Trade: Surveys show EU's Green Box subsidies are trade-distorting

Berlin, 16 Aug (Marita Wiggerthale*) -- In the current negotiations on agricultural subsidies at the World Trade Organisation, much of the attention has been given to the issue of the overall trade-distorting support (OTDS) of developed countries.

The Green Box is not part of the OTDS, as it is supposed to be non or minimally trade-distorting. The Green Box is thus underestimated in the WTO negotiations.

However, in reality, it is a critical issue whether the Green Box is in fact trade-distorting. If trade-distorting practices can take place, then the Green Box becomes or continues to be an "escape route" that allows distorting subsidies to be maintained or even increased, even if the OTDS declines.

Where the European Union is concerned, it is the Green Box that is strategically used as the "key tool" for increasing international competitiveness of the food sector, given the fact that the strategic interest of the EU is in the export of processed food.

With a turnover of approximately 800 bil Euros and approximately 4 million employees, the food and drinks industry represents the largest processing sector in the EU, ahead of the automobile and chemicals industries.

Decoupled payments and investment aids are the main Green Box measures used by the EU to increase the competitiveness of its agriculture. This article analyses the EU's investment aids, because these payments allow for targeted support of productive farms and food processing companies and because there is so far little analysis on these payments.

First, an overview is given about the structure of CAP expenditure and the use of investment aids within the Green Box. Then, an analysis is done on investment aids with a focus on their production effects.

The conclusion is that EU investment aids are not in conformity with the fundamental requirement to have no or at most minimal trade-distorting effects. A thorough review of the Green Box, the closure of the loopholes and the integration of environmental and social aspects are therefore vital for the promotion of sustainable farming, both in the North and the South.

THE STRUCTURE OF CAP EXPENDITURE

In 2005, the European Union spent 52.69 bil Euros on agriculture and rural development, of which 8.53 bil Euros (16%) was on interventions in agricultural markets, 33.85 bil Euros (64%) on direct aids and 9.92 bil Euros (18.8%) on rural development. Exports refunds (being part of the support category "interventions in agriculture markets") accounted for some 3 bil Euros or roughly 6% of CAP expenditure. Thereof 335 million was spent on the export of processed food, ranking third after dairy and sugar.

In 2005, decoupled payments belonging to the support category of "direct aids" did not form a large part of CAP expenditure. They amounted only to 1.45 bil Euros. However, this is changing. The European Union allotted 15.97 bil Euros of decoupled payments (29.3% of CAP expenditure) for the financial year 2006 and 30.19 bil Euros (57% of CAP expenditure) for the financial year 2007.

Former estimations, that were assuming about 25 bil Euros of decoupled support, will be exceeded. The 30 bil Euros of decoupled payments in 2007 may be notified under the Green Box in the future.

Direct payments are not equally distributed. In the EU-15, 20% of beneficiaries receive around 80% of the direct payments. This unequal distribution puts family farmers in Europe at a disadvantage, as most of the money goes to high performance, rationalised and input intensive farms. Additionally, there is much criticism by environmental NGOs that "cross compliance" - conditions imposed on producers receiving decoupled payments - is widely an ineffective instrument for environmental regulation.

In 2005, 435.67 mil Euros were spent on investment aids (payments of member states not included). They are split into investments in farms (252.66 mil Euros) and investments in processing and marketing (183 mil Euros). For the whole financial period 2000-2006, investments in farms totalled 6.5 bil Euros or 10% of total public expenditure for rural development, investments in processing and marketing 3.7 bil Euros or 5.7 %.

The total EU financial plan for all rural development financial instruments in the period 2000-2006 amounted to around 64.4 bil Euros. The expenditures for the period 2000-2005 represented 67% of the budget foreseen for the whole period for the EU-27. Payments on rural development will increase up to 77.66 bil Euros in the period 2007-2013.

INVESTMENT AIDS IN THE GREEN BOX

Investment aids rank second in the EU-15's Green Box Declarations from 1995/96 to 2003/04. The annual average amounts to 5.27 bil Euros. In 2003/2004, investment aids increased by 1.56 bil Euros to 6.8 bil Euros, being of first importance in that year.

Investment aids in the Green Box have to comply with the basic and policy specific criteria of Annex II of the WTO's Agreement on Agriculture (AoA). All measures exempted from the AoA's reduction obligation should have no or at most minimal effects on production and should not provide market support/price support for the producers, i. e. not imply an improved competition position - such as maintenance or expansion of production - when non-participation in a programme would have led to reduction or stagnation.

Article 7 of the AoA obliges member states to handle Green Box measures in accordance with the agreement. If no "green" evidence of these domestic support measures is provided, they should be subjected to reduction commitments under the AMS (or amber box).

PRODUCTION EFFECTS FROM INVESTMENTS IN AGRICULTURAL HOLDINGS

According to the objectives laid down in the EU's regulation on rural development 1257/99, support for investment in agricultural holdings shall contribute to the reduction of production costs and to the improvement and re-deployment of production. Support can only be granted to economically viable agricultural holdings.

