e. a requirement of production'.[104] Further, the Panel accepted the argument advanced by the United States that Paragraph 6(b) should permit decoupled income support that requires the recipient to engage in the production of no crops at all, since the provision only prohibits the amount of payments being related to, or based on, the type or volume of production in any year after the base period. Accordingly, in the view of the Panel, the prohibition would not cover those required to undertake no production at all.[105]

On this point, the Appellate Body agreed with the Panel. It decided that, by prohibiting Members from making 'green box' measures contingent on continued production, the URAA implied that Members were 'allowed, in principle, to require no production at all'. The Appellate Body also addressed Paragraph 6(b) and the argument that making payments contingent on a total ban on production could be seen as a way of relating the amount of payment to the volume of production (the volume of production in this case being nil). This argument was felt to be inconsistent with the combined meaning and effect of Paragraphs 6(b) and (e), so favouring an interpretation of Paragraph 6(b) that permitted a total ban of production.[106]

With specific reference to the SFP scheme, however, a different problem may be encountered in that, although there is no requirement to continue production in order to receive support payments, the cross-compliance conditions may themselves indirectly require a minimum level of production. In particular, farmers are obliged to maintain all agricultural land in good agricultural and environmental condition;[107] and, according to the Community standards set out in the 2003 Horizontal Regulation, this may involve, for example, the maintenance of 'minimum livestock stocking rates and/or appropriate regimes'.[108] There must be an argument that this language requires some level of production in contravention of Paragraph 6(e).

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[104] (2004) WT/DS267/R, para 7.368.
[105] Ibid., para. 372.
[106] (2005) WT/DS267/AB/R, para 327.
[107] 2003 Horizontal Regulation, OJ 2003 L 270/1, Art.5.
[108] Ibid., Annex IV.

Further difficulty may arise from the fact that Paragraph 6(d) requires that 'the amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period'. It has, for instance, been argued that this criterion may be contravened by the obligation in the Community legal order to 'match' SFP payment entitlements to eligible land in order to unlock payments.[109]

Finally, it may be suggested that the SFP scheme has the effect of channelling production into certain crops and that, following the decisions of both the Panel and the Appellate Body in *United States – Subsidies on Upland Cotton*, this would exclude 'green box' compatibility. In that dispute, receipts from production flexibility contracts under the Federal Agriculture Improvement and Reform Act of 1996 and direct payments under the Farm Security and Rural Investment Act of 2002 were both held to be related to the type of production undertaken by the producer after the base period, and thus failed to conform with Paragraph 6(b). Under both regimes producers were not required to grow any particular crop in order to receive payment; and under both regimes they could choose to grow nothing at all. In the case of production flexibility contracts, however, planting flexibility was constrained by a specific provision reducing or eliminating payments if, subject to exceptions, fruit and vegetables (other than lentils, mung beans and dry peas) were planted on upland cotton base areas. The same constraints applied in the case of direct payments, subject to the important addition of wild rice to the list of crops covered by the planting flexibility limitations. The Appellate Body, agreeing with the Panel, took the view that this 'partial exclusion of some crops from payments has the potential to channel production towards the production of crops that remain eligible for payments. In contrast to a total production ban, the channelling of production that may follow from a partial exclusion of some crops from payments will have

[109] A Swinbank and R Tranter, 'Decoupling EU Farm Support: Does the New Single Payment Scheme Fit within the Green Box?', (2005) 6 *Estey Centre Journal of International Law and Trade Policy* 47; and A Swinbank, 'Developments in the Doha Round and WTO Dispute Settlement: Some Implications for EU Agricultural Policy.

positive production effects as regards crops eligible for payments'.[110] It therefore rendered the schemes in breach of URAA obligations.

With regard to the SFP, the chief threat to its 'green box' compatibility on these grounds is the provision that prevents farmers sustaining a claim for the SFP on land under, *inter alia*, fruit, vegetables and potatoes (except, in the case of potatoes, where they are intended for the manufacture of potato starch).[111] As indicated, it could be contended that the effect is to channel support into sectors not subject to this exclusion. It must be remembered, however, that where a Member State opts to allocate the SFP on a regional basis, the exclusion may not apply, with the result that 'green box' compatibility may be preserved.[112]

