

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

by Marita Wiggerthale

In the current negotiations on agricultural subsidies at the World Trade Organisation (WTO), much of the attention has been given to the issue of the overall trade-distorting domestic support (OTDS) of developed countries.

The Green Box category of subsidies 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, whether the Green Box is in fact trade-distorting is a critical issue. 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 (EU) is concerned, it is the Green Box that is strategically used as the "key tool" for increasing the 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 billion 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 (Wiggerthale 2005: 6).

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

First, an overview is given of the structure of the EU's Common Agricultural Policy (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

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**TWN** THIRD WORLD NETWORK is a network of groups and individuals involved in bringing about a greater articulation of the needs, aspirations and rights of the people in the Third World and in promoting a fair distribution of world resources and forms of development which are humane and are in harmony with nature.

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, in both the North and the South.

### The structure of CAP expenditure

In 2005, the EU spent 52.69 bn euros on agriculture and rural development, of which 8.53 bn euros (16%) was on interventions in agricultural markets, 33.85 bn euros (64%) on direct aids and 9.92 bn euros (18.8%) on rural development. Export refunds (part of the support category “interventions in agricultural markets”) accounted for some 3 bn euros or roughly 6% of CAP expenditure. 335 mil euros was spent on the export of processed food, ranking third after dairy and sugar (European Commission 2007a).

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 bn euros. However, this is changing. The EU allotted 15.97 bn euros of decoupled payments (29.3% of CAP expenditure) for the financial year 2006 and 30.19 bn euros (57% of CAP expenditure) for the financial year 2007 (European Commission 2007a). Previous estimates, which assumed about 25 bn euros of

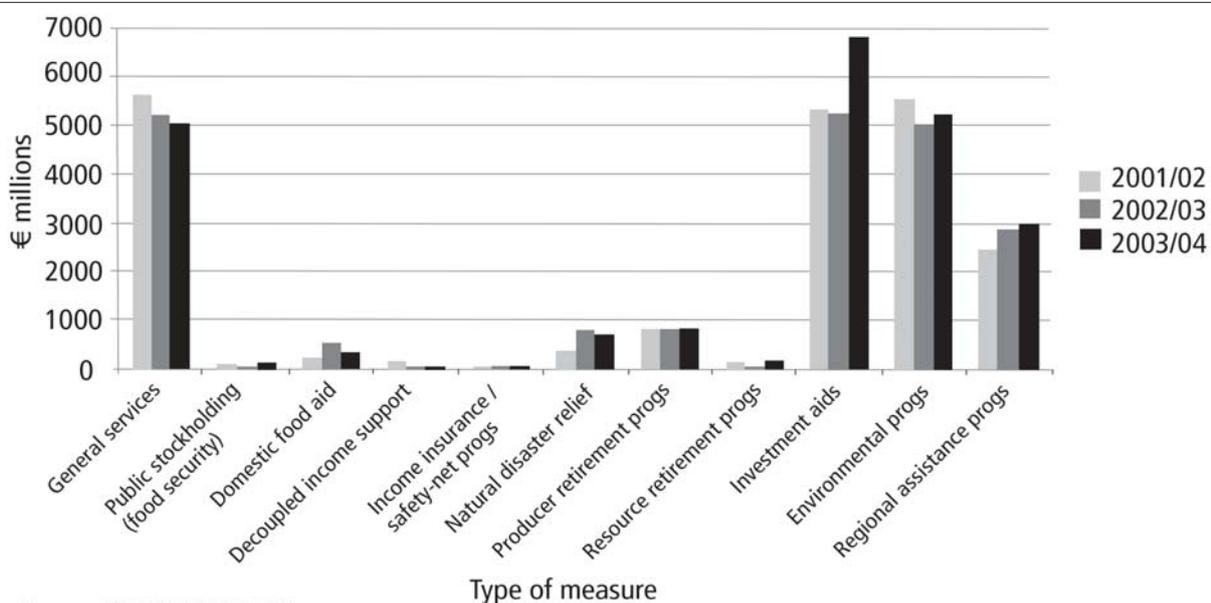
decoupled support, will be exceeded (ActionAid et al. 2005: 13). The 30 bn euros of decoupled payments in 2007 may be notified under the Green Box in the future.