According to the EU's Mid-Term Evaluation, there is strong evidence that supported investments contribute positively in terms of reducing production costs through the more efficient use of labour resulting in positive impacts on income. Also, a range of reports including in relation to France, Wales (UK), Flanders (Belgium), Sweden and Germany show that investments are used to increase the production of surplus products.

In Germany, the government has given in total 1,021 mil Euros of investment aids in 33,883 cases, triggering 4.27 bil Euros of investments in 2000-2004, according to a report by FAL (the Federal Agricultural Research Centre of Germany). Of this, 80% were spent on buildings, of which half were for cowsheds followed by piggeries.

As the main reform of the dairy market organisation is still outstanding, investment support is used as a key tool for spurring the rationalisation of dairy farms and the structural change in the dairy sector.

Data from surveys conducted on a sample of farms in Germany in 2005 by FAL show that the investment aids provided increased the productivity and the production of the farms.

The survey results show that productivity in supported farms increased by 40-73%, the milking performance per cow increased by 6-10%, the number of cows increased by 7-47% and milk production rose by 30-59%. Of the total farms interviewed, 30-42% reported that they would not have realised the investments without the aid given by the state.

The surveys showed that growth in production in Western Germany derived mainly from an expansion of production capacity. In Eastern Germany, the situation is different. Increased production is derived mainly from a higher milking performance and increased productivity mainly from the saving of labour force.

In France, the government introduced a new instrument for the modernisation of cattle, goat and sheep farms ("plan de modernisation des batiments d'elevage", PMBE) giving at most 60-70,000 Euros or 90-100,000 Euros per farm for the construction of buildings (depending on the geographical area).

In 2005, the distribution of the 129 mil Euros under the PMBE was scheduled as follows: 46% for dairy farms, 45% for cattle farms, 9% for sheep and goat farms (there was no support for pork and poultry farms). In eight regions, the total sum for the modernisation of farms exceeded the total sum for extensive livestock farming. According to a report by the French Agriculture Ministry, the strategies pursued by farmers are oriented towards the expansion of production capacity. Diversification is the exception from the rule.

INCREASED COMPETITIVENESS THROUGH INVESTMENTS IN PROCESSING AND MARKETING OF AGRICULTURAL PRODUCTS

According to the EU regulation 1257/99, support for investments in the processing and marketing of agricultural products must contribute among other objectives to encourage the development of new outlets for agricultural products, to rationalise marketing channels and processing procedures, to apply new technologies and favour innovative investments.

Enterprises for which support is given must be able to demonstrate economic viability and must contribute to improving the situation of the basic agricultural production sector in question. According to the European Commission's Mid-Term Evaluation, the question of competitiveness was considered relevant. In two-thirds of cases, the measures have helped to increase the competitiveness of agricultural products through improved and rationalised procedures.

According to data is several recent reports, the aids given have led to increases in farm production capacity and productivity. The EC's 2005 Mid-Term Evaluation reports showed that:

-- In Spain, 70% of the beneficiaries in the Basque Country state felt that there has been an increase of production capacity as a result of support. In Aragon, 86% of beneficiaries stated that production processes have improved following support, 70% have incorporated new technologies and 63% claim that production costs were reduced.

-- In Sweden, more than 70% of supported investments were used to rationalise the production process.

-- In the UK, 91% of beneficiaries in Wales reported enhanced capacity use, 73% as a result of new buildings and/or new equipment and 36% due to the better use of existing facilities. Almost three-quarters of beneficiaries (73%) indicated that costs had reduced as a result of their participation and the average reduction made was 10%.

-- In France, 28% of the beneficiaries in the wine, fruits and vegetable sector stated an improvement of export competitiveness, according to a 2003 report of the Agriculture and Fish Ministry.

And in Germany, a survey in North Rhine-Westphalia showed that the increase in competitiveness plays a very prominent role. 85% of the beneficiaries stated "outlet orientation" as a top-ranking objective, according to a 2005 report of the Federal Agricultural Research Centre.

When it comes to the question of added value, 9 of 10 EU Member States considered the investment aids relevant. In just more than half of the Mid-Term Evaluation reports (56%), the supported investments were considered to have helped to increase the added value and competitiveness of agricultural products by improving quality.

The reports show that:

-- In Italy, the total additional added value through supports amounts to 47 bil Euros split between the wine, fruit, vegetable and dairy sectors.

-- In Spain, 58% of the beneficiaries in the Basque Country stated that improved quality had resulted in higher added value. In La Rioja, the main impact of the support has been an increase in production of higher quality wines (crianza and reserve wines).

-- In the UK, the majority of beneficiaries in Wales reported that throughput of higher quality produce had increased by an average of 122%, mainly through better processing facilities (64% of cases).

The picture with regard to the company size of the supported beneficiaries is a mixed one. In Bavaria (Germany), supporting larger enterprises was considered by the implementing authority to be a safer course of action as these are more economically sustainable. Experience from Sweden and Denmark show that a higher degree of dead-weight is associated with support of larger companies and the scheme has been adjusted to address this in Denmark.

EXAMPLE OF INVESTMENT AID TO A GERMAN COMPANY

An example of how a European company benefits from agricultural investment aid is given in a case study by the German NGO BUND about the Muller Group, which in 2005 was the third-largest and financially strongest dairy company in Germany.