C. Non-trade Concerns

In the case of the SFP and other direct payments, the cross-compliance obligations imposed by the 2003 Horizontal Regulation do expressly address matters that could be regarded as 'non-trade concerns'. Thus, the statutory management requirements set out in Annex III to the 2003 Horizontal Regulation are directed to: public, animal and plant health; environmental protection; and animal welfare. Nevertheless, the generally applicable cross-compliance obligations are arguably of insufficient rigour to justify 'green box' exemption under any paragraph of Annex 2 to the URAA. By way of illustration, it would be difficult to classify those relating to the environment as 'payments under environmental programmes' within Paragraph 12 of Annex 2 to the URAA. Not least, the eligibility criteria under Paragraph 12 include, *inter alia*, participation in a 'clearly-defined government environmental or conservation programme'. Accordingly, in the context of the WTO, it is perhaps not surprising that, rather than laying emphasis on cross-compliance, the Community has expressly predicated all claims to 'green box' compatibility for the SFP upon its

[110] (2005) WT/DS267/AB/R, para.329.
[111] 2003 Horizontal Regulation, OJ 2003 L 270/1, Art.51, as amended by Council Regulation 864/2004, OJ 2004 L 161/48.
[112] 2003 Horizontal Regulation, OJ 2003 L 270/1, Art.60, as amended by Council Regulation 864/2004, OJ 2004 L 161/48.

categorisation as 'de-coupled income support'. The more multifunctional elements of the SFP would appear rather to be highlighted internally, with a view to promoting public acceptance of the new support regime. As affirmed by Commissioner Fischer Boel, '[c]ross compliance will do the *additional job* of making an explicit link between the environmental standards which the public expects and the support which the farmer receives'.[113]

That said, it may be argued that set-aside payments qualify as 'structural adjustment assistance' provided through resource retirement programmes, under Paragraph 10 of Annex 2 to the URAA. Because, however, the ability for farmers to set aside land on a rotational basis has survived the Mid-term Review, these provisions are open to the objection that they constitute primarily a supply-side market management tool, as opposed to 'structural adjustment assistance' of the kind envisaged by the 'green box' criteria. Indeed, the objective of controlling production was made explicit when set aside was first introduced by Council Regulation 1094/88.[114] It should also be noted that the Mid-term Review requires farmers to maintain land set aside in good agricultural and environmental condition, ready to resume production should the need arise, a requirement that is of questionable compatibility with the concept of 'structural adjustment assistance'.

Turning to the more targeted financial support provided under the Rural Development Regulation, the most important category of 'green box' exemption is arguably that covering 'payments under environmental programmes'.[115] Under this category, as indicated, eligibility for payments must be determined as part of a clearly-defined government environmental or conservation programme. It must also be dependent on the fulfilment of specific conditions, 'including conditions related to production methods or inputs', while the amount of payments must 'be limited to the extra costs or loss of income involved in complying with the governmental programme'. Although the broad intent of the exemption is clear, no definition is offered for a qualifying 'environmental' or 'conservation' programme. This omission

[113] Speech/05/345, *CAP Reform and the European Model of Agriculture'*, Slovenia, 10 June 2005 (emphasis added).
[114] OJ 1988 L 106/28.
[115] URAA, Annex 2, para 12.

could lead to disputes where, as is the case for several important Common Agricultural Policy initiatives, the aims and objectives of support schemes are mixed, with both an environmental and non-environmental component. An example may be furnished by support for less-favoured areas and areas with environmental restrictions, where there is both a focus on environmental protection and a parallel focus on social issues. In WTO terms, there would seem to be no difficulty with the objective, as set out in the Rural Development Regulation, that support for less-favoured areas should 'maintain and promote sustainable farming systems which in particular take account of environmental protection requirements'. But the Rural Development Regulation also permits payments in less-favoured areas 'to ensure continued agricultural land use and thereby contribute to the maintenance of a viable rural community'; and this objective, more difficult to characterise as 'environmental', is given equal weight in the legislation.[116]

In the context of payment schemes that are targeted at clearly environmental objectives, it may also be unclear to what extent the measures must be 'targeted and deep', as opposed to 'broad and shallow', in order to qualify for 'green box' exemption.[117] A good illustration is provided by the recently introduced Environmental Stewardship Scheme in England.[118] The land management options open to farmers include a less rigorous 'entry level' and a more rigorous 'higher level'.[119] 'Green box' compatibility will be less easy to articulate in the case of the former, where minimal changes in land use practices are required. Indeed, other environmental schemes based on the 'broad and shallow' model, such as *Prime a l'Herbe* in France, have been criticised as arrangements to provide disguised income support, with no genuine environmental component.[120] A similar objection to 'green box'

[116] Council Regulation 1257/1999, OJ 1999 L 160/80, Art.13(a).
[117] See, generally, e.g., H Buller, 'The Agri-environmental Measures (2078/92)' in F Brouwer and P Lowe (eds.), *CAP Regimes and the European Countryside* (Wallingford: CABI Publishing, 2000), 199.
[118] Environmental Stewardship (England) Regulations 2005, SI 2005 No.621.
[119] Basic management prescriptions for 'entry level' stewardship' agreements are set out in Sch. 2, Part 2. These are targeted at the maintenance of existing natural habitats, the prevention of water pollution and the prevention of overgrazing by livestock. More advanced prescriptions for inclusion in 'higher level' stewardship' agreements are set out in Sch.2, Part 3. These include management prescriptions targeted at the recreation of selected natural habitat types.
[120] See, e.g., H Buller, 'The Agri-environmental Measures (2078/92)' in F Brouwer and P Lowe (eds.), *CAP Regimes and the European Countryside* (Wallingford: CABI Publishing, 2000), 199.

compatibility could be also applied to the Environmentally Sensitive Areas programme in England.[121] Like the Environmental Stewardship Scheme, there is more than one 'tier' of participation, including a basic 'tier' which offers payments for minimal changes in land use practice; and again there are both environmental and socio-economic objectives.

Against this background, the *EC Comprehensive Negotiating Proposal*, submitted to the WTO in 2000, accepted that the criteria for environmental schemes must be well targeted, transparent and implemented in a way which is not more than minimally trade-distorting;[122] but there was no attempt to address the substantive issue, namely, what is meant by 'environmental' protection in the context of the farmed environment? That said, it must be conceded that to determine the scope and objectives of agri-environmental schemes which will potentially qualify for 'green box' exemption could prove complex, given the close inter-relationship between farming and the environment. As with maintaining land in good agricultural and environmental condition, many environmental concerns can only be met through continued farming, albeit using farming practices adapted to give a particular environmental benefit. Examples would be the adoption of extensive grazing regimes aimed at re-creating moorland habitats or arable-cropping patterns targeted at protecting ground-nesting birds.

It is clear that the position adopted by the Community is based on the multifunctional premise that agri-environmental schemes produce joint products: agricultural produce and environmental services (i.e. public goods). Indeed, the Community has already shown some sensitivity to the potentially trade-distorting effects of such schemes where they also allow continued farm production. In a *Discussion Paper on Agriculture's Contribution to Environmentally and Culturally Related Non-trade Concerns*, submitted to the WTO in 2000, the Community rejected the suggestion that agricultural produce generated by activities

[121] Implemented under the Agriculture Act 1986. The relevant designation orders, made under Section 18, are: Environmentally Sensitive Areas (Stage I) Designation Order 2000, S.I.2000 No.3049; Environmentally Sensitive Areas (Stage II) Designation Order 2000, S.I.2000 No.3050; Environmentally Sensitive Areas (Stage III) Designation Order 2000, S.I.2000 No.3051; and Environmentally Sensitive Areas (Stage IV) Designation Order 2000, S.I.2000 No.3052, all as amended.

[122] WTO, G/AG/NG/W/90, 14 December 2000, para.16.

funded under environmental schemes should be withdrawn from the market as wasteful and cost inefficient. However, it accepted that the joint production of marketable products and environmental services should not be used to conceal distortive economic subsidies.[123] The discussion paper put forward the proposal, therefore, that where society requires farmers to deliver public goods in pursuit of a 'legitimate environmental or cultural objective', then governments should only recompense farmers for their additional costs and income foregone, taking account of the income they derive from selling commodities on the market.

This approach poses several questions, however. Which environmental objectives may be categorised as 'legitimate' for these purposes? For example, is it proposed that 'green box' exemption will cover both schemes promoting farmland biodiversity and schemes for the improvement of landscape values? Additionally, the stated negotiating position of the Community ignores the fact that the Rural Development Regulation itself permits Member States to take account not only of income foregone and additional costs when devising payment regimes for agri-environmental schemes, but also the 'need to provide an incentive'.[124] Under the Community legal order for rural development, payments must be determined on the basis of objective criteria; and a ceiling does limit the incentive element to a maximum of 20 per cent of the income foregone and the additional cost of carrying out the commitments.[125] The provision of incentive payments clearly has the potential to be trade-distorting. It may, therefore, be no coincidence that the recent proposal for a new Council Regulation on support for rural development by the European Agricultural Fund for Rural Development, which will replace the Rural Development Regulation, limits payments to additional costs and income foregone as a result of the commitment given, plus, where necessary, the option of covering transaction costs.[126]

As has been seen, since the Mid-term Review farmers may receive payment under the Rural Development Regulation for not just environmental but also animal welfare

[123] WTO, *Note on Non-trade Concerns*, G/AG/NG/W/36, 22 September 2000, para.5.
[124] OJ 1999 L160/80, Art.24.
[125] Commission Regulation 445/2002, OJ 2002 L 74/1, Art.19.
[126] European Commission, COM(2004)490, Art.37(4).

commitments, provided that these involve more than the application of usual good farming practice, including good animal husbandry practice.[127] A problem for the Community is that animal welfare payments do not yet feature within the categories of 'green box' support. Some comfort may nonetheless be provided by the fact that, when Chairman Harbinson issued in February 2003 his *First Draft of Modalities for the Further Commitments*, a suggested amendment to Annex 2 was the inclusion within Paragraph 12 of animal welfare payments as well as payments under environmental programmes; and this suggested amendment survived through to the revised document issued in March 2003.[128] On the other hand, no specific mention was made of animal welfare in either the Doha Declaration or the 2004 Framework Document.[129] Likewise, it is not readily apparent that the payments in respect of 'meeting standards' and food quality, added to the Rural Development Regulation by the Mid-term Review, are compatible with current or proposed 'green box' criteria. Paragraph 2(f) of Annex 2 of the URAA refers to 'marketing and promotion services, including market information, advice and promotion relating to particular products'. However, no measures granted green box exemption under Paragraph 2 may involve direct payments to producers or processors.

For the time being, the 2004 Framework Document commits WTO Members to the retention of the 'green box' in principle. But it also identifies its review and clarification as a priority 'with a view to ensuring that Green Box measures have no or at most minimal trade distorting effects or effects on production'.[130] Similarly the Hong Kong Ministerial Declaration saw agreement that the 'green box' criteria should be revisited, '*inter alia*, to ensure that programmes of developing country Members that cause not more than minimal trade-distortion are effectively covered'.[131] There would seem to be agreement in principle

[127] OJ 1999 L 160/80, Art.23(2), as amended by Council Regulation 1783/2003, OJ 2003 L 270/70 (which introduced payments for animal welfare commitments).
[128] Respectively, WTO, TN/AG/W/1, 17 February 2003; and WTO, TN/AG/W/1/Rev.1, 18 March 2003.
[129] Respectively, WTO, WT/MIN(01)/DEC/W/1, 14 November 2003; and WTO, WT/L/579, 2 August 2004, Annex A.
[130] WTO, WT/L/579, 2 August 2004, Annex A, para 16.
[131] WTO,WT/MIN(05)/DEC, 22 December 2005, para 5

that non-trade concerns should be granted exemption from domestic support reduction commitments; but there would also seem to be recognition that the rules, as currently drafted, lack clarity and are arguably non-justiciable.[132] The extent to which the 'green box' should be reviewed is already a matter of some dispute, with some Members seeking to widen or narrow its terms substantially, while other Members see the purpose of the exercise as rather the refinement and reform of the existing arrangements in order to give them greater clarity and efficacy.[133] Any widening or narrowing of the 'green box' will be largely a matter for political discussion and agreement. On the other hand, whether or not the 'green box' is widened or narrowed in scope, the refinement of its qualifying criteria to give them greater clarity and effectiveness is primarily a matter for legal discourse. What can be said with some certainty is that if the URAA is to become an effective vehicle for the settlement of agricultural trade disputes, then its terms must be defined with much greater precision.

D. Quantification

An underlying principle of the URAA was to increase transparency. A prime example of this principle in action, in the context of market access, was the conversion of most non-tariff barriers into tariffs capable of being bound and reduced. By contrast, many of the problematic measures under discussion in the Doha Round are less susceptible to precise measurement. The Mid-term Review has emphasised the importance of the 'green box', which in turn highlights the need to establish a mechanism to determine the difficult question whether measures meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. This raises the important issue of the

[132] See, generally, e.g., B O'Connor, 'A Note on the Need for more Clarity in the WTO Agreement on Agriculture', (2003) 37 *Journal of World Trade* 839.

[133] See WTO, *Agriculture Negotiations Status Report II: Looking Forward to the Hong Kong Ministerial – Assessment by the Chairman*, WT/TN/AG/19, 1 August 2005), paras 9 and 10 (identifying the key issues to be resolved if a political consensus on 'green box' reform is to be reached).

quantification of trade impacts, which will be examined here with regard to both decoupled income support and agri-environmental payments.

In the case of decoupled income support, most economists agree that fixed payments tied to a variable, such as past production in a reference period, is not production-neutral.[134] Both the SFP and the direct payments regime in the United States would in principle seem to fall within this category. The payment performs an income substitution function, substituting a fixed income for a variable and uncertain profit. This can have a variety of behavioural effects on the enterprise. In the case of a farmer facing debt constraints, for example, the provision of a guaranteed and fixed annual income will facilitate forward financial planning and increase the range of available production decisions based on profit maximisation. The application of sophisticated economic behavioural models has also demonstrated that an increase in production will be generated even in cases where no debt constraint is present. Not least, such direct payments reduce the degree of risk experienced by the farmer.[135]

Significantly, in the only decision in which the Community has been held to be in violation of its commitments under the URAA, *European Communities – Export Subsidies on Sugar*, the Appellate Body displayed a willingness to place considerable weight on the economic *effects* of payment regimes under the Common Agricultural Policy rather than their strict legal form.[136] The focus of *European Communities – Export Subsidies on Sugar* was not directly upon domestic support, but rather the alleged payment of export subsidies on sugar production in violation of commitments under Article 9.1 (c) of the URAA.

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[134] See, e.g., D Hennessy, 'The Production Effects of Agricultural Income Support Policies Under Uncertainty', (1998) 80 *American Journal. of Agricultural Economics* 46; J Rude, 'Under the Green Box', (2001) 35 *Journal of World Trade* 1013; I Robert, T Podbury and M Hinchy, 'Reforming Domestic Agricultural Support Policies through the World Trade Organisation', ABARE Research Report 01.2 (Canberra: ABARE, 2001); and ME Burfisher and J Hopkins (eds), 'Decoupled Payments: Household Income Transfers in Contemporary U.S. Agriculture', Agricultural Economics Report No.822 (Washington, DC: ERS, USDA, 2003).

[135] See, e.g., H de Gorter, 'Market Access, Export Subsidies, and Domestic Support: Developing New Rules', in MD Ingco and LA Winters (eds), *Agriculture and the New Trade Agenda: Creating a Global Trading Environment for Development* (Cambridge: Cambridge University Press, 2004), 151; but see also ME Burfisher and J Hopkins (eds), 'Decoupled Payments: Household Income Transfers in Contemporary U.S. Agriculture', Agricultural Economics Report No.822 (Washington, DC: ERS, USDA, 2003), 18 (where it is noted that farmers, in particular in the United States, may avail themselves of crop insurance).

[136] (2005) WT/DS265/AB/R; (2005) WT/DS266/AB/R; and (2005) WT/DS283/AB/R.

Nonetheless, several aspects of the decision have resonance with the issues which are being considered. Under the common organisation of the market in sugar, growers of sugar beet received domestic support in the form of intervention, basic and minimum prices for sugar produced within their 'A' and 'B' quotas. This domestic support secured prices which could be three times higher than those obtaining on the world market. Sugar produced in excess of the A and B quotas (known as 'C' sugar) was not to be sold within the Community in the year in which it was produced.[137] The overall effect of these provisions was that export of C sugar over the period 1997-2002 amounted to between 1.3 and 3.3 million tonnes annually at prices that did not 'even remotely' cover the average total cost of production.[138]

Two aspects of the ruling in *European Communities – Export Subsidies on Sugar* are important in the present context. First, as indicated, it was held that the Community regime involved a 'payment on the export of an agricultural product …financed by virtue of governmental action' within the meaning of Article 9.1 (c) of the URAA.[139] There was a 'tight nexus' between the mechanism by which the payments were financed and governmental action.[140] In the view of the Appellate Body, without the highly remunerative prices guaranteed for A and B beet, sales of C beet could not take place profitably at a price below the total cost of production.[141] Secondly, there was a transfer of resources in that C sugar producers were able to use the profits made on the sale of A and B sugar to cross-subsidise the export of C sugar at prices lower than the cost of production. Cross-subsidisation in this manner constituted an export subsidy within the meaning of the URAA.[142] In coming to this conclusion both the Panel and the Appellate Body used the average total cost of production as a benchmark to evaluate whether there was, in fact, a

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[137] For the relevant Community legislation, see Council Regulation 1260/2001, OJ 2001 L 178/1.
[138] (2005) WT/DS265/AB/R; (2005) WT/DS266/AB/R; and (2005) WT/DS283/AB/R, para 267.
[139] Ibid., paras 237-239.
[140] Ibid., para 237. See *Canada – Dairy (Article 21.5 – New Zealand and US)* (2001) WT/DS103/AB/RW; (2001) WT/DS113/AB/RW, para 115, for the formulation of the rules concerning the need for a 'tighter nexus' between payments and governmental action in this context.
[141] (2005) WT/DS265/AB/R; WT/DS266/AB/R; and WT/DS283/AB/R, at para 239.
[142] Ibid., paras 251ff; and especially para 264: '[t]he "payment" in this case is not a "purely *notional*" one [as argued in the submission of the European Communities] but, rather, reflects a very concrete transfer of economic resources to C sugar production' (emphasis supplied by Appellate Body).

'payment' in the sense of a real transfer of resources from A and B sugar production to C sugar production destined for export.[143]

The Appellate Body's reasoning emphasises the linkage between domestic support and export subsidies. Its willingness to go behind the 'formalistic'[144] structures of the common organisation of the market, and to look instead at the economic realities of production and export costs, could also have major implications for any assessment of the potentially trade-distorting effects of the SFP. As noted above, it is generally accepted that the payment of direct income support is not production-neutral and that (at the very least) it supplies an income substitution function for agricultural producers. In *European Communities – Export Subsidies on Sugar*, the Appellate Body was at pains to emphasise that its interpretation of the Community sugar regime did not erode the boundary between domestic support and export subsidies.[145] In particular, there was an obligation to export C sugar with the result that the export was not an incidental effect of the domestic support system, but rather a direct consequence of the Community sugar regime.[146] There may, indeed, be no obligation on producers to export in the case of the SFP. Nevertheless, in terms of their economic effect, there are obvious, if not exact, analogies between domestic support in the case of the SFP and under the Community sugar regime that was found to infringe WTO disciplines in *European Communities – Export Subsidies on Sugar*.

Aside from any question of cross-subsidisation, the key issue in relation to the SFP and domestic support is not whether decoupled income support is trade-distorting (it is generally accepted that it is), but whether it is *minimally* so. This raises the further issue as to how can its distorting effects be quantified. In order to apply the fundamental requirement for 'green box' exemption correctly in this context would require a complex measurement of the economic effects of the support in question. Yet the URAA gives no indication as to how this measurement is to be carried out, the criteria to be applied or the benchmarks against which it

[143] Ibid,, para 267.
[144] Ibid., para 265: '[t]he European Communities' approach is, in our view, too formalistic'.
[145] Ibid., para.279.
[146] Ibid., paras 280 and 282.

is to be done. It may also be ventured that, if the support is genuinely to target deficiencies in income, then the income of the producer (or lack thereof) should form a key criterion within any calculation of the level of support. This is demonstrably not the case with either the SFP or the direct payments regime in the United States. However, it must also be recognised that any attempt for these purposes to determine the income of producers would be fraught with difficulty. For example, to what extent would off-farm income be taken into account? And to what extent would it be permissible to 'average' income to address major fluctuations in profitability?[147]

Different considerations would seem to apply in the case of environmental payments. In such circumstances, the proper application of Paragraph 12 of Annex 2 to the URAA would seem to require a measurement of the environmental externalities addressed by the support scheme in question (for example, reducing water pollution from agriculture) and the cost of implementing the scheme targeted at the problem. If the cost of the corrective mechanisms outweighs the benefit from the change sought in the level of the adverse environmental externality, then in principle no action should be taken.[148] Indeed, if the scheme in this case were to be implemented, any funds provided would be a disguised income support and potentially trade-distorting. To prevent such abuse, new 'green box' criteria should arguably be developed. Again, this may be no easy task in light of the range of mechanisms used to deliver support, such as tax incentives and management contracts. For the same reason, some means should be found to ensure that support is targeted towards the factor generating the adverse environmental externality in question, and not simply towards the farming activities associated with it.

Against this background, the importance of developing a more effective monitoring mechanism cannot be stressed too strongly. The 2004 Framework Document places particular emphasis on the need to develop enhanced monitoring and surveillance disciplines, but offers no guidance as to how this might be achieved. It signals an intention to amend Article 18 of

[147] In the case of income tax, United Kingdom farmers have long been able to 'average': see now Income Tax (Trading and Other Income) Act 2005, ss.221-225.
[148] See, e.g., J Rude, 'Under the Green Box', (2001) 35 *Journal of World Trade* 1013.

the URAA, so as to improve monitoring and ensure full transparency by requiring timely and full notification by WTO Members in respect of domestic support, market access and export competition commitments. Nonetheless, the lack of a detailed strategy in the case of the 'green box' is evident from the fact that, in the only specific reference to the issue, it is simply stated that 'the improved obligations for monitoring and surveillance of all new disciplines … will be particularly important with respect to the Green Box'. [149]

On a more positive note, considerable work on this problem has already been done outside the confines of the WTO. In its 1998 Communiqué, the OECD Committee for Agriculture at Ministerial Level stressed the need to develop the appropriate analytical tools to monitor and evaluate developments in agricultural policies,[150] and a series of initiatives has followed. For example, the OECD report, *Multifunctionality: a Framework for Policy Analysis*, proposed work on the evaluation of non-market benefits;[151] and another report, *Market Effects of Crop Support Measures*, addressed the key question of the trade consequences of domestic support.[152] Parallel initiatives have also been undertaken by individual WTO Members. For example, in 2000 the Community issued *Indicators for the Integration of Environmental Concerns into the Common Agricultural Policy*.[153] It remains to be seen, however, whether a sufficiently transparent and robust system can be developed to inspire the confidence of the broader membership of the WTO. Most importantly of all, it must be appreciated that improved monitoring will not, in itself, deliver an improvement in 'green box' discipline. This can only be achieved if it is combined with the adoption of new criteria for the application of 'green box' exemption against which the effects of support can be measured more readily. One approach might involve the establishment of baseline criteria against which the degree to which a measure is 'distorting' can be measured. Another

[149] WTO, WT/L/579, 2 August 2004, Annex A, paras 16 and 48.
[150] OECD, Communiqué of the Meeting of the Committee for Agriculture at Ministerial Level, 5-6 March 1998 (http://www.oecd.org/agr/ministerial/commune.htm, visited 6 March 2001).
[151] OECD, AGR/CA(98)9 (Paris: OECD, 1998); and see, subsequently, OECD *Multifunctionality: Towards an Analytical Framework* (Paris: OECD, 2001).
[152] OECD, *Market Effects of Crop Support Measures* (Paris: OECD, 2001).
[153] European Commission, *Indicators for the Integration of Environmental Concerns into the Common Agricultural Policy*, COM(2000)20.

approach might involve limiting the amounts of permissible annual support that can be delivered through decoupled income support, or placing a time limit on its application.[154] Imposing a cap on the amount of total 'green box' support is another strategy that would target this problem. Indeed, such an approach has already been advocated by developing countries in the current WTO negotiations.[155] Any movement in this direction would spell serious problems for the Community and would be strongly resisted; and one line of defence already explored has been to seek to divide the assault by differentiating between developing countries which are major exporters of agricultural commodities and developing countries which are in clear need of greater protection under any re-negotiated URAA.[156]

V. CONCLUSION

The URAA has been roundly criticised for the obscurity of its drafting and for its unnecessary complexity.[157] Before detailed measures for its successful reform can be agreed, a fundamental question must be addressed: what are the *functions* that a successful WTO agreement on agriculture should perform? Attention has hitherto focused almost exclusively on the political agenda and the pressing need to establish a more equitable framework for agricultural trade. Any re-negotiated agreement should also provide a framework of rules that are justiciable and sufficiently clear to form a basis for the resolution of disputes between Members. And it must provide a sufficiently robust set of rules to prevent abuse, especially abuse of the 'green box' criteria for exemption from domestic support reduction commitments. A weakness of the current agreement is that the interpretation of several key legal provisions depends on the application of economic criteria to determine whether or not farm support is

[154] This is advocated by J Rude, 'Under the Green Box', (2001) 35 *Journal of World Trade* 1013.
[155] *Agra-Europe Weekly*, No.2071, 12 September 2003, EP/1-EP/2.
[156] See, e.g., Commissioner Fischler, Speech/04/88, *Restarting the Doha Round*, Washington, DC, 19 February 2004.
[157] See, e.g. B. O'Connor, 'A Note on the Need for more Clarity in the WTO Agreement on Agriculture', (2003) 37 *Journal of World Trade* 839.

trade-distorting (principally, in relation to the so-called 'quantification' issue in its different applications).

Such obscurity may account for the fact that, despite the controversy surrounding farm support measures, the dispute resolution machinery established following the Uruguay Round has in the past been sparingly used in relation to the URAA. However, the landscape has now been substantially reconfigured by *United States – Subsidies on Upland Cotton* and *European Communities – Export Subsidies on Sugar;* and numerous support schemes and, indeed, the SFP itself looks more open to attack. The decision in *European Communities – Export Subsidies on Sugar* has graphically illustrated not only the vulnerability of some Common Agricultural Policy regimes under WTO disciplines, but also the potential for the WTO dispute resolution machinery to drive significant internal change in the Community legal order. Following the decision of the Appellate Body the common organisation of the market for sugar has been subjected to root and branch reform to reduce prices and switch domestic support under the umbrella of the SFP.[158] At the same time, the 'green box' has assumed far greater significance in the Doha Round for the simple reason that it now contains a far greater volume of farm support payments. This significance will be yet further enhanced if the re-negotiated agreement includes the provision in the 2004 Framework Document that 'blue box' payments should be capped at 5 per cent of the total value of agricultural production during a reference period (yet to be agreed).[159] The Community has already signalled a willingness to accept such a limitation.[160]

It will be apparent from the above discussion that some facets of the SFP and schemes funded under the Rural Development Regulation make them vulnerable to the argument that they fall outside the 'green box'. The stance adopted by the Community in the

[158] Substantial reform to bring the Community sugar regime into conformity with WTO disciplines was introduced by Council Regulation 318/2006, OJ 2006 L 58/1. For incorporation of payments under the umbrella of the SFP, see the 2003 Horizontal Regulation, OJ L 270/1, as amended by Council Regulation 319/2006, OJ L 58/32.

[159] WTO, WT/L/579, 2 August 2004, Annex A,, paras 14 and 15.

[160] MEMO/05/357, *Statement of Conditional EU Negotiating Proposals – with Explanatory Annotations*, Brussels, 10 October 2005; and the Hong Kong Ministerial Declaration noted a proposal to reduce this to 2.5 per cent: WT/MIN(05)/DEC, 22 December 2005, Annex A, para 9.

negotiations presupposes the retention and revision of the 'green box'. However, revising the 'green box' criteria, so as to draw a clear line between measures that are trade-distorting (or at most minimally trade-distorting) and measures that are not, will prove extremely challenging. In this context, the 2004 Framework Document directs its focus on improved monitoring.[161] But monitoring will be of little use unless clear benchmarks and criteria are established against which measurable effects can be monitored. Possible solutions might be to apply a fixed cap to the aggregate amount of 'green box' support that is permissible and/or to clarify the fundamental requirement. A further solution might be to monitor, on an annual basis, the effect of support against published production criteria for a fixed base year. More radical solutions of this type are gaining support among developing countries within the WTO;[162] and this casts doubt on the ability of the Community to gain wider acceptance for the Mid-term Review and for its own vision of 'green box' reform to accommodate it.

Indeed, there is growing evidence of a challenge from developing countries to the whole ethos of domestic support. With the Mid-term Review, the Community may have re-packaged its direct payment regime with the clear intent of securing 'green box' compatibility under the URAA as currently constituted; and the SFP does substantially track the detailed criteria for decoupled income support. Yet, with direct payments accounting for approximately 30 billion Euros each year, the Community is faced with the compelling argument that, into whatever box such direct payments fall, the sheer volume of support cannot but influence production decisions and distort trade.[163] It is ultimately this more

[161] WTO, WT/L/579, 2 August 2004, Annex A, paras 16 and 48.

[162] For an early example, see Recommendation 1 in WTO, G/AG/NG/W/14, *Agreement on Agriculture: Green Box/Annex 2 Subsidies. Proposal by Cuba, Dominican Republic, Honduras, Pakistan, Haiti, Nicaragua, Kenya, Uganda, Zimbabwe, Sri Lanka and El Salvador*, 23 June 2000.

[163] For 2005, the budget for the SFP was estimated at 20,025.6 million Euros: European Commission, *Long-term Policy Perspective for Sustainable Agriculture*, COM(2003)23, Annex A-2 (although this would be reduced by delayed implementation ad partial decoupling). However, as indicated, in January 2005 it was claimed that 90 per cent of direct payments were decoupled: Commissioner Fischer Boel, Commissioner Fischer Boel, Speech/05/773, *WTO – Hong Kong Ministerial: Time to Get Serious*, Brussels, 8 December 2005. On 'box shifting' generally, see, e.g., D Diakosavvas, 'The Uruguay Round Agreement on Agriculture in Practice: How Open are OECD markets?', in MD Ingco and LA Winters (eds), *Agriculture and the New Trade Agenda: Creating a Global Trading Environment for Development* (Cambridge: Cambridge University Press, 2004), 37.

general argument that may yet present the greatest difficulty for the Community and for the prospects of securing a new Agreement on Agriculture.