Direct payments are not equally distributed. In the EU-15, 20% of beneficiaries receive around 80% of the direct payments (European Commission 2007b: 5). 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 largely an ineffective instrument for environmental regulation.

In 2005, 435.67 mil euros (contribution of member states not included) was spent on EU investment aids (which fall under the support category of “rural development”). They were split into investments in farms (252.66 mil euros) and investments in processing and marketing (183.01 mil euros). For the whole financial period 2000-2006 investments in farms totalled 6.5 bn euros or 10% of total public expenditure for rural development, and investments in processing and marketing 3.7 bn euros or 5.7% (European Commission 2005: 29).

The total EU financial plan for all rural development financial instruments in the period

Figure 1: EU notified Green Box spending, marketing years 2001/02, 2002/03 and 2003/04



Source: ICTSD (2007: 18)

2000-2006 amounted to around 64.4 bn euros (European Commission 2006: 11).<sup>1</sup> The expenditures for the period 2000-2005 represented 67% of the budget foreseen for the whole period for the EU-27 (European Commission 2006: 12). Payments on rural development will increase to up to 77.66 bn euros in the period 2007-2013.<sup>2</sup>

### 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 bn euros (Swinbank 2007: 7). In 2003/04 investment aids increased by 1.56 bn euros to 6.8 bn euros, being of first importance in that year (ICTSD 2007: 39). (See Figure 1.)

Investment aids in the Green Box have to comply with the basic and policy specific criteria of Annex 2 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 (Wiggerthale 2004: 23).

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) category.

### 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 redeployment of production. Support can only be granted to economically viable agricultural holdings.

According to the European Commission'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 (European Commission 2005: 41-55).

In **Germany**, the government has given a total of 1.021 bn euros of investment aids in 33,883 cases, triggering 4.27 bn euros of investments in 2000-2004, according to a report by the country's Federal Agricultural Research Centre (FAL). Of this, 80% were spent on buildings, of which half were for cowsheds followed by piggeries (FAL 2006: 1).

Table 1: Production and productivity effects of investment promotion in the dairy sector in Germany (average values)

	Unit	Lower Saxony	Bavaria/Baden W.	Mecklenburg W.P./Saxony A.
No. of interviewed farms	—	22	24	16
Productivity increase	%	73	59	40 (Top quartile: 90)
Number of cows	—	72 (+47%)	63 (+35%)	445 (+7%)
Milking performance	kg/cow	8,098 (+6%)	7,513 (+8%)	8,569 (+10%)
Dairy production increase	t/year	214 (+59%)	154 (+52%)	497 (+30%)
Investment volume	€	177,583	177,583	441,250
Realisation of big investments without aid?	%	35 No	42 No	30 No

Source: Based on FAL (2005a)

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 (see Table 1).

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% (FAL 2005a). Of the total farms interviewed, 30-42% reported 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 was different. Increased production was derived mainly from 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 Ministry of Agriculture and Fisheries, the strategies pursued by farmers are oriented towards the expansion of production capacity. Diversification is the exception to the rule (MAAPAR 2003a: 9).

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 encouraging the development of new outlets for agricultural products, to rationalising marketing channels and processing procedures, and to applying new technologies and favouring innovative investments. Enterprises to 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 in several recent reports, the aids given have led to increases in farm production capacity and productivity. The European Commission's 2005 Mid-Term Evaluation reports showed that (European Commission 2005: 154-158):

- . In **Spain**, 70% of the beneficiaries in the Basque Country state felt that there had been an increase of production capacity as a result of support. In Aragon, 86% of beneficiaries stated that production processes had improved following support, 70% had incorporated new technologies and 63% claimed 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 declined 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 reported an improvement in export competitiveness, according to a 2003 report of the Agriculture and Fisheries Ministry (MAAPAR 2003b: 16).

And in **Germany**, a survey in North Rhine-Westphalia showed that increase in competitiveness played a very prominent role. Eighty-five percent of the beneficiaries stated "outlet orientation" as a top-ranking objective, according to a 2005 FAL report (FAL 2005b: 31).