The EU Commission approved in 2004 the investment plan presented by the dairy company Sachsenmilch, a member of the Muller Group, for the modernisation of its factory in Leppersdorf (Saxony).

The financial support amounted to 31.3 mil Euros. Additionally, there was an investment aid of 40 mil Euros given by the Federal State of Saxony that was also approved by the EU Commission. In sum, over 70 mil Euros were spent to increase the production of surplus dairy products.

Also, there was no net creation of jobs, as the Muller Group closed down at that time one factory in Lower Saxony (with 150 job losses) and one in North Rhine-Westphalia (15 job losses). Taking into account the newly created 158 jobs in Leppersdorf, this means in the end a net loss of jobs and an industry relocation made possible with the help of the EU and local investment aids.

INSUFFICIENT ANALYSIS OF SOCIAL AND ENVIRONMENTAL EFFECTS

The main question raised by many civil society organisations is how to achieve a sustainable and equitable farming and food system both in the North and the South in order to protect livelihoods, ensure food security, create jobs, maintain the viability of rural areas, allow for diversity in production, protect natural resources, preserve bio-diversity and facilitate regional economic cycles and marketing systems. If one looks at EU investment subsidies, these issues are mostly not taken into account.

The EC's Mid-Term Evaluation indicates that supported investments had environmental improvements as a side-effect. However, there has not been a thorough or comprehensive environmental impact assessment. The damages are likely to be underestimated as the Mid-Term Evaluation reports did not look at greenhouse gas emissions, water pollution with nitrates and associated costs of water pollution control, loss of bio-diversity etc.

Support for investments in intensive livestock farming is even continuing in areas with high densities of livestock and serious nitrate pollution such as Lower Saxony (Germany) and Brittany (France). Approximately half of the 1.3 mil Euros requested and/or approved for piggery units in 2003-2005 are concentrated in Lower Saxony (Germany).

As self-sufficiency with pork is at 107%, every additional piggery unit means therefore increasing pork exports and increasing liquid manure polluting watercourses at home, according to a BUND report.

The 2006 reforms of German rural development legislation for the period 2007-2013 also allow in principle big investors to apply for investment aids for piggeries with 10,000 or more units. In Brandenburg and Saxony (Eastern Germany), there are piggeries planned with 85,000 to 95,000 units.

However, in some countries, environmental improvements have been the main aim for specific support categories (e. g. in Flanders, due to a shift in investment policy in Germany in the period 2002-2004 following the BSE crisis). The "best practices" in Germany ranged from extensive livestock farming, and animal welfare to machines for environmental friendly farming, renewable energy and energy saving investments.

With regard to the social impact assessment, the Mid-Term Evaluation concludes that there is evidence "to suggest a positive impact on both job creation and particularly job maintenance". However, on the other side, it is mentioned also that investments leading to efficiency improvements potentially result in job losses. In general, maintaining employment has not been an objective of investments in agricultural holdings, according to the Mid-Term Evaluation.

There are also shortcomings in the analysis of social impacts. Job losses are perceived as somehow "normal side-effects" of induced efficiency gains, leading eventually to increased competitiveness. Also, there is no analysis of the direct or indirect social effects of investment aids within the current policy framework.

For example, the structural change in the dairy sector, supported among other instruments by investment aids, will force approximately 50,000 dairy farms (45%) in Germany to give up their business till 2013, potentially triggering further negative effects in other related economic sectors, according to one study.

The focus of the reports on the maintenance of employment of the supported bigger and most productive dairy farms is hiding these negative effects. And finally, no consideration is given to the quality of employment.

CONCLUSIONS

Developing countries have been asking again for new disciplines for the use of Green Box subsidies to ensure that they are really non trade-distorting by meeting the "fundamental requirement" in Annex II of the Agreement on Agriculture. These include the G-20 proposal (June 2005 and May 2006), the ACP proposal (July 2007) and the African Group proposal (July 2007).

The developing countries are right in doing so. The above analysis of EU investment aids does show that there are considerable production effects involved because they are desired by policy makers in the EU Member States and at the European Commission level.

Investments are first and foremost used to increase international competitiveness. If there are other objectives, they are at best secondary. The current spending on investment aids is not in conformity with the fundamental requirement in the Green Box to have no or at most minimal trade-distorting effects.

In the current WTO negotiations, the reluctance of the EU and US to substantially revise or change the Green Box and to support a thorough review is obvious. They have a strategic interest in maintaining the current language in the Agreement on Agriculture in order to preserve the existing loopholes.

It is important to review the Green Box, as this does not only offer the chance "to green" the Green Box, but also to ensure that its provisions help to promote sustainable agricultural production with the help of decoupled, but targeted payments.

In order to achieve a sustainable and equitable farming and food system both in the North and the South, provisions are needed for protecting livelihoods, ensuring food security, creating jobs in rural areas, maintaining the viability of rural areas, allowing for diversity in production, protecting natural resources, preserving bio-diversity and facilitating regional economic cycles and marketing systems.

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