#### **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 (Friends of the Earth Germany) about the Müller Group, which in 2005 was the third-largest and financially strongest dairy company in Germany.

The European Commission approved in 2004 the investment plan presented by the dairy company Sachsenmilch, a member of the Müller 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 European Commission. In sum, over 70 mil euros was spent to increase the production of surplus dairy products.

There was no net creation of jobs, as the Müller 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 meant in the end a net loss of jobs and an industry relocation made possible with the help of the EU and local investment aids.

Source: BUND (2005)

When it comes to the question of added value, 9 of 10 EU member states considered the investment aids relevant. In just over 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 amounted to 47 bn 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 was 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, however, shows that a higher degree of deadweight is associated with support of larger companies, and the scheme in Denmark has been adjusted to address this.

#### **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 in both 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 biodiversity and facilitate regional economic cycles and marketing systems. If one

looks at EU investment subsidies, these issues are mostly not taken into account.

The European Commission's Mid-Term Evaluation indicates that supported investments had environmental improvements as a side-effect. However, there has been no thorough or comprehensive environmental impact assessment. The environmental damage is 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 biodiversity, 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. As self-sufficiency in pork is at 107%, every additional piggery unit therefore means increasing pork exports and increasing liquid manure polluting watercourses at home, according to a BUND (Friends of the Earth Germany) report (BUND 2006: 31).

The 2006 reforms of German rural development legislation for the period 2007-2013 also in principle allow 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; 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 environmentally 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 (European Commission 2005: 51).

There are also shortcomings in the analysis of social impacts. Job losses are perceived as being somehow "normal side-effects" of induced efficiency gains, leading eventually to increased competitiveness. In addition, 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, according to the German farmers association (Schmidt 2006: 13). This destruction of farm jobs will potentially trigger further negative effects in other, related economic sectors.

The focus of the reports on the maintenance of employment in the supported bigger and most productive dairy farms hides these negative effects. And finally, no consideration is given to the quality of employment (European Commission 2005: 51).

## Conclusions

Developing countries have time and again called for new disciplines on the use of Green Box subsidies to ensure that the subsidies really are non-trade-distorting by meeting the fundamental requirement in Annex 2 of the WTO Agreement on Agriculture. Developing-country proposals towards this end include the Group of 20 (G20) proposal (June 2005 and May 2006), the African, Caribbean and Pacific (ACP) Group proposal (July 2007) and the African Group proposal (July 2007).

The developing countries are right in advocating such disciplines. The above analysis of EU investment aids shows that there are considerable

production effects involved because they are desired by policymakers 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 the 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 offers the chance to not only “green” the Green Box, but also 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 in 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 biodiversity and facilitating regional economic cycles and marketing systems.

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Marita Wiggerthale is a Berlin-based freelance researcher specialising in agriculture and trade issues.

## ENDNOTES

1. The European Agricultural Guidance and Guarantee Fund (EAGGF) provides for 95% of the budget. The EAGGF is a fund within the overall EU budget for the financing of the CAP. The Special Accession Programme for Agriculture and Rural Development (SAPARD) reaches about 5%. SAPARD is a programme created by the EU to support the efforts of the Central and Eastern European candidate countries to prepare for participation in the CAP and the single market in the pre-accession period. In 2005, a single fund and a single financial management system for rural development, the European Agricultural Fund for Rural Development (EAFRD), was adopted by the EU Council to replace the EAGGF and the Rural Development Financial Instrument (RDFI) for the EU-10.
2. In December 2005, the European Council agreed on the allocation of 69.75 bn euros for rural development in the financial period 2007-2013. In September 2006 the European Commission approved a total budget of 77.66 bn euros as it includes compulsory modulation to first pillar

payments (4% in 2007 and 5% onwards) and cotton and tobacco transfers (see [http://ec.europa.eu/agriculture/publi/fact/rurdev2007/en\\_2007.pdf](http://ec.europa.eu/agriculture/publi/fact/rurdev2007/en_2007.pdf)).